
Additional FATCA Guidance Relevant to Private Investment Funds

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Introduction

On April 8, 2011, the Internal Revenue Service issued Notice 2011-34 (the "Notice"), which provides additional guidance regarding Sections 1471 through 1474 of the Internal Revenue Code (commonly referred to as the "Foreign Account Tax Compliance Act" or "FATCA"). Under FATCA, a private investment fund formed under the laws of a non-U.S. jurisdiction generally will be treated as a "foreign financial institution" (an "FFI") and will be required to enter into an agreement with the IRS (an "FFI Agreement") to comply with certain diligence, reporting and withholding obligations with respect to its account holders (*i.e.*, the investors in the fund). An FFI that does not comply with FATCA will suffer a 30% withholding tax on any "withholdable payments" (as described below) that it receives. **FATCA is generally not effective until January 1, 2013.**

The Notice, which can be found [here](#), is the second piece of guidance issued by the IRS with respect to FATCA. A link to our prior Email Alert discussing the initial guidance issued last August, Notice 2010-60, is provided [here](#).

Guidance in Notice Relevant to Private Investment Funds

Notice Creates Concept of "Passthru Payment Percentage"

FATCA requires an FFI to withhold a 30% tax from any "passthru payment" that the FFI makes to an account holder that is a "non-participating FFI" or a "recalcitrant account holder." A "passthru payment" is defined under FATCA as a "withholdable payment or other payment to the extent attributable to a withholdable payment." A "withholdable payment" includes any payment of interest or dividends from sources within the United States, any gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources within the United States (*e.g.*, the gross proceeds from the sale of stock of a U.S. portfolio company), and certain other types of U.S. source income.

The Notice provides the method by which an FFI, which may hold both U.S. and non-U.S. assets, determines the extent to which a payment the FFI makes to its account holders is a "passthru payment." Under the Notice, a payment made by an FFI will be a passthru payment to the extent of: (i) the amount of the payment that is a withholdable payment, plus (ii) the amount of the payment that is not a withholdable payment multiplied by the FFI's "passthru payment percentage."

An FFI's "passthru payment percentage" is a percentage that the Notice requires an FFI to calculate each fiscal quarter that is determined by dividing: (i) the sum of the gross asset values of the FFI's "U.S. assets" on the determination date by (ii) the sum of the gross asset values of the FFI's total assets on that date. The Notice requires an FFI to "publish" its passthru payment percentage by, for example, making the percentage available on the FFI's website (private funds and their investment managers should consider

any possible securities law implications of providing information in this manner). A "participating FFI" that does not calculate and publish its passthru payment percentage will be deemed to have a passthru payment percentage of 100%.

The IRS intends to issue regulations defining a "U.S. asset" to include any asset to the extent that it is of a type that could give rise to a passthru payment. The Notice requests comments on various issues related to the passthru payment percentage concept, including the definition of "U.S. asset" and the manner in which an FFI publishes its passthru payment percentage.

IRS Considers Centralized Compliance Option for Funds Associated with Common Asset Manager

The Notice indicates that the IRS is considering a centralized compliance option for FFIs that are funds associated with a common asset manager. Under this option, an asset manager would execute a single FFI agreement on behalf of the funds that contract with the asset manager. The asset manager would be required to act as a point of contact for the IRS with respect to all issues concerning the FFIs in its group (or to designate an agent to assume this responsibility) and comply with certain other requirements.

Category of "Deemed-Compliant FFIs" Remains Limited

The IRS continues to consider whether certain funds will be deemed to have complied with their obligations under FATCA (*i.e.*, will be treated as "deemed-compliant FFIs"). Under the Notice, only funds which satisfy the following three requirements will be deemed-compliant: (i) all holders of

record of direct interests in the fund are participating FFIs or deemed-compliant FFIs holding on behalf of other investors, or entities described in Section 1471(f) (e.g., foreign governments, international organizations, and foreign central banks); (ii) the fund prohibits the subscription for or acquisition of any interests in the fund by any person that is not a participating FFI, a deemed-compliant FFI, or an entity described in Section 1471(f); and (iii) the fund certifies that any passthru payment percentages that it calculates and publishes will be done in accordance with the Notice. Obviously this provision will apply only to a very narrow category of funds. The Notice indicates that the IRS may designate additional categories of funds as deemed-compliant in future guidance.

Additional Guidance

The U.S. Treasury and the IRS are still considering many issues relating to the implementation of the FATCA provisions, and additional guidance, including proposed Treasury Regulations and a form of FFI Agreement, is expected before the FATCA provisions become effective on January 1, 2013.

IRS CIRCULAR 230 DISCLOSURE:

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