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# Impact of Proposed FATCA Regulations on Private Investment Funds

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## Introduction

On February 8, 2012, the Internal Revenue Service ("IRS") issued proposed Treasury Regulations (the "Proposed Regulations") under Sections 1471 through 1474 of the Internal Revenue Code (commonly referred to as the "Foreign Account Tax Compliance Act" or "FATCA"). The [Proposed Regulations](#) provide detailed guidance regarding many aspects of FATCA, including those discussed below which have specific relevance to private investment funds.

The Proposed Regulations are the fourth piece of guidance issued by the IRS with respect to FATCA. Please see our prior Client Alerts on this topic, which discuss the initial pronouncement issued in [August of 2010](#) (IRS Notice 2010-60) and the additional guidance issued in [April of 2011](#) (IRS Notice 2011-34) and [July of 2011](#) (IRS Notice 2011-53).

## FATCA – In General

FATCA, enacted in March of 2010, imposes due diligence, information reporting and withholding obligations on "foreign financial institutions" ("FFIs") and withholding obligations on other persons making "withholdable payments" to non-exempt foreign payees. A private investment fund formed under the laws of a non-U.S. jurisdiction is generally included in the definition of an FFI for FATCA purposes. An FFI will be required to enter into an agreement (an "FFI Agreement") with the IRS to undertake certain due diligence to identify its "United States accounts" (as determined under FATCA), information reporting with respect to such United States accounts and certain withholding obligations, or else suffer a 30% withholding tax on any "withholdable payments" that the FFI receives. A "withholdable payment" includes: (i) any payment of interest, dividends or other "fixed or determinable annual or periodical" income from sources within the United States ("U.S. FDAP") and (ii) any gross proceeds from the sale or other disposition of any property that can produce interest or dividends from U.S. sources (for example, gross proceeds from the sale of stock of a Delaware portfolio company) ("U.S. Gross Proceeds"). A private investment fund formed under U.S. law will also have certain obligations under FATCA, including withholding the 30% FATCA tax from any withholdable payments allocable to an FFI that has not entered into an FFI Agreement with the IRS (a "nonparticipating FFI") and certain other account holders.

## Proposed Regulations – Certain Key Aspects Relevant to Private Investment Funds

The Proposed Regulations provide detailed guidance regarding many aspects of FATCA. Certain key aspects of the Proposed Regulations that are relevant to private investments funds are summarized below.

1. *Withholding and Reporting Obligations to be Phased In.* Consistent with prior IRS guidance, the Proposed Regulations phase in the withholding and reporting obligations under FATCA.

- *Withholding.* A withholding agent must withhold the 30% FATCA tax from a withholdable payment that constitutes either (i) U.S. FDAP, **beginning January 1, 2014**, or (ii) U.S. Gross Proceeds, **beginning January 1, 2015**. A "participating FFI" (i.e., an FFI that enters into an FFI Agreement with the IRS and otherwise complies with FATCA) will not be required to begin withholding on payments attributable to, but that do not themselves constitute, withholdable payments (defined in FATCA as "passthru payments") **prior to January 1, 2017**. A withholding agent (which may be a private investment fund formed under either U.S. or non-U.S. law) will be required to withhold the 30% FATCA tax (i) if the payee of the withholdable payment does not provide the documentation required under FATCA or is a nonparticipating FFI or (ii) in certain other circumstances. The Proposed Regulations contain rules for determining when a withholdable payment will be treated as paid to a payee and thus subject to the 30% FATCA withholding tax.
- *Reporting.* The first deadline for a participating FFI to report the information required under FATCA to the IRS with respect to its United States accounts is **September 30, 2014**. By this first reporting deadline, a participating FFI will be required to report to the IRS (on forms yet to be issued by the IRS), with respect to accounts that it is required to treat as United States accounts as of **June 30, 2014**, the following information: (i) the name, address and taxpayer identification number of each "specified United States person" that is an account holder and, in the case of an account holder that is a "United States owned foreign entity," the name, address and taxpayer identification number (if any) of such entity and each "substantial United States owner" of such entity (all terms in quotations, as defined under FATCA), (ii) the account balance or value and (iii) the account number of the account. Beginning in 2016 (with respect to the 2015 calendar year), a participating FFI will also be required to report under FATCA payments with respect to its United States accounts. A participating FFI will also be required to report certain information to the IRS regarding its "recalcitrant account holders" (as defined under FATCA).

2. *Classifying Accounts for FATCA Purposes.* The Proposed Regulations provide detailed rules identifying the "payee" of a withholdable payment and determining the classification of that payee under FATCA (i.e., whether the payee is a participating FFI, etc.) The IRS will be issuing revised IRS Forms W-8, including W-8IMY for certain intermediaries and W-8BEN for beneficial owners, that request the information necessary for a withholding agent to classify a payee under FATCA. The Proposed Regulations also provide rules regarding classifying payees for accounts opened prior to **January 1, 2013** or, with respect to a participating FFI, prior to the effective date of its FFI Agreement.

3. *FFI Agreement*. The Proposed Regulations describe certain elements of the FFI Agreement, for which the IRS expects to issue a draft model early in 2012. In addition to other requirements, the FFI Agreement will require a participating FFI to adopt written policies and procedures governing its compliance with FATCA, to conduct periodic reviews of that compliance and to have a responsible officer periodically certify that compliance to the IRS.

4. *Refunds of FATCA Tax*. The Proposed Regulations provide that no refund of the 30% FATCA tax will be available for payments that are beneficially owned by a nonparticipating FFI except to the extent required under a U.S. income tax treaty.

5. *"Deemed-Compliant" FFIs*. The Proposed Regulations identify certain types of investment funds that will be considered "deemed-compliant" FFIs (i.e. FFIs that will not be required to enter into an FFI Agreement with the IRS in order to avoid the 30% FATCA tax on withholdable payments). However, most typical private investment funds are unlikely to fall within the deemed-compliant FFI categories described in the Proposed Regulations.

In addition to the Proposed Regulations, on February 8, 2012, the United States, France, Germany, Italy, Spain and the United Kingdom issued a "Joint Statement regarding an Intergovernmental Approach to Improving International Tax Compliance and Implementing FATCA" (the "Joint Statement"). The Joint Statement describes an alternative approach to implementing FATCA for FFIs established in a jurisdiction that is a party to the Joint Statement. As many private investment funds are not formed in such jurisdictions, the approach described in the Joint Statement has less direct relevance for such funds.

#### **Additional Guidance**

The U.S. Treasury and IRS are still considering a number of issues relating to FATCA including the application of the rules regarding passthru payments, the categories of funds that will be deemed-compliant FFIs and other issues that are relevant to private investment funds. Additional guidance is expected before FATCA becomes effective.

#### **IRS CIRCULAR 230 DISCLOSURE:**

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