
Preliminary FATCA Guidance Relevant to Private Investment Funds

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Introduction

On March 18, 2010, the Hiring Incentives to Restore Employment Act of 2010 was enacted. Certain provisions of this new law (commonly referred to as the "Foreign Account Tax Compliance Act" or "FATCA" provisions), which are now set forth in Sections 1471 through 1474 of the Internal Revenue Code (the "Code"), impose due diligence, information reporting and withholding obligations on "foreign financial institutions." A private investment fund formed under the laws of a non-U.S. jurisdiction (a "Non-U.S. Fund") will be a "foreign financial institution" that is subject to the FATCA provisions because the statute includes investment vehicles as "financial institutions" and the limited exceptions set forth in Internal Revenue Service Notice 2010-60, issued on August 27, 2010 (the "Notice"), are not relevant to the typical fund. A private investment fund formed under U.S. law (a "U.S. Fund") will also have certain obligations under the FATCA provisions.

The [Notice](#) provides preliminary guidance on certain aspects of the FATCA provisions, including some relevant to private investment funds. This Alert summarizes key aspects of the FATCA provisions and the Notice. **The FATCA provisions described below are generally not effective until January 1, 2013.**

Non-U.S. Funds

Requirement for Non-U.S. Fund to Enter into FFI Agreement with IRS

As a "foreign financial institution" (an "FFI"), a Non-U.S. Fund will be required to enter into an agreement with the IRS (an "FFI Agreement") or suffer a 30% withholding tax on any "withholdable payments" which it receives. According to the Notice, the IRS will publish a draft FFI Agreement as well as draft information reporting and certification forms. In general, under the FFI Agreement, a Non-U.S. Fund must agree to:

1. Obtain such information regarding each of its accounts (i.e., each equity or debt interest in

the Fund, other than any interests which are regularly traded on an established securities market) as is necessary to determine which (if any) of such accounts are "United States accounts."

2. Comply with due diligence procedures prescribed by the IRS with respect to the identification of United States accounts.
3. Report to the IRS, on an annual basis, certain information with respect to its United States accounts.
4. Withhold a 30% tax from any withholdable payment, or payment attributable to a withholdable payment, to an account holder: (i) that does not provide information reasonably requested by the Non-U.S. Fund to comply with its obligations under the FFI Agreement or that fails to provide the waiver described in item 6, below (a "recalcitrant account holder"); (ii) that is an FFI that has not entered into an FFI Agreement (a "non-participating FFI"); or (iii) in certain other circumstances.
5. Comply with requests by the IRS for additional information with respect to any United States accounts maintained by the Non-U.S. Fund.
6. In any case in which any foreign law would prevent the reporting of any information required to be reported with respect to any United States account maintained by the Non-U.S. Fund, attempt to obtain a waiver of such law from the account holder and, if the waiver is not obtained within a reasonable period of time, close the account.

A "United States account" is an account held by either of the following:

1. A "specified United States person," which generally means any United States person other than certain excluded categories of persons (e.g., publicly traded companies, individual retirement plans, organizations exempt from tax under Section 501(a) of the Code).
2. A "United States owned foreign entity," which generally means any foreign entity in which a specified United States person owns, directly or indirectly, a greater than 10% interest or, if the foreign entity is itself an FFI, any interest, regardless of the level of ownership.

If Non-U.S. Fund Does Not Enter into FFI Agreement with IRS

If a Non-U.S. Fund does not enter into an FFI Agreement with the IRS, a non-refundable 30% tax will be withheld from any "withholdable payment" made to such Non-U.S. Fund. 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 (for example, the gross proceeds from the sale of stock of a U.S. portfolio company), and certain other types of U.S. source income. If a

Non-U.S. Fund invests exclusively outside the United States and does not receive any withholdable payments, it will not be subject to the FATCA provisions.

Classifying Accounts for Purposes of Complying with FATCA Provisions

As set forth above, to comply with its FFI Agreement, a Non-U.S. Fund must determine which (if any) of its accounts are "United States accounts." The Non-U.S. Fund must also determine whether it has any withholding obligations with respect to its accounts (such as "recalcitrant account holders" or non-participating FFIs). The FATCA provisions provide that certain categories of account holders are exempt from FATCA, such as, among other categories, foreign governments or any political subdivision of a foreign government, foreign central banks and corporations the stock of which is regularly traded on an established securities market. The Notice adds a further category of entities that are exempt from FATCA: entities which are engaged in an active trade or business (other than the business of a "financial institution").

The Notice describes the categories into which a Non-U.S. Fund must classify its accounts and also describes the documentation which a Non-U.S. Fund may rely on to determine the appropriate classification. The documentation which a Non-U.S. Fund may rely on differs depending upon whether the account exists on the date the Non-U.S. Fund's FFI Agreement becomes effective or is established thereafter. In particular, for accounts that exist on the date its FFI Agreement becomes effective, the Non-U.S. Fund is required only to review information in its electronically searchable files for purposes of classifying its account holders. However, the Non-U.S. Fund may be required to request additional documentation from certain account holders (for example, if an account holder is tentatively classified as an FFI based on the information in its electronic records, the Non-U.S. Fund will be required to request certification from the FFI that it is a participating FFI) or permit account holders to establish non-U.S. status.

The [two attached diagrams](#) show certain of the routine categories into which a Non-U.S. Fund will be required to classify its accounts and specify certain basic consequences under the FATCA provisions that are associated with such categories of accounts.

U.S. Funds

A U.S. Fund will not be required to enter into an FFI Agreement with the IRS. However, a U.S. Fund will be required to classify its accounts that are held by entities into the categories set forth in the Notice so that the U.S. Fund may comply with its withholding obligations under the FATCA provisions. In particular, a U.S. Fund will be required to withhold a 30% tax from any withholdable payment made to any of the following: (i) a non-participating FFI; (ii) an FFI which has elected to be subject to withholding; and (iii) a non-financial foreign entity ("NFFE") which does not fall into a category of entities exempt from FATCA and has not either certified that it does not have any substantial U.S. owners or provided to the U.S. Fund the name, address and taxpayer identification number of each substantial U.S. owner.

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 Treasury Regulations, is expected before the FATCA provisions become effective on January 1, 2013.

For more information on this or other tax matters, contact [William C. Benjamin](#) or [Marguerite R. Lombardo](#). For more information on this or other fund formation matters, contact [Sarah Rothermel](#). For more information on this or other investment management matters, contact [Leonard A. Pierce](#) or [Timothy F. Silva](#).

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