

THE FACTS
ABOUT FATCA:
WHAT PRIVATE FUND
MANAGERS NEED TO KNOW

SEWARD & KISSEL LLP

February 27, 2013

Agenda

- Background and Outline of FATCA
- Getting Ready for FATCA
- The Due Diligence Process
- Examples of FATCA Compliance In Typical Fund Structures

Background and Outline of FATCA

Foreign Account Tax Compliance Act (FATCA)

- Enacted in March 2010 as part of the Hiring Incentives to Restore Employment Act of 2010 (the “HIRE Act”)
- FATCA is intended to prevent tax evasion by U.S. persons through the use of offshore financial accounts
- By its terms FATCA was scheduled to be effective on January 1, 2013, but implementation has been delayed

Basic Outline of FATCA

- A “foreign financial institution” (e.g., a private investment fund) must enter into an agreement with the U.S. Treasury to report certain information about its “United States accounts”
- If an agreement is not entered into, a 30% withholding tax is imposed on interest, dividends and gross proceeds from U.S. securities
- FATCA imposes detailed due diligence and reporting obligations on foreign financial institutions
- Therefore, offshore funds will be required to complete due diligence procedures with respect to their investors in order to determine whether they have any “United States accounts”

“Foreign Financial Institution”

- Any foreign entity which is:
 - A Bank, Custodian, Insurance Company or
 - An “Investment Entity”
 - Trades in securities, commodities, futures, etc. or engages in individual or collective portfolio management or otherwise invests, administers or manages funds, money or financial assets on behalf of other persons (e.g., an investment advisor) or
 - Its gross income is primarily attributable to investing, reinvesting or trading financial assets and it is professionally managed or
 - Holds itself out as a hedge fund, private equity fund, etc.

“United States Account”

- Any financial account held by one or more “specified United States persons” or a foreign entity more than 10% owned by a U.S. person (reduced to 0% in the case of a fund)
- “Specified United States person” means any U.S. person except for publicly-traded corporations (and their affiliates), banks, tax-exempt organizations, IRAs, federal, state and local governments, REITs, RICs, dealers, brokers, and common trust funds

Agreement With Treasury

- A foreign financial institution (an “FFI”) must enter into an agreement with Treasury to:
 - determine whether any of its accounts is a U.S. account or held by recalcitrant accountholders or non-compliant FFIs
 - annually report certain information about its U.S. accounts
 - adopt a compliance program under the authority of a “responsible officer” to periodically verify compliance with its FFI agreement
 - comply with requests by the Treasury for additional information with respect to its U.S. accounts
 - withhold on recalcitrant accountholders and non-participating FFIs and
 - obtain a waiver of any foreign law confidentiality provisions with respect to its U.S. accounts (or to close the account)
- The IRS plans to create a secure online web portal by July 15, 2013 so that FFIs can register with the IRS and receive a “Global Intermediary Identification Number” (“GIIN”)

Information On U.S. Accounts

- If an FFI enters into an agreement with the IRS, it must annually report the following information about each of its U.S. accounts on soon to be released IRS Form 8966 by March 31 (plus a 90-day extension):
 - the name and address and tax identification number of the U.S. account holder
 - the account number
 - the account balance and
 - the gross receipts and gross withdrawals or payments from the account

30% Withholding Tax

- If a foreign financial institution does not enter into an agreement with the IRS by December 2013 to report the required information about its U.S. accounts, then a withholding agent is required to withhold 30% of any “withholdable amounts” payable to the foreign financial institution beginning in 2014
- “Withholdable amounts” include U.S. source dividends, interest, other FDAP income, and, significantly, gross proceeds from U.S. securities (e.g., from sales of stock and repayments of debt), which includes return of investment as well as income

Intergovernmental Agreements

- The statutory provisions in FATCA are the default provisions that are applicable to FFIs
- An FFI's country of organization may enter into an Intergovernmental Agreement ("IGA") with the IRS
- An IGA may modify or change an FFI's obligations under FATCA
- There are two model IGAs but the actual IGAs vary from country to country
- There are 50 to 60 countries reported to be in negotiations with the IRS regarding IGAs
- The Cayman Islands has not yet entered into an IGA but has established a FATCA Task Force to review the existing IGAs

Model IGAs

Model 1

- FFI does not register with the IRS
- FFI reports required FATCA information to its home country taxing authority
- Information is then automatically shared with the IRS
- U.K., Germany, Spain, Ireland, Denmark, Mexico, Norway

Model 2

- FFI registers with the IRS
- FFI reports information to IRS directly
- Supplemental information may be reported to IRS by home country taxing authority
- Japan and Switzerland

Getting Ready for FATCA

Important Dates for FATCA

- January 2013—Final Regulations Issued
- Spring 2013—Revised Forms W-8 issued by IRS
- July 15, 2013—FATCA registration portal opens
- October 25, 2013—deadline for entering into FFI agreement for 1/1/14 effectiveness
- January 1, 2014—withholding begins on U.S. source dividends and interest to noncompliant FFIs
- March 31, 2015—FFIs must begin reporting U.S. account holders to IRS (first report due with respect to 2013 and 2014)
- January 1, 2017—withholding begins on gross proceeds on U.S. securities to noncompliant FFIs and by funds to recalcitrant accountholders

Compliance Checklist

- ✓ Determine whether FATCA is applicable
- ✓ Determine who will be responsible for FATCA in your organization, including Responsible Officer
- ✓ Develop a FATCA compliance program
- ✓ Register with the IRS via the online portal
- ✓ Due Diligence
 - ➔ Handled Internally or Externally?
- ✓ Review Fund Documents for Potential Modifications
- ✓ Begin Reporting to IRS

Identifying FFIs

- Investment Funds
 - Restricted Fund and Qualified Collective Investment Vehicle Status
- Joint Venture Vehicles
- SPVs
 - Disregarded entities are disregarded
- Non-U.S. Management Companies

Responsible Officer

- An FFI must appoint a responsible officer (who may act through delegates) to oversee the FFI's compliance with the FFI agreement
 - Establish compliance program
 - Periodically review compliance program
 - Certify with IRS every three years that RO has reviewed the compliance program and whether there have been any material failures of such program
 - Make an initial certification to the IRS that, to the best of the RO's knowledge, there were no formal or informal practices or procedures in place at any time from August 6, 2011 through the date of the certification to assist account holders in avoiding FATCA

Sponsored FFI Reporting

- Allows an entity (the “sponsoring entity”) to perform FATCA compliance on behalf of one or more FFIs
- The sponsoring entity must be authorized to manage the FFI and enter into contracts on behalf of the FFI
- The sponsoring entity registers with the IRS as such and agrees to perform the due diligence functions on behalf of the sponsored FFI
- For example, an investment manager could agree to be the sponsoring entity for all of its offshore funds

Review of Fund Documents

- Conduct review of offshore fund organizational documents to determine whether fund has the authority to comply with FATCA obligations
- Determine whether amendment will be required; shareholder approval?
- Survey existing shareholders/investors

Review of Articles of Association or Other Organizational Documents

- Power to effect compulsory redemption
- Specific authority to implement necessary withholding:
 - redemption payments
 - dividend payments
 - any other type of distribution
- Ability to allocate withholding taxes to recalcitrant shareholders that remain in fund
- Special allocation of FATCA associated expenses to relevant shareholders
- Power to segregate recalcitrant shareholder shares to special class (or “side pocket”) for FATCA purposes by conversion or similar action

Review/Update of Subscription Documents

■ Suggested Provisions

- subscribers (direct or indirect) agree to provide FATCA information and comply with all due diligence requests
- subscribers acknowledge that Fund can disclose FATCA information to IRS or third parties in order for the Fund to comply with reporting obligations
- waiver of any non-U.S. law provisions which would prevent disclosure by the Fund
- investor acknowledgement of non-compliance/disclosure consequences
- compulsory redemption

Review/Update of Subscription Documents (continued)

- Suggested Provisions (continued)
 - conversion to new class
 - holdback from redemption proceeds/distributions
 - updated W-8 and W-9 Forms should be attached to subscription document or separately circulated
 - consider exculpation of fund and Directors liability arising from FATCA compliance
 - special indemnification of fund and Directors if withholding amounts exceed recalcitrant shareholder's investment

Service Provider Review

- Identify responsible service provider (e.g., Fund Administrator) to coordinate FATCA compliance and process
- Amend service provider agreement to include FATCA obligations
- Identification of Responsible Officer providing certifications

The Due Diligence Process

Determining FATCA Status

- The goal is to determine the “FATCA Status” of an investor
- In order to determine FATCA Status, a fund will generally be able to rely on IRS Forms W-8 and W-9 as well as other information in its possession
- However, the process is somewhat more complex than normal W-8/W-9 reliance

Step 1: Entity or Individual?

- The rules for entities and individuals are different, so a fund should first determine whether an investor is an entity or an individual
- This can usually be easily determined based on the name of the entity or other information in the possession of the fund

Step 2E: What type of Entity?

- If the investor is an entity, then a fund must determine whether an entity is a beneficial owner or an intermediary
- In the case of a foreign beneficial owner, Form W-8BEN-E should be obtained
- In the case of a foreign intermediary, Form W-8IMY should be obtained
- In the case of a U.S. entity, Form W-9 should be obtained

Step 3E: FATCA Status

- Using the Forms W-8 and W-9, the fund determines the proper classification of the investor:
 - Compliant FFI (Participating & Deemed Compliant FFIs)
 - Exempt Foreign Entity
 - U.S. person other than a Specified U.S. Person
 - Specified U.S. Person
 - Non-Compliant FFI
 - Non-Financial Foreign Entity
- In general, Form W-8 and W-9 can be relied upon, although additional information may be required

Step 4E: Determine Obligations

- Finally, the FFI must effectively divide its entity investors into three categories:
 - Entities exempt from withholding and reporting
 - Compliant FFIs
 - Other Exempt Entities
 - U.S. Persons who are not “Specified U.S. Persons”
 - Entities subject to withholding
 - Non-compliant FFIs
 - Entities subject to reporting but not withholding
 - “Specified U.S. Persons”
 - NFFE Owners who are “Specified U.S. Persons”

Step 2I: U.S. or Non-U.S. Individual

- If an individual investor provides a W-9, then such person is presumed to be a U.S. person and would be required to be reported under FATCA
- If an individual investor provides a W-8BEN, then a fund must review all information collected with respect to the opening or maintenance of the investment in the fund, including documentation collected as part of its subscription procedures (e.g., the subscription document) and documentation collected for other regulatory purposes (e.g., AML/KYC) to determine if an investor has “U.S. indicia”

Step 3I: Looking for U.S. Indicia

- The following are “U.S. indicia”:
 - Identification of an investor as a U.S. resident or citizen
 - U.S. place of birth
 - U.S. resident or mailing address (including a U.S. post office box)
 - U.S. telephone number (and no non-U.S. telephone number on file)
 - Standing instructions to transfer funds to an account maintained in the United States
 - Power of attorney or signatory authority granted to a person with a U.S. address or
 - An “in-care-of” address or “hold mail” address that is the sole address the fund has identified for the investor

Step 4I: Further Documentation

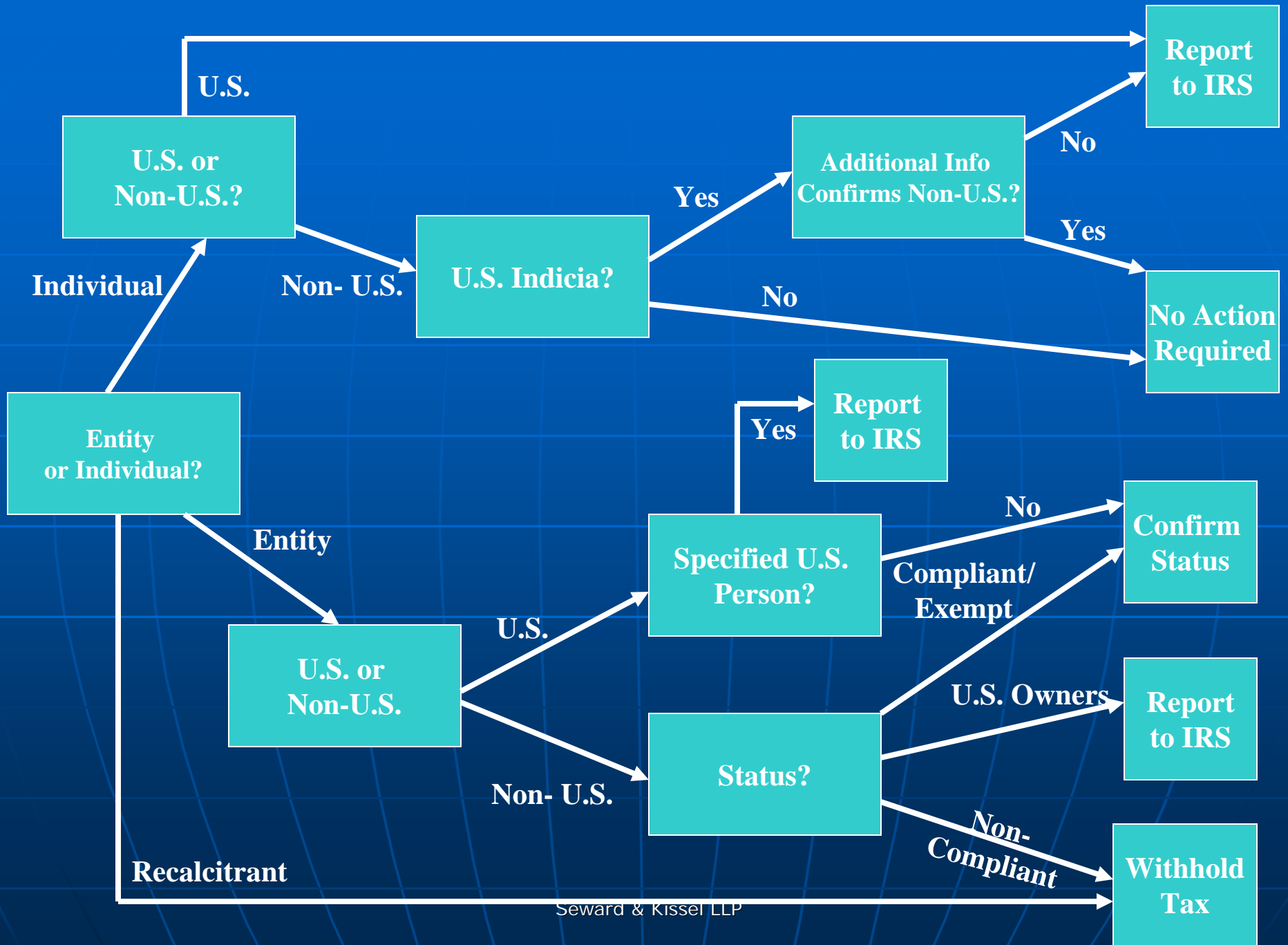
- If an investor has U.S. indicia, then a fund must obtain additional documentation from the investor in order to certify the investor is not a U.S. person. If such documentation cannot be obtained, the fund must treat the investor as a U.S. person
- The particular documentation that must be obtained is dependent upon the type of U.S. indicia
- For example, if an investor has a U.S. place of birth, a fund must obtain:
 - a Form W-8BEN
 - a non-U.S. passport or other government-issued identification evidencing citizenship in a country other than the U.S. and
 - a copy of the individual's Certificate of Loss of Nationality of the United States (Form I-407), or a reasonable explanation of the account holder's renunciation of U.S. citizenship or the reason the account holder did not obtain U.S. citizenship at birth

Step 5I: Determine FATCA Status

- Finally, based on the above, the fund classifies the investor as a U.S. individual or a non-U.S. individual
- In the case of a U.S. individual, information is reported to the IRS on Form 8966
- In the case of a non-U.S. individual, no information is reported to the IRS

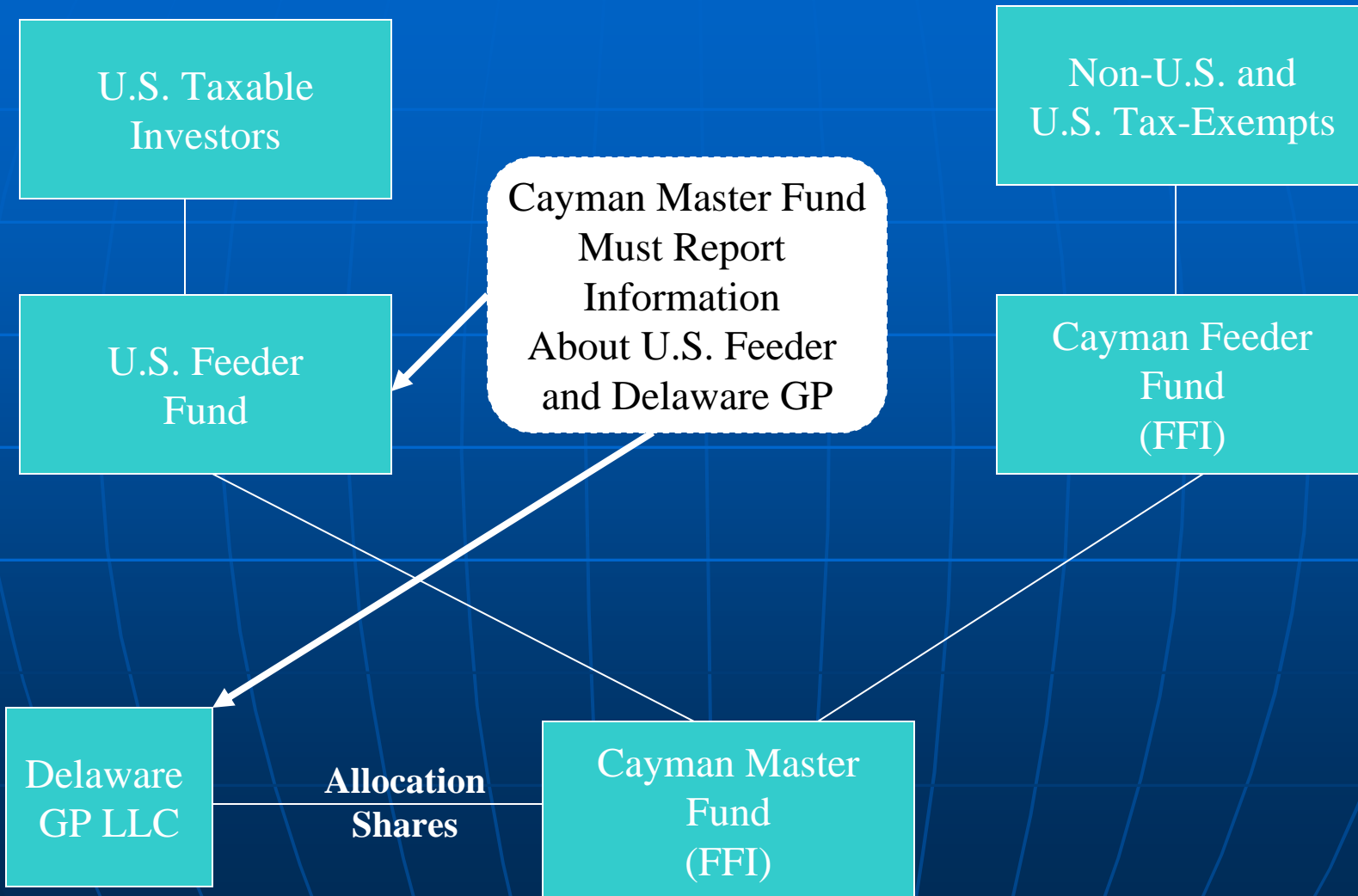
Recalcitrant Account Holders

- If an investor refuses to provide information to a fund, then the fund must treat the investor as a “recalcitrant account holder” and impose 30% FATCA withholding on U.S. source income
- Funds may want to consider mandatorily redeeming recalcitrant account holders to avoid the administrative burden of the withholding tax

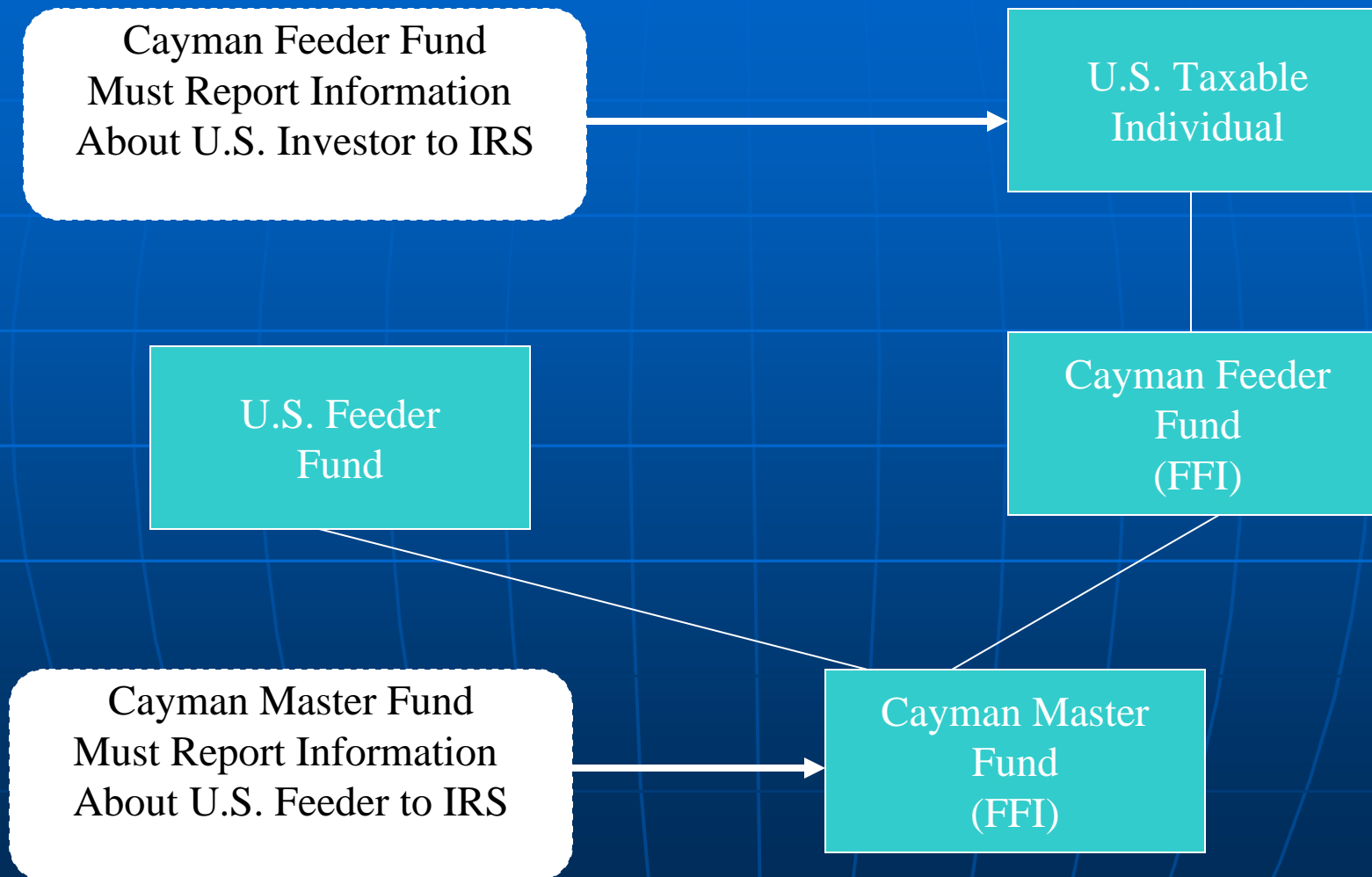


The Application of FATCA in Typical Fund Structures

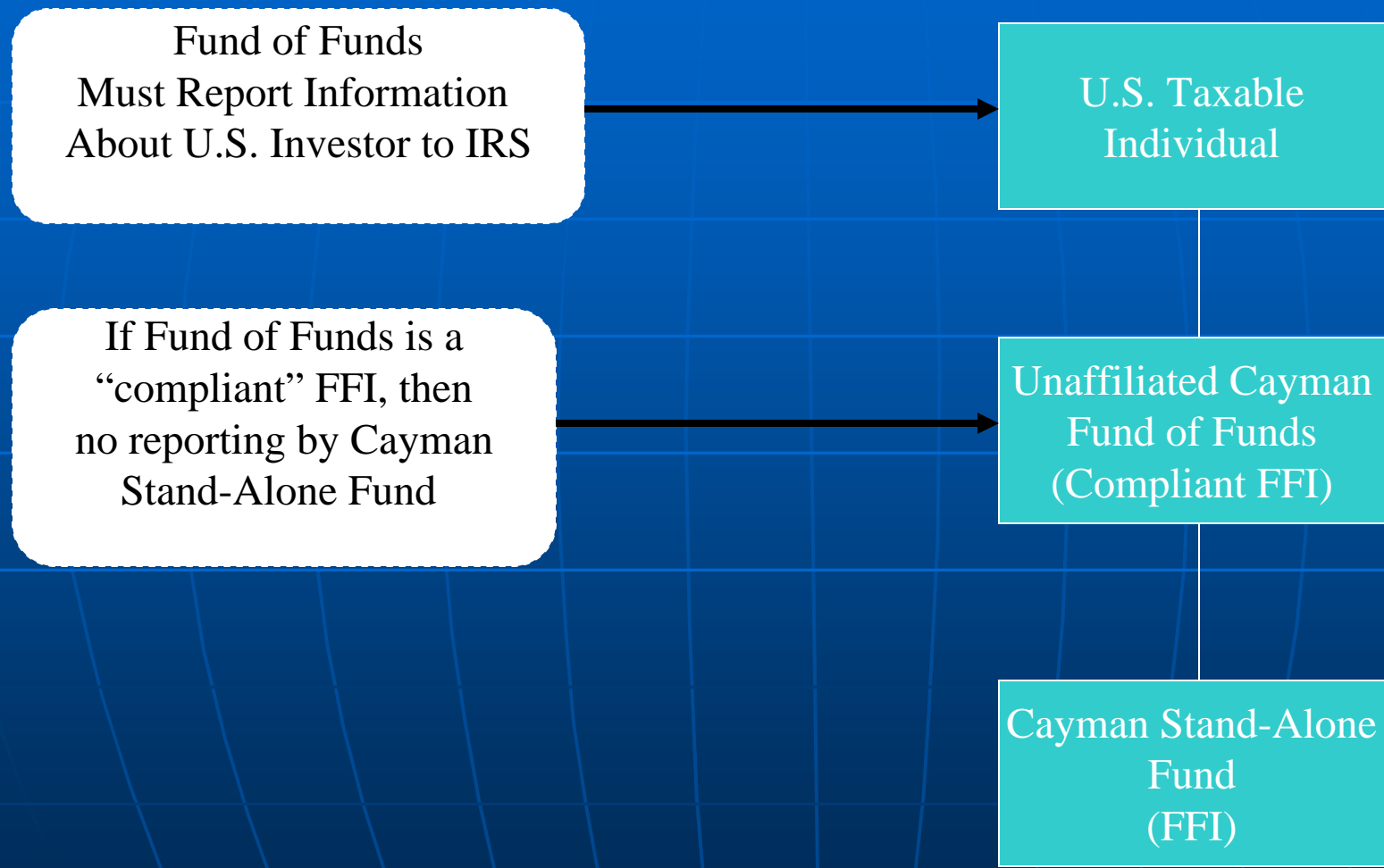
Example—Typical Fund Structure



Example—Direct U.S. Investor



Example—Indirect U.S. Investor I



Example—Indirect U.S. Investor II

If U.S. Beneficiaries receive more than \$5,000 from trust, then they must be reported to IRS under FATCA.

U.S. and Non-U.S.
Individual
Beneficiaries

Discretionary
Non-Grantor Trust
(Bermuda)

Cayman Stand-Alone
Fund
(FFI)

Disclaimers

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- To ensure compliance with Treasury regulations regarding practice before the IRS, we inform you that any federal tax advice contained in this communication was not intended or written to be used, and cannot be used, by any taxpayer for the purpose of (i) avoiding penalties that may be imposed on the taxpayer under United States federal tax law, or (ii) promoting, marketing or recommending to another party any tax-related matters addressed herein.

Contact Information

Ronald P. Cima

cima@sewkis.com

(212) 574-1471

James C. Cofer

cofer@sewkis.com

(212) 574-1688

Daniel C. Murphy

murphyd@sewkis.com

(212) 574-1210

Patricia Poglinco

poglinco@sewkis.com

(212) 574-1247