

# FATCA After the Final Regulations and IGA Proliferation

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- ▶ An active speaker and author, Mr. Bortnick has written materials and spoken for several major private equity tax conferences. Topics of his presentations include private equity, venture capital, cross-border investing, venture capital operating company issues, and merger and acquisition tax issues.



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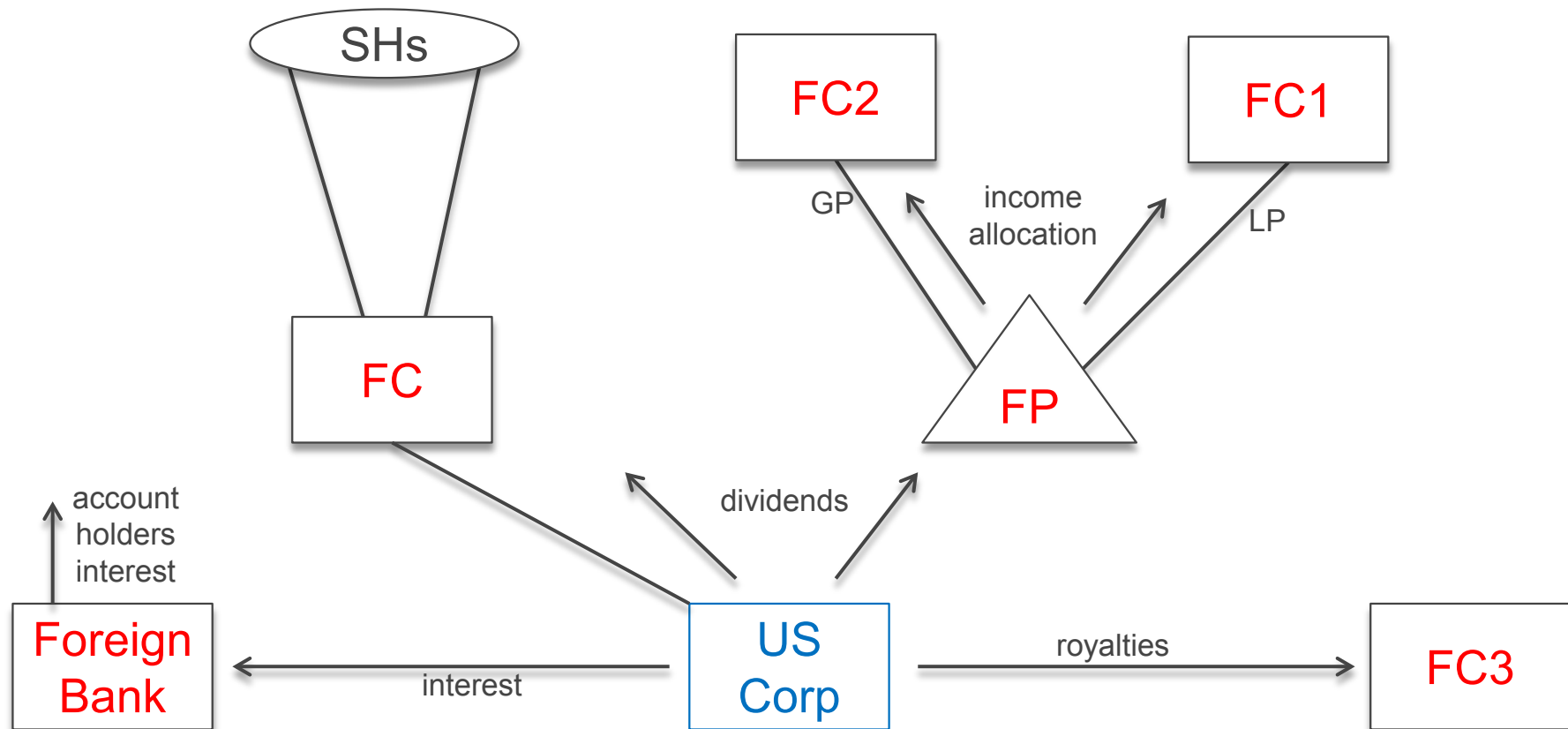
- ▶ Morgan Klinzing is an associate in the Tax Practice Group of Pepper Hamilton LLP, resident in the Philadelphia office.
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- ▶ Ms. Klinzing is admitted to practice in Georgia.



# FATCA Overview

- ▶ FATCA (Foreign Account Tax Compliance Act) added a new chapter 4 to the Code and was enacted as part of the Hiring Incentives to Restore Employment (“HIRE”) Act in March 2010
  - Addresses US tax non-compliance by providing transparency with respect to assets and investments held offshore
  - Intended to provide increased reporting, not collect tax, but the “hammer” is a new 30% withholding tax
- ▶ Proposed Regulations released February 8, 2012
- ▶ Final Regulations issued January 17, 2013
- ▶ Final, Temporary and Proposed Regulations updating the 2013 Final Regulations released February 20, 2014

# The Paradigm



- ▶ FATCA wants to make sure that no US people are hiding behind a red entity

# What If an FFI is not FATCA Compliant?

- ▶ Starting in July 2014, U.S. source interest, dividends, royalties and other fixed determinable and periodic income is subject to 30% U.S. withholding tax
- ▶ Starting no earlier than January 1, 2019
  - 30% withholding on sale of U.S. loans and stock
  - 30% withholding on loan principal
  - 30% withholding on “pass through” payments

# What Does a FFI Need to Do?

- ▶ Sign an FFI agreement with the IRS
  - Undertaken due diligence on account holders
  - Report U.S. account holders
- ▶ Certain exceptions apply to need for an agreement
  - Residents in certain jurisdictions, but they will still need to undertake due diligence and reporting
  - Certain deemed compliant entities

# FATCA Overview

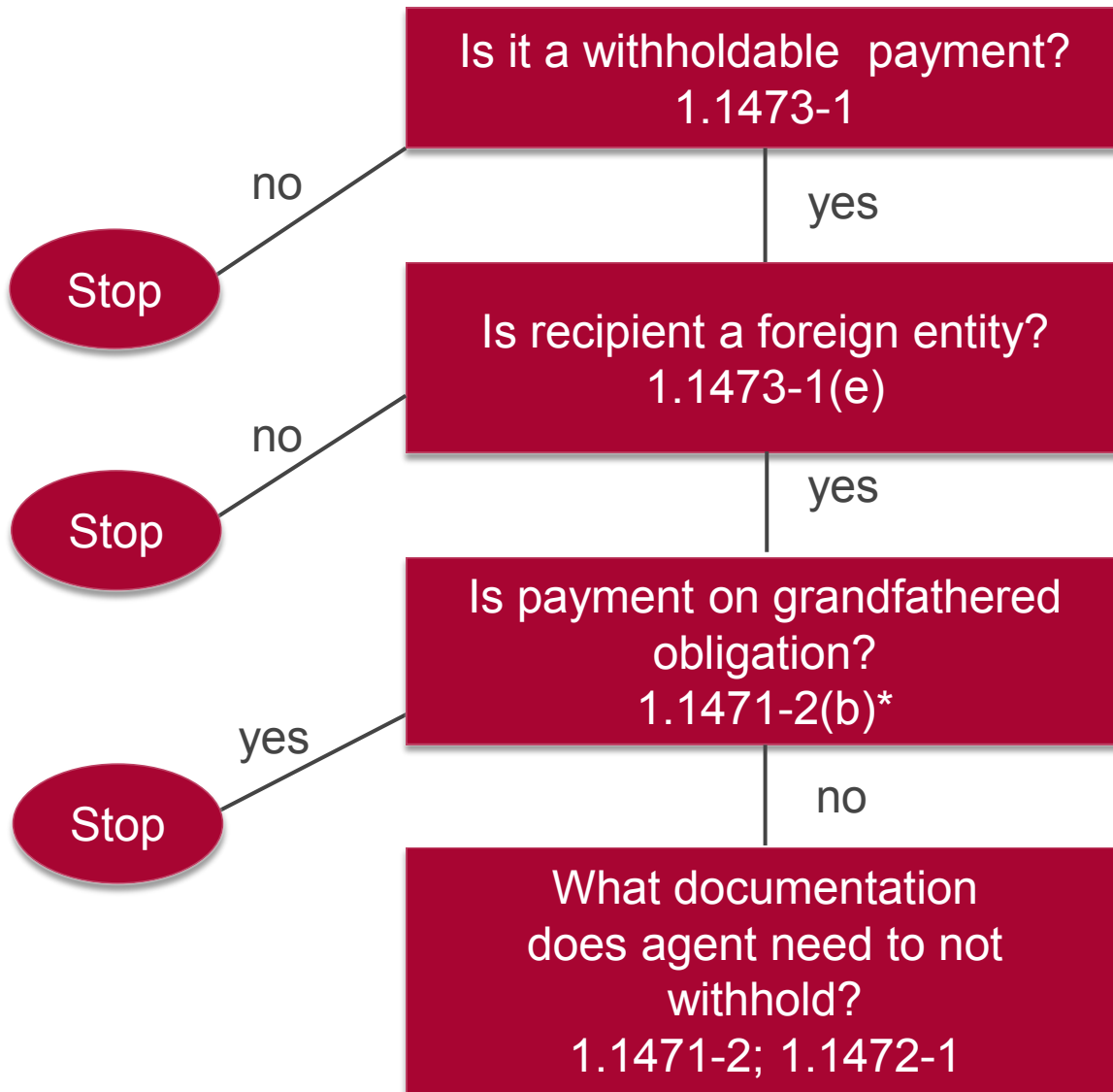
- ▶ What are FFIs? A foreign entity that:
  - Accepts deposits in the ordinary course of a banking or similar business such as retail banks;
  - Is engaged in the business of holding financial assets for the account of others such as investment banks and custodians; or
  - Is engaged primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or derivatives in the above such as mutual funds, hedge funds, private equity funds, and securitization vehicles.
  - Includes an entity that provides investment management services to customers. (New)
- ▶ Certain insurance companies



# FATCA Overview

- ▶ Payments made with respect to “grandfathered obligations” are not subject to FATCA withholding
  - “Obligation” includes any legal agreement that produces or could produce withholdable payments, other than any instrument treated as equity for US tax purposes or any legal agreement that lacks a definitive expiration or term
  - Outstanding on 7/1/14 and not materially modified thereafter
- ▶ With respect to dividend equivalent payments and foreign pass through payments, obligations outstanding prior to six months after regs are finalized will be grand fathered
- ▶ Special rules for collateralized obligations

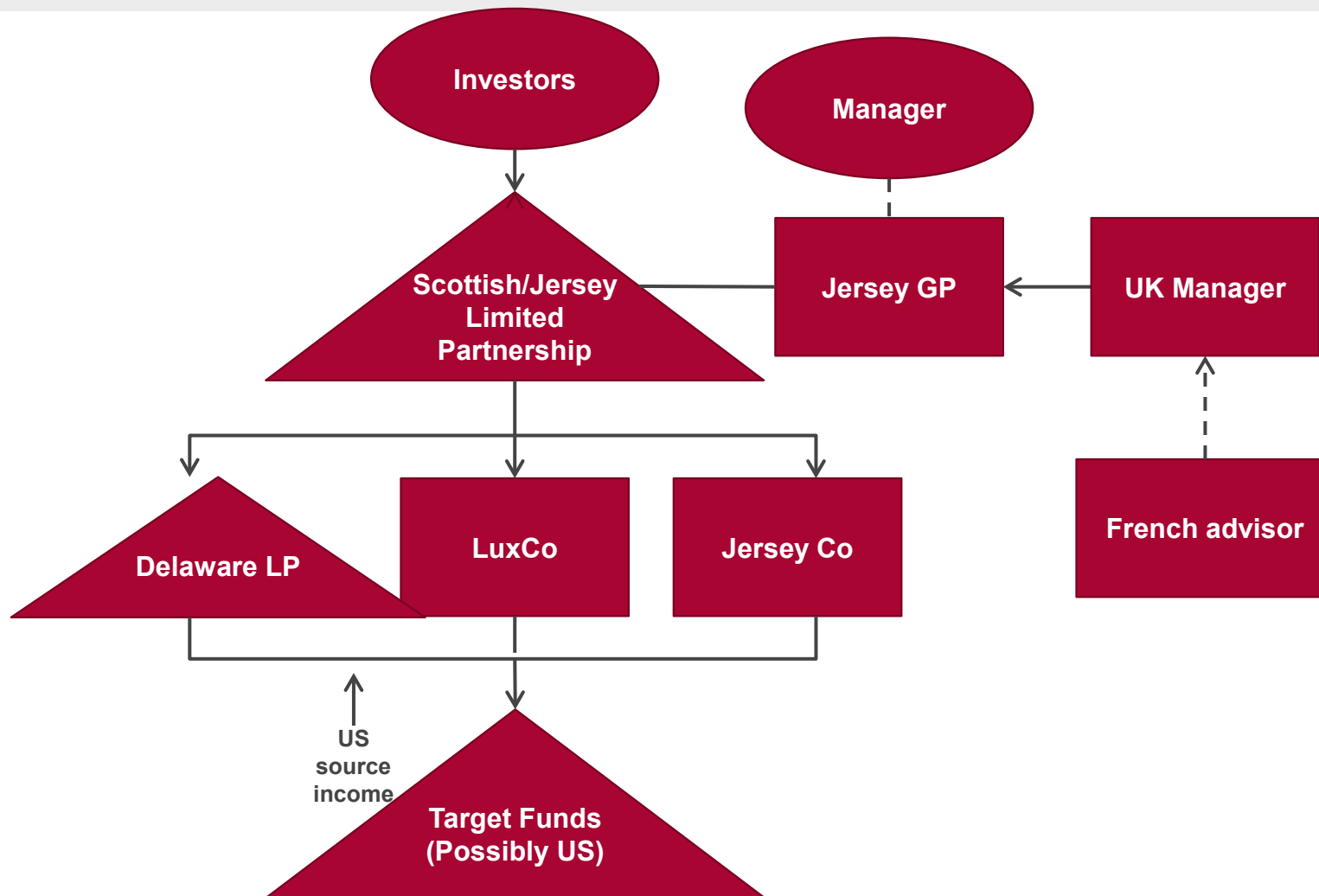
# Payment by Payment – US Withholding Agent



- ▶ US source FDAP/gross proceeds exceptions:
- ▶ No documentation needed
  - Short-term interest
  - Ordinary course payments
  - Fractional share payments
  - Sale of property that can produce short term interest, or ordinary course payment
- ▶ Documentation required
  - ECI (if no PE claim made) and sale of instruments that produce ECI

\*But reporting applies

# Fund of Funds

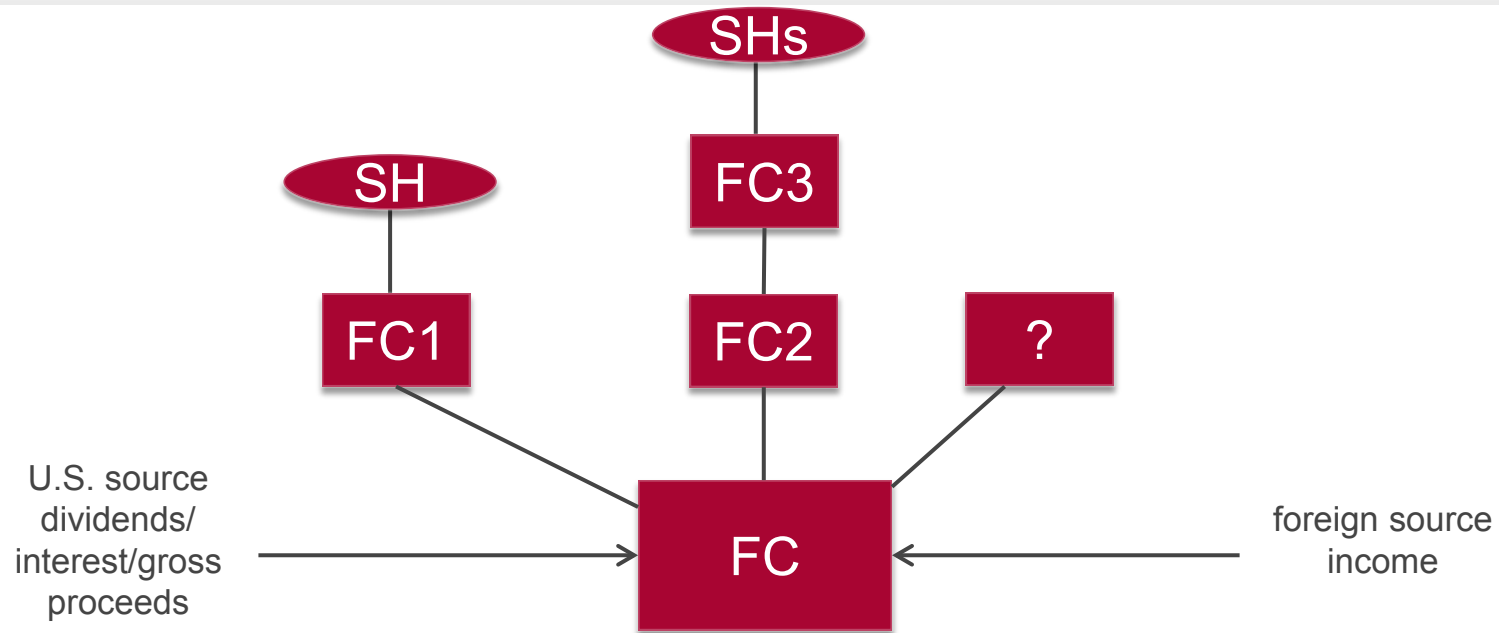


- ▶ Identify FFIs
- ▶ FATCA W/H on Luxco, Jersey Co and Scottish LP unless each is FATCA compliant

# How To Be FATCA Compliant

- ▶ Be a participating FFI
  - Enter an agreement with the IRS to comply with certain requirements
  - Become a Participating FFI (a “PFFI”)
  - Under the agreement, a PFFI will be required to:
    - Obtain information on all account holders (investors) to determine which accounts are US accounts
    - Comply with required due diligence/verification procedures and certify completion of such procedures
    - Report information on US accounts
    - Deduct and withhold a 30% tax on any “passthru payment” to recalcitrant account holders or other FFIs that are not PFFIs, deemed compliant FFIs, or exempt entities
    - Comply with IRS information requests
    - Attempt to obtain a waiver of applicable bank secrecy or other information disclosure limitations or close the US account
- ▶ Or, be a deemed Compliant FFI

# Payment by Payment – What Does it Mean to the Recipient?



- ▶ Assuming FC is not publicly traded
- ▶ To avoid FATCA withholding
  - Enter an agreement with the IRS to comply with certain requirements. Become a Participating FFI (a “PFFI”)
  - Under the agreement, a PFFI will be required to:
    - Obtain information on all account holders (investors) to determine which accounts are US accounts
    - Comply with required due diligence/verification procedures and certify completion of such procedures
    - Report information on US accounts
    - Deduct and withhold a 30% tax on any “passthru payment” to recalcitrant account holders or other FFIs that are not PFFIs, deemed compliant FFIs, or exempt entities
    - Comply with IRS information requests
    - Attempt to obtain a waiver of applicable bank secrecy or other information disclosure limitations or close the US account

# Deemed Compliant FFI

- ▶ FFIs can avoid 30% withholding and the PFFI agreement if they are a deemed compliant FFI
- ▶ Two types: Registered and Certified
- ▶ Registered deemed compliant FFIs are still required to meet certain requirements including performing diligence to identify and eliminate US accounts and registering with IRS
- ▶ Certified deemed compliant FFIs are required to certify status to the withholding agent

# Registered Deemed Compliant FFI

- ▶ FFI deemed compliant through intergovernmental agreement (“IGA”)
  - Draft agreement released July 2012 and updated in the fall of 2014. Significant definitional problems
  - IGAs with 112 separate countries
  - Comply with IGA constitutes compliance with FATCA
  - Report to local jurisdiction – tax authorities exchange information – no direct reporting to IRS

# IGA Jurisdictions

Algeria	Cayman Islands	Greenland	Jersey	Norway	St. Kitts and Nevis
Angola	Chile	Grenada	Kazakhstan	Panama	St. Lucia
Anguilla	China	Guernsey	Kosovo	Paraguay	St. Vincent and the Grenadines
Antigua	Colombia	Guyana	Kuwait	Peru	Sweden
Armenia	Costa Rica	Haiti	Latvia	Philippines	Switzerland
Australia	Croatia	Holy See	Liechtenstein	Poland	Taiwan
Austria	Curaçao	Honduras	Lithuania	Portugal	Thailand
Azerbaijan	Cyprus	Hong Kong	Luxembourg	Qatar	Trinidad and Tobago
Bahamas	Czech Republic	Hungary	Macao	Romania	Tunisia
Bahrain	Denmark	Iceland	Malaysia	San Marino	Turkey
Barbados	Dominica	India	Malta	Saudi Arabia	Turkmenistan
Belarus	Dominican Republic	Indonesia	Mauritius	Serbia	Turks and Caicos Islands
Belgium	Estonia	Iraq	Mexico	Seychelles	Ukraine
Bermuda	Finland	Ireland	Moldova	Singapore	United Arab Emirates
Brazil	France	Isle of Man	Montenegro	Slovak Republic	United Kingdom
British Virgin Islands	Georgia	Israel	Montserrat	Slovenia	Uzbekistan
Cabo Verde	Germany	Italy	Netherlands	South Africa	
Cambodia	Gibraltar	Jamaica	New Zealand	South Korea	
Canada	Greece	Japan	Nicaragua	Spain	



# Registered Deemed Compliant FFI

- ▶ Local FFI
  - Doesn't apply to financial entities that are FFIs solely because they are investment entities
- ▶ Non-reporting member of participating FFI group
  - Doesn't permit any US accountholders

# Registered Deemed Compliant FFI

- ▶ Qualified collective investment vehicles
  - Qualifies as FFI solely because it is an investment entity
  - Must be regulated in its country of incorporation or organization as an investment fund
  - Holders of debt interests in excess of \$50,000 or equity must be
    - PFFI
    - registered deemed compliant FFI
    - US person
    - exempt beneficial owner
  - If part of an EAG, all members must be PFFI or registered deemed compliant FFI

# Registered Deemed Compliant

## ▶ Restricted Funds

- Solely investment entities
- Regulated as investment fund in country of incorporation
- Interests sold solely through distributors that are PFFIs, deemed compliant FFIs, restricted distributions
- Every agreement with the funds distributors (other than those with distributors that are themselves participating FFI) prohibit sales of fund to US persons, non-participating FFIs, or passive NFFEs with one or more substantial US owners (these are basically blocker entities);
- The funds' prospectus and all marketing materials must indicate that sales to US persons, passive NFFEs, and nonparticipating FFIs (other than shares which are both distributed by and held through a participating FFI) are prohibited;
- Agree to certain reporting to IRS
- All members of EAG must be PFFI or registered deemed Compliant FFI

# Obligations for a Registered Deemed Compliant FFI

- ▶ As a registered deemed-compliant FFI, a fund will be required to—
  - Have its chief compliance officer or an individual of equivalent standing with the FFI certify to the IRS that all of the requirements for the deemed-compliant category claimed by the FFI have been satisfied as of the date the FFI registers as a deemed-compliant FFI;
  - Obtain from the IRS a confirmation of its registration as a deemed-compliant FFI and a GIIN;
  - Agree that if it chooses to publish a passthru payment percentage, it will do so in accordance with the procedures;
  - Monitor compliance and renew its certification every three years; and
  - Agree to notify the IRS if there is a change in circumstances which would make the FFI ineligible for the deemed-compliant status for which it has registered.

# Exempt Beneficial Owners

- ▶ Exempt beneficial owners are not subject to FATCA withholding and not required to register with IRS
  - Retirement funds (and investments funds solely of retirement funds)
  - Foreign governments, political subdivisions, wholly-owned agencies or instrumentalities thereof
  - International organizations or wholly-owned agencies or instrumentalities thereof
  - Foreign central bank of issue
  - Governments of US territories
  - Entities wholly-owned by exempt beneficial owners
  - Entities described as exempt under IGA

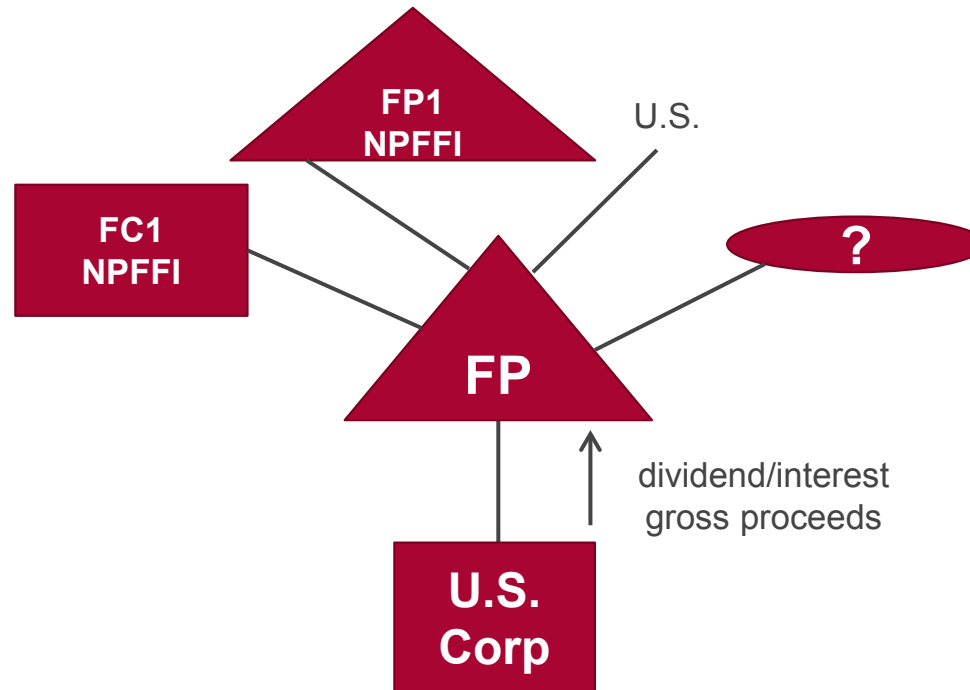
# Certified Deemed Compliant FFI

- ▶ Non-registering local bank
- ▶ Low value accounts (N/A to investment funds)
- ▶ Sponsored, closely held investment vehicles
- ▶ Investment advisors and investment managers
  - May not maintain financial accounts

# Some Special Rules

- ▶ Affiliated groups: All members required to be participating FFIs or deemed compliant
  - Transition rule: before 2016 PFFI groups can have members that cannot meet PFFI or deemed compliant requirements if they perform diligence and meet other requirements (limited branch or limited FFI)
- ▶ Special elections
  - Elect to be withheld on
- ▶ Special rules for US territory FIs
  - Elect to be treated as a US payor

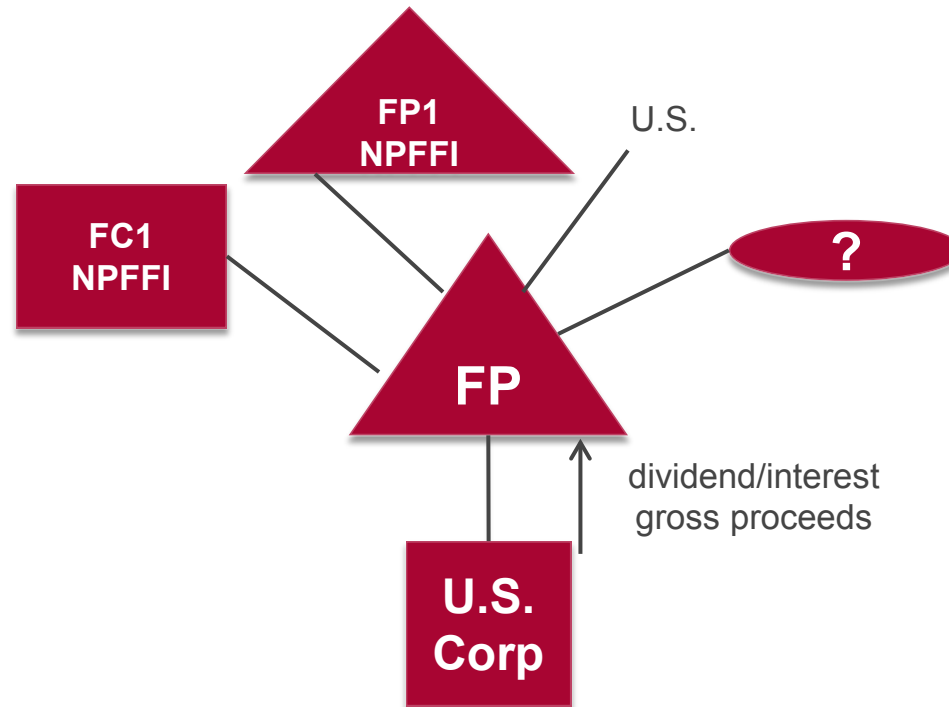
# Investment Fund Is Flow Through



- ▶ FP is FFI
  - If NPFFI, 30% FATCA withholding on full amount
  - If PFFI and a “withholding partnership”, no withholding by U.S. Corp
    - FP has obligation to do FATCA withholding on income allocable to NPFFIs and recalcitrant account holders



# Investment Fund Is Flow Through

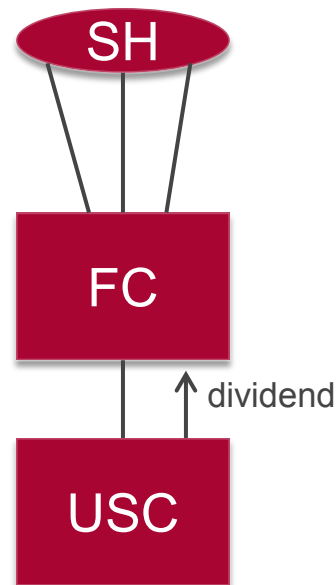


## ▶ FP is FFI

- If PFFI and not a withholding partnership, FP tells U.S. Corp the percentage of its members that are NPFFI or recalcitrant account holders, and U.S. Corp applies FATCA withholding to that amount

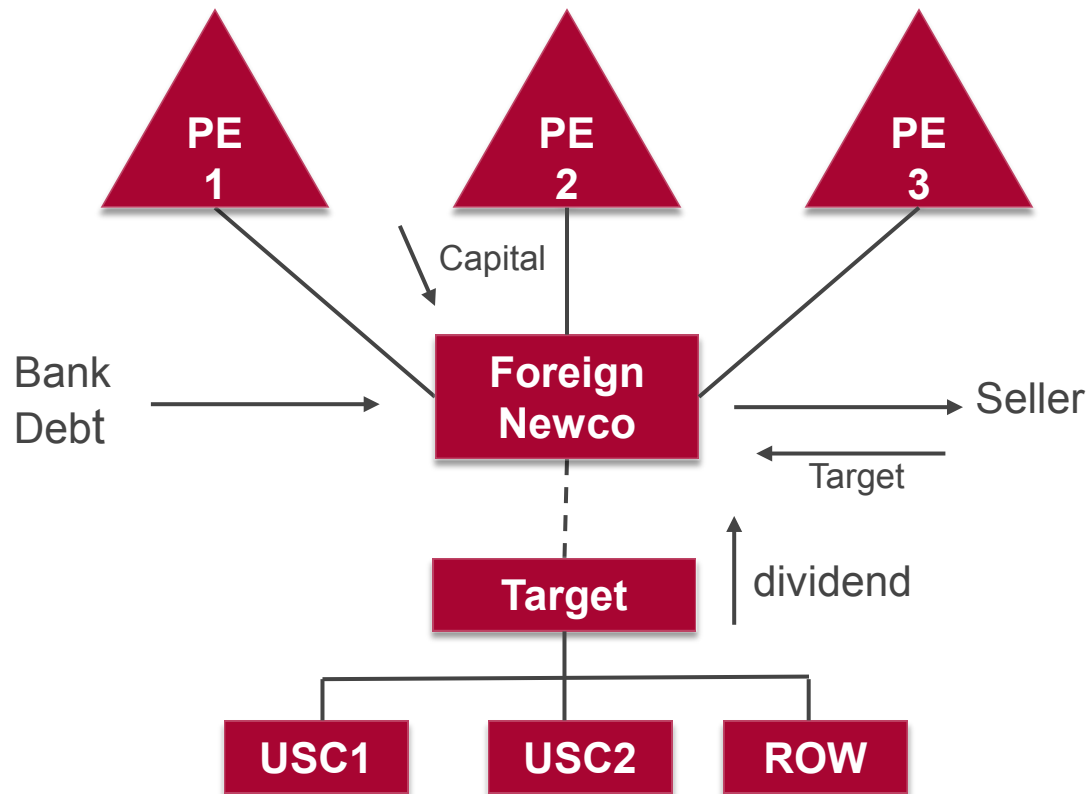
# Payment by Payment

- ▶ Non financial holding company



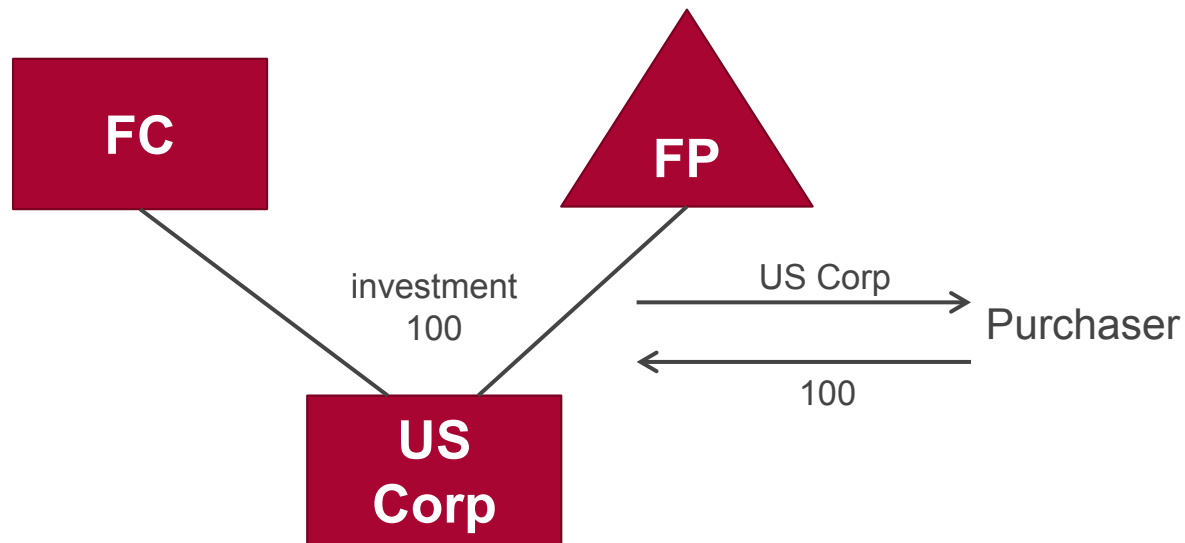
- ▶ If substantially all of the activities of FC are the ownership of stock of subsidiaries and no subsidiary is an FFI, then FC not FFI
- ▶ If FC is a non-financial holding company, it is also NFFE
  - How does payor know status — reliably associate with documentation
  - FC cannot hold itself out, or function as an investment fund, such as PE fund, VC fund or an investment vehicle whose purpose is to acquire or fund companies and then hold interests on those companies for investment purposes

# Is Holding Company a PE Fund?



- ▶ Newco formed by PE funds for purpose of buying Target
  - Does it matter whether exit is planned as a sale of Newco or Target?
- ▶ Does borrowing activity mean that the test of “substantially all of the activities are holding stock of subsidiaries” is not met?

# Gross Proceeds



- ▶ The gross proceeds of 100 are subject to FATCA 30% withholding, unless FC and FP are
  - PFFI
  - Deemed compliant PFFIs
  - Compliant NFFE
  - Exempt NFFEs
- ▶ This withholding starts 1/1/2019
  - Details, particularly for non-compliant FP to be worked out

# Timeline

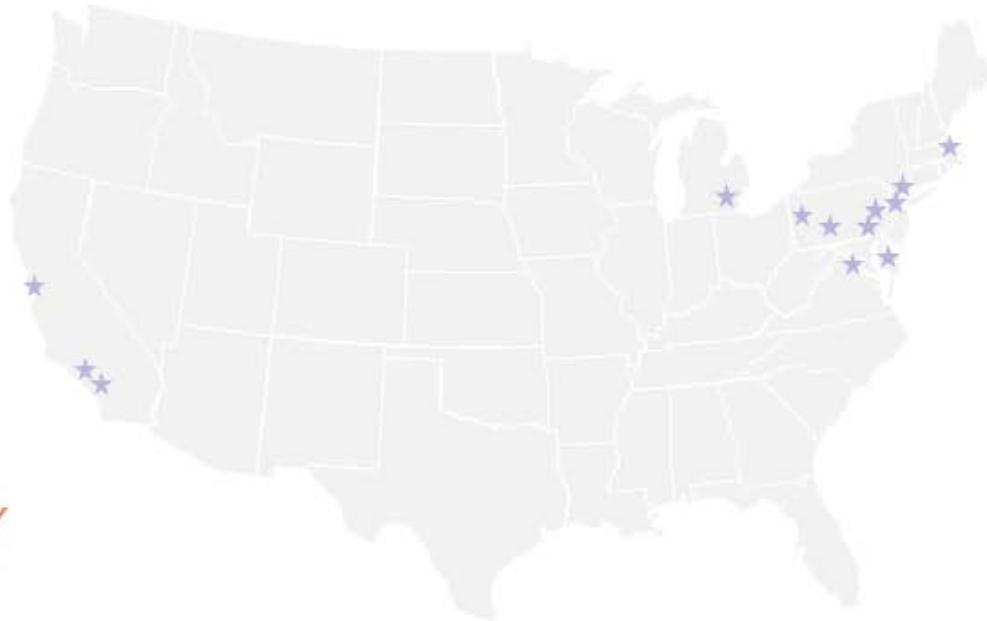
- ▶ Withholding (inc. instruments outstanding as of 7/1/14)
  - 7/1/14 withholding began for:
    - FDAP
  - 1/1/19 - withholding begins for gross proceeds with respect to sales or dispositions made on or after that date
  - 1/1/19 - withholding on passthru payments to a recalcitrant account holders or non-participating FFIs will not begin earlier than this date (or the date of the publication of Regulations defining foreign passthru payments)
- ▶ Reporting
  - 3/15/15 - Annual reporting (Forms 1042 and 1042-S) for ch4 reportable amounts begins
  - 9/30/15 - Report identifying information, account balance or value and TIN for US accounts and recalcitrant account holders begins (with respect to 2014)
- ▶ Miscellaneous
  - 2/20/2014 - Conforming changes to ch3 and ch61 made

# FFI Agreement

- ▶ Fall 2013 - Draft model agreement made available
- ▶ Summer 2014 - Final model agreement made available
- ▶ 8/19/13 - Online registration for FFIs began
- ▶ 5/5/14 – FFIs that did not complete the process by this date risked not having their GIIN in time to prevent withholding
- ▶ 1/1/16
  - Must re-submit registration for PFFI status if have limited branches (i.e., branches that aren't PFFIs or deemed compliant FFIs)

# Locations

BERWYN  
BOSTON  
DETROIT  
HARRISBURG  
LOS ANGELES  
NEW YORK  
ORANGE COUNTY  
PHILADELPHIA  
PITTSBURGH  
PRINCETON  
SILICON VALLEY  
WASHINGTON  
WILMINGTON



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