FATCA impact on funds industry

June 2012

Introduction

Any entity which makes a payment of US source income must consider whether it is subject to FATCA. FATCA may apply to both financial and non-financial operating companies.

Due to this breadth, FATCA impacts virtually all non-US entities, directly or indirectly, receiving most types of US source income, including gross proceeds from the sale or disposition if US property which can produce interest or dividends.

US entities, both financial and non-financial, that make US source payments will also be impacted as they may now be required to withhold a punitive 30% tax on payments made to incorrectly/insufficiently documented investors under FATCA.

This will require the US entities to maintain documentation on those clients and also track how those persons are classified under FATCA.

What is a FFI?

A FFI is a foreign financial institution, which is any non-US entity that:

- Accepts deposits in the ordinary course of a banking or similar business,
- As a substantial portion of its business, holds financial assets for the account of others, or
- Is engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interest in such securities, partnership interests, or commodities.

Generally non-US entities such as banks, broker/dealer, insurance companies, hedge funds, securitisation vehicles, and Private equity funds will be considered FFIs.

As an FFI, the fund must enter into an agreement with the IRS in order to become a Participating FFI (PFFI).

Thus, the FFI agreement will specify the PFFI's obligation to:

- Withhold tax on passthru payments made to recalcitrant account holders and NPFFIs;
- Obtain such information as to determine whether accounts are US accounts, recalcitrant or accounts held by NPFFIs;
- Report on an annual basis with respect to US accounts and accounts held by recalcitrant account holders;
- Obtain a waiver from local law that would otherwise prevent it from complying with the requirements of the FFI agreement;
- Adopt written policies and procedures governing: ◦its due diligence procedures for identifying and documenting account holders;
    - its withholding requirements;
    - its reporting withholding obligations.
- Conduct periodic reviews of its compliance with these policies and procedures;

Next steps

FATCA preparation and compliance can represent a multi-year process, so it is important to begin preparation activities in the near term for future compliance requirements.

Some of the specific action items for funds to consider when developing their FATCA compliance programs are:

- Analyse current fund and organisation structures to determine each entities' classification under the FATCA categories;
- Determine whether entities classified as FFIs need to register with the IRS; **Note:** The proposed regulations expanded the definitions of deemed compliant entities which might include certain types of funds, though these remain restrictive.
- Classify investor accounts into FATCA categories;

- Remediate investor information as required for pre-existing accounts
  Note: Similar considerations apply to counterparties and third party service providers;
- Conduct reviews of investor onboarding processes to identify where additional data is required to be collected for new accounts;
  Note: The proposed regulations modified due diligence procedures to rely more on current AML/KYC procedures, increased de minimis thresholds for individual and entities, and, in certain cases, permits reliance on existing Form W-8 and W-9;
- Analyse AML/KYC programs performed internally and by third party service providers to confirm compliance with FATCA requirements;
- Develop a governance structure for implementation and identify "Responsible Officer(s)" who are required to certify compliance;
- Update fund documents, such as offering documents and subscription documents, to incorporate language that outline the FATCA requirements, indicate whether the funds' plans to register as an FFI, and the implications of non-compliance;
- Outline a solution for supporting the FATCA withholding and reporting requirements which are phased in from 2014 to 2017 or later;
- Analyse current fund and organisation structures to determine whether any modifications can be made to reduce the impact of FATCA;
- Develop communication strategies for investors, counterparties, and third party service providers; and
- Educate investor relations personnel and distributors about the impact to their business or functions, and identifying the impact to existing processes or technology platforms.

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