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# FATCA Implications for Offshore Investment Funds and their US Investment Managers

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**CATEGORY:**
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## FATCA Background

The Foreign Account Tax Compliance Act ("FATCA") was enacted in response to concerns that US taxpayers were avoiding US tax by using offshore financial institutions to hide assets and avoid reporting income. Generally, FATCA imposes due diligence, information reporting and withholding obligations on non-US financial institutions ("FFIs") and withholding obligations on other persons making withholdable payments to non-exempt non-US persons.

Generally, FFIs will need to register with the IRS and annually report certain information to the IRS or the foreign jurisdiction of organization. The reporting obligations will depend on whether the foreign country of organization has a FATCA agreement with the US (an "IGA"), and what type of agreement it is. Generally, however, the FFI will be required to report information about its US accountholders, including their name, address and US taxpayer identification number and the value of their account. FATCA encourages compliance by imposing on non-compliant FFIs a 30% withholding tax on payments of US investment income and, beginning in 2017, gains from the sale of US investment assets.

## Application of FATCA to Investment Funds

FATCA applies to more than just traditional financial institutions, like banks and brokerage companies. A wide range of entities that fall within the category of "investment entities" also are classified as FFIs and are subject to FATCA. Included in the investment entity category are most non-US investment funds as well as other non-US entities in a typical fund structure (such as master funds or offshore feeders organized in the Cayman Islands, holding companies in private equity structures and some investment managers). These entities also must comply with FATCA or face FATCA withholding on their US income and gains.

Further, although funds and other investment entities that are organized in the US are not FFIs, some of these entities will be withholding agents under FATCA and must withhold on payments to non-US investors who are either not compliant with FATCA or refuse to provide the fund with the necessary information and/or documentation to certify their FATCA status. As a FATCA withholding agent, the fund would be liable for any FATCA withholding tax it fails to collect with the possible addition of interest and penalties. As a result, US funds also must perform extensive due diligence reviews to classify their non-US investors for FATCA purposes.

## Role of Fund Manager

Under FATCA, a centralized reporting option is available for fund managers to consolidate FATCA compliance for all FFIs they manage, including funds and other relevant non-US entities in the structure. Under these rules, the fund manager is a "sponsoring entity" and performs all of the FATCA requirements on behalf of the FFIs it sponsors. The "sponsored FFIs" remain liable for their own FATCA compliance vis-à-vis the IRS but currently will not have to separately register with the IRS or directly comply with FATCA.

## What Should Funds and Fund Managers Do?

As a general matter, a fund manager needs to determine the FATCA implications for itself and all of the entities in the fund structure. To comply with FATCA, all FFIs in the structure must do the following: (i) obtain information regarding all of their accountholders, and the accountholders' ultimate owners, to determine if there are any US accountholders, (ii) comply with certain verification and due diligence procedures, (iii) report annually certain identifying information to the IRS or the relevant local government authority and (iv) perform FATCA withholding to the extent necessary. Further, for FATCA purposes, any US entities will need to perform due diligence on, and request information from, their non-US accountholders.

For funds, an accountholder will generally be a fund investor (i.e., a holder of the fund's equity or debt). In order for the fund to properly perform its obligations, it should update its fund documentation, including partnership agreements and subscription documents, to account for these requirements. For example, the funds may want to request representations from investors regarding their US or non-US status or include special FATCA tax allocations or mandatory withdrawals for non-compliant investors. Also, to the extent permitted by local law, funds may want to ask investors to waive any rights that would prevent the fund from taking any necessary steps to comply with FATCA and to consent to the fund reporting the necessary information. Finally, funds may want to update their offering documents to add FATCA disclosures. Funds should begin requesting the applicable IRS Form W-8 or W-9 from all new investors going forward.

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