



# *Third China Venture Capital and Private Equity CFO Conference*

## *FATCA*

Silicon Valley Bank >



Steve Franklin  
SFranklin@Gunder.com  
650.463.5430

Terrance Philips  
[TPhilips@svb.com](mailto:TPhilips@svb.com)  
852 800908874



**pwc**

Fred Sroka  
Frederick.W.Sroka  
@us.pwc.com  
415.777.0300

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# **FATCA Overview**

***FATCA (the “Foreign Account Tax Compliance Act”), was enacted by the U.S. Congress in 2010. FATCA is intended to prevent U.S. taxpayers from hiding income in foreign entities.***

***FATCA forces American payors to inquire about the tax status of both direct and indirect owners of foreign payees, and to withhold 30% of payments if adequate documentation is not received.***

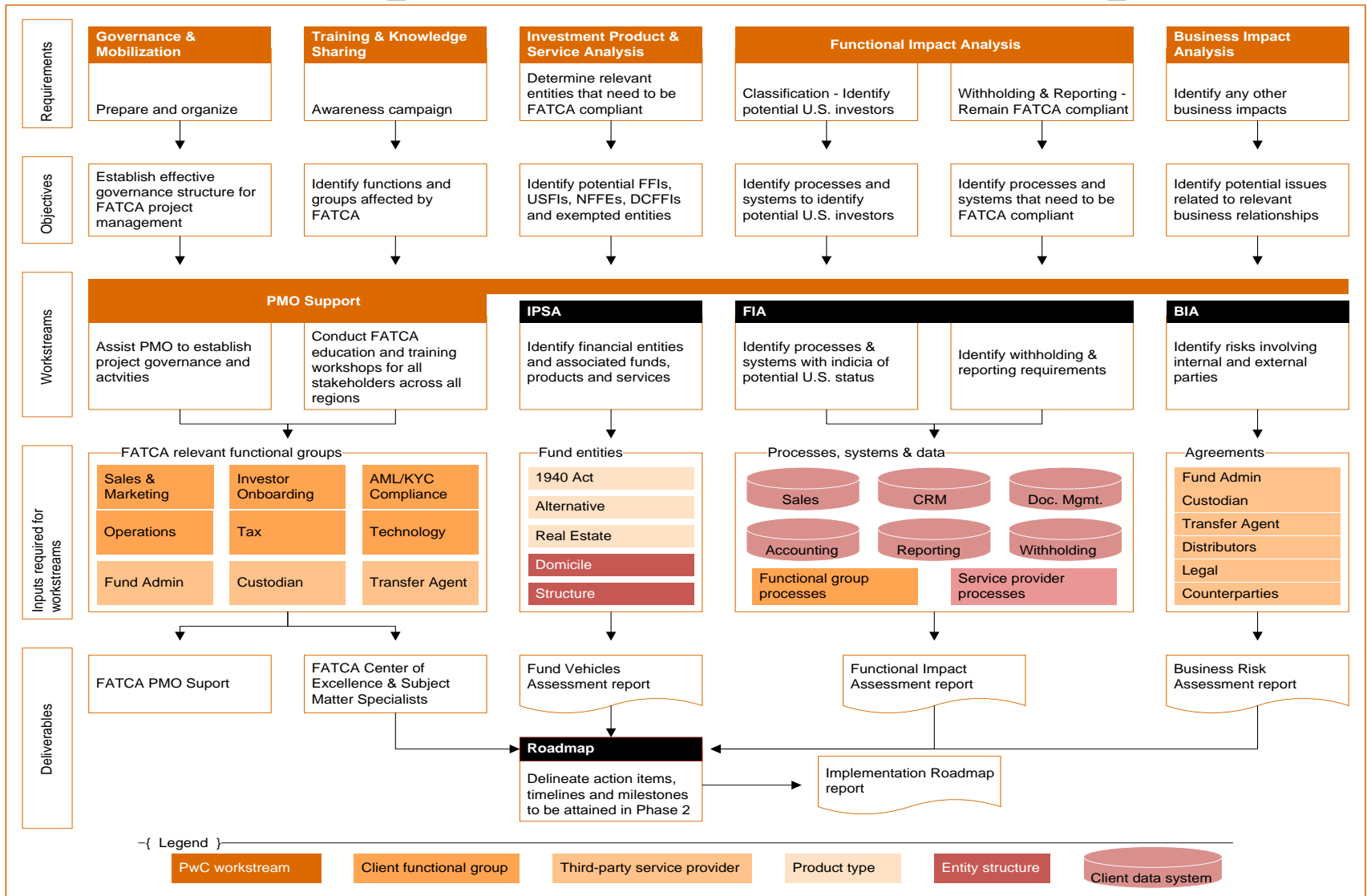
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# FATCA Timeline

*FATCA will become effective over several years:*

- *2013: Foreign entities register with IRS*
- *2014: Withholding starts on interest and dividends*
- *2015: Withholding starts on gross proceeds*
- *2017: Law applies to all payors and all payments*

# FATCA is complex, but the basics are simple . . .



# ***FATCA requires payors to “know their customer”.***

## ***One question***



## ***Six Answers***

- 1. “I am an American”**
- 2. “I am European”**
- 3. “I am a foreign individual”**
- 4. “I am a foreign government or pension fund”**
- 5. “I am a foreign business”**
- 6. Almost any other answer winds up being classified as a “Foreign Financial Institution” (FFI)**

# *“I am an American”*



- 1. Americans provide the payor with forms W-9, providing their names, addresses, and taxpayer identification numbers.**
- 2. Payors are relieved of any FATCA responsibilities.**
- 3. Payors report the payment to IRS on regular income tax forms.**

<b>Form W-9</b> (Rev. December 2011) Department of the Treasury Internal Revenue Service		<b>Request for Taxpayer Identification Number and Certification</b>		<b>Give Form to the requester. Do not send to the IRS.</b>
<b>Print or type specific instructions on page 2.</b>	Name (as shown on your income tax return)			
	Business name/disregarded entity name, if different from above			
	Check appropriate box for federal tax classification: <input type="checkbox"/> Individual/sole proprietor <input type="checkbox"/> C Corporation <input type="checkbox"/> S Corporation <input type="checkbox"/> Partnership <input type="checkbox"/> Trust/estate  <input type="checkbox"/> Limited liability company. Enter the tax classification (C=C corporation, S=S corporation, P=partnership) ▶ _____  <input type="checkbox"/> Other (see instructions) ▶ _____			<input type="checkbox"/> Exempt payee
	Address (number, street, and apt. or suite no.)		Requester's name and address (optional)	

# ***“I am European”***



- 1. France, Germany, Italy, Spain and the United Kingdom have announced their intent to implement rules similar to FATCA.**
- 2. IRS expects that payees in these countries will be relieved of any FATCA obligations.**
- 3. IRS is in negotiations with other countries to pursue similar bilateral agreements designed to eliminate tax evasion.**

# *“I am a foreign individual”*



- 1. Individuals who are not U.S. citizens or residents need to confirm their tax status by providing forms W-8 BEN.**
- 2. Payments made to foreign individuals are exempt from FATCA, *unless* the payment is made for the benefit of someone else.**

<b>Form W-8BEN</b> (Rev. February 2006) Department of the Treasury Internal Revenue Service		<b>Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding</b> ▶ Section references are to the Internal Revenue Code. ▶ See separate instructions. ▶ Give this form to the withholding agent or payer. Do not send to the IRS.	OMB No. 1545-1621
<b>Do not use this form for:</b> <ul style="list-style-type: none"><li>• A U.S. citizen or other U.S. person, including a resident alien individual . . . . . W-9</li><li>• A person claiming that income is effectively connected with the conduct of a trade or business in the United States . . . . . W-8ECI</li><li>• A foreign partnership, a foreign simple trust, or a foreign grantor trust (see instructions for exceptions) . . . . . W-8ECI or W-8IMY</li><li>• A foreign government, international organization, foreign central bank of issue, foreign tax-exempt organization, foreign private foundation, or government of a U.S. possession that received effectively connected income or that is claiming the applicability of section(s) 115(2), 501(c), 892, 895, or 1443(b) (see instructions) . . . . . W-8ECI or W-8EXP</li></ul> <b>Note:</b> These entities should use Form W-8BEN if they are claiming treaty benefits or are providing the form only to claim they are a foreign person exempt from backup withholding. <ul style="list-style-type: none"><li>• A person acting as an intermediary . . . . . W-8IMY</li></ul> <b>Note:</b> See instructions for additional exceptions.		<b>Instead, use Form:</b>	
<b>Part I Identification of Beneficial Owner</b> (See instructions.)			
<b>1</b> Name of individual or organization that is the beneficial owner		<b>2</b> Country of incorporation or organization	

# *“I am a foreign government or pension fund”*



1. Foreign governments and sovereign wealth funds will be excused from FATCA registration.
2. Foreign pension funds will have “simplified” FATCA registration or exemption procedures.

<b>Form W-8EXP</b> (Rev. February 2006)  Department of the Treasury Internal Revenue Service	<b>Certificate of Foreign Government or Other Foreign Organization for United States Tax Withholding</b> (For use by foreign governments, international organizations, foreign central banks of issue, foreign tax-exempt organizations, foreign private foundations, and governments of U.S. possessions.)  ▶ Section references are to the Internal Revenue Code. ▶ See separate instructions. ▶ Give this form to the withholding agent or payer. Do not send to the IRS.	OMB No. 1545-1621
<b>Do not use this form for:</b> <ul style="list-style-type: none"><li>• Any foreign government or other foreign organization that is not claiming the applicability of section(s) 115(2), 501(c), 892, 895, or 1443(b).</li><li>• A beneficial owner solely claiming foreign status or treaty benefits.</li><li>• A foreign partnership or a foreign trust.</li><li>• A person claiming that income is effectively connected with the conduct of a trade or business in the United States.</li><li>• A person acting as an intermediary.</li></ul>		<b>Instead, use Form:</b> <ul style="list-style-type: none"><li>W-8BEN or W-8ECI</li><li>W-8BEN</li><li>W-8BEN or W-8IMY</li><li>W-8ECI</li><li>W-8IMY</li></ul>
<b>Part I Identification of Beneficial Owner</b> (See instructions before completing this part.)		
1 Name of organization	2 Country of incorporation or organization	

# ***“I am a foreign business”***



- 1. An active business will have a simplified process of complying with FATCA documentation.**
- 2. IRS calls these entities “Non-financial foreign entities (NFFE)”**
- 3. NFFEs must identify any “substantial” U.S. owners (vote or value > 10%).**

<b>Form W-8ECI</b> (Rev. February 2006) Department of the Treasury Internal Revenue Service	<b>Certificate of Foreign Person's Claim That Income Is Effectively Connected With the Conduct of a Trade or Business in the United States</b>  ▶ Section references are to the Internal Revenue Code. ▶ See separate instructions. ▶ Give this form to the withholding agent or payer. Do not send to the IRS.	OMB No. 1545-1621
<b>Note:</b> Persons submitting this form must file an annual U.S. income tax return to report income claimed to be effectively connected with a U.S. trade or business (see instructions).		
<b>Do not use this form for:</b>		<b>Instead, use Form:</b>
• A beneficial owner solely claiming foreign status or treaty benefits . . . . .		W-8BEN
• A foreign government, international organization, foreign central bank of issue, foreign tax-exempt organization, foreign private foundation, or government of a U.S. possession claiming the applicability of section(s) 115(2), 501(c), 892, 895, or 1443(b) . . . .		W-8EXP
<b>Note:</b> These entities should use Form W-8ECI if they received effectively connected income (e.g., income from commercial activities).		
• A foreign partnership or a foreign trust (unless claiming an exemption from U.S. withholding on income effectively connected with the conduct of a trade or business in the United States) . . . . .		W-8BEN or W-8IMY
• A person acting as an intermediary . . . . .		W-8IMY
<b>Note:</b> See instructions for additional exceptions.		
<b>Part I Identification of Beneficial Owner</b> (See instructions.)		
<b>1</b> Name of individual or organization that is the beneficial owner	<b>2</b> Country of incorporation or organization	

# ***“I am something else . . .”***



- 1. Other entities (and all investment funds) are likely to be classified as investment entities**
- 2. IRS calls these entities “Foreign Financial Institutions (FFIs)”**
- 3. FFIs offer the greatest opportunity for U.S. taxpayers to hide from the IRS. As a result, FATCA imposes severe rules on FFIs.**
- 4. If an FFI expects any payments from U.S. sources, it should consider entering into an agreement with the IRS.**

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## ***How FFIs can deal with FATCA***

### **1. Avoid U.S. Investments:** FATCA only applies to certain payments made from U.S. sources:

- *U.S. borrowers:* Payments of interest, principal, or proceeds from the sale of the note. Certain U.S. debt incurred before 2013 will be exempt from FATCA.
- *Stock in U.S. Corporations:* Payments of dividend income, redemption or sales proceeds from sale of the stock.
- *U.S. Rental property:* Rental or royalty income from U.S. properties
- *Other Payments:* FATCA applies to certain other payments from U.S. sources, whether made directly or indirectly through another FFI. IRS has suggested that payments will be treated as made ratably from all underlying assets, so half of a dividend from a foreign corporation might be treated as U.S. source if half the fund's assets are based in the U.S.!

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## ***How FFIs can deal with FATCA***

- 2. Persuade your government to collaborate with IRS:** France, Germany, Italy, Spain and the United Kingdom have announced plans to enter into bilateral agreements with IRS. These agreements will relieve local funds from FATCA compliance. IRS has announced that it is in negotiations with other countries.
- 3. Lose 30% of U.S. investments:** Ignoring FATCA risks the loss of up to 30% of a fund's U.S. assets. This is BEFORE the regular 30% U.S. withholding on interest and dividends, and U.S. tax on business income.
- 4. Register with IRS:** Enter into a contract with IRS to become a "participating Foreign Financial Institution".

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## ***Participating FFIs pick up a lot of duties beyond registration. . .***

FATCA requires participating FFIs to perform one or more of the following functions:

- 1. Entity Classification:** Categorize all funds and operating companies based on domicile, activities, and investments
- 2. Investor Due Diligence:** Develop and implement procedures for classifying pre-existing and new accounts by searching for or gathering, respectively, and verifying information on individual and entity investors.
- 3. Documentation:** Request, receive, validate, and store a number of different tax certificates and certification from investors and be able to provide such information when requested.
- 4. Withholding:** Certain funds will be required to withhold on payments to nonparticipating foreign financial institutions (FFIs) and recalcitrant account holders that do not comply with FATCA requirements.
- 5. Reporting:** Certain funds will need to report investor information to the US government, such as account balances and cash flow information.
- 6. Certification:** Funds will need to certify compliance with the provisions of the FATCA regulations. The “Responsible Officer” will need to be able to provide the US government with a number of certifications of compliance with FATCA’s requirements.

The first step in any FATCA process will be Entity Classification. Remaining responsibilities will be determined in relation to each entity’s FATCA Classification.

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# ***Entity Classification***

Entity classification generally determines the obligations under FATCA for each of the entities in a fund's operating structure

## **Examples of Fund and Related Entities**

1. A foreign limited partnership
2. A foreign GP entity
3. A foreign ultimate GP entity
4. One or more foreign holding companies treated as either partnerships or disregarded entities for U.S. tax purposes
5. Side funds
6. Management companies
7. Sub Advisor entities

## **The Expanded Affiliated Group (EAG)**

Each FFI that is a member of an expanded affiliated group must obtain the status of either a participating FFI or registered deemed-compliant FFI as a condition for any member of such group to obtain the status of either a participating FFI or registered deemed-compliant FFI.

Members of an expanded affiliated group may include partnerships, corporations, and other entities under common control.

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# *Investor Due Diligence*

Certain entities will be required to or must perform Investor Due Diligence to determine the reporting and withholding obligations with respect to each investor. The level of examination required varies depending on the type of account held.

Action items to meet the due diligence requirement may include:

1. Identify processes currently in place such as collection of information (in addition to Forms W-8s and W-9s) from each client (investor or account holder?), the type of information stored for each client (investor or account holder?), and the existing investor on-boarding process for new funds.
2. Consider whether to adopt a policy to request documentary evidence for all non-US accounts regardless of whether there is US indicia to avoid having to do manual or electronic searches.
3. Consider whether to adopt a policy to close any recalcitrant accounts or non-participating FFIs (and consider if you are legally able to do so).
4. To the extent information is stored in multiple places, develop a process to streamline the investor information maintenance so there is only one master file.
5. Develop a process for determining when a waiver of local-jurisdiction secrecy laws may be needed and a procedure requesting such waiver.
6. Develop protocols and procedures for handling communications with investors (e.g., how FFI will request investors to provide documentation, how Investor Relations will handle inquiries from investors, etc.)

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# ***Documentation***

FATCA requires various forms of documentation to be obtained from account holders and it must be tracked and stored.

Action items to meet the documentation requirement may include:

1. Identify processes currently in place in tracking and storing various documentation about the funds' account holders.
2. If not already in place, develop policies and procedures for soliciting, processing, and storing Forms W-8, W-9 and additional documentary evidences as required.
3. Develop a process to perform the following:
  - a. Track dates and status of requests for additional account holder documentation,
  - b. Record relevant information from and about documentation obtained from account holders. For example, the type of document, foreign tax identification number contained in the document, the place of issuance, the dates of issuances and expiration (if any),
  - c. Document inquiries to and responses from investor relations and,
  - d. Monitor the expiration of the validity period of account holder documentation.

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# ***Withholding & Reporting***

FATCA's withholding and reporting obligations apply where there is a withholdable payment (payment related to US source FDAP income or gross proceeds from the sale of assets that generate US source interests and dividends). It is, therefore, important to track a payment's "source" and identify which instruments generate US source interests and dividends.

Action items to meet the withholding requirement may include:

1. Assess what process is already in place to perform identification of US source income, withholding and depositing for US source fixed or determinable annual or periodical ("FDAP") payments such as interests and dividends.
2. FFIs should register for electronic payments with the IRS to deposit tax withheld according to the prescribed timetable.

Action items to meet the reporting requirements (starting in 2014) may include:

1. Ensure that a process is in place to obtain information and fulfill the reporting requirements relating to US Accounts, Recalcitrant Accounts, etc.
2. Determine whether you will perform these functions in-house, or outsource them to a third-party service provider.
3. Put policies and procedures in place:
  - (1) to process and track waivers of local country disclosure restrictions and/or data protection laws that prevent reporting to IRS and
  - (2) that address tension with local laws that prohibit closure of accounts held by recalcitrant account holders.

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# *Certification*

A FFI must appoint a responsible officer to enter into an FFI Agreement with the IRS and make periodic certifications regarding the FFI's compliance. This function cannot be outsourced to a third party. Thus, even if a third-party service provider performs some of the other required FATCA functions (i.e. reporting compliance), the responsible officer must be satisfied that all of the FATCA requirements have been adequately completed before providing certification.

Action items to meet the certification requirement may include:

1. Identify who the responsible officer will be.
2. Develop processes and controls for the responsible officer to sign off on certifications required under FATCA within specified timeframes.
3. Consider developing a sub-certification process to enable various individuals in the organization performing different FATCA roles to provide assurance to the certifying officer.
4. Draft internal procedures and protocol document relevant to the FATCA compliance process (required as part of the certification).
5. Enter into FFI Agreement with IRS (when available).

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# ***Legal and Investor Relations Considerations***

## Identify key legal issues:

- Do subscription documents currently allow you to demand information necessary to comply with FATCA?
- Do you have tax indemnity obligations (e.g., under gross-up provisions) that are impacted by FATCA?
- Do any foreign laws and/or contractual provisions applicable within the scope of your “FATCA footprint” conflict with FATCA’s reporting and/or withholding requirements? Consider:
  - Data protection / privacy / confidentiality laws protecting customers’ and investors’ privacy.
  - Contractual provisions prescribing lock-ups or limiting use of client information.
- Do any foreign laws and/or contractual provisions conflict with FATCA’s reporting requirements or the requirement that certain recalcitrant accounts be closed?
- Have you given consideration to legal issues regarding allocation of any tax withheld (whether rightly or wrongly) amongst investors in an investment vehicle (e.g. Cayman blocker may be a corporation and withholding tax on blocker may need to be allocated amongst all investors rather than specifically allocated to recalcitrant investors)?

## Investor Relations issues:

- How is information currently shared among different parties involved in communicating with investor?
- How will you request additional information of the investor, if needed for FATCA purposes?
- How can an investor change his account or contact information and how is this change processed?
- How are records of client correspondence maintained?

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## ***How FATCA may change your fund documents***

- 1. FFI Agreement:** Promoters should consider asking investors to agree that the fund can enter into a “participating FFI Agreement” with IRS. This permission should include a waiver of any legal restrictions on the provision of FATCA information to IRS. Some investors may demand that the fund comply with FATCA, others may object.
- 2. FATCA Information:** Require investors to provide information necessary or convenient for the fund to comply with FATCA. The information generally will be provided on forms W-9 or W-8, but additional information may be required.
- 3. Remove “Bad” Investors:** It is possible that IRS will demand that a fund remove any investor who does not provide the necessary FATCA documentation, or else disqualify the fund as a participating FFI.

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# ***Planning Opportunities***

## **Domestication**

Reconsider the location of your future and existing funds. Domestic funds do create certain issues – including potential phantom income and increased filing requirements (PFIC, etc.). However, in practice, phantom income is often not material and controlling filing requirements can ease investor relations.

## **Aggregation**

Foreign LPs with multiple US investments may wish to aggregate their investments into a single investment flow through vehicle. For example, a foreign LP could establish a single U.S. LP to act as an investment platform into the U.S. The LP would likely not be required to satisfy multiple FATCA information requests, and would control cross-border distributions and related filing requirements.

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## ***Key Upcoming Dates for Withholding***

Calendar year	Due Date	Action Item
2013	July 1, 2013	FFIs must enter into FFI agreements with the IRS; application to come online by January 1, 2013 at the latest
2014	January 1, 2014	FATCA withholding on FDAP begins
2015	January 1, 2015	FATCA withholding on Gross Proceeds begins

# ***Key Dates for Reporting US Accounts***

Calendar year	Reporting due	Reporting Requirement to US accounts*
2013	July 1, 2013	FFIs must enter into FFI agreements with the IRS; application to come online by January 1, 2013 at the latest
2013	September 30, 2014	Required to report only name, address, TIN, account number, and account balance with respect to US accounts identified as of June 30, 2014
2014	March 31, 2015	Required to report only name, address, TIN, account number, and account balance
2015	March 31, 2016	Required to report only name, address, TIN, account number, account balance, and income paid
2016	March 31, 2017	Required to report only name, address, TIN, account number, account balance, income paid, and gross proceeds
2017	March 31, 2018	All of the reporting for calendar-year 2016 as well as foreign pass-through payments

\* In the case of US-owned foreign entity, the information must be reported for the entity as well as the name, address, and TIN for each substantial US owner.

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