

Private Equity Alert

Proposed FATCA Regulations Released

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On February 8, 2012, Treasury and the IRS released proposed regulations under Sections 1471 through 1474 of the Code, known familiarly as "FATCA."¹ Although the proposed regulations provide some long-anticipated guidance relating to FATCA, there are many questions yet to be addressed. In this *Private Equity Alert*, we offer some observations on how the proposed regulations may impact private fund sponsors and their investors.

FATCA's Applicability to Non-US Private Funds

A private equity fund or hedge fund (including any feeder fund, master fund, and alternative or parallel investment vehicle) organized in a non-US jurisdiction will generally be classified as a foreign financial institution (an FFI). Unless such a fund is exempt by reason of the rules described below, as an FFI it will be required to enter into an agreement with the IRS to provide to the IRS certain information concerning its US account holders. If the fund does not enter into such an agreement, it will be a "non-participating FFI," and US Withholdable Payments² made to it will generally be subject to a 30% withholding tax. However, under certain circumstances a US Withholdable Payment made to a non-participating FFI that is allocable to an account whose beneficial owner is itself a participating FFI or a "deemed compliant" FFI as described below may not be subject to withholding.³

The agreement with the IRS will require the fund to report to the IRS certain information with respect to each of its US partners, including the partner's name, address, and taxpayer identification number and the account balance (or value) of the partner's interests in the fund. The fund would be required to treat any partner who does not provide the required information as a "recalcitrant holder," and must withhold 30% on US Withholdable Payments made to such partner. The fund will also be required to withhold the tax on payments to non-participating FFIs. The fund may eventually be required to close the account of a recalcitrant account holder, although the timing of this and its application to private equity funds currently remains unclear.

1 Prior *Private Equity Alerts* discussing FATCA are available here on our website: [November 2009 issue](#) and [December 2009 issue](#).

2 US Withholdable Payments are payments of US source interest (including original issue discount), dividends, rents, royalties or other types of fixed or determinable annual or periodic income from US sources, as well as payments of gross proceeds on stocks, securities and debt instruments which produce US source interest or dividends.

3 Proposed Regulation Section 1.1471-3(d)(4)(ii).

Weil News

- Weil advised Oak Hill Capital in connection with the \$4.2 billion sale of its portfolio company, RSC Holdings, to United Rentals, Inc. in a cash-and-stock transaction
- Weil advised Canada's Public Sector Pension Investment Board in connection with its participation in a consortium of investors effecting the \$6.3 billion take private of Kinetic Concepts, a US-based medical devices company
- Weil advised Thomas H Lee Partners in connection with its \$2.2 billion acquisition of Acosta, Inc., a leading full-services sales and marketing agency in the consumer packaged goods industry
- Weil advised Berkshire Partners and OMERS Private Equity in connection with their \$2.1 billion of Husky International, a Canada-based manufacturer of injection molding machines, molds and integrated systems
- Weil advised Mubadala Development Company in connection with its participation in the \$2.2 billion acquisition of EMI Music Publishing by a consortium which also included Sony Corporation and Blackstone Group
- Weil advised Providence Equity in connection with its \$1.8 billion take private of Blackboard, a developer and licensor of e-learning, transaction processing, e-commerce and online community software applications and related services

FATCA's Applicability to US Private Funds

A domestic private fund is not required to enter into any special agreement with the IRS in order to comply with FATCA. However, a domestic fund does need to determine if its limited partners are subject to FATCA withholding. The fund is a withholding agent, and thus would generally be required to withhold 30% on US Withholdable Payments made to any partner that fails to provide the fund with the documentation needed to determine whether such partner is a US person, an exempt or deemed-compliant foreign person, or a participating FFI. US withholding agents are also required to meet certain documentation requirements to determine whether an existing or a new account is beneficially owned by a US person. The IRS intends to issue revised withholding certificates (e.g., IRS forms W-8) to include additional FATCA related information.

Payments made to certain persons may be exempt from withholding provided that the withholding agent receives appropriate documentation as to the entity's classification. Among the entities classified as exempt owners are foreign governments (including political subdivisions, and wholly owned instrumentalities and agencies), international organizations, foreign central banks, and certain foreign retirement plans.⁴

FATCA's Applicability to Non-US Portfolio Companies

Payments made to a foreign person that is not an FFI – referred to in FATCA as an NFFE – may also be subject to withholding. Although NFFEs are not required to enter into an agreement with the IRS to avoid FATCA withholding, absent an applicable exemption they must certify their status as compliant with certain reporting requirements designed to ensure that they have no significant US owners.

The proposed regulations include an expanded list of NFFEs that are exempt from FATCA withholding. Among the entities that are exempt are certain public companies and members of its expanded affiliated group, active business entities, certain non-financial holding companies, and certain start-up companies.⁵

A non-US portfolio company may be an FFI or an NFFE. In that case, unless it is exempt or compliant, it may also be subject to withholding US Withholdable Payments it receives from third parties.

Expanded Set of Entities that Are Deemed Compliant; Six-Nation Agreement

The proposed regulations expand the types of entities that may be treated as deemed compliant with FATCA. Some private funds may themselves be deemed compliant, and

⁴ Proposed Regulation Section 1.1471-6(a).

⁵ Proposed Regulation Sections 1.1472-1(c)(a) and 1.1471-5(e)(5).

Weil News (cont)

- Weil advised Ontario Teachers' Pension Plan in connection with its participation in the \$1.3 billion going private acquisition of Blue Coat Systems by a consortium led by Thoma Bravo
- Weil advised Advent International in connection with its €1.15 billion acquisition of the Card Systems and Identity divisions France based Oberthur Technologies

thus would not have to enter into agreements with the IRS. For example offshore funds targeting mainly non-US persons may be deemed compliant. The proposed regulations set out three categories of deemed compliant FFIs: registered, certified and owner-documented. In general, registered deemed compliant FFIs must register with the IRS, whereas certified deemed compliant FFIs may self-certify their status as such. Each category has its own set of requirements necessary to meet the deemed compliant status.⁶

Most funds, however, will not qualify for deemed compliant status. For these funds, a Treasury initiative announced on February 8, 2012, may ultimately allow them to be deemed compliant. Treasury announced an "agreement to explore a common approach to FATCA implementation through domestic reporting and reciprocal automatic exchange and based on existing bilateral tax treaties" with France, Italy,

Germany, Spain and the United Kingdom.⁷ This "agreement to agree" would provide an alternative reporting mechanism whereby certain FFIs organized in a participating country can meet the FATCA reporting requirements by agreeing to turn over to such country the applicable information on its US accounts. An FFI utilizing this alternative reporting mechanism, if and when it becomes available, would be considered a deemed compliant FFI.

Under the framework, a participating country would agree to enact provisions parallel to FATCA and to turn over to the IRS the information it collects thereunder. An FFI in that country would not be exempt from FATCA, and would still have to register with the IRS. However, instead of reporting the required information to the IRS, the FFI would report the same information to its own country's revenue agency and the FFI would not be subject to withholding or subject to the requirement to close the accounts of any recalcitrant account holder. At this time it is uncertain whether any bilateral agreement or the implementation legislation for such agreement will be in place prior to the start of FATCA withholding.

Highlights of Certain Other FATCA Provisions

Following is a brief summary of how some of the provisions in the proposed regulations, if enacted in their present form, would affect a private fund.

- **Grandfathered obligations.** Under the proposed regulations, any US Withholdable Payment made under any US source obligation outstanding on January 1, 2013, and any gross proceeds from the disposition of such obligation, will not be subject to FATCA withholding.⁸ US source obligations that are not eligible for this grandfather treatment include obligations that are treated as equity for US tax purposes, that lack a stated expiration or term, or that are made under an unfunded master agreement that merely sets forth general and standard terms and conditions.⁹ Moreover, an obligation that is modified after January 1, 2013 may cease to qualify for grandfather treatment.¹⁰
- **Phase-in of withholding and reporting obligations.** Beginning on January 1, 2014, participating FFIs and US withholding agents will be required to start withholding

⁶ Certain types of foreign retirement funds, a common class of private equity investor, are among the entities "deemed compliant" with FATCA.

⁷ Treasury Press Release dated February 8, 2012.

⁸ Proposed Regulation Section 1.1471-2(b)(2)(i).

⁹ Proposed Regulation Section 1.1471-2(b)(2)(ii).

¹⁰ Proposed Regulation Section 1.1471-2(b)(2)(iv).

Important FATCA Dates under the Proposed Regulations

“Early” 2012	IRS is expected to release a draft model Participating FFI Agreement
Fall 2012	IRS is expected to finalize the model Participating FFI Agreement
January 1, 2013	Obligations outstanding on January 1, 2013 are generally exempt from FATCA withholding
January 1, 2013	Online FFI registration set to begin
June 30, 2013	Application deadline for FFI registration in order to be included in the first publicized list of Participating FFIs
January 1, 2014	FFIs and withholding agents are required to start withholding on US Withholdable Payments other than gross proceeds
September 30, 2014	First year of FFI reporting is due (only limited reporting is required on certain identification information and account balance information)
January 1, 2015	FFIs and withholding agents are required to start withholding on all US Withholdable payments, including gross proceeds
March 15, 2015	Second year of FFI reporting is due (only limited reporting is required on certain identification information and account balance information)
January 1, 2016	Participating FFIs must start reporting to the IRS non-gross proceeds payments subject to FATCA withholding (with respect to the 2015 calendar year)
March 15, 2016	Third year of FFI reporting is due (payments made with respect to each account is also required to be reported)
January 1, 2017	Participating FFIs must start reporting to the IRS gross proceeds subject to FATCA withholding (with respect to the 2016 calendar year)
January 1, 2017	Withholding will not be required with respect to foreign passthru payments before January 1, 2017

on US Withholdable Payments other than gross proceeds.¹¹ Withholding on gross proceeds will not begin until January 1, 2015.¹²

- **Passthru Payments.** Special withholding rules may apply to payments made by a participating FFI to a non-participating FFI, referred to as foreign passthru payments. Withholding on foreign passthru payments will begin no earlier than January 1, 2017. It is still uncertain as to what constitutes a foreign passthru payment. Participating FFIs will nevertheless be required to report annually to the IRS the aggregate amount of certain payments made to each non-participating FFI for the 2015 and 2016 calendar years.¹³
- **Short-term obligations.** The proposed regulations clarify that a payment of interest on any short-term obligation payable 183 days or less from the date of original issue is not subject to FATCA withholding.¹⁴

Summary

The IRS has repeatedly stated that the purpose of FATCA is to increase transparency and disclosure of US accounts being held outside of the United States

¹¹ IRS Notice 2011-53.

¹² IRS Notice 2011-53.

¹³ Proposed Regulation Section 1.1474-1(d)(2)(1).

¹⁴ Proposed Regulation Section 1.1473-1(a)(4)(i).

and not to function as a revenue raiser. Accordingly, the IRS is relying on participating FFIs to create such transparency and to avoid FATCA withholding. The proposed regulations have added

some clarity to FATCA. However, many uncertainties remain in FATCA's application, and it is uncertain whether the proposed regulations will be enacted in their present form.

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