KPMG
cutting through complexity

FATCA
Application to European Private Equity

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FATCA for European Funds
Introduction

FATCA has developed since our original guidance was issued in February; FATCA has become the catalyst for a global effort to combat tax evasion, leading to multi-lateral reporting and diligence regimes.

We have therefore updated this guidance to help demystify FATCA, and what it means for European private equity funds.

Although FATCA continues to evolve, it is important that private equity firms consider as soon as possible how FATCA will impact their structure and how they will comply with the rules.

For simplicity, we have mainly concentrated on UK funds, although private equity firms will need to consider the rules relevant where each entity in the structure is resident.

Whilst we have tried to be as helpful as possible, this guide is only intended to be an overview of important issues to be considered. It does not comment on all considerations that are relevant to private equity funds. The exact impact of FATCA varies depending upon differences between fund structures and to provide a comprehensive guide applicable to all would simply be impossible. We would be happy to help you understand how FATCA applies to your particular structure and we have demonstrated in this guide how we can help through the different stages.

Reminder: What is FATCA?

FATCA (the Foreign Account Tax Compliance Act) is the U.S. part of legislation aimed at reducing tax evasion by U.S. taxpayers. The legislation requires 'Foreign Financial Institutions' ('FFIs') to pass information about their U.S. Customers and some U.S.-controlled non-U.S. entities on to the IRS. FATCA imposes certain obligations on investment funds which in most cases will themselves qualify as FFIs. These include the requirement to register with the IRS, due diligence obligations and reporting requirements in respect of certain investors. The U.S. regulations impose a 30% withholding tax on certain U.S. source income or sales proceeds paid to any FFI which does not comply.

In order to support the underlying policy goal of FATCA while addressing perceived conflicts with local laws, some countries signed up to Intergovernmental Agreements ('IGAs') with the U.S. Treasury. These broadly fall into two categories: Model 1 (where information is exchanged via the local government, in some cases reciprocally) and Model 2 agreements (where information is passed on directly to the U.S. by the FFI). The UK has entered into a Model 1 agreement. There are also dozens of countries who are negotiating or considering entering into an IGA.

Countries who have signed up to Model 1 agreements are expected to enact legislation in order to effect the application of FATCA in their home jurisdiction. The UK legislation, regulations and guidance provide a reasonable outline of how this will be implemented. Please note that not every jurisdiction will enter into an IGA and those that do will agree to its own terms with the U.S. albeit subject to the terms of the Model; however, we expect the IGAs and related guidance of jurisdictions that are intending to enter into a Model 1 agreement to be similar to the UK's. Several countries that are important to the PE business model have announced that they will pursue a Model 1 agreement with the U.S. These include Guernsey, Jersey, the Cayman Islands, Luxembourg and others.

The broader FATCA regime has therefore developed into a lattice of different and quite complex regulations, including the U.S. regulations, the IGAs and the domestic laws and guidance enacted (or due to be enacted) in several countries. The effect of these rules will vary depending on your structure and the residence of each entity. This paper is intended to summarise the likely key implications of FATCA, how you can prepare and what we can do to help.

Please speak to your KPMG contact or one of our FATCA advisors for further information or advice in respect of the legislation and the impact for you.

Contact us

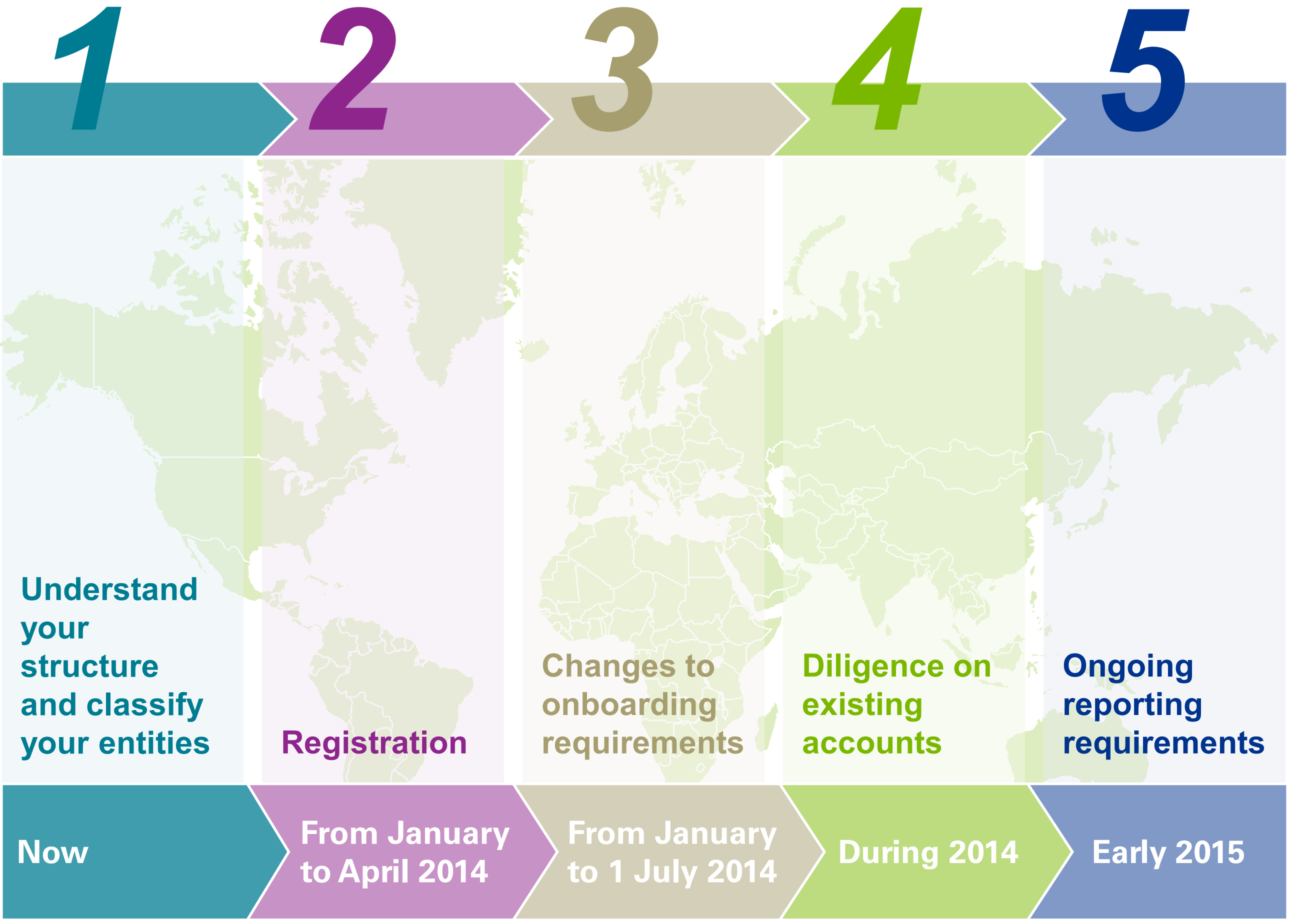
Jennifer Sponzilli
U.S. International Tax
T. + 44 (0)20 7311 1878
E. jennifer.sponzilli@kpmg.co.uk

Paul McCartney
Private Equity Group
T. + 44 (0)20 7311 6495
E. paul.mccartney@kpmg.co.uk

FATCA for European Funds
Workflow

The diagram below illustrates the various phases required and the mandatory obligations to implement FATCA. We have indicated likely timescales, although you may consider earlier initial preparatory work in order to facilitate a smooth implementation.

We have explained each step further on the following pages.

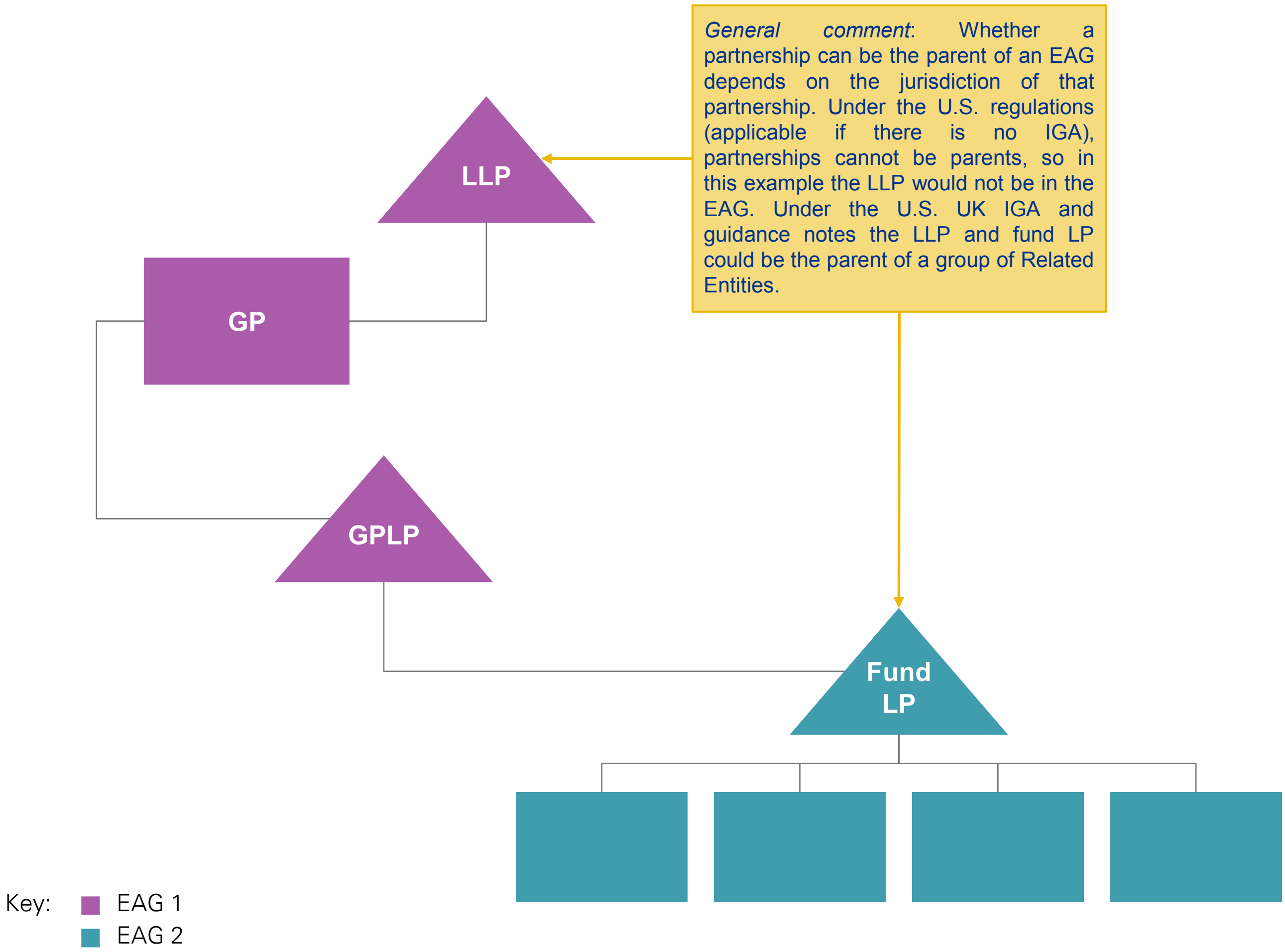


FATCA for European Funds
Step 1: Understanding your structure

In order to implement FATCA, it is firstly important to understand your structure and how each entity is affected. Depending on where each entity in the structure is resident, a slightly different rule set may apply to determine its classification under FATCA.

The implementation of the rules is affected by which entities are in a 'group' (known as an Expanded Affiliated Group) for FATCA purposes, as all members of a group that qualify as FFIs are expected to register in order to comply with the FATCA regulations. This is explained further below.

Expanded Affiliated Group overview



- Expanded Affiliated Groups are broadly groups of entities under common control (per the U.S. definitions). The UK has its own rules with similar effect.
- In order to identify the members of the affiliated group, it is important to identify any related investors, which together may hold a significant stake in the investment business.
- Partnerships are treated as part of the affiliated group if they are under the control of other entities in the group.
- Consideration will also need to be given to the relationship between the fund, its general partner, the manager and other entities within the group. Applying the rules to a 'typical' private equity fund, we would not generally expect the general partner to control the fund. It is therefore probable that there would be two or more EAGs within a fund structure.
- A fund structure may consist of several different groups.

FATCA for European Funds

Step 1: Understanding your structure (cont.)

Understanding the entities within your structure

Once the group has been identified, the next step is to ascertain what each entity's classification is for FATCA purposes.

The FATCA rules are primarily aimed at Foreign Financial Institutions ('FFIs') and amounts that are paid to FFIs. It is therefore important to identify which entities within the group are FFIs and where each entity is resident or organised.

This analysis is made more complex because of different types of FFIs (such as certain deemed compliant categories) that will affect the FFI's registration, diligence and reporting responsibilities.

An FFI is broadly a non-U.S. financial institution. For a typical private equity fund, these will include:

- The fund entity.
- The general partner.
- The manager of the fund.
- Portfolio holding and financing companies which are controlled by a fund are considered to be FFIs for the purpose of these rules.
- Any carry partnership or other investment entities within the group.

A Non-Financial Foreign Entity ('NFFE') is broadly any non-U.S. entity which is not an FFI, and would likely include many portfolio entities.

Foreign impact

- Some structures are likely to have entities in many different countries.
- Each entity within the group may be subject to different FATCA requirements:
  - If there is no IGA, they would be expected to complete due diligence, report and withhold in line with the wider U.S. FATCA regulations.
  - If they are in a country with a Model 2 agreement, then the expectation is for them to follow the wider U.S. FATCA regulations as modified by the Model 2 agreement, i.e. to report limited information to the IRS and then provide additional information to their local tax authority as requested.
  - If they are in a country with a Model 1 agreement, they would register with the IRS and complete due diligence as set out by local laws and prepare reports for their home tax authority.

Investor classification

The classification of investors will impact on the requirements going forward and may even drive a fund's qualification for certain deemed compliant statuses. These reporting requirements are considered later, but you may consider an initial review of your investors in order to ascertain the expected reporting requirements.

How we can help

We are currently assisting a number of clients identify the group(s) within their structure and to categorise the relevant entities, including considering the different types of FFI classification that may be applicable and any deemed compliant categories that may be applicable to reduce the FATCA burden.

We can generally do this one of two ways, we can either collate all relevant informaiton from you, and undertake the analysis, or we can explain our tools to you which you can use to preliminarily categorise the entities, which we would be happy to review.

FATCA for European Funds
Step 2: Registration

- In order to comply with FATCA, FFIs would normally need to register with the IRS.
- In order to register, all entities within an Expanded Affiliated Group will need to register as one or more groups. Funds will therefore need to consider which entities form part of their affiliated group prior to registration.

Registration of entities in a Model 1 jurisdiction

- It is hoped that other Model 1 agreement jurisdictions will follow the UK lead and require their entities to be registered on the IRS portal.
- Although FFIs in Model 1 jurisdictions will have additional time beyond 1 July 2014 to register, we would generally recommend early registration to ensure that they are included on the IRS FFI list before **January 1, 2015**.

Registration of entities in other jurisdictions

- Entities in countries which have not signed up to a Model 1 agreement need to register by 25 April 2014, which includes ticking a box to agree to the terms of an FFI Agreement, to avoid potential withholding on U.S. source income.
- They will also be issued an identification number, the global intermediary identification number ('GIIN').

Registration portal

- The registration portal is now open but on a test basis, entities can open accounts on the system but cannot yet finalize registration as FFIs.
- Submissions of the registration can only be done officially after 1 January 2014.

Sponsored investment entities

- It may be suitable for some entities within the structure like asset managers and general partners to be treated as sponsored investment entities.
- Where this is the case, we expect the entity's obligation to be fulfilled by the fund manager/advisor.
- This may reduce the overall burden on the fund family by centralising compliance.

How we can help

We are able to offer guidance regarding how to register entities within the group, including process and controls around initial registration and ongoing maintenance.

We should also be able to assist in the registration process where that is required.

FATCA for European Funds

Step 3-4: Due diligence

Investor classification

It is firstly important that each financial institution within the structure correctly identifies its account holders. This may include shareholders for some entities, although equity holders of (say) the manager will generally not be account holders. Also, securities that are regularly traded on a recognised stock exchange are generally not reportable accounts.

Once the accounts have been identified, it is necessary to classify investors, as there are different diligence requirements depending on their classification and country of residence.

Bearing in mind that the purpose of FATCA is to identify and report on specified U.S. persons and non-participating Financial Institutions, it is important that investors are classified so that the diligence can be tailored for each classification.

The main investor classifications include:

- **FFIs in IGA model 1 territory:** Where an FFI is located in an IGA model 1 territory, the fund is able to initially assume that it is participating financial institution.
- **FFIs in other territories:** In this case it will be necessary to identify if the FFI is participating. We would generally recommend enquiring what the institutions intentions are, and whether they classify themselves as being exempt for any reason.
- **Passive NFFEs** (i.e. entities resident outside of the U.S. that are not FFIs and are not active). In the case of Passive NFFEs, the financial institution will need to establish whether the entity is controlled by one or more Specified U.S. persons or Controlling Person (in the case of an IGA).
- **Active NFFEs:** Where the account is confirmed as being held by an Active NFFE (e.g. a trading company) then further diligence should not be necessary.
- **Individual accounts:** Diligence is required in respect to individuals to ascertain if they are Specified U.S. persons.
- **U.S. entity accounts:** It is necessary to determine whether such entity accounts are Specified U.S. persons (and therefore should be reported upon).
- **Indirect holdings:** Where an investor does not invest directly, but instead invests via (say) a custodial account in the name of a broker, it is important to identify the broker as a participating or IGA FFI.

How we can help

We are currently assisting clients with a review of their onboarding process to ensure that all the proper documentation and information is being requested and collected from 1 July 2014.

We are also currently working with clients to assist in classifying their account holders. This then gives them a clear picture of what is required going forward and puts them in a good position to make any enquiries to any relevant investors.

FATCA for European Funds
Step 3-4: Due diligence

Due diligence requirements

FATCA effectively imposes certain requirements to undertake diligence on investors and counterparties in order to determine whether they are U.S. taxpayers or non-participating FFIs. The exact requirements depend on the mandating laws.

For UK resident funds, the following diligence is generally required (note that 'accounts' is likely to relate to investor commitments to a fund):

Existing individual investors

- For accounts with a balance of less than $1 million, only computerised records need to be reviewed for U.S. indicia (i.e. factors that indicate that the account holder may be a U.S. person).
- For accounts in excess of $1 million (or that later exceed $1 million) if the computerised records are insufficient, then other paper records should be reviewed. In addition, the knowledge of the 'relationship manager' should also be taken into account if they have knowledge that the account holder is a Specified U.S. Person.
- If any relevant records show U.S. indicia, then the institution is required to either treat the account as reportable or follow certain criteria to satisfy themselves that the account is not reportable.

New individual accounts

- New accounts require for self-certification to be obtained that the account holder is not a U.S. resident or citizen, which should be consistent with other documents obtained as part of their KYC checks.
- If the account holder is a U.S. citizen, then their Tax Identification Number ('TIN') number should be obtained.

Existing entity accounts

- The institution should review information maintained to determine whether the information indicates that the entity account holder is such that a report needs to be made.

How we can help

We can work with you to determine a system that best fits with your current procedures. We can follow that with detailed instructions that best suit your account base and fits with your current systems.

FATCA for European Funds
Step 5: Reporting

Under the UK/US IGA: For UK resident funds, reports for reportable accounts must be filed with HMRC annually from 31 May 2015 for the prior calendar year.

Reportable accounts are broadly

- Accounts held by one or more entities that are Specified U.S. Persons (i.e. a U.S. entity that does not fall within certain exceptions).
- Passive NFFEs with one or more controlling persons who are U.S. citizens.
- Non-participating FFIs (payment reporting for 2015 and 2016).

Information to be reported

- The name, address and U.S. TIN for each Specified U.S. person that is an Account Holder of such account.
- In the case of a Non-U.S. entity that, after due diligence, is identified as having one or more U.S. controlling persons, the name, address and U.S. TIN of such entity and each U.S. person.
- The account number.
- The name and identifying number of the FFI.
- The account balance or value as of the end of the year.

In respect to 2015 and later periods, also report

- The total gross amount of interest, dividends and other income generated.
- The gross proceeds credited in the year (from 2016 only).

How we can help

We are able to offer guidance regarding the appropriate structure and process of reporting to local authorities or the IRS, including the preparation of the forms, where required.

FATCA for European Funds
FATCA timeline

Several key dates have changed and many have been delayed by 6 months. We have highlighted some of the key dates below:

U.S. deadlines

1 January 2014
FATCA portal open for definitive registrations.

25 April 2014
Deadline for non-IGA entities to register with the IRS in order to be listed by the IRS on the date that withholding starts.

1 July 2014
FATCA withholding rules come into force.

31 March 2017
Reporting commences for gross proceeds.

2013 · 2014 · 2015 · 2016 · 2017

1 July 2014
New onboarding procedures required for any new accounts after this date.

30 June 2015
Due diligence for pre-existing high value accounts due.

31 May 2015
Expected reporting date for 2014 onwards.

30 June 2016
Deadline to complete due diligence in respect of other pre-existing accounts.

31 May 2017
Reporting for gross proceeds in respect to 2016 onwards

UK (and other Model 1) deadlines

FATCA for European Funds
FAQs

My fund purely operates in Europe and has no U.S. investors. Why does FATCA apply to me?
FATCA is not purely a U.S. 'issue'. The regulations which form the UK law apply to all financial institutions resident in the UK regardless of where they invest.

If the fund, on undertaking the required due diligence, determines that there are no U.S. investors, then its reporting requirements will be limited. That said, the global outlook means that it may be required to identify, not just whether investors are U.S. taxpayers, but the jurisdiction in which they are tax resident.

The rules seem to continuously change and there seems to be quite a lot of uncertainty. When are the rules going to become final?

The UK rules and guidance have now been passed, and, albeit that they may be changed in the future, they are effectively final. In addition, the U.S. rules have now been finalised for the most part.

Whilst some reporting forms remain outstanding, there is a significant amount of information available.
In addition, the final U.S. regulations allow for a financial institution which is in a country which is in discussion with the IRS to be deemed compliant as if an IGA has been entered into notwithstanding the lack of local implementing law.

What are other private equity houses doing about FATCA?
Whilst a number of houses originally took the decision to wait, an increasing amount of houses are now considering what they need to do in order to implement FATCA, reviewing the information they have and what else needs to be done.

So what should private equity houses be doing now?
There is a reasonable amount of work to ascertain how FATCA would apply to each fund, and what is required in order to comply.

In order to be prepared for FATCA, it is important to be on the right foot, to understand which entities in the structure will be Financial Institutions under the rules, understand where they are relevant, which entities will be in a group for FATCA purposes and how their investors are classified under the rules (and therefore what due diligence requirements are for each).

Funds can then prepare for registration and complete the onboarding and diligence requirements.

How can KPMG help?

We are helping a number of PE clients prepare for FATCA, including helping demystify the rules, explaining how the rules relate to different funds, presenting to their boards, assisting with classifying entities within the group and investors and providing guidance regarding the due diligence process that is required.

Please contact a member of our team for further guidance.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.