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KIRKLANDPEN
Private Equity Newsletter

July 23, 2013

Three Things a Private Fund Should Know About FATCA and Its New Effective Dates

PENpoints

The IRS recently extended a number of FATCA deadlines, but a private fund should have already begun preparing for upcoming FATCA reporting and withholding obligations.

The Foreign Account Tax Compliance Act (FATCA), enacted in 2010, imposed burdensome federal income tax reporting and withholding obligations on many business enterprises (including private funds and their portfolio companies), intended to prevent U.S. citizens and residents from avoiding U.S. income tax by hiding ownership of U.S. assets overseas.[1]

The IRS has issued voluminous FATCA regulations and has several times delayed implementation of the FATCA reporting and withholding obligations. In fact, on July 12, 2013, the IRS extended further a number of FATCA deadlines. Nevertheless, a private fund should have already begun organizing its compliance with FATCA reporting and withholding obligations.

This *PEN* discusses three things:

- what every private fund organized under U.S. law must know about FATCA,
- what every private fund organized under non-U.S. law and every U.S. fund with a feeder, AIV or blocker entity organized under non-U.S. law must know about FATCA, and
- what every private fund (and its portfolio companies) borrowing from a lender organized under non-U.S. law must know about FATCA.

U.S. Private Fund

Once FATCA goes into effect, a private fund organized under U.S. law (e.g., a Delaware partnership) must withhold (and pay over to the IRS) 30 percent of the fund's U.S. source income allocable to a general or limited partner which is an entity (an "entity partner") organized under non-U.S. law, unless the non-U.S. entity partner has agreed to supply the IRS with information as to its U.S. investors and account holders.[2] The FATCA 30 percent withholding tax is not intended to impose a new tax. Rather, amounts withheld by the private fund are credited against the U.S. tax liability (if any) of the person or entity entitled to receive the U.S. source payment, with any excess withholding generally refunded upon filing of a U.S. income tax return or refund claim.

The types of the U.S. fund's income that are subject to FATCA's 30 percent withholding are (a) U.S. source dividends, interest, royalties, certain rent income and (b) gross proceeds (not merely gain) from sale of most U.S. debt instruments and corporate stock (e.g., stock in a portfolio company organized under U.S. law).

For a U.S. private fund, the withholding obligations now generally go into effect on July 1, 2014, unless the non-U.S. entity partner has agreed to supply the IRS with information as to its U.S. investors and account holders.

Non-U.S. Private Fund or U.S. Private Fund with Non-U.S. Feeder, AIV, or Blocker Entity

Once FATCA goes into effect, a private fund organized under non-U.S. law (e.g., a Cayman partnership) or an entity organized under non-U.S. law that is related to a fund organized under U.S. law (e.g., a non-U.S. feeder, AIV or blocker entity) must agree to supply the IRS with information as to any of its U.S. equity owners in order to avoid FATCA withholding on its U.S. source income. As part of this agreement with the IRS, the non-U.S. private fund must also withhold (and pay over to the IRS) 30 percent of the fund's U.S. source income allocable to any entity partner organized under non-U.S. law, unless the non-U.S. entity partner has agreed to supply the IRS with information as to its U.S. investors and account holders.[3]

The types of the non-U.S. entity's income that are subject to FATCA's 30 percent withholding are (a) U.S. source dividends, interest, royalties, certain rent

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income and (b) gross proceeds (not merely gain) from sale of most U.S. debt instruments and corporate stock (e.g., stock in a portfolio company organized under U.S. law).

For a non-U.S. private fund or a non-U.S. entity related to a U.S. private fund, the withholding obligations now generally go into effect on July 1, 2014, unless such fund or such related entity has obtained information from its non-U.S. entity partners as to their U.S. investors and account holders and supplied such information to the IRS.

The IRS strongly suggests that, in order to ensure no FATCA withholding as of July 1, 2014, a non-U.S. private fund or a non-U.S. entity related to a U.S. private fund enter into the required agreement (or otherwise register) with the IRS on or before April 25, 2014.

U.S. Private Fund or U.S. Portfolio Company Borrowing from Non-U.S. Lender

Certain types of private funds (e.g., hedge funds) borrow money (often from a lender organized under non-U.S. law). Other types of private funds (e.g., LBO funds) arrange for their portfolio companies to borrow money (often from a lender organized under non-U.S. law).

Once FATCA goes into effect, a private fund (or its portfolio company) organized under U.S. law borrowing from a lender organized under non-U.S. law (e.g., a European bank) must withhold (and pay over to the IRS) 30 percent of each post-June 30, 2014, interest payment on a loan made or materially modified after June 30, 2014, unless the non-U.S. lender has agreed to supply the IRS with information as to its U.S. investors and account holders.[4]

The documentation for a loan from a non-U.S. lender to a U.S. borrower should specify whether the U.S. borrower or the non-U.S. lender will bear the cost of FATCA's 30 percent U.S. withholding. Under current market practice, which is consistent with the view of the Loan Syndication and Trading Association, the non-U.S. lender, not the U.S. borrower, bears such cost. In addition, other FATCA-specific provisions to protect the borrower should be negotiated into a new loan agreement or an amendment to an existing loan agreement.

1 See March 22, 2010 *KirklandPEN* describing FATCA and November 9, 2012 *KirklandPEN*.

2 The reporting rules differ depending on whether the non-U.S. entity partner is publicly or privately held.

3 See footnote 2.

4 The reporting rules differ depending on whether the non-U.S. lender is publicly or privately held.

If you have any questions about the matters addressed in this *KirklandPEN,* please contact the following Kirkland authors or your regular Kirkland contact.

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PENnotes

Structuring and Negotiating LBOs
Chicago, September 12, 2013
New York, September 19, 2013
San Francisco, September 27, 2013

This biennial event, chaired by partner Jack S. Levin, focuses on the legal, tax, structuring and practical negotiating aspects of buyouts and other complex private equity deal-doing. Registration details to come.

Hot Topics in Mergers & Acquisitions 2013
Chicago, September 19, 2013
New York, October 15, 2013

With the equity markets climbing into record territory in early 2013 and the debt markets continuing to experience favorable pricing, the environment seems ripe for a strong M&A rebound. Join our expert faculty of lawyers, general counsels, regulators and investment bankers as we explore the fascinating state of M&A and the trends you need to be aware of for the year ahead. Kirkland partners R. Scott Falk and Sarkis Jebejian are co-chairs of the event. Also, Kirkland partner Jon A. Ballis will be speaking at the Chicago seminar and partner Taurie M. Zeitzer will be speaking at the New York seminar. Click here for more information.

Understanding the Securities Laws 2013
Chicago, October 24-25, 2013

This program provides an overview and discussion of the basic aspects of the U.S. federal securities laws by leading in-house and law firm practitioners and key SEC representatives. Emphasis will be placed on the interplay among the Securities Act of 1933 and the Securities Exchange Act of 1934 and related SEC regulations, how those laws were affected by the Sarbanes-Oxley Act, the Dodd-Frank Act and the controversial Jumpstart Our Business Startups (JOBS) Act, which created the concept of "emerging growth companies." Kirkland partner Theodore A. Peto is a speaker at this event. Click here for more information.

Securities Filings 2013: Practical Guidance in a Changing Environment
Chicago, November 14-15, 2013

This program will analyze in detail the principal forms used for filings with the SEC under the Securities Act of 1933 (Securities Act), and the Securities Exchange Act of 1934 (Exchange Act), with particular emphasis on the mechanics of and timing for assembling particular filings. Each segment of the program will incorporate practical drafting and disclosure tips. Ethics credit and recent legislation and SEC rule changes affecting disclosure obligations, in particular those resulting from the JOBS Act, will be woven within the topics covered. Kirkland partner Gerald T. Nowak will be speaking at the event. Click here for for information.

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Private Equity Practice at Kirkland & Ellis

Kirkland & Ellis' nearly 400 private equity attorneys have handled leveraged buyouts, growth equity transactions, recapitalizations, going-private transactions and the formation of private equity, venture capital and hedge funds on behalf of more than 400 private equity firms around the world.

Kirkland has been widely recognized for its preeminent private equity practice. The Firm was named "Private Equity Group of the Year" in 2012 and 2013 by *Law360* and was commended as being the most active private equity law firm of the last decade in *The PitchBook Decade Report*. In addition, Kirkland was awarded "Best M&A Firm" and "Best Private Equity Firm" in the United States at *World Finance*'s 2012 Legal Awards and was honored as the "Private Equity Team of the Year" at the 2011 *IFLR* Americas Awards.

In 2012 and 2013, Chambers and Partners ranked Kirkland as a Tier 1 law firm for Investment Funds in the United States, UK, Asia-Pacific and globally. The Firm was ranked as the #1 law firm for both Global and U.S. Buyouts by deal volume in Mergermarket's *League Tables of Legal Advisors to Global M&A for Full Year 2011 and 2012*, and has consistently received top rankings among law firms in Private Equity by The Legal 500, the Practical Law Company and IFLR, among others.

The Lawyer magazine has recognized Kirkland as one of its "Transatlantic Elite" every year since 2008, having noted that the firm is "leading the transatlantic market for the provision of top-end transactional services ... on the basis of a stellar client base, regular roles on top deals, market-leading finances and the cream of the legal market talent."

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