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KIRKLANDPEN
Private Equity Newsletter

November 9, 2012

Three Things a Private Fund Should Know About FATCA

PENpoints

Private funds must keep three points in mind as they begin preparing to comply with 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. But it is now time for private funds to begin preparing to comply with FATCA reporting and withholding obligations.

This PEN discusses three things every private fund should know about FATCA:

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

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 types of the U.S. fund's income 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).[3]

For a U.S. private fund, the withholding obligation goes into effect for 2014 (a few months later for some old entity partners) and subsequent years, 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 or non-U.S. entity related to a 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 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.[4]

The types of the non-U.S. entity's income 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).

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For a non-U.S. private fund or a non-U.S. entity related to a U.S. private fund, the withholding obligations go into effect for 2014 (or in some cases somewhat later) and subsequent years, unless such fund or such related entity has obtained information from its non-U.S. entity partners as to its U.S. investors and account holders and supplied such information to the IRS.

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 which borrows 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 interest payment on the loan paid after 12/31/13, unless the non-U.S. lender has agreed to supply the IRS with information as to its U.S. investors and account holders.[5]

However, there is no FATCA withholding on a pre-1/1/13 loan unless such loan is "materially modified" after 12/31/12 (*i.e.*, a "grandfathered obligation").

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 and into amendments to an existing loan agreement.

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1 See March 22, 2010 *KirklandPEN* describing FATCA.

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

3 FATCA is not intended to impose a new tax. Rather, amounts withheld are credited against the U.S. tax liability (if any) of the person or entity entitled to receive the U.S. source payment. Excess withholding will generally be refunded upon filing of a U.S. income tax return or refund claim.

4 See footnote 2.

5 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

The Private Equity Transactions Symposium 2012
London, England
November 15, 2012

The Private Equity Transactions Symposium 2012, a conference presented by the Private Equity Subcommittee of the IBA Corporate and M&A Law Committee, and supported by the IBA European Regional Forum, will take place in London on November 15, 2012. The topics will include an overview of the private equity industry, investor perspectives, themes from emerging markets, tax: a global threat to the industry and current issues. Kirkland partner Kirk Radke serves as co-chair for the event. Partner Jay Ptashek will be speaking at the event and partner David Eich will be session chair.

Click here for more information and to register for this event.

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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 300 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" for 2012 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 in the United States" at *World Finance*'s 2011 Legal Awards and was honored as the "Private Equity Team of the Year" at the 2011 *IFLR* Americas Awards.

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 has consistently received top rankings among law firms in Private Equity by Chambers & Partners, *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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