

U.S. Withholding Tax and Reporting Action Items for Investment Funds and Asset Managers (Fall 2018)

October 5, 2018

Key Points

- **Foreign Investor Forms W-8:** An update of Forms W-8 on file for non-U.S. investors is generally recommended by December 31, 2018 to ensure that a date of birth (DOB) and non-U.S. taxpayer identification number (Foreign TIN) are included where relevant to avoid incurring 30 percent U.S. withholding on certain U.S. source income.
- **FATCA Withholding – Gross Proceeds:** Withholding under the U.S. Foreign Account Tax Compliance Act (FATCA) on gross proceeds is scheduled to go into effect on January 1, 2019.
- **FATCA Certifications:** Investment funds that are based in a jurisdiction with a Model 2 intergovernmental agreement (IGA) (e.g., Bermuda, Hong Kong and Switzerland) or without an IGA (e.g., the Marshall Islands) generally must submit certain FATCA certifications to the IRS by December 15, 2018.
- **Section 871(m) Withholding:** Relief from U.S. withholding for “non-delta 1.0” swaps and other derivatives involving U.S. equities is extended to 2021; U.S. withholding with respect to such trades with “delta 1.0” are generally subject to U.S. withholding and should continue to be monitored.
- **CRS Reporting:** Investment funds resident of the Cayman Islands, or of other jurisdictions that have changed the definition of a “controlling person” for purposes of the Organisation for Economic Co-operation and Development’s (OECD) Common Reporting Standard (CRS) must generally update any controlling person information on file for any passive non-financial entity (NFE) investors by December 31, 2018.
- **FBAR Reporting:** U.S. persons that have not yet reported any reportable financial interest or signature authority over foreign financial accounts maintained in 2017 under the Foreign Bank Account Reporting (FBAR) regime were granted automatic extension and should report by October 15, 2018.

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As asset managers and investment funds focus on the implementation of the tax reform adopted under the U.S. Tax Cuts and Jobs Act of 2017 towards the end of 2018, they should also consider the following action items. This is a general summary of complex rules and cannot be relied upon as specific advice. Managers and their investment funds should work with their administrators to take action with knowledge of their particular circumstances.

1. Forms W-8 – Date of Birth and Foreign Taxpayer Identification Number Requirements

Treasury Regulations were adopted in 2017 that generally require financial institutions to document and report a DOB and/or Foreign TIN for non-U.S. investors who provide a withholding tax form (e.g., a Form W-8BEN or W-8BEN-E) with respect to a financial account maintained at a U.S. branch or office. The purpose is to enable the IRS to obtain information it may need to satisfy exchange of information obligations with third countries. Exceptions may apply, including when a Foreign TIN cannot be provided (e.g., if the investor is resident in a jurisdiction that does not issue TINs).

Transitional relief permits relevant financial institutions to rely on an otherwise valid Form W-8 without a DOB that was signed by an individual investor before January 1, 2018 for payments they make before January 1, 2019. In addition, an otherwise valid Form W-8 without a Foreign TIN that was signed before January 1, 2018 may continue to be treated as valid until the earlier of its expiration date or December 31, 2019 ([Notice 2017-46](#)). Forms W-8 provided since January 1, 2018 do not benefit from the transitional relief and already need to include a DOB and Foreign TIN, where applicable, to be treated as valid.

While it is not entirely clear whether non-U.S. investors in an investment fund treated as a flow-through for U.S. federal income tax purposes are captured by these rules, U.S. withholding agents are likely to require Forms W-8 to include a DOB and a Foreign TIN, as applicable, from all non-U.S. investors that are required to be reported on an IRS Form 1042-S. Therefore, in light of the expiration of the transitional relief, it is generally recommended that investment funds update any Forms W-8 on file that do not yet include a DOB or a Foreign TIN by December 31, 2018 to avoid that non-U.S. investors incur U.S. withholding.

2. FATCA Withholding and Reporting

a. Gross Proceeds Withholding to Apply as of January 1, 2019

To avoid 30 percent U.S. withholding on certain U.S. source income, FATCA generally imposes due diligence, withholding and reporting requirements on foreign financial institutions (FFIs) and certain other non-U.S. entities, which includes many master funds and offshore feeders. FATCA withholding currently applies to payments of certain U.S. source investment income, including income that may be exempt from general U.S. federal withholding tax (e.g., portfolio interest or treaty-exempt income). As of January 1, 2019, absent notice otherwise, U.S. withholding agents will also be required to deduct 30 percent FATCA withholding from payments of gross proceeds from the sale or other disposition of any property of a type that can produce U.S. source dividends or interest (e.g., U.S. stock or bonds) that would generally be subject to FATCA withholding. Debt securities outstanding since July 1, 2014 that have not been “significantly modified” would be grandfathered.

b. RO and COPA Certification Deadline by December 15, 2018 for Model 2 IGA and Non-IGA FFIs

As part of their FATCA compliance, non-U.S. investment funds in jurisdictions that (i) have a Model 2 IGA (e.g., Bermuda, Hong Kong or Switzerland) or (ii) do not have an IGA (e.g., the Marshall Islands), are required to designate a responsible officer (RO) to act on their behalf vis-à-vis the IRS. The ROs must make a one-time certification to confirm the fund has complied with relevant diligence requirements for investors that invested in the fund on or before certain cut-off dates (a certification of pre-existing accounts or “COPA”). In addition, ROs must certify after each three-year period that they continue to meet ongoing FATCA compliance requirements (a periodic RO certification).

The due dates for funds registered as a participating FFI or reporting Model 2 IGA FFI required to make these certifications are:

- December 15, 2018, for the first certification period in the case of a fund that was registered on or before December 31, 2014
- July 1 of the year following the third full calendar year following the effective date of registration, for a fund that was registered on or after January 1, 2015
- July 1 of the year following the third full calendar year following the previous certification period, for renewal certifications.

Funds in jurisdictions with a Model 1 IGA (e.g., the Cayman Islands) that are registered as reporting Model 1 IGA FFIs are not required to make either the periodic RO certification or the COPA certification (although they may be subject to certification requirements under local law). However, the IRS recommends that such funds also confirm or update their FATCA classification status on the IRS web site to avoid receiving unnecessary notifications to update their status in the future.

3. Section 871(m) Withholding

The IRS has recently further extended the effective date for the full application of U.S. withholding on synthetic equity trades and other derivative transactions under Section 871(m) of the Internal Revenue Code for so-called “non-delta 1.0” transactions until 2021 ([Notice 2018-72](#)). Final Treasury Regulations that apply Section 871(m) to “delta 1.0” transactions continue to apply. For further detail and certain to do items for investment funds and their offshore clients in this context, including whether to obtain updated Forms W-8IMY from certain non-U.S. brokers or dealers acting as qualified derivative dealers (QDD), see the recent [Akin Gump Tax Alert](#) on this topic.

4. CRS – Deadline for Updated Controlling Person Diligence by December 31, 2018

Under the CRS regime, Cayman and other investment funds that qualify as reporting financial institutions must perform due diligence on their investors and, where applicable, report certain investor information to their local tax authorities. Subject to limited exceptions, investors that do not themselves qualify as financial institutions for CRS purposes, but focus primarily on passive investments (i.e., so-called passive NFEs, which includes many privately held investment companies, offshore trust arrangements and family office investors) are generally required to disclose the tax

residence of their “controlling persons” to investment funds in which they hold equity or debt interests. In addition, investment entities resident of a jurisdiction that does not participate in the CRS, such as the United States, are generally treated as passive NFEs for this purpose. Investment funds in participating jurisdictions are required to conduct CRS due diligence and reporting with respect to such controlling persons as if they were direct investors in the fund. A “controlling person” for CRS purposes generally is a natural person who (i) owns more than a threshold percentage of the relevant investor entity; (ii) absent significant equity ownership, otherwise exercises control over such entity; or (iii) if control is not otherwise established, is in charge of the effective management of such entity.

The Cayman Islands and certain other jurisdictions currently participating in CRS have lowered the threshold percentage that investment funds must take into account when determining reportable “controlling person” status by reference to ownership with respect to investors that are, or are treated as, passive NFEs from 25 percent to 10 percent of ownership. Thus:

- Existing funds should contact their CRS administrators and confirm the correct “passive NFE” investor information is on file by December 31, 2018
- Controlling persons of new “passive NFE” investors must be documented by reference to the new 10 percent threshold
- The 2019 CRS filing will need to reflect any reportable controlling person information by reference to the new 10 percent threshold.

5. FBAR Reporting by October 15, 2018

U.S. asset managers should consider any foreign bank account reporting (FBAR) requirements they or the U.S. vehicles they utilize may have on FinCEN Form 114 for foreign financial accounts maintained in 2017, by October 15, 2018, which is an automatic extension from the due date for “regular” U.S. income tax return filing requirements.

FBAR generally applies to U.S. persons with financial interests in or signatory authority over any foreign financial accounts maintained during the previous calendar year if the aggregate value of such accounts exceeded \$10,000 at any time during such year, irrespective of any income generated by such account. U.S. persons with certain significant equity ownership in U.S. or lower-tier entities that maintain such accounts are generally also required to make such filings by attribution (for example, direct or indirect ownership of more than 50 percent by vote or value in a corporation, or of more than 50 percent in the capital or profits of a partnership). Potentially significant penalties may apply in case of willful or non-willful failure to timely file any FinCEN Form 114. U.S. managers who failed to timely file FBAR reports for prior years should note that under certain conditions the IRS’ delinquent submission procedures continue to be available to rectify noncompliance. The offshore voluntary disclosure program (OVDP) for U.S. persons with exposure to potential criminal liability and/or substantial civil penalties under FBAR due to a willful failure to report has closed effectively September 28, 2018. However, the IRS has suggested that updated procedures will be announced. We also note that certain regulations have been proposed, but not yet finalized, that may provide certain relief from reporting in the future.