

How will FATCA Affect Cayman Islands Investment Fund Vehicles?

FATCA is a USA and UK tax initiative with significant obligations imposed on Cayman Islands funds. All Cayman Islands funds will need to consider whether such are required to register under FATCA and undergo regular reporting. The following briefing paper provides a wide overview and guidance on registration and on-going reporting requirements.

Overview

Sections 1471 – 1474 of the Internal Revenue Code of 1986 (referred to as “FATCA”, or the Foreign Account Tax Compliance Act) were enacted to cause United States persons, including individuals who live outside the United States, to report their financial accounts held outside of the United States, and for the Internal Revenue Service (IRS) to collect information from foreign financial institutions about their US clients. In summary, FATCA is primarily intended to ensure that additional tax revenue is collected from US taxpayers holding assets outside the US. FATCA was enacted as part of the 2010 Hiring Incentives to Restore Employment Act (HIRE).

The United Kingdom (UK) also followed suit and entered into an agreement with the Cayman Islands in late 2013, which similarly requires information reporting on UK taxpayers’ financial accounts. We use the term “UK FATCA” herein for simplicity. It is anticipated that further countries may well follow and agree similar requirements with the Cayman Islands in the future.

FATCA is implemented in the Cayman Islands through three (3) primary document types (FATCA Documents):

1. An Intergovernmental Agreement (IGA) between the Government of the United States of America and the Government of the Cayman Islands dated 29 November 2013 (and an IGA between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Cayman Islands to Improve International Tax Compliance dated 5 November 2013 which is similar);
2. Local legislation and regulations in the form of Tax Information Authority Law (The Tax Information Authority (Amendment) (No.2) Law, 2014) and regulations pursuant thereto, being The Tax Information Authority (International Tax Compliance) (United Kingdom) Regulations, 2014, and The Tax Information Authority (International Tax Compliance) (United States) Regulations, 2014; and
3. Guidance Notes issued by the Cayman Islands Tax Information Authority (TIA) to give practical guidance on interpretative matters.

In this note, “FATCA” means all of the arrangements described in the FATCA Documents. Note the FATCA

Documents above are complex and the following is a summary only. Similar investment funds may have different FATCA classifications so specific individual advice is needed. Capitalised terms not defined herein carry the meaning given by the FATCA Documents. The focus of this note is on the US FATCA documents, but as UK FATCA documents are similar some comparisons are drawn to the UK arrangement.

If financial institutions do not comply with US FATCA requirements, a 30% withholding tax is imposed on US source income of that financial institution. Such withholding is currently scheduled to begin with respect to US source dividends, interest, and similar payments made after 30 June 2014 and with respect to payments of gross proceeds and certain non-US source payments made after 31 December 2016. Financial institutions are also required to close accounts where their US customers do not provide information to be collected by the financial institution.

The information below does not contain a detailed description of the manner of reporting under FATCA as it is expected reporting for Funds will generally be outsourced to professional administration firms, and not be undertaken by fund managers personally.

Key Concepts and Terminology

FATCA classifies all entities as either:

1. Financial Institutions (FI), also referred to as Foreign Financial Institutions (FFI); or
2. Non-Financial Foreign Entities (NFFE).

Financial Institutions that do not comply with FATCA are termed Nonparticipating Financial Institutions. They will generally be subject to withholding.

Most Cayman Islands funds will be FI's (Financial Institutions). FI's are then classified as Reporting Financial Institutions or Non-Reporting Financial Institutions; all Cayman Islands FI's are Reporting Financial Institutions unless there is an exemption available.

Entities which are not Financial Institutions will be NFFEs. NFFEs are further divided into Active NFFEs and Passive NFFEs. A Financial Institution may have reporting obligations in respect of Financial Accounts it maintains for a Passive NFFE.

Specified Persons are either US tax resident persons or nationals or UK tax resident persons. Cayman Islands funds will have reporting obligations for Specified Persons as discussed below.

A NFFE, whether Passive or Active, has no reporting or other obligations under the FATCA Documents. But, to avoid withholding, it will have to determine its FATCA/IGA classification, self-certify/confirm its status and provide details of controlling persons if requested to do so by a Financial Institution with which it has an account. As regards US Financial Institutions, this will commonly be done by completing a Form W8-BEN. For other entities, the self-certification forms provided by the TIA may be used. Consequently, a passive NFFE may be

required to obtain self-certification from a Controlling Person of that NFFE.

Key Obligations of Cayman Islands Funds for FATCA

For the purposes of simplicity, FATCA can be said to place three (3) primary obligations on Cayman Islands investment funds:

1. Register and obtain a Global Intermediary Identification Number (GIIN) for the Fund – this does not apply for UK FATCA;
2. Undertake identification of the investors of the Fund as to their tax residency; and
3. Make annual filings with the Cayman Islands Tax Information Authority as to certain types of Fund investors being “Reportable Accounts” – being Specified Persons or Passive NFFEs with one or more Controlling Persons who are Specified Persons (and for US FATCA only, Nonparticipating Financial Institutions) and relevant information including such investor’s name, address, US Tax Identification Number (TIN) and the Net Asset Value of the equity interest in the Fund along with information on income distributed.

As a result of FATCA, Funds are updating their offering document to describe the impact of FATCA, amending the Fund subscription form to permit Funds to both collect additional required information, and disclose information to tax authorities for FATCA, as well as to include approved “self-certification forms” and other verification required and in order to allow for the Fund to allocate any specific financial obligation or penalty to any relevant non-compliant investor. For a Fund that is ultimately designated as a Nonparticipating Financial Institution (i.e. is one which does not comply with its FATCA obligations), there may well be withholding tax consequences which should be allocated to the specific non-compliant investors, the Fund may then choose to then compulsorily redeem or withdraw such investor.

For many industry participants, the Fund will engage their Fund administrator to undertake some or all of these tasks and in effect, delegate responsibility for compliance with FATCA. Funds should satisfy themselves that their Fund administrator has the expertise and resources to undertake this role, and consider asking for periodic reports from the Fund administrator as to any issues that have arisen. The Cayman Islands Regulations provide that Funds may use third party service providers to fulfil the obligations imposed on Funds. However, the Fund must have access to the records and documentary evidence used to identify and report on Reportable Accounts and the Fund is ultimately responsible for any failure of the delegate to carry out its obligations notwithstanding fault lies with the delegate.

Note: FATCA affects all Funds whether structured as companies, limited partnerships or unit trusts.

Funds Exempt from FATCA

FATCA is not limited to the US and additionally because of the drafting of the FATCA Documents, Funds without US investors cannot assume that the Fund can simply ignore these developments.

The US IGA provides that “Reporting Cayman Islands Financial Institutions” are subject to the FATCA requirements. A “Financial Institution” includes any entity managed by another entity where the managing entity conducts as a business, portfolio management amongst other language, so effectively all Cayman Islands investment funds are “Financial Institutions”.

Note: certain Real Estate funds will be exempt due to the investment holding of direct real estate.

Exempt from these obligations are certain categories of Funds which are “Non-Reporting Cayman Islands Financial Institutions” including any listed in Annex II to the US IGA or otherwise a “deemed compliant FFI”, “Owner Documented FFI’s” or an “exempt beneficial owner”. See Appendix 1 to this note for more details on this.

Note: Segregated Portfolio Company Funds may elect to apply differing FATCA classifications to different segregated portfolios.

Funds or Fund investors which are listed on certain exchanges (not including the Cayman Islands Stock Exchange) may be exempt from FATCA as well.

Non-Reporting Cayman Islands Financial Institutions may still need to certify their status to US payors to avoid withholding taxes.

To emphasise the point, all Cayman Islands funds must comply with FATCA unless a relevant exemption applies.

Note: a Fund exempt from the FATCA provisions may voluntarily elect to comply with FATCA and submit annual reports etc.

Transitional Provisions

All Funds must register with the IRS by no later than 31 December 2014 (NB the cut-off date to appear on the IRS list by 1 January 2015, is 22 December 2014), or if established later, within thirty (30) days of establishment. All Funds must register with the TIA by 31 March, two (2) months before the first report is due on the 31 May for such year.

The first annual reporting period is for the calendar year 2014 with gradual increase in scope of reporting obligations to 2016, covering income and gross proceeds.

For Pre-existing Accounts, the Fund is not obliged to specify the US TIN (tax identification number) before 2017 if the Fund does not hold such information, but for an individual where the Fund holds the date of birth, this should be provided instead.

Note the GIIN registration application refers to a “responsible officer”. Whilst the responsible officer title is a feature of the IRS FATCA portal registration process, registration by a Fund does not invoke the US Treasury concept of a responsible officer. The submission of the registration on behalf of the Fund should be made by an authorised person who certifies to the best of their knowledge and belief that the information is accurate and

complete, and that the Fund will comply with their obligations.

Identification Procedures

For Fund entity investors, the Fund must classify each as (i) Specified US Persons (ii) Cayman Islands Financial Institutions (or equivalent in other jurisdictions subject to FATCA) (iii) “participating FFIs”, a “deemed-compliant FFI” or an “exempt beneficial owner” (see Appendix 1 to this note) or (iv) an “Active NFFE” or “Passive NFFE”. An NFFE is a non-US entity that is not a foreign financial institution. A Passive NFFE is any NFFE that is not an Active NFFE. An Active NFFE needs to meet one of several criteria such as (i) less than 50% of its gross income for the last year is passive and less than 50% of the assets held produce passive income or (ii) being listed on an established securities market (the Cayman Islands Stock Exchange is not one) or (iii) other categories.

The Fund can classify a Fund investor as a (i) Cayman Islands Financial Institution (or equivalent in other jurisdictions subject to FATCA) or (ii) an Active NFFE, if it reasonably determines on the basis of the investor’s GIIN or other information. Note if the Fund investor is a Cayman Islands Financial Institution (or equivalent in other jurisdictions subject to FATCA) classified by the IRS as a Nonparticipating Financial Institution, it will be subject to reporting (but not technically a US Reportable Account).

Note: reporting is needed by Fund to specify Fund investors who are (i) Specified US Persons and (ii) Passive NFFEs with one or more Controlling Persons who are US citizens, along with Nonparticipating Financial Institutions.

Annex I to the US IGA provides information to classify the status of Fund investors for FATCA divided between Fund investors as at 30 June 2014 (“Pre-existing Accounts”) and subsequent investors (“New Accounts”), including:

1. Pre-existing Individual Accounts

- Funds can ignore Fund individual investors who had less than US\$50,000 invested at 30 June 2014, unless they subsequently increase their investment to aggregate US\$1,000,000 invested in the Fund;
- For Fund investors which had between US\$50,000 and US\$1,000,000 invested at 30 June 2014, the Fund should conduct an electronic search of its data to locate any of the listed US indicia applicable to an investor. Only if US indicia are identified and none of the exceptions apply (such as a self-certification form from the Fund investor asserting it is not a US investor as a supporting document), will such Fund investor be subject to FATCA reporting. If no US indicia are discovered, no action is required until US indicia are identified or the Fund investor has a value of at least US\$1,000,000 invested in the Fund. This review of Fund investors must be completed by 30 June 2016; and
- For Fund investors which had in excess of US\$1,000,000 invested at 30 June 2014 (or December 31 2015 or its anniversary), the Fund should conduct an electronic search of its data to locate any of the listed US indicia applicable to an investor. If the electronic search includes certain information, then no further steps need be taken if no US indicia found – otherwise, certain paper documents need be inspected. Only if US indicia are identified and none of the exceptions apply (such as a self-certification form from the Fund investor asserting it is not a US investor as a supporting document), will such Fund investor be subject to FATCA reporting. However, if a relationship manager is assigned to the Fund

investor who has actual knowledge that the Fund investor is a US Reportable Account, the Fund must adopt that classification. The review of the status of these Fund investors must be completed by 30 June 2015 or by June 30 of the year following the increase by the Fund investor of its investment to in excess of US\$1,000,000.

2. New Individual Accounts

- The Fund must obtain a self-certification form and consider the reasonableness of this based on the information obtained in the account opening, such as KYC documents; and
- If there is a change in circumstance that causes the Fund to know, or have reason to know, that the original self-certification form is incorrect or unreliable, the Fund must obtain a fresh self-certification, otherwise the Fund investor will be a US Reportable Account.

3. Pre-existing Entity Accounts

- Funds can ignore Fund entity investors who had less than US\$250,000 invested at 30 June 2014, until such balance exceeds US\$1,000,000;
- The Fund must review information held for regulatory or customer relationship purposes, such as KYC, and only Fund investors which provide a self-certification form to the contrary or which the Fund reasonably determines, are not US Reportable Accounts; The Fund must likewise determine if the Fund investor is a Financial Institution based on such documents and otherwise see if the Fund investor has a GIIN;
- The Fund must likewise determine if the Fund investor is a “Passive NFFE” and look at whether there are US Controlling Persons; and
- This review is due by (i) June 30, 2016 for Fund entity investors who had in excess of US\$250,000 invested at 30 June 2014 and (ii) 30 June in the year after a Fund investor exceeds US\$1,000,000 invested.

4. New Entity Accounts

- For Fund investors, the Fund must classify each investor based on the information provided by the investor including a self-certification form from the Fund investors;
- If a Passive NFFE, the Fund must identify under KYC protocols, the Controlling Persons;
- Note any Active NFFEs, participating FFIs, deemed-compliant FFIs or exempt beneficial owner or Passive NFFEs who have no US Controlling Persons are not US Reportable Accounts, and, therefore, are not subject to reporting.

5. General

- The Fund cannot rely on self-certification forms or documents it knows, or has reason to know, are incorrect or unreliable;
- The Fund must consider if and when it has reasonable cause to believe the person’s United States status has subsequently changed;
- The Fund is not required to redeem Fund investors who are recalcitrant on providing identification

information to the Fund; and

- Fund interests held by one investor across multiple Funds for a single sponsor may need to be aggregated for determining the above monetary thresholds.

Other Reporting Considerations

In summary, only Specified Persons or Passive NFFEs with one or more Controlling Persons who are Specified Persons need to be reported, along with Nonparticipating Financial Institutions.

If, after application of the specified due diligence procedures, the Fund investor is not determined to be a US Reportable Account, then the Fund investor will not be subject to reporting.

A US Reportable Account excludes Fund investors such as (i) certain listed US entities (ii) affiliated investors (iii) US governmental entities (iv) certain US tax-exempt investors and retirement plans (v) deceased or personal representatives of the deceased (vi) those holding the Fund interest solely in relation to judgements awarded or to secure performance of certain contractual obligations, amongst others categories.

Instead of applying the due diligence procedures in the US IGA, the Fund can elect to apply the procedures in relevant US Treasury Regulations for determining whether Fund investors are US Reportable Accounts or an account held by a Nonparticipating Financial Institution.

For the purposes of the monetary thresholds, Funds may be required to aggregate Fund investors' interests depending in part on whether their Fund interests are linked and whether (for higher value monetary thresholds) any relationship manager believes such Fund interests should be aggregated. There are broad/wide-ranging anti-avoidance provisions that also assist in aggregation. Fund interests denominated in non-USD amounts should be converted on the last day of the applicable year using a published spot rate.

The report filed with the TIA must contain information as to name and address of the Reportable Account, its US TIN, the Fund investor's account number, the balance of the account, (and over a transitional period, any dividends or any redemption payments) and if the Fund investor is a Passive NFFE, the Controlling Person must be identified, for which a 25% threshold of ownership of the Fund investor is relevant.

If the Fund has no Reportable Accounts, then a report will need to be filed with the TIA to confirm that position. Reports are due by 31 May each year in respect of the prior year. A separate report must be filed in 2015 and 2016 as to Nonparticipating Financial Institutions. If the Fund effects, or acts as intermediary for, a "US Source Withholdable Payment" to a Nonparticipating Financial Institution, the Fund must disclose this to the US payor.

Funds must implement arrangements to obtain the TIN of each Specified US Person who is the account holder (i) by 1 January 2017, for pre-existing Fund investors at 30 June 2014 and (ii) on subscription for new Fund investors subscribing after 1 July 2014.

Records must be maintained for a period of six (6) years from the commencement of reporting for such Fund interest.

If a Fund investor is required to self-certify their FATCA status, the Fund may require the investor to provide further specified information as the Fund considers appropriate, such as a certificate of residence or a passport.

The TIA may require a Fund to provide information as to books, documents, or other records, or any electronically stored information that the TIA may reasonably require or make available for inspection such information.

Significant financial and custodial penalties arise from (i) failure to comply with requests for provision of information and inspection (ii) without reasonable cause, failure to file reports with the TIA (iii) fraudulently or negligently making a false report (iv) failure to implement arrangements or procedures to comply with the Regulations (v) altering, destroying, mutilating, defacing, hiding or removing any document or information, including documents or information electronically held or (vi) wilfully obstructing an inquiry by the TIA. Penalties include fines of US\$6,000 or, for offences under (i), (iii), (iv), (v) and (vi) above, imprisonment for two (2) years. Importantly, where the offence is committed by an entity with the consent or connivance of, or attributable to the neglect of, any director, manager, secretary or other similar officer of the body corporate, such person is also considered to have committed the offence and liable to prosecution.

Appendix 1

Non-Reporting Cayman Islands Financial Institutions

Non-Reporting Cayman Islands Financial Institutions includes those listed in Annex II to the US IGA or otherwise a “deemed compliant FFI” or an “exempt beneficial owner” including:

1. The Cayman Islands government and its affiliates, including the Cayman Islands Monetary Authority (ii) an international governmental organization or (iii) a central bank;
2. Certain Cayman Islands pension plans;
3. Funds where all investors to the Fund are “exempt beneficial owners” and any lenders to the Fund are either exempt beneficial owners or a depository institution;
4. Funds which have Cayman Islands residents holding at least 98% of the equity interests of the Fund along with other requirements (which are Certified Deemed Compliant Funds);
5. Certain small funds where no investor has more than US\$50,000 invested (which are Certified Deemed Compliant Funds);
6. Certain sponsored funds (which are Certified Deemed Compliant Funds);
7. Investment Managers and Advisors who are not Nonparticipating Financial Institutions;
8. Funds which have a reporting sponsor or reporting trustee which will undertake the FATCA process (note the UK IGA requires that certain of these sponsor entities be Cayman Islands entities specifically) – note the sponsoring entity must register as a sponsoring entity with the IRS;
9. Funds regulated by the Cayman Islands Monetary Authority, all the investors in which must satisfy one of the following categories:

- Exempt beneficial owners;
- Active NFFEs;
- (US IGA only) are US citizens or tax residents other than Specified US Persons; or
- (US IGA only) are Financial Institutions that are not Nonparticipating Financial Institutions,

(and which are Certified Deemed Compliant Funds)

10. Funds which are domiciled in other “Partner Jurisdictions” or satisfy the US Treasury Regulation definition of “qualified collective investment vehicle”.

Deemed Compliant Funds include (i) Funds referred to as Registered Deemed Compliant which will be obliged to register with the IRS and obtain a GIIN, but not required to report and (ii) Funds referred to as Certified Deemed Compliant which will not need to register with the IRS (save for certain limited exceptions), but may need to self-certify with withholding agents to evidence their status and avoid the imposition of 30% withholding on US source payments.

Categories of Registered Deemed Compliant Funds include:

1. A non-reporting Fund that is a member of a group of entities which includes at least one Participating Financial Institution – such Funds must review Fund investor details to identify US Reportable Accounts and Nonparticipating Financial Institutions;
2. A Qualified Collective Investment Vehicle Funds where all Fund investors are one of the following (i) persons other than US Persons and UK Persons, (ii) Participating Foreign Financial Institutions, (iii) investors not typically subject to FATCA withholding or reporting obligations, such as retirement funds and non-profit organisations or (iv) others. The Investment Manager must be “regulated” (note it is to be clarified whether this requires a full licence under the Securities Investment Business Law of the Cayman Islands);
3. A Restricted Fund that imposes prohibitions on the sale of units to Specified Persons, Nonparticipating Financial Institutions and Passive NFFEs with Controlling Persons and such Funds must meet all following requirements:
 - The Investment Manager must be “regulated” (it is not clear whether this requires a full licence under the Securities Investment Business Law of the Cayman Islands);
 - Fund interests issued directly by the Fund are redeemed or transferred by the Fund and not sold by investors on a secondary market;
 - Fund interests that are not issued directly by the Fund are sold only through certain distributors that are specified such as Participating Foreign Financial Institutions;
 - The Fund must ensure each distribution agreement and the offering document prohibit the sale of units to Specified Persons, Nonparticipating Financial Institutions and Passive NFFEs with Controlling Persons, unless held through a Participating Financial Institution, and additionally that the distribution agreement requires the distributor to notify the Fund of changes in its status;

- With respect to any of the Fund's pre-existing direct investors that are held by the beneficial owner of the interest in the Fund, the Fund must review those accounts to identify any Reportable Account or account held by a Nonparticipating Financial Institution, save that the Fund will not be required to review the account of any individual investor that purchased its interest at a time when all of the Fund's distribution agreements and its offering document contained an explicit prohibition of the issuance and/or sale of shares to US entities and US resident individuals;
- By the later of 30 June 2014 or six (6) months after the date it registers as a Deemed Compliant Fund, the Fund is required to notify the TIA that either it did not identify any Reportable Account or account held by a Nonparticipating Financial Institution as a result of its review or, if any such accounts were identified, that it followed certain steps;
- By the later of 30 June 2014, or the date that it registers as a Deemed Compliant Fund, the Fund must implement policies and procedures to ensure that it either does not open or maintain an account for, or make a withholdable payment to, any Specified Person, Nonparticipating Financial Institution, or Passive NFFE with one or more substantial US owners and, if it discovers any such accounts, closes all accounts for any such person within six (6) months of the date that the Fund had reason to know the investors became such a person; or reports on any account held by, or any withholdable payment made to, any specified US person, Nonparticipating Financial Institution, or Passive NFFE with one or more substantial US owners to the extent and in the manner that would be required if the Fund were a Participating Financial Institution.

Rather than register with the IRS, Certified Deemed Compliant Financial Institutions should self-certify with withholding agents to evidence their status and avoid the imposition of 30% withholding on US source payments. Examples are listed above.

Should you have any queries regarding the above, or if we can be of any assistance, please do not hesitate to contact your usual Campbells contact or any of the following:



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