



Current Taxation Issues for Non-Tax Professionals

Jersey Fund Association

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Neil Oliver – Director – Ernst & Young

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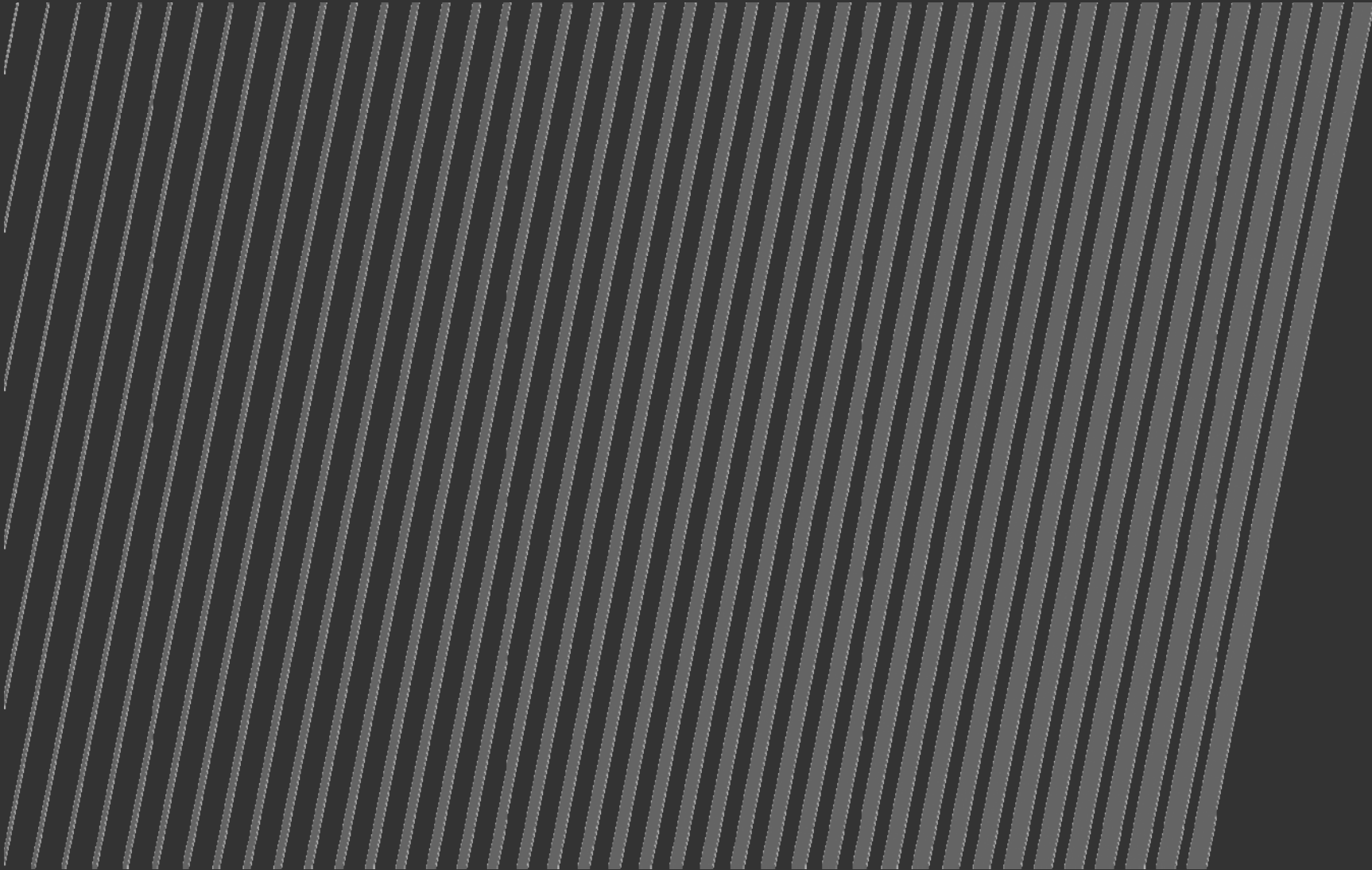
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The strategies presented in this presentation are subject to E&Y Independence Confirmation process prior to implementation.

Agenda

- ▶ FATCA
- ▶ Offshore funds
- ▶ Offshore penalty regime
- ▶ Jersey funds exemption

Foreign Account Tax Compliance Act (“FATCA”)



What FATCA requires & how it will impact funds

What is the Foreign Account Tax Compliance Act (FATCA)?

- FATCA is a new US tax law designed to prevent US taxpayers from avoiding US tax on their income by investing in the US through non-US financial institutions and offshore investment vehicles.
- ▶ FATCA was enacted on March 18, 2010, and becomes effective January 1, 2013.
 - ▶ FATCA requires third-party information reporting to the IRS regarding offshore accounts and investments held by US persons.
 - ▶ Notices 2010-60 and 2011-34 provide preliminary guidance on how the IRS will administer FATCA.

How will FATCA impact you?

- FATCA generally requires US financial institutions (USFIs) to classify all foreign account holders as either individuals, Foreign Financial Institutions (FFIs) or non-financial foreign entities (NFFEs).
- ▶ FFIs must become “participating FFIs” by entering into agreements with the IRS to identify US accounts and report certain information about those accounts to the IRS on an annual basis.
 - ▶ FFIs must notify US institutions making payments to them of their “participating FFI” status.
 - ▶ USFIs and FFIs must report certain information to the IRS about substantial US owners of NFFEs.

What is the “cost” of non-compliance?

- Thirty percent withholding will apply to all US source dividend and interest payments plus the gross sales proceeds resulting from the sale of an asset that gives rise to US source income if paid to either a “nonparticipating FFI” or an NFFE that has not disclosed its substantial US owners.
- ▶ A USFI and an FFI will always be liable for any tax that they should have withheld but did not, plus interest and potential penalties.

Sample impacted business units

- ▶ Regulated funds
- ▶ Private equity/hedge funds
- ▶ Trust/fund administration

Impacted functional areas

- ▶ Corporate tax
- ▶ Tax operations
- ▶ On-boarding and KYC processes
- ▶ Investor relations
- ▶ Payment processing systems

Financial Institution

A financial institution is any entity that:

- ▶ Accepts deposits in the ordinary course of a banking or similar business
- ▶ Holds financial assets for the account of others as a substantial portion of its business
or
- ▶ Is engaged primarily in the business of investing, reinvesting, or trading in securities, interests in partnerships, commodities or any interest (including a futures or forward contract or option) in such securities, partnership interests or commodities
 - ▶ Includes non-US Bank, Broker, Custodian, investment fund, private equity fund, hedge fund, trusts and certain insurance companies

FATCA legislation defines a Foreign Financial Institution (FFI) as:

- ▶ “any financial institution which is a foreign entity”

FATCA legislation defines a Non-Financial Foreign Entity (NFFE) as:

- ▶ “any foreign entity which is not a financial institution”

30% withholding exposure

Potential 30% US Withholding Exposure: FATCA requires a 30% withholding tax on any “withholdable payment” made to a foreign financial institution (“FFI”) or nonfinancial foreign entity (“NFFE”) unless:

- ▶ FFI enters into an “FFI Agreement” with the IRS to comply with certain requirements
- ▶ NFFE provides certain information regarding its owners

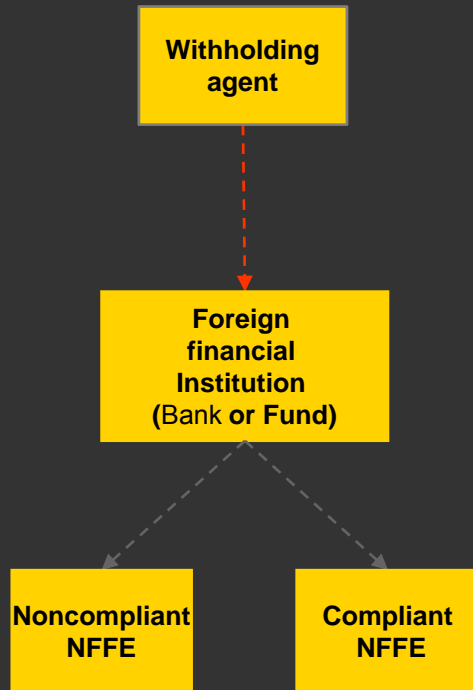
Withholdable Payment: Includes US source fixed or determinable, annual or periodical (“FDAP”) payments plus original issue discount, and gross proceeds from the sale of property that can produce US source interest or dividends

- ▶ Return of capital and gains is subject to such withholding
- ▶ Portfolio interest is subject to withholding
- ▶ Payments from foreign branches of domestic financial institutions are considered US (vs. foreign) source income for this purpose
- ▶ Excludes effectively connected income (“ECI”)

Scope (Section 1471 IRC)

- ▶ FATCA's objective is simple: make it more **difficult for US Persons to avoid taxes** through foreign vehicles
- ▶ Under FATCA, foreign financial institutions (“FFIs”) must
 - ▶ enter into an **agreement with the IRS**
 - ▶ provide information **identifying their US accounts and certain US owners** of their customers,
 - ▶ obtain a **waiver** from account holders to allow information reporting to the IRS or **closure of the account**, and
 - ▶ withhold on “recalcitrant” account holders and account holders that are non-compliant FFIs.
- ▶ **Otherwise:**
 - ▶ FATCA imposes a **new 30% withholding** tax on certain payments (“withholdable” and “passthru” payments) made to the non-participating FFI, unless the FFI certifies to the IRS that it has **no US accounts** and to recalcitrant account holders **and** NPFFIs or PFFIs whose recalcitrant account holders do not cooperate with requests for required information.

Non-Financial Foreign Entities (NFFE)



Withholding agents must apply a withholding tax at 30% on 'withholdable payments' to a non-financial foreign entity ("NFFE") unless the NFFE agrees to:

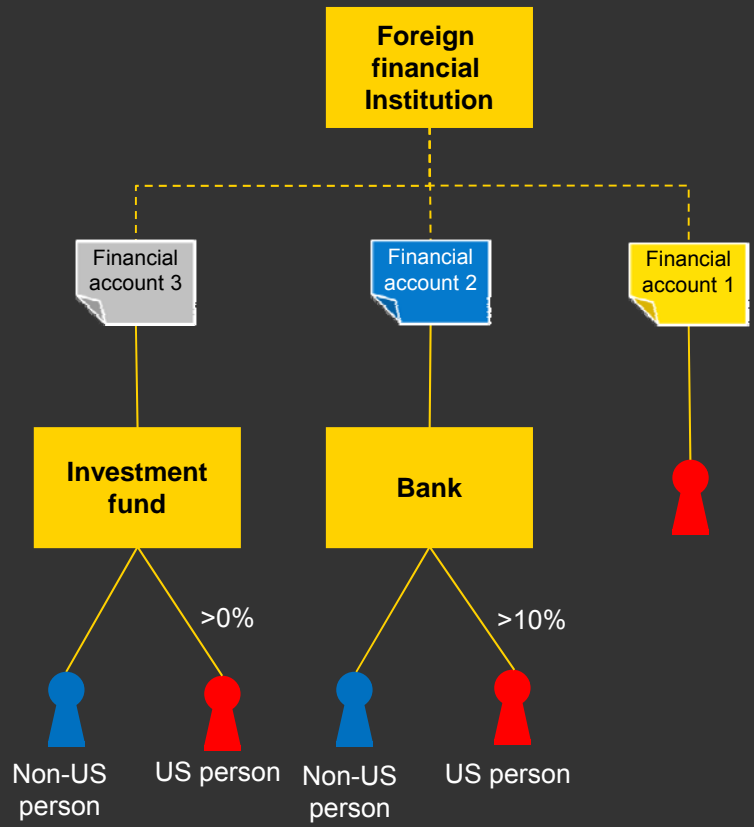
- ▶ Disclose its **substantial US owners'** names, addresses, and US tax identification number to enable withholding agent to report to the IRS, or
- ▶ Certify that it has no **substantial US owners**
- ▶ Withholding agent "must not know or have reason to know" that certifications or information is incorrect

Substantial US owners are 'specified US persons' who own more than 10% of the foreign entity

Exception for publicly-held and certain other foreign corporations

- ▶ Treasury has authority to exclude other recipients that pose a low risk of tax evasion, such as foreign governments, international organizations and foreign central banks

US accounts



A US account is a financial account that is held:

- ▶ **Directly by one or more “specified US persons”**
 - ▶ *De minimis* rule of \$50,000 for depository accounts held by natural persons (accounts must be aggregated)
- ▶ **Indirectly by “substantial US owners” of US owned foreign entities**
 - ▶ Substantial US owner: “specified US person” who owns more than 10% of the foreign entity; more than 0% if foreign entity is an investment vehicle
- ▶ Specified US persons are US persons, excluding generally:
 - ▶ Publicly traded corporations; tax-exempt organizations, the US government or state or possession of the US, and (as defined in the Internal Revenue Code) certain US banks, REITs, RICs and common trust funds, as well as certain charitable trusts

A financial account means:

- ▶ Any depository or custodial account maintained by a financial institution (i.e., customer accounts)
- ▶ Any equity or debt interest in the financial institution (other than interests that are regularly traded on an established securities market)

Notice 2011-34

- ▶ Chief Compliance Officer Certification
- ▶ Documenting pre-existing individual accounts
- ▶ Information that needs reporting
- ▶ Passthru payment rules
- ▶ Centralised compliance options for funds
- ▶ Deemed compliant and low risk FFIs

Chief Compliance Officer Certification

- ▶ The Notice provides that the chief compliance officer or another equivalent-level officer (responsible officer) of a foreign financial institution (FFI) must certify to the IRS as to the completion of certain customer identification procedures outlined in the Notice related to the identification of pre-existing accounts as U.S. accounts for purposes of the FATCA provisions.
- ▶ In addition, the Notice states that one of the certifications will require the responsible officer to certify that, between the publication date of Notice 2011-34 and the effective date of the FFI's FFI Agreement (which typically will be 1 January 2013), FFI management personnel did not engage in any activity, or have any formal or informal policies and procedures in place, directing, encouraging, or assisting account holders with respect to strategies for avoiding identification of their accounts as US accounts.
- ▶ The Notice further provides that the responsible officer must certify that the FFI had written policies and procedures in place as of the effective date of the FFI's FFI Agreement prohibiting its employees from advising US account holders on how to avoid identification.

Documentation of preexisting individual accounts

Notice 2011-34 replaces the rules for identification of preexisting individual accounts by participating FFIs described in Notice 2010-60, and distinguishes the following types of accounts:

- ▶ Step 1: Documented US accounts
 - ▶ Step 2: Accounts of \$50,000 or less
 - ▶ Step 3: “Private banking” accounts
 - ▶ Step 4: Accounts with US indicia
 - ▶ Step 5: Non-private banking accounts of \$500,000 or more
-
- ▶ Steps 2, 3, and 5 contain new rules, while Steps 1 and 4 contain similar rules, but not identical to the rules set forth in Notice 2010-60
 - ▶ Steps 1, 4 and 5 will be particularly relevant for asset management clients

Documentation of preexisting individual accounts

Private banking clients

“Private banking accounts” are accounts maintained with an FFI’s “private banking department”, defined as one that:

- ▶ Focuses on high-net-worth individuals or families
- ▶ Provides personalized services to individual clients or their families (e.g., banking, investment advisory, estate planning)
- ▶ Gathers information about individual clients’ personal, professional and financial histories, in addition to information ordinarily gathered for retail customers
- ▶ Is treated as a private banking department for AML/KYC purposes

Or:

- ▶ Is referred to by the FFI as a “private banking”, “wealth management” or similar department

The private banking rules are broadly construed to include accounts where personalized services are provided to individual account holders

Documentation of preexisting individual accounts

Accounts with US indicia

A due diligence review of “electronically searchable information” must be performed for an account that is not identified as a:

- ▶ US account in Step 1;
- ▶ Non-US account in Step 2; or
- ▶ As a private banking account in Step 3

Due diligence includes looking for the following US indicia:

- ▶ Identification of the account holder as a US citizen or US resident
- ▶ US place of birth for the account holder
- ▶ US address residence or US correspondence address (including a US P.O. Box address)
- ▶ Standing instructions to transfer funds to an account in the US
- ▶ Hold mail or c/o address as the sole address in FFI’s records
- ▶ Power of attorney or signatory authority granted to a person with a US address

Documentation of preexisting individual accounts

Accounts with US indicia (continued)

- ▶ Electronically searchable information means information/documentation maintained in tax reporting files, customer master files or similar files that can be searched by standard queries in programming languages
 - ▶ Pdf or scanned documents are not in electronically searchable format
- ▶ If an account contains US indicia, the FFI must request documentation confirming the account holder's US status within one year of the effective date of the FFI's FFI Agreement
- ▶ Account holders have two years from the effective date of the FFI Agreement to provide the requested documentation
 - ▶ If not provided, then account will be treated as recalcitrant

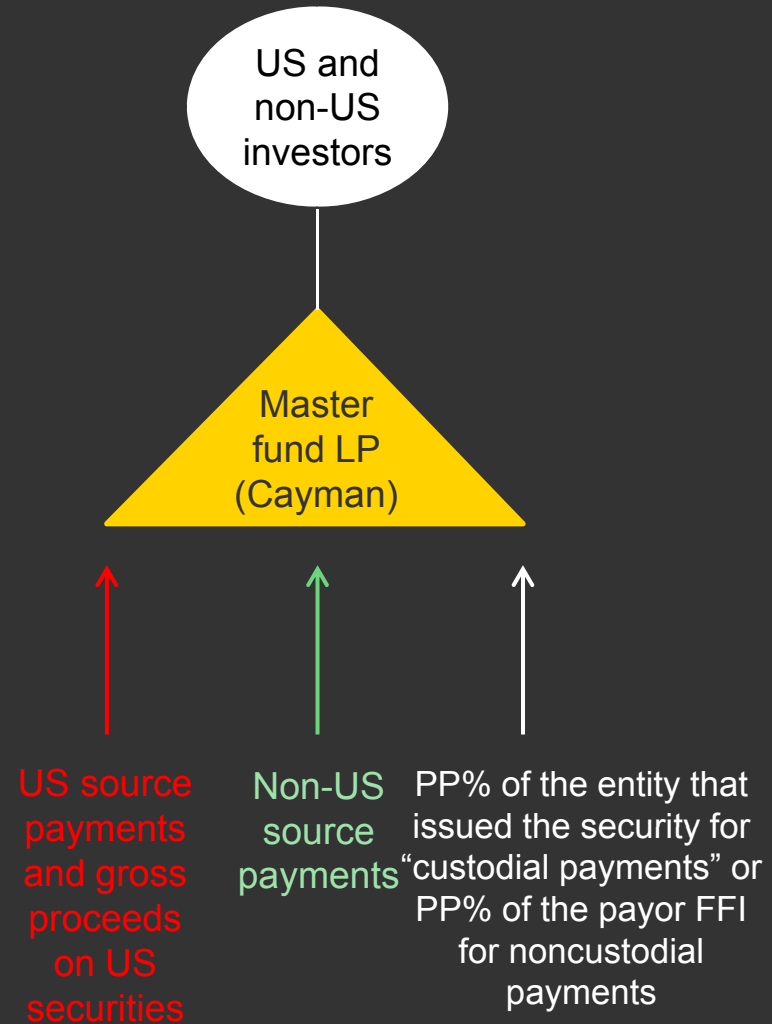
Documentation of preexisting individual accounts

High-value accounts (non-private banking)

- ▶ High value account is a non-private banking account with a balance or value of \$500,000 plus at the end of the year preceding the effective date of the FFI's FFI Agreement, which was not identified as:
 - ▶ US accounts in Step 1 or as a non-US accounts in Step 2
- ▶ Must perform a diligent review of ALL account documentation (not just electronically searchable data) for US indicia using US account indicia standards
- ▶ If an account contains US indicia, the FFI must request documentation confirming the account holder's US status. Timing of request is not specified in Notice.
- ▶ Account holders have two years from the effective date of the FFI Agreement to provide the requested documentation
 - ▶ If not provided, then account will be treated as recalcitrant

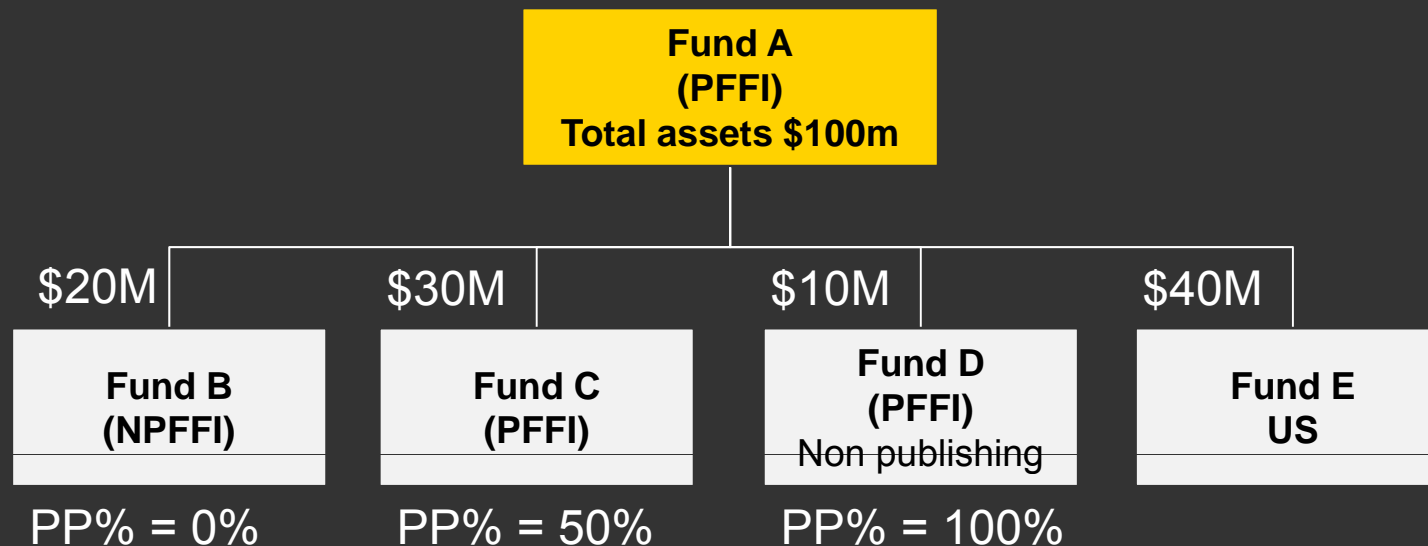
Notice 2011-34: passthru payments

- ▶ **Definition:** Any withholdable payment or other payment to the extent attributable to a withholdable payment.
- ▶ **Application: An FFI payment will be a passthru payment to the extent of:**
 - ▶ The amount of the payment that is a withholdable payment, **PLUS**
 - ▶ The amount of the payment that is NOT a withholdable payment, **times**
 - ▶ passthru payment percentage (PP%) of the entity that issued the security for “custodial payments”
 - ▶ PP% of the pay or FFI for noncustodial payments
- ▶ **Calculation:** PP% is calculated quarterly (based on FFI’s fiscal year) and PP% must be published on a website or database, readily searchable by the public, within three months after the quarterly test date.



Notice 2011-34: passthru payments example

- ▶ Fund A (PFFI) has total assets of \$100M
- ▶ Fund A's US assets = \$65M (B = 0%, C = 30x50% = 15, D = 10x100% = 10, E = 40)
- ▶ Fund A's PP% = 65% (\$65M/\$100M)
- ▶ If there are any redemption proceeds paid to a recalcitrant account holder in Fund A, Fund A will be required to apply passthru withholding on 65% of that payment.

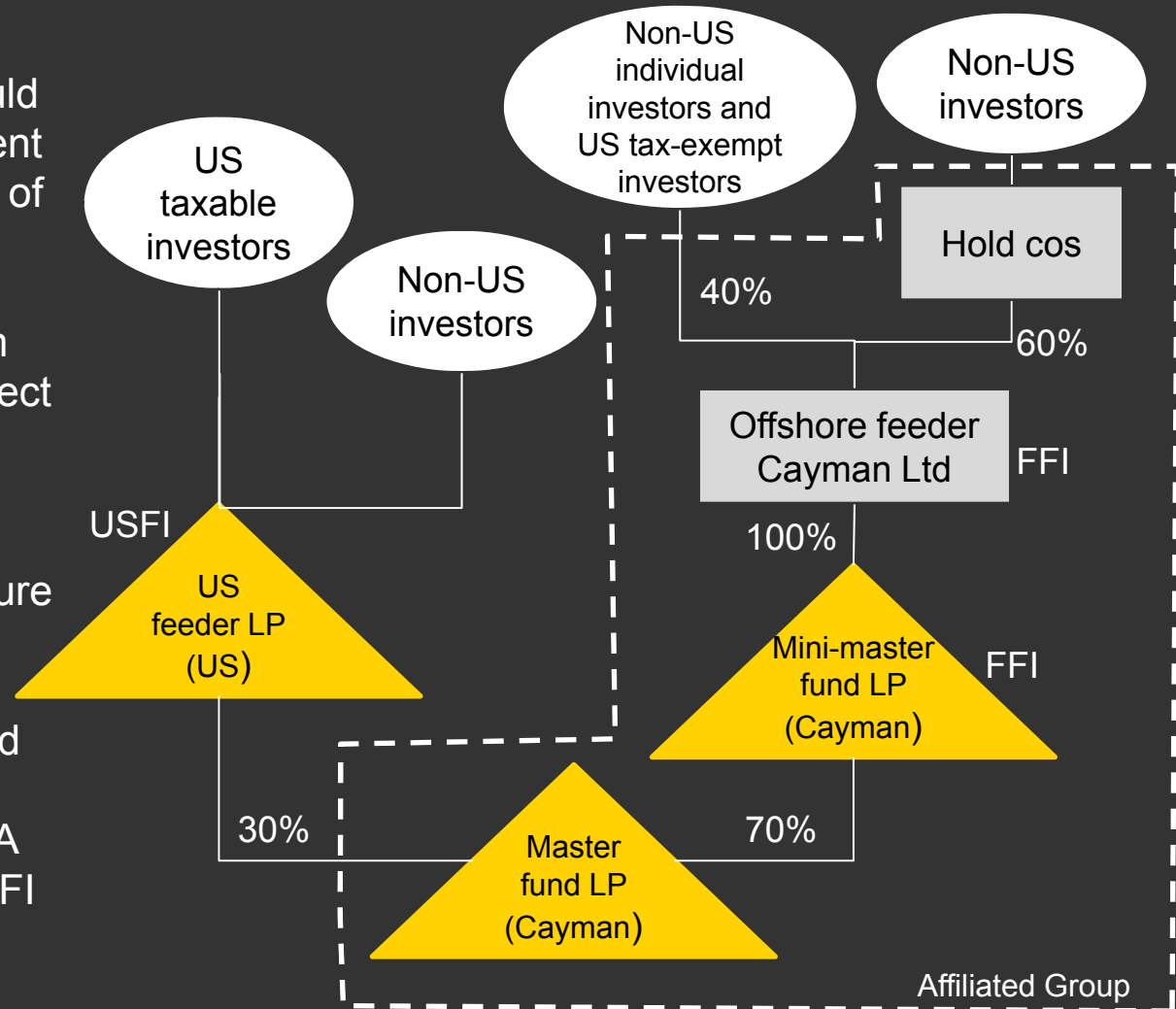


Reporting on US accounts

- ▶ The information reporting rules set forth in Notice 2010-60 are modified. Such reporting now requires:
 - ▶ **Account balance or value:** use year-end account balances/values
 - ▶ **Gross receipts and withdrawals:**
 - ▶ FFIs that are banks and custodians will be required to report all of the following:
 - ▶ Gross dividends paid/credited to the account
 - ▶ Gross interest paid/credited to the account
 - ▶ Other income paid/credited to the account and
 - ▶ Gross proceeds from the sale or redemption of property paid/credited to the account with respect to which the FFI acted as custodian, broker, nominee or other agent of the account holder
- ▶ FFIs that are funds must report all distributions, interest and similar payments credited during the year and each redemption payment made during the year

Centralised compliance options for the funds

- ▶ **Umbrella concept:** Asset manager (or other agent) would execute a single FFI Agreement covering members of a group of funds
- ▶ Asset manager would contractually agree to perform obligations required with respect to each such fund under the single FFI Agreement
- ▶ Asset manager would need to implement procedures to ensure each fund's compliance with Chapter 4 requirements
- ▶ **Each fund is liable:** Each fund would remain liable for the performance of its own FATCA obligations under the single FFI Agreement



Deemed compliant FFIs

Scope and definitions (certain investment vehicles)

- ▶ **No general carveout:** Notice 2011-34 does not provide a general carveout from FATCA for publicly-traded, regulated and other investment funds. Treasury and the IRS are considering whether funds with a restricted investor base and exchange-traded funds could be deemed compliant
- ▶ **Limited carveout will apply to:** a fund meeting the following 3 requirements:
 - ▶ All direct investors are either –
 - ▶ participating FFIs or deemed compliant FFIs holding such interests for other investors, or
 - ▶ entities described in Section 1471(f) (e.g., foreign governments, international organizations, their agencies and instrumentalities, foreign central banks of issue, or any entity designated as posing a low-risk of tax evasion)
 - ▶ The fund prohibits persons other than those described above from subscribing for, or acquiring interests in, the fund; and
 - ▶ The fund certifies that any passthru payment percentage that it calculates and publishes will be done according to the rules described above for participating FFIs

Obligations of Deemed compliant FFIs; Low Risk FFIs

- ▶ **Other categories of deemed-compliant funds are under consideration:** funds that are exchange-traded; funds with limited distribution; and certain foreign retirement plans

- ▶ **Deemed compliant FFIs will be required to:**
 - ▶ Apply for deemed compliant status with the IRS (not automatic)
 - ▶ Obtain an FFI identification number (FFI-EIN) from the IRS, identifying it as a deemed compliant FFI; and
 - ▶ Certify to the IRS every three years that it meets the requirements for deemed compliant FFI status

- ▶ **Low risk foreign retirement plans:** Treasury and IRS are considering the types of foreign retirement plans that should be treated as posing a low risk of tax evasion.

Why act now

Identify synergies with other investor data projects and information gathering for new investors:

Take advantage of other projects with similar investor data requirements (e.g., AML, Dodd-Frank). Early integration of solutions may avoid duplicative efforts and reduce costs

Complex implementation: FATCA projects could last 6-12 months if software development or system changes are required.

Enable effective communication strategies: Identification of impacted investors – direct and through structures – needs to be sized quickly to enable an effective communication strategy and action plan.

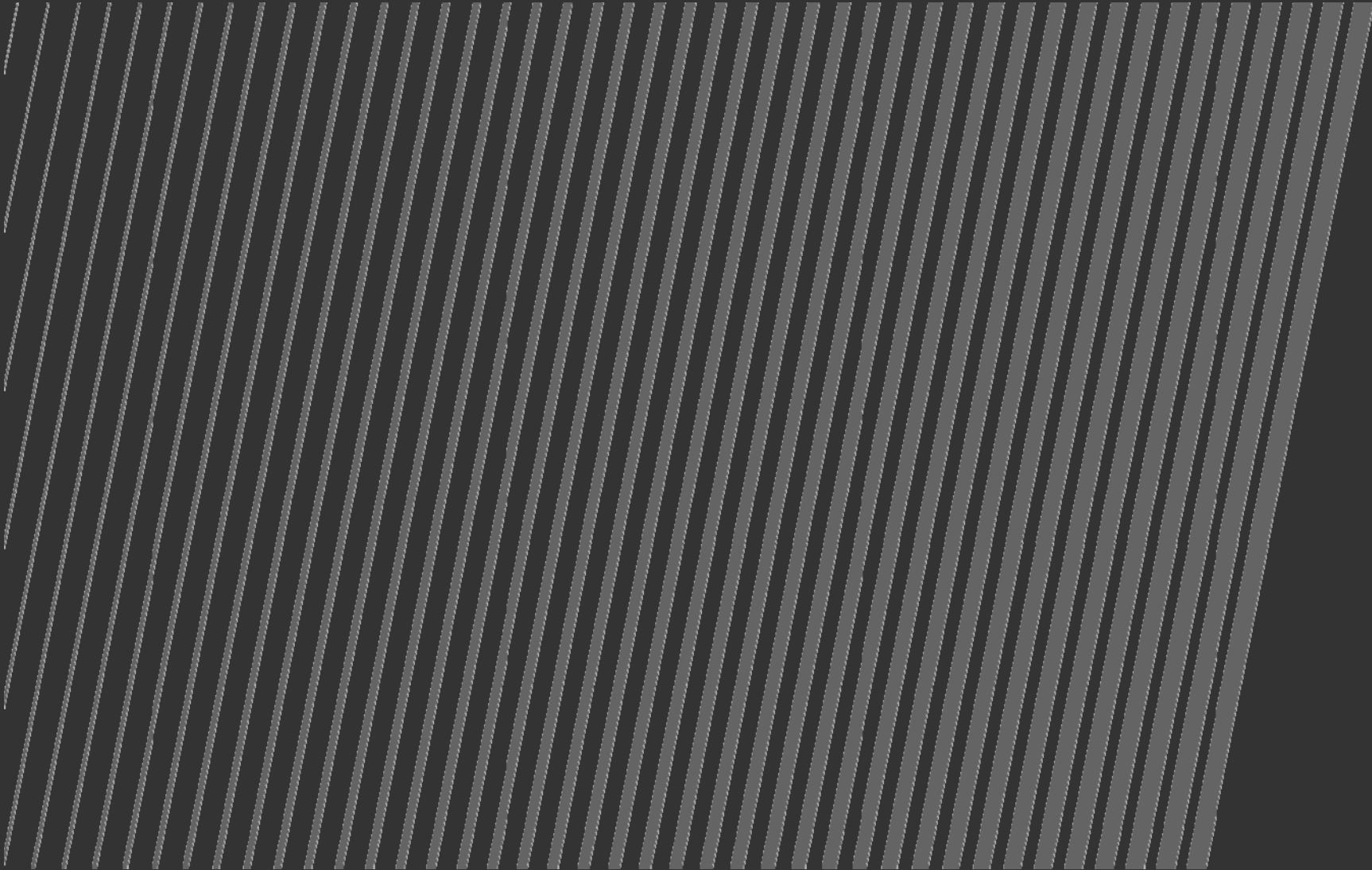
Reduce risks that businesses, investors, or activities are overlooked upon implementation:

Establishing and implementing processes to obtain, maintain, manage and, most importantly, report key data (investor information, fund structure, LPAs, PPMs, subscription documents, etc.).

Cross-divisional programs are by their nature difficult to deliver: The earlier the program starts in a controlled and well governed way the more likely the implementation will run smoothly.

Technical solutions: Suitability of technical solutions must be analyzed early in the process to be ready at the go-live date.

Offshore funds



The new reporting fund regime

- ▶ Purpose of the offshore fund regime:
 - ▶ Prevent UK Taxpayers rolling up income into a capital gain
 - ▶ Provide similar tax treatment for investors in offshore and UK authorised funds
- ▶ UK Tax rates up to 50% on income, flat rate 18%/28% on capital gains
- ▶ Regime is elective by the fund
- ▶ A modern reporting fund regime to achieve this

The new reporting fund regime

Aims of the changes

- ▶ Simplify the operation of the regime
- ▶ Provide more certainty to UK investors and funds
- ▶ Remove UK tax barriers to multi-tiered fund structures
- ▶ Strengthen anti-avoidance rules so that UK investors who choose to invest into offshore funds do so based on commercial decisions and not to obtain tax advantages

Key points of a Reporting Fund

Reporting fund

Advance approval, but need to meet ongoing reporting requirements

No cash distribution required, however annual requirement to report 100% of reportable income on which UK investors are taxed

Reportable income calculation based on IAS or GAAP with agreed method of adjustment for effective interest

No investment restriction, but reportable income must be adjusted for holdings in other offshore funds

Elective deemed disposal mechanism available where reporting fund status is gained or lost

New tax definition of offshore fund

Finance Act 2009

- ▶ An offshore fund is a 'mutual fund' constituted by any of the following:
 - ▶ A body corporate resident outside the UK
 - ▶ A trust with trustees outside the UK
 - ▶ Arrangements in the nature of co-ownership under the law of another jurisdiction, but excluding partnerships
- ▶ A 'mutual fund' means arrangements which:
 - ▶ Allow the participants to share in the property, or in the income arising from it
 - ▶ Do not give investors day-to-day control
 - ▶ Allow investors to recover net asset value, or an amount determined by an index, on disposal
- ▶ Share classes are treated as separate offshore funds
- ▶ Arrangements may not be a mutual fund in certain circumstances

The new reporting fund regime: the detail

Advance application procedure

- ▶ Application must be received by HMRC no later than the end of the first period of account for which status is required or if later 3 months after UK investors
 - ▶ The manager of an existing offshore fund, or
 - ▶ The expected manager of a proposed offshore fund
- ▶ Contents of the application
 - ▶ Prospectus
 - ▶ Period of account
 - ▶ Undertaking to meet reporting fund requirements
 - ▶ IAS or GAAP? If GAAP, which GAAP?
 - ▶ Where not IAS:
 - ▶ Statement specifying the entries in the fund's accounts that are considered to equate to **'total comprehensive income for the period'** per IAS
 - ▶ How the fund intends to comply with the requirement to report interest income on a basis similar to effective interest or calculate the effective interest adjustment
 - ▶ How equalisation will be operated

The new reporting fund regime: the detail

Ongoing requirements

For each period of account, a reporting fund must:

- ▶ Prepare accounts in accordance with IAS, or the GAAP as specified in the application
- ▶ Provide a computation of its reportable income
- ▶ Provide the required reports to participants
- ▶ Provide the required information to HMRC

The new reporting fund regime: the detail

Provision of information to participants

- ▶ A reporting fund must provide a report to each participant for each reporting period
- ▶ By post or email, or published on a website or in a UK newspaper
- ▶ Content of the report
 - ▶ The amount actually distributed to participants per unit of interest in the fund in respect of the reporting period
 - ▶ The excess of the amount of the reported income per unit of interest in the fund for the reporting period over the amount actually distributed to participants per unit of interest in the fund in respect of the reporting period
 - ▶ The dates on which the distributions were made
 - ▶ The fund distribution date
 - ▶ A statement whether or not the fund remains a reporting fund at the date the fund makes the report available
 - ▶ Equalisation
- ▶ Deadline: within six months of the end of each reporting period

The new reporting fund regime: the detail

Provision of information to HMRC

- ▶ A reporting fund must provide the following information to HMRC in relation to each period of account:
 - ▶ Audited financial statements (prepared under IAS or the GAAP specified in the application)
 - ▶ A computation of the fund's reportable income for the period of account based on its audited financial statements
 - ▶ A copy of the report made available to participants for each reporting period falling within the period of account
 - ▶ The reported income of the fund for the reporting period
 - ▶ The amount actually distributed to participants in respect of the reporting period
 - ▶ The number of units in the fund in issue **at the end of** the reporting period
 - ▶ The amount of the reported income per unit of interest in the fund in respect of the reporting period
 - ▶ A declaration confirming that the fund has complied with its reporting fund obligations
- ▶ Equalisation
- ▶ Deadline: within six months of the end of the period of account

The new reporting fund regime: the detail

Breaches of reporting fund requirements

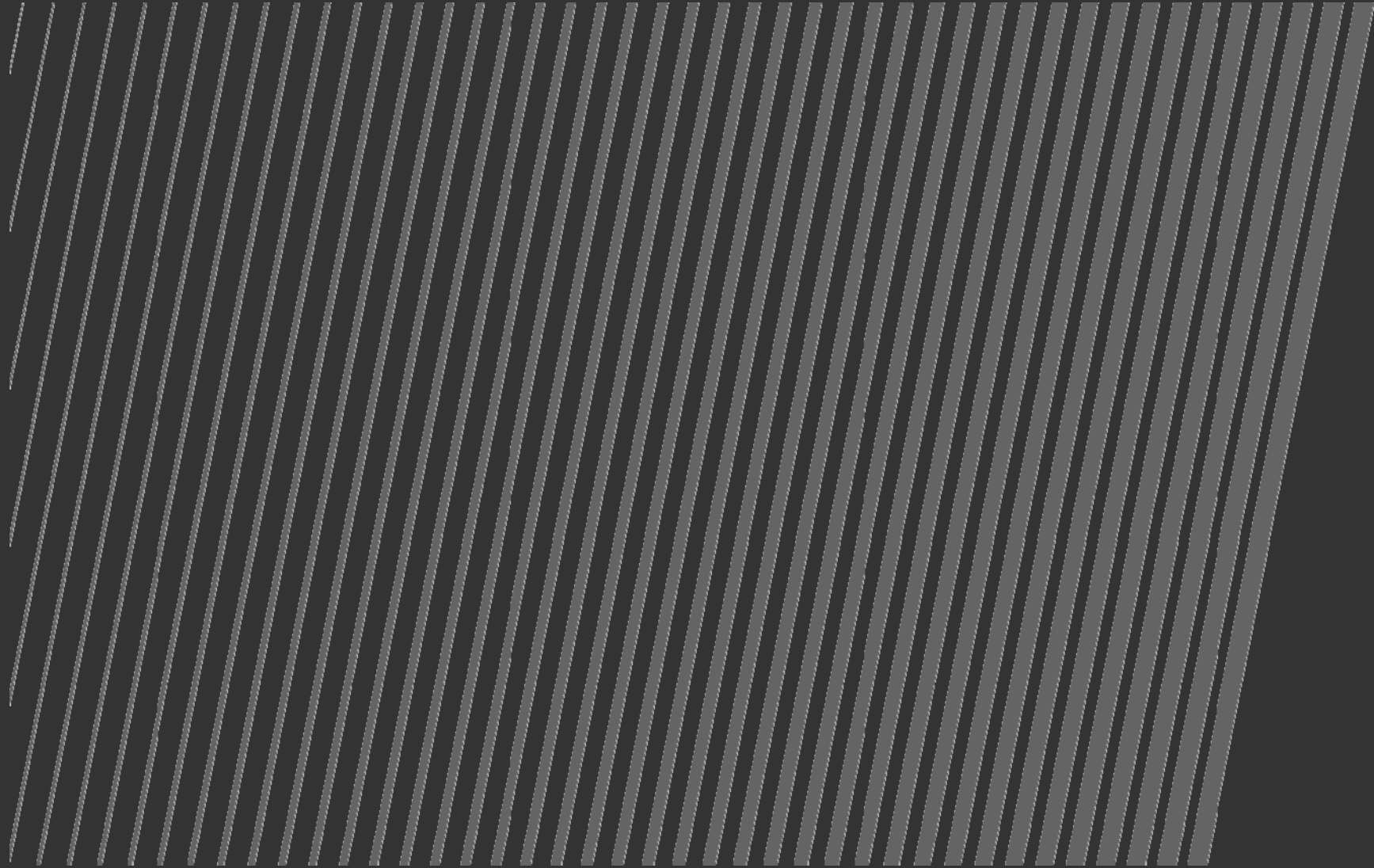
- ▶ Circumstances resulting in a breach
 - ▶ Provision of incorrect or incomplete report
 - ▶ Errors in the calculation of reportable income
 - ▶ Failure to provide participant reports within six months of period end
 - ▶ Failure to provide report to HMRC within six months of period end
- ▶ Minor breaches
 - ▶ Fund continues to be treated as a reporting fund if:
 - ▶ Breach is inadvertent and remedied as soon as reasonably possible
 - ▶ There is a reasonable excuse for the breach
 - ▶ ‘Four strikes and you’re out’ rule – applied over a 10 year period, where the 4th breach will be considered a serious breach
 - ▶ A minor breach is not regarded as a breach if the reporting fund corrects the breach without any HMRC intervention
- ▶ Serious breaches
 - ▶ Any breach which is not a minor breach, including certain offences specifically set out in the regulations
 - ▶ Fund will lose reporting fund status prospectively

The new reporting fund regime: the detail

Amendments to regulations

- ▶ HMRC recently published amending regulations which came into force on 27 May 2011
- ▶ Income equalisation – five options
 - ▶ Equalisation
 - ▶ Full equalisation
 - ▶ Income adjustments on the basis of reportable income (default if no election made)
 - ▶ Income adjustments on the basis of accounting income
 - ▶ No equalisation or adjustments to income
- ▶ Transparent funds
- ▶ Taxable date for investors
 - ▶ not related to date report made to investor
 - ▶ 6 months after the end of the reporting period

Offshore penalty regime



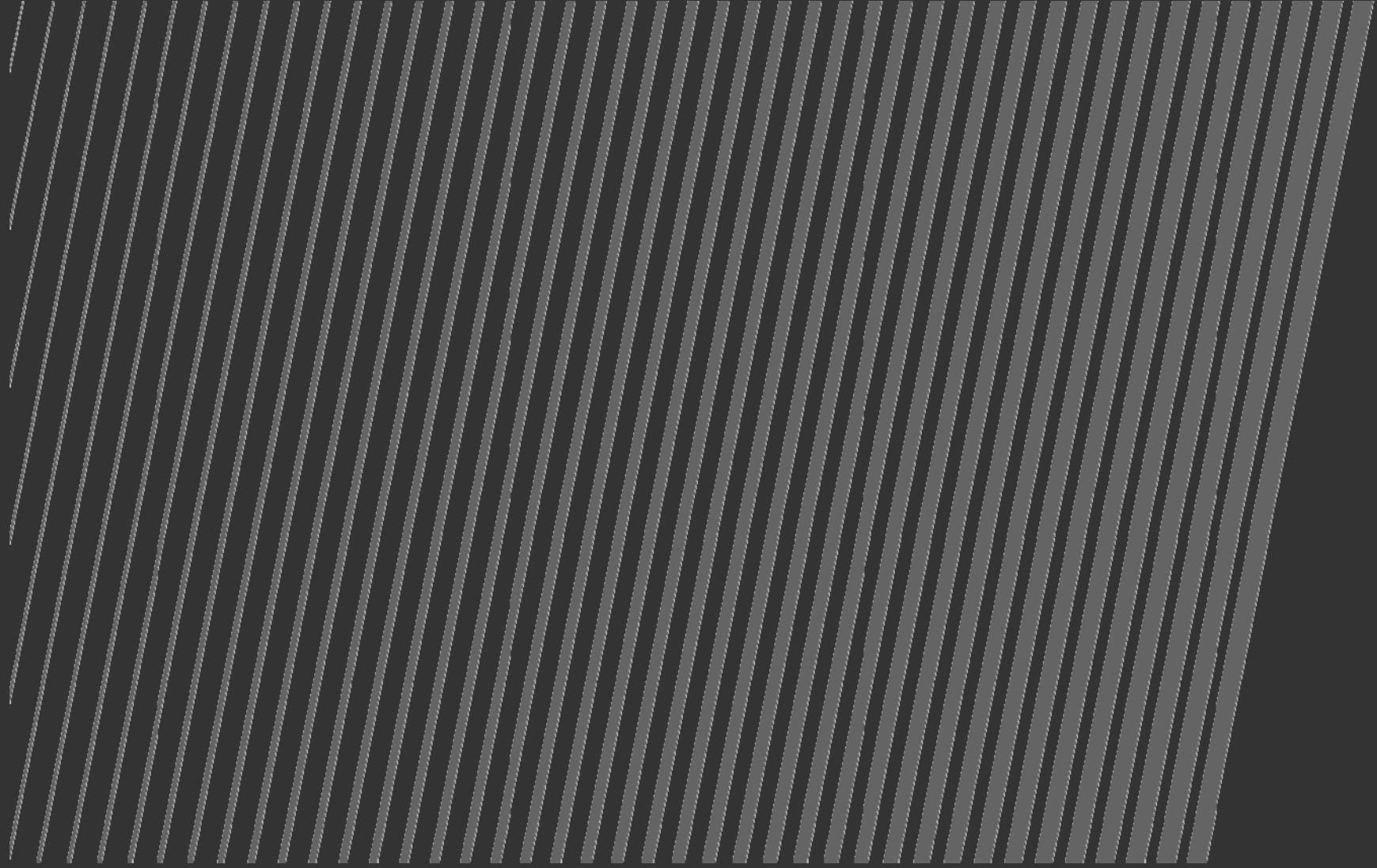
Offshore penalty regime

- ▶ From 6 April 2011 new penalties
- ▶ Up to 200% on income or capital gains arising offshore
- ▶ Only applicable to individuals
- ▶ Can be charged for failure to take reasonable care
- ▶ Applies if taxpayer
 - ▶ Fails to notify chargeability
 - ▶ Submits inaccurate return
 - ▶ Fails to file a return

Offshore penalty regime (continued)

- ▶ Three levels of maximum penalty
- ▶ Category one
 - ▶ Territories transparent and with automatic exchange on savings
 - ▶ Existing penalties – up to 100%
- ▶ Category two
 - ▶ Countries not on lists one or three
 - ▶ Penalties up to 150%
- ▶ Category three
 - ▶ Least transparent
 - ▶ No or insufficient exchange of information
 - ▶ Penalties up to 200%

Jersey funds exemption



Jersey funds exemption

- ▶ Allow persons issuing units or securities in eligible investment schemes to register with the Comptroller of Taxes in order to be exempt from income tax
- ▶ Applies to registered persons provided that no trade is carried out through a permanent establishment in Jersey during the period of registration

Jersey funds exemption

- ▶ £500 annual application fee
- ▶ Application for exemption is not currently beneficial as general tax rate is 0%
- ▶ May be useful going forward if changes to zero/ten regime are implemented. However significant changes to the current regime are not currently anticipated
- ▶ Consider if the exemption should be mentioned in the fund prospectus

Presenter's details

Neil Oliver – Tax Director
noliver@uk.ey.com
01534 288221

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