

- Financial Institutions and Investment Entities
- Non-Reporting Financial Institutions
- Reporting Financial Institutions
- Registration with IRS

The Impact of FATCA on British Virgin Islands Funds

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*In March 2014, the British Virgin Islands Government announced that it had concluded negotiations with the US with respect to a Model 1B Intergovernmental Agreement with the United States (the **IGA**). The IGA (which was eventually signed on 30 June 2014) provides the framework for the implementation of the US Foreign Account Tax Compliance Act (**FATCA**) in the British Virgin Islands (**BVI**). BVI entities are not directly subject to FATCA however the IGA requires the BVI to implement legislation requiring certain BVI entities to identify and report US accounts as set out in this Guide.*

The IGA requires that BVI Financial Institutions report to the BVI International Tax Authority (**ITA**). The ITA will automatically pass that information on to the United States Internal Revenue Service (**IRS**). A BVI Financial Institution that complies with the BVI laws implementing the IGA will, under US law, be “deemed compliant” with the requirements of FATCA and will not be subject to the 30 per cent withholding tax which may otherwise be applied.

Implementing legislation will shortly be adopted in the BVI. The BVI Government has set up a FATCA Working Group with industry representation (on which Harneys is represented). The Working Group is reviewing the measures required to implement automatic exchange of information in relation to the IGA, the IGA between the BVI and the United Kingdom as well as additional reporting requirements which are likely to be implemented in future by other countries under the Common Reporting Standards (**CRS**). Draft Guidance Notes were issued on 18 July 2014 for consultation.

This Guide focuses on the impact of FATCA and the IGA on BVI domiciled funds whether they are companies registered under the BVI Business Companies Act, 2004 or limited partnerships registered under the

Partnership Act, 1996. References are made in this Guide to the draft Guidance Notes. It should be noted that the final Guidance Notes may be amended following the consultation period. This Guide will be updated to take into account any such amendments once the Guidance Notes are finalised.

Financial Institutions and Investment Entities

The definition of a “Financial Institution” (**FI**) (equivalent to a Foreign Financial Institution (**FFI**) in the FATCA Regulations) is key to the application of the IGA.

The IGA defines a FI as a Custodial Institution, a Depository Institution, an Investment Entity or a Specified Insurance Company. In the funds context, Investment Entity is the most relevant. The term is clearly defined in the IGA itself. However, the Guidance Notes provide flexibility for entities to elect to apply the IGA definition of Investment Entity or the definitions used in the FATCA Regulations or the CRS. In other words, an entity may avoid treatment as an Investment Entity unless it falls within all three of the definitions.

The IGA definition of Investment Entity is any entity which conducts as a business (or is managed by an entity that conducts as a business) any of a variety of financial activity for or on behalf of a customer including managing funds or money. The IGA definition also captures managers, advisors and administrators of funds.

The CRS and FATCA Regulations definitions are generally narrower and refer to gross income of the entity being primarily attributable (more than 50 per cent) to investing in Financial Assets. In practice, the majority of BVI investment funds are expected to fall within all three definitions and must be treated as FIs under the IGA.

Non-Reporting Financial Institutions

The IGA distinguishes between Reporting FIs and Non-Reporting FIs. A Non-Reporting FI is any FI that falls within any of the exemptions set out in Annex II to the IGA or the FATCA Regulations or one which otherwise qualifies as a Deemed Compliant FI, an Owner Documented FI or an Exempt Beneficial Owner. A complete analysis of all of the exemptions is outside the scope of this Guide but in an investment funds context the most relevant exemptions are:

- Sponsored Investment Entity – a FI that is an Investment Entity¹ may agree for another entity to act as its sponsoring entity to fulfil the registration and related requirements. The Sponsoring Entity must register with the IRS. This provision is proving popular for fund groups where the manager or an affiliate can act as the sponsoring entity for the funds which it manages.
- Trustee Documented Trusts – a BVI trust is a Non-Reporting FI if the trustee is a Reporting FI and reports all information required to be reported pursuant to the IGA.
- Investment Advisers and Managers – any Investment Entity which is a FI solely because (a) it renders investment advice to, and acts on behalf of or (b) manages portfolios for, and acts on behalf of, a customer for the purposes of investing, managing or administering funds deposited in the name of the customer with a FI (other than a Non-Participating FI). This category may include entities that delegate their investment management and advisory obligations such as a general partner of a limited partnership.
- Collective Investment Vehicle – this is a limited exemption only available to collective investment vehicles which are regulated in BVI and all interests in which are held by or through certain categories of persons such

¹ Provided it is not a qualified intermediary, withholding foreign partnership or withholding foreign trust.

as other FIs. Investment Entities seeking to take advantage of this category need to follow certain other rules set out in Annex II. The majority of BVI funds are unlikely to fall within this exemption.

Many Non-Reporting FIs will not need to register and obtain a Global Intermediary Identification Number (**GIIN**) or carry out the due diligence and reporting requirements under the IGA,² such Non-Reporting FIs will provide certification to a relevant withholding agent as to its status through the modified W8 certification.

Reporting Financial Institutions

BVI funds which do not fall within any of the exemptions referred to above are classified as Reporting FIs and will be required to comply with the reporting and registration obligations imposed under the IGA and BVI legislation. The most notable obligations are:

- (a) to identify US Reportable Accounts in accordance with the due diligence requirements set out in Annex I of the IGA and the Guidance Notes;
- (b) to report annually to the ITA certain specified information with respect to any US Reportable Accounts; and
- (c) to register with the IRS to obtain a GIIN (even if the Reporting FI has no US Reportable Accounts).

Registration with IRS

A BVI fund which is a Reporting FI or a Registered Deemed Compliant FI is required to register online with the IRS before the end of 2014 to obtain a GIIN. The first list of GIINs was published by the IRS in June 2014 and will going forward be updated on a monthly basis. FIs are not required to provide verification of a GIIN to withholding agents to establish their FATCA status prior to 1 January 2015 (to be on the IRS list by 1 January 2015, a FI must register and obtain a GIIN by 22 December 2014). Obtaining a GIIN will provide independent certification to prime brokers, custodians and other counterparties of FATCA compliance. Between 1 July 2014 and 31 December 2014, FIs should be able to confirm their status through self-certification on Form W8 or informing the withholding agent that they are a Model 1 Financial Institution. However, it is advisable for entities to liaise with their counterparties to establish any new requirements that may be introduced in the period leading up to 1 January 2015.

When registering for a GIIN, the IRS portal requires the name of a natural person to be listed as the FI's Responsible Officer despite the fact that under the IGA there is no specific role. The Responsible Officer of a BVI FI will be required to deal with the IRS online registration, certify that certain information (entered as part of the online registration) is accurate, and certify that the BVI fund will comply with its FATCA obligations. It does not invoke the US Treasury concept of a Responsible Officer and those obligations are not imported into the BVI legal framework.

Identifying US Reportable Accounts

A US Reportable Account is any Financial Account maintained by the FI and held by one or more Specified US Persons or by a non-US entity with one or more controlling persons that is a Specified US Person.

² Registered Deemed Compliant FIs will still need to register for a GIIN (or be registered by another entity). Such a FI will not need to report but details of Financial Accounts maintained by that FI may be reported by another entity.

In the funds context, a Financial Account is any equity or debt interest in the Investment Entity other than interests which are regularly traded on established securities markets. A Specified US Person is generally defined as a US Person that is not otherwise:

- a corporation listed on an established stock exchange;
- a member of an expanded affiliated group (of the FI);
- a US federal or state agency;
- any tax exempt organisation under the IRS Code; or
- an entity registered with the SEC.

A US Person includes any US resident or citizen, any US partnership or corporation and any trust over which a US court has jurisdiction over the administration of the trust or one or more US Persons have the authority to control all substantial decisions of the trust.

The IGA provides that the term “controlling person” is to be interpreted in a manner consistent with the FATF Recommendations. The Guidance Notes provide that it includes a natural person on whose behalf a transaction is being conducted and those persons who exercise effective control whether directly or indirectly.

Annex I and the Guidance Notes set out detailed steps which a FI must take to identify US Reportable Accounts and distinguishes between Pre-existing Accounts (those in existence as at 30 June 2014) and New Accounts (those opened on or after 1 July 2014). However, the IGA implements part of IRS Notice 2014-33 by allowing the BVI to apply a limited six month relief which means that new entity accounts opened on or after 1 July 2014 but before 1 January 2015 may be treated as pre-existing accounts³. Although the draft Guidance Notes do not currently provide for this relief the accompanying announcement from Government states that the Notes will be updated to make such provision. In addition, the IGA provides limited relief for the period between 1 July 2014 and the IGA coming into force.

Reporting to the International Tax Authority

The IGA requires the ITA to provide information to the IRS by the end of nine months from the end of each calendar year. The first information will need to be supplied to the IRS by 30 September 2015. The Guidance Notes provide that Reporting FIs must report to the ITA no later than 31 May in each year. The information which must be provided about each US Reportable Account increases through 2014 to 2016. For 2014, the information on each Specified US Person holding a US Reportable Account or as a controlling person of an entity holding an account comprises name, address, US Taxpayer Identification Number (**TIN**) (where applicable or date of birth for pre-existing accounts), account number and account balance or value as at the period end.

Non-Participating FIs

Reporting FIs are not subject to withholding tax unless they are designated as Non-Participating FIs. The IRS may classify a BVI Reporting FI as a Non-Participating FI following the conclusion of the procedures set out in the IGA. The IRS may determine that a Reporting FI is in “significant non-compliance” with the FATCA obligations. It may then notify the ITA and require it to compel the Reporting FI to obtain and report the required information.

³ While the provision in the IGA provides relief in line with Notice 2014-33, there is no corresponding relief under the intergovernmental agreement between the BVI and the UK. New entity accounts opened on or after 1 July 2014 must comply with requirements of Annex I of such agreement.

Failure to do so within 18 months of first notification permits the IRS to deem the Reporting FI to be a Non-Participating FI and the BVI entity will be subject to withholding tax.

Review of fund documentation

To address the issues arising under FATCA, fund managers are well advised to review their documentation. Provisions which may be considered to include the following:

- a power for the fund to compulsorily redeem the interests of any investor which does not provide the required due diligence to determine whether or not it is a Specified US Person (a **Recalcitrant Investor**).
- specific authority to withhold from redemptions, dividends and other distributions due to a Recalcitrant Investor.
- ability to allocate any amounts withheld from the fund to a Recalcitrant Investor – without such a provision, other investors potentially suffer losses due to one Recalcitrant Investor.
- ability to move Recalcitrant Investors to separate share classes in which the withholding can be applied – ie the ability to convert shares/partnership interests from one class to another without the consent of the investor affected.
- exculpation of directors/general partner and the fund from liability arising from FATCA compliance.
- specific disclosures describing the effect and risks of FATCA compliance.

Subscription documents require special attention to include:

- an obligation on the investor to provide FATCA information and comply with due diligence requests which may require the provision of nationality, permanent residency information and tax residency representations.
- an acknowledgement that the fund will disclose FATCA information to the IRS, UK, third parties etc.
- a general waiver of any legal restrictions which might otherwise prevent disclosure of information by the fund.
- an acknowledgment of the effect of non-compliance and lack of disclosure by an investor and an acknowledgement that the fund may take any of the actions outlined above.
- an agreement that the investor shall not have any claim against the fund for any damages or liability arising as a result of actions taken by the fund or remedies pursued by the fund in order to comply with any existing IGAs or any future obligations imposed either under future IGAs or any enabling legislation enacted in the BVI Islands.

Summary of actions for BVI investment funds

1. *Entity Classification* – it is necessary to determine the status of each entity within the fund structure. Is it a FI? If so, is it a Reporting FI or Non-Reporting FI?

2. *IRS Registration* – all Reporting FIs and Registered Deemed Compliant FIs must register and obtain a GIIN in advance of 1 January 2015.⁴
3. *Implement a comprehensive FATCA compliance program and carry out due diligence on investors* – Reporting FIs should put in place a due diligence program to meet the requirements of Annex I of the IGA. The FI should note the deadlines for obtaining due diligence on pre-existing accounts.
4. *Review of Fund Documents* – see section above with respect to specific changes that may be contemplated.
5. *Report relevant FATCA information to the ITA* – Investment Entities will have to be ready to report information with respect to 2014 by no later than 31 May 2015.

Harneys Services

Harneys Services offers a number of services to assist clients with their FATCA obligations including assisting with registration to obtain GIINs, entity classification, classification of account holders and implementation of new investor on boarding and compliance programs.

⁴ A Reporting FI should have registered prior to 1 July 2014 if (1) it maintains one or more branches in jurisdictions that are not covered by a Model 1 IGA (2) it is renewing its QI, WP or WT Agreement or (3) it intends to be a Lead FI for one or more Member FIs that are not established in and operating exclusively in other Model 1 IGA jurisdictions.

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