FATCA Compliance:
What Every Investment Manager Should Know

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The Foreign Account Tax Compliance Act (FATCA) will impact many foreign financial institutions (FFIs), including fund management companies in Singapore. FATCA is a response to the perception that US individuals are not reporting all US income earned outside the US either due to the lax standards or intentional actions of certain foreign entities.

Why is FATCA important?

FATCA carries important implications for investment managers by:

- significantly increasing the types of payments that could be subject to US withholding tax, such as direct and indirect payments of gross proceeds and payments on certain swaps;
- expanding the number of entities that could have liability for US tax on these payments, such as offshore funds and offshore distribution channel intermediaries that hold, or through which others hold, direct or indirect interests in US investments;
- imposing US tax documentation requirements on direct and indirect US and non-US investors, including the need to capture new customer information; and
- forcing companies to modify internal systems, control frameworks, processes and procedures in order to be FATCA compliant, costing investment managers significant time and money.

Who will be affected by FATCA?

FATCA presents a number of substantial challenges to FFIs and the definition of an FFI is expansive. It includes any foreign entity that (1) accepts deposits in the ordinary course of a banking or similar business, (2) is engaged in the business of holding financial assets for the account of others, or (3) is engaged (or holds itself out as being engaged) primarily in the business of investing, reinvesting, or trading securities, interests in partnerships, or commodities or any interest (including a futures or forward contract or option) in such securities, partnership interests, or commodities. Accordingly, the term may include a number of different entities that ordinarily would not be considered financial institutions - including hedge funds, private equity funds, and certain insurance products.

How will FATCA work?

FATCA will impose a 30 percent US withholding tax on certain US-sourced income, and the gross proceeds from the sale or other disposition of investments that can produce US sourced interest or dividends, received by any offshore fund or other FFI. This withholding tax is avoided if the FFI enters into an agreement with the US Government ("FFI Agreement") and agrees to comply with new documentation requirements, due diligence procedures, and reporting obligations.

When will FATCA become effective?

FATCA was enacted on 18 March 2010. Its provisions will be effective for payments made on or after 1 January 2013.

What will be required under a FFI Agreement?

Under a FFI Agreement, FFIs will be obligated to perform the following tasks:

- obtain information on each investor ("account holder") that holds the FFI's equity or debt ("accounts") necessary to determine which accounts are US accounts;
- perform required due diligence and verification procedures, including searching files for indicators of US status of the account holders;
- seek waivers from US account holders for any applicable bank secrecy, confidentiality, data privacy or other information disclosure restrictions;
- withhold a 30 percent tax on any 'passthru payment' to recalcitrant account holders (i.e., account holders that do not provide adequate information) or noncompliant FFIs; and
- report information on US accounts to the US tax authorities.

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When should companies begin preparing for FATCA?

FATCA compliance will present substantial business and operational challenges, from the identification and documentation of investors, to the fund's portfolio and IT systems, which may affect multiple functions (tax, legal, back-office administration, operations, IT, etc.) and take substantial time and resources to address. Investment managers who complete a timely assessment of the critical business, tax, and operational impacts to their funds and operational functions arising from FATCA increase their opportunity to address the issues through a complete, effective, timely, and cost-efficient FATCA implementation program. Thus, offshore funds with long or synthetic, direct or indirect, exposures to US capital markets should begin to prepare for FATCA as soon as possible.

What steps should companies be taking?

FATCA compliance generally should start with a comprehensive impact assessment, which identifies and assesses the following:

- impacted entities and funds;
- tax issues affecting relevant fund groups and management company affiliates;
- business issues affecting internal and outsourced business functions and key business relationships (e.g., adequacy of current subscription documentation, tax indemnity provisions and service agreement provisions); and
- data and operational gaps across people, process, and technology categories .

Steps should also be taken to prepare staff and stakeholders for the impact FATCA will have on daily operations. An effective FATCA preparation program should be designed to:

- educate internal stakeholders (e.g., internal council, compliance, IT and investment relations) about FATCA requirements;
- select, train and mobilize an global, multidisciplinary, intercompany FATCA response team;
- develop and execute an implementation roadmap; and
- estimate the amount of funding required for FATCA implementation and remediation.

Final Thoughts

FATCA is not only a tax issue. The principal impact is on technology, operations and the customer; it is a business issue. Substantial implementation costs are anticipated as increased due diligence, verification and reporting are required for a larger base of customers.

Investment managers should begin to identify and assess the operational, technological and business impacts now. Doing so will increase an investment manager's ability to address issues that arise and implement programs that will allow for full FATCA compliance by the effective date, 1 January 2013.

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