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FATCA's Challenges for Global Investment Funds

By Keith Lawson

The rules proposed to implement the [Foreign Account Tax Compliance Act](#) (FATCA) pose a number of serious challenges for ICI Global members. ICI Global's [recent comment letter](#) to the U.S. Department of the Treasury and the Internal Revenue Service (IRS) made several recommendations on how the FATCA rules should be amended so that ICI Global's members—regulated funds that are publicly offered to investors in leading jurisdictions worldwide—can overcome these challenges without compromising the tax compliance benefits contemplated by FATCA.

FATCA Background: The Statute and the Ways Global Investment Funds Can Comply with It

Congress [enacted FATCA](#) in 2010 in response to efforts by certain U.S. taxpayers to hide assets and income subject to U.S. tax. To enhance tax compliance by U.S. taxpayers, FATCA imposes significant new customer identification, reporting, and withholding obligations on both U.S. and foreign financial institutions. Any foreign financial institution that fails to become FATCA compliant will suffer 30 percent withholding tax on all payments from U.S. sources, including income receipts and sales proceeds.

If a global investment fund has individual investors directly on its share register, the fund can attain FATCA compliance by qualifying as one of the following:

- **Participating foreign financial institution (PFFI):** The fund can enter into an agreement with the IRS to become a PFFI. This is a difficult step for many firms, given the substantial compliance burdens that will arise from such agreements.
- **Restricted fund:** The fund can qualify as a restricted fund by meeting various requirements, including providing in its prospectus and distribution agreements that the fund may not be purchased by U.S. citizens or residents.

If a global investment fund's individual investors all hold the fund through nominees that distribute the fund's interests, it also can become FATCA compliant in a third way: by satisfying requirements to be treated as a qualified collective investment vehicle, or qualified CIV.

FATCA Challenges: Restricted Funds and Qualified CIVs

Funds seeking to become FATCA compliant without becoming PFFIs face several key challenges, given the way the proposed rules are written.

- **Distributors:** Before a fund can register as a restricted fund or a qualified CIV, the fund must know that each of its distributors is FATCA compliant. This will be a daunting proposition, given that a fund may have hundreds, or even thousands, of distributors and sub-distributors.
- **Investors:** Before a fund can register as a qualified CIV, the fund must know that each of its direct investors qualifies as an eligible institution. The problem is that those requirements, as written now, are unnecessarily restrictive. For example, a fund may not become a qualified CIV if its investors include certain retirement plans or exempt organizations. We believe this type of restriction could be relaxed with no sacrifice of tax compliance benefits.

Our comment letter offers ways to address these challenges. One important proposal is to give funds more time to comply with

FATCA. We've asked that FATCA's requirements apply no sooner than one full calendar year after the FATCA regulations are completed.

FATCA Challenges: Intergovernmental Agreements

Funds seeking to become FATCA compliant because they operate in a country that enters into a reciprocal information-sharing agreement with the United States (an "intergovernmental agreement") face additional key challenges.

First, the breadth and scope of these agreements are unknown. While the United States has announced negotiations with five European countries, no agreements are in effect. Second, no guidance has been provided for the requirements imposed on a fund with distributors in many countries, particularly if some of the countries do not have intergovernmental agreements with the United States. At present, these uncertainties make it nearly impossible for funds to decide on how to approach FATCA compliance.

ICI Global will continue to provide input to U.S. regulators to improve FATCA's application to global funds and their investors. For more on FATCA from the perspective of U.S. funds, see the [Viewpoints](#) post on ICI's recent [FATCA letter](#).

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