The interaction of US FATCA and UK CDOT poses unique challenges

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In brief

Asset managers have been closely monitoring the evolution of guidance on the application of US FATCA to funds resident in key jurisdictions. Several jurisdictions that are relevant to the asset management industry are also now subject to a UK equivalent regime (commonly referred to as UK CDOT) that is in place between the UK and the 10 Crown Dependencies (CDs) and Overseas Territories (OTs). The 10 jurisdictions in which UK CDOT applies are Anguilla, Bermuda, the British Virgin Islands, the Cayman Islands, Gibraltar, Guernsey, the Isle of Man, Jersey, Montserrat, and the Turks and Caicos Islands. Guidance issued by the UK, the Cayman Islands, and the CDs of Jersey, Guernsey, and the Isle of Man has highlighted some of the ways in which the two regimes will interact.

The introduction of UK CDOT has raised questions as to how this new regime would interplay with US FATCA. Her Majesty's Revenue and Customs (HMRC) has described in guidance notes that its intent was to maximize consistency between the US/UK intergovernmental agreement (IGA) and those negotiated between the CDs and OTs so as to minimize additional costs and burdens to businesses trying to comply with both regimes. However, HMRC noted that there were areas where it was not appropriate to exactly mirror the US model due to differences in context.

This Insight highlights three areas of such differences which are of particular relevance to asset managers:

1. differences in documentation requirements under the two regimes
2. the impact of the effective date provisions (including for new account onboarding)
3. a high-level summary of some of the differences between the two regimes that may require refinements to the compliance operating model(s) that asset managers have been developing.

In detail

Documentation requirements

UK CDOT requirements

Generally, financial institutions (FIs) subject to UK CDOT must establish whether their account holders and controlling persons are tax resident in CDOT countries for which reporting is required. However, the Internal Revenue Service (IRS) Forms W-8 (W-8) and the Form W-9 (W-9) used in the US require the account holder to declare not only their non-US status, but also their permanent residence address, as opposed to details of each country in which they are a tax resident. In contrast, the self-certification approach prescribed by the Model 1 IGAs does request such information. This means that where an FI requires an account holder or controlling

person to provide a W-8 or W-9, it may also need to require further self-certification with regard to their tax residence for UK CDOT purposes.

Observation: *The issue is the fact that an individual can be subject to taxation in multiple countries. For example, a US citizen living in the UK may provide a Cayman fund a W-9 for US FATCA purposes, but the same W-9 would not provide sufficient details of their UK or other non-US tax residence other than perhaps the address.*

In addition, the W-8 requests information with respect to US substantial owners (or controlling persons for IGA purposes) of passive non-financial foreign entities (NFFEs). For UK CDOT purposes, controlling persons who are residents of the relevant jurisdictions must be identified. The jurisdictions for which such identification and reporting is required will depend on whether the IGA for that CDOT country is unilateral or reciprocal.

For example, the agreement the UK has with the Caymans is unilateral in that the UK will not be providing information on Cayman residents as they have no taxation. Therefore, Cayman funds' responsibilities under the agreement is to identify UK tax residents only in relation to UK CDOT and do not have to also identify Cayman residents or residents of other CDOT countries. This information must be provided by a separate self-certification as the ability to provide this information does not exist on a W-8.

In addition, a US entity can be a passive non-financial entity (NFE) for UK CDOT purposes. Under US FATCA, such entities will complete a W-9 and will need to complete a separate self-certification to provide the information on controlling persons in the UK CDOT relevant jurisdiction.

US FATCA and Chapter 3 requirements

On the other hand, if an FI obtains a self-certification for UK CDOT purposes, must it also obtain a W-8 or W-9 in order to satisfy US FATCA requirements?

The US FATCA regulations generally require a withholding agent to obtain a valid withholding certificate (e.g., a W-8 or W-9) from an account holder or payee in order to treat the account holder or payee as having a particular FATCA status. Most notably, the US regulations provide that a valid withholding certificate is required under each of the following circumstances:

1. a US withholdable payment is being made to the payee
2. the payee claims a reduced rate of withholding under an income tax treaty
3. the payee of a US withholdable payment is an intermediary, flow-through entity, or US branch of such entity in which case it must provide a Form W-8IMY, as well as documentation to establish its beneficial owners' foreign status. [1]

In circumstances where an actual W-8 or W-9 may not be required, information such as the payee's FATCA status and a global intermediary identification number (GIIN) must be provided to the payor in order to avoid FATCA withholding.

Observation: *There are certain circumstances in which an actual W-8 may not be required. For example, in a typical master-feeder structure, the Cayman offshore feeder is typically a non-US corporation for US tax purposes. As such, it is not making any US withholdable payments because its payments are foreign source. In such a scenario, a Cayman self-certification from an account holder could be sufficient for both US FATCA and UK CDOT purposes and a W-8 would not be required.*

However, in the case of a Cayman partnership that is flowing through US source payments to its investors, the Cayman partnership would likely need to request both a W-8 or W-9 for US purposes and a self-certification for UK CDOT purposes.

IRS allows use of certain substitute forms

The IRS regulations permit the use of 'substitute forms,' as long as certain conditions are satisfied. Among these conditions are the requirement that certain specific parts of the form be included (including key representations and the terms and conditions around the signature block) and that instructions be provided. As a general rule, withholding agents and FIs subject to the US FATCA regulations may be able to rely on substitute forms as templates if they contain all provisions that are relevant to the transaction for which they are furnished and the forms are signed under penalties of perjury.

Observation: *Asset managers have considered the use of substitute forms that would satisfy both US FATCA and UK CDOT requirements. For example, the self-certification could be modified to include an addendum*

[1] There may be other instances where US withholding certificates are required, including the avoidance of backup withholding on redemptions, which are beyond the scope of this alert. Due to the complexities involved in avoiding backup withholding without a US withholding certificate, some assets managers opt to request them as a routine matter.

that requires signature under penalties of perjury so it is sufficient for US FATCA. Alternatively, a W-8 could be modified to include an addendum that requests information on tax residency and controlling owners so it is sufficient for UK CDOT. In many cases, however, the modifications required to the forms are so substantial as to be unadministrable. The diversity of jurisdictions, sophistication of investor, and complexity of ownership structures all affect the practicability of this alternative.

Effective dates

One issue that is highly relevant to Cayman funds in particular is the impact of the UK CDOT regime on the effective dates for US FATCA for Cayman funds. Under the FATCA regulations, new account onboarding procedures were required to be in place as of July 1, 2014. A similar provision applies for UK CDOT with the same effective date. Pursuant to IRS Notice 2014-33, FIs are permitted to treat entity accounts created prior to January 1, 2015 as pre-existing accounts; that is, new account onboarding procedures are not required to be in place for entities until the end of the calendar year.

UK CDOT, on the other hand, had a fixed start date of July 1, 2014. The UK did not adopt a similar rule for either the US/UK IGA or UK CDOT so that all accounts created after June 30, 2014 are treated as new accounts requiring the implementation of new account onboarding procedures. The Caymans followed suit with respect to UK CDOT; in the final guidance issued on July 22, 2014, a new entity account is defined as an account opened on or after July 1, 2014. Apparently the desire to have consistent effective dates and procedures under the two regimes outweighed the perceived benefits of the deferral. With respect to US FATCA, however, the Caymans allowed for elective deferral of new account procedures consistently with Notice 2014-33.

In response to the deferral in onboarding new entity accounts contained in Notice 2014-33, the UK pointed out that, if an FI is not able to obtain the requisite self-certification at the time the account was opened, it would still be compliant if it remediated the account at a later date. This position gives FIs some flexibility in documenting new accounts so long as the documentation relates back to the date of the opening of the account. Of course, the documentation, when obtained, must satisfy the new account onboarding procedures rather than the pre-existing account due diligence documentation standards. The Caymans have not indicated whether they will adopt a similar position.

Asset managers with entities in other UK CDOT jurisdictions should check the local rules to determine whether they have adopted a similar position. In the draft guidance notes provided by the CDs (Guernsey, Isle of Man, and Jersey), the new account date was moved to align with Notice 2014-33 so that entity accounts opened before January 1, 2015 will be treated as pre-existing accounts.

Observation: *Asset managers may not be aware that Cayman FIs cannot take advantage of the deferral provisions of Notice 2014-33. With respect to any account created after June 30, 2014, the documentation obtained with respect to the account must meet the new account onboarding standards. Assuming Cayman follows the UK position, there may be some flexibility as to when the new documentation is obtained, but it will have to conform to the new documentation standards as of the date on which the account is opened.*

Notable distinctions in US FATCA and UK CDOT

While there are a number of detailed changes in UK CDOT versus US FATCA, the following highlighted areas are relevant to asset managers generally:

1. There are some changes to the exemptions to foreign financial institution (FFI) status; in particular, non-profit organizations are not excluded from the definition of FI under UK CDOT. Therefore, a non-profit organization investing in a fund could be classified as an FI, active non-financial foreign entity, or passive NFFE depending on the particular activities carried on by that entity. If the entity is classified as a passive NFFE, the controlling persons are treated as 'limited capacity beneficial owners' with respect to their interest in the non-profit organization, such that there is no requirement to carry out further due diligence or report on the underlying beneficial owners of a non-profit organization.
2. Legal entities that are covered by UK CDOT, but exempt under US FATCA, and are not required to register to obtain a GIIN will have to obtain and provide a local tax identification or reference number. So, for example, a UK resident non-profit organization that would be treated as an FI under UK CDOT would be required to furnish its UK tax identification number to the fund as part of establishing its UK CDOT status.
3. US entities are foreign entities for the purposes of UK CDOT. Therefore, they are subject to the same due diligence requirements as any other entity. In the event they qualify as passive NFEs, it is necessary to look through to the

'controlling persons' to identify reportable account holders.

4. The definition of 'specified person' under UK CDOT differs from that under US FATCA. For example, there are a number of investment entities that are likely to be 'specified persons' under the UK CDOT IGAs and therefore reportable account holders.

5. The indicia of residency are modified to reflect the fact that the UK taxes on the basis of residency, not citizenship. There are other changes to the indicia and acceptable cure documentation which will require asset managers to modify their US FATCA procedures. So, for example, evidence of UK residence is treated as an indicator of UK status whereas UK citizenship is not.

6. There is no requirement to identify non-participating FFIs under UK CDOT as there is no withholding.

7. With respect to both 2014 and 2015, the first reporting period under UK CDOT is 2016, a year later than for US FATCA. For the Caymans, for example, the first reporting date for US FATCA is May 31, 2015 with respect to 2014, but for UK CDOT it is May 31 2016 with respect to both 2014 and 2015. It should be noted not all jurisdictions have the same reporting date.

The takeaway

Asset managers should engage in further analysis to determine the specific forms and statements they intend to request from investors. This challenge promises to expand as more jurisdictions implement their own separate FATCA regimes outside of the US, likely pursuant to the newly issued Common Reporting Standard. As part of this analysis, they should consult with their administrators and service providers to agree documentation procedures that are best suited to their situation.

While it would be preferable to have overlapping effective dates and compliance models, it is apparent that funds in UK CDOT countries will have to adapt their operating models to deal with these two different regimes. In addition, as the Caymans have not opted to take advantage of the deferral period provided in Notice 2014-33 with respect to UK CDOT, Cayman funds need to implement new account onboarding procedures for entity accounts immediately. With respect to any accounts opened since July 1, 2014 remediation should be undertaken as soon as is practicable.

Time is of the essence to create an action plan and take steps towards implementation. According to Notice 2014-33, calendar years 2014 and 2015 will be regarded as a transition period for purposes of IRS enforcement and administration of the due diligence, reporting, and withholding provisions under FATCA. However, with respect to this transition period, the IRS will take into account the extent to which an organization has made good faith efforts to be US FATCA compliant.

Let's talk

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