

# The impact of FATCA on the real estate industry: Are you ready?



September 2011

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The provisions of the Financial Account Tax Compliance Act (FATCA), as currently drafted, will impose a 30% U.S. withholding tax on any U.S.-sourced income and gross proceeds from the sale of investments that produce U.S. sourced interest or dividends (withholdable payments<sup>1</sup>) received by any offshore fund or other foreign financial institution (FFI). This withholding tax can be avoided if the FFI enters into an agreement with the U.S. Government and agrees to adopt the new documentation requirements, due diligence procedures, and reporting obligations under FATCA. These new requirements are focused on identifying U.S. tax residents that may be evading U.S. federal income tax by holding investments directly or indirectly through an FFI. According to a recent PwC poll, aimed at examining the asset management industry's readiness for FATCA, only one-third of fund managers have begun making preparations to be ready in time for the initially proposed deadline of January 2013 and a significant percent have not yet assessed the time needed to comply. Much to the relief of the industry, on July 14, 2011, the Internal Revenue Service (IRS) issued Notice 2011-53<sup>2</sup>, which provides a timeline for FFIs and U.S. withholding agents to implement the various provisions under FATCA. Specifically, the Notice phases in the implementation of FATCA in the following manner:

- The withholding on U.S. source fixed or determinable, annual or periodical (FDAP) income, e.g., interest and dividends, will generally begin on January 1, 2014; however, withholding on "passthru payments"<sup>3</sup> and gross proceeds from the disposition of securities that could produce U.S. source interest and dividends will be effective on January 1, 2015.
- In order to ensure that it will be identified as a participating FFI in sufficient time to allow withholding agents to refrain from withholding beginning on January 1, 2014, an FFI with certain U.S. assets must enter into an agreement with the IRS by June 30, 2013. FFIs that enter into agreements before July 1, 2013 will be participating FFIs effective on July 1, 2013.<sup>4</sup>
- For participating FFIs, the due diligence requirements for identifying new and pre-existing U.S. accounts will begin in 2013. Reporting requirements will begin in 2014 (based on calendar year 2013 balances) and will be significantly simplified for the first year.
- Notice 2011-53 indicates that Treasury and the IRS anticipate issuing proposed regulations by the end of 2011 and final regulations by the summer of 2012.

<sup>1</sup> The term "Withholdable Payment" includes but is not limited to gross proceeds from the sale of U.S. stocks and securities, payments on certain U.S. equity swaps, and U.S.-source dividends, interest, rents, and royalties.

<sup>2</sup> Notice 2011-53 supplements and modifies the guidance provided in Notice 2010-60 and Notice 2011-34.

<sup>3</sup> The term "Pass-thru Payment" means any Withholdable Payment or other payment to the extent attributable to a Withholdable Payment which is paid by an FFI to another FFI.

<sup>4</sup> Formerly, FFIs needed to enter into an agreement effective January 1, 2013, as withholding could have begun as early as that date.

While the Notice allows for an extension of the implementation of certain provisions, it does not serve as a metaphorical red light for all efforts FATCA related. FATCA, as currently proposed, will create a challenge for the real estate industry. RE fund managers may have to revisit their current approach to fund structures -- e.g. where the entities are located, marketing to investors, maintenance of investor information, interactions with investors, distribution strategies and the list goes on. The example structure chart on page four provides more specific detail of the impact FATCA, as currently proposed, will have to a fund structure on an entity by entity basis.

As demonstrated by the structure, the FATCA "net" is significantly wider than the current withholding regime under Chapter 3 of the Internal Revenue Code ("IRC"). Some very commonly used structures, historically used for foreign investors, may fall under FATCA, for example:

- Blocker corporations and REIT structures - current and liquidating distributions may qualify as withholdable payments under FATCA, as currently drafted. As a result, to avoid a 30% withholding tax on distributions, information on all investors in the blocker corporation/REIT will be required to be gathered and disclosed to ensure there are no recalcitrant investors, and the blocker corporation will be FATCA compliant.

To comply with FATCA, as currently drafted, RE fund managers will have to update their operating models at the most fundamental levels, from the identification and documentation of investors, through the product portfolio, to internal processes and IT systems. Each fund manager will need to also consider the question of where FATCA fits within its organization from a responsibility perspective, (e.g. which department tax/legal etc. is taking the lead).

Final regulations have not been issued; and current guidelines, while improving, still remain sufficiently vague. As such, the exact magnitude of the changes that will be needed are not yet fully understood. However, there are some steps RE

fund managers can take now to begin assessing how big of an impact FATCA will have on their organization.

In preparation for the final FATCA regulations, RE fund managers can currently assess three main areas of impact: operational impacts, impacts to investor relations and impacts to compliance.

### ***Operational Impacts***

RE fund managers can assess which processes and systems might be impacted and how, some examples include:

- Investor onboarding - Review current Anti-Money Laundering / Know Your Client procedures and highlight changes needed to incorporate new U.S. indicia rules<sup>5</sup> to create a new investor onboarding process
- Business Partners / Service Providers- Communication with both Business Partners / Service Providers to determine division of responsibilities; create and share a 'FATCA readiness plan'; consider whether service provider agreements may also need to be modified to require associates to be FATCA compliant as well
- Investment Reference Data – Collect additional attributes on investments needed to calculate Pass-thru Payment Percentages<sup>5</sup> if applicable
- Withholding/Reporting requirements - Understand FATCA implications to any current withholding and/or reporting under current regulations and determine which components of existing withholding processes can be leveraged and enhanced to support FATCA relevant reporting needs (e.g., account numbers, account holder info, etc.)<sup>6</sup>
- Fund structures - Take the opportunity to inventory the latest fund entity structures and fund specific information; understand and plan for requirements related to affiliated groups<sup>5</sup>

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<sup>5</sup> Please see full Notices and PwC publications for additional detail, as further discussion of this is out of the scope of this alert.

<sup>6</sup> Periodic FATCA specific reports may need to be created and circulated for management's consideration and compliance / controls monitoring.

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##### ***Impacts to Investor Relations***

RE fund managers should begin to consider the impact to current investor relations processes. For example:

###### *Update processes for New Client onboarding:*

- Create/update forms to accommodate U.S. indicia items for new clients on-boarding
- Maintain one lead copy of client reference data
- Communicate with investors about the implications of FATCA on their individual / entity status
- Embed FATCA considerations in the prospectus or investor communications

###### *Considerations for existing investors:*

- Run indicia tests on available data points and assign tentative classifications
- Develop plan and approach for reaching out to existing clients (investors / intermediaries) for seeking waivers and/or additional information
- Discuss business decisions to handle recalcitrant account holders based on affiliated fund groups

###### *Considerations for Institutional investors:*

- Plan to reach out to FFI or non-financial foreign entity ("NFFE") institutional investors to learn their plans of becoming FATCA certified, and subsequently getting their FFI-EIN, as applicable

##### ***Impacts to Compliance***

FATCA will have a significant impact to fund level compliance requirements. It is vital that real estate fund managers begin contemplating the potential impact to compliance processes for each fund and affiliated group as early as possible. Some considerations include:

###### *Fundamental considerations:*

- Determine the Chief Compliance Officer<sup>7</sup> or Equivalent roles and responsibilities

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<sup>7</sup> Please see full Notices and PwC publications for additional detail, as further discussion of this is out of the scope of this alert.

- Review and update policies and procedures
- Determine management reports that will help monitor compliance checks and attestation

###### *More complex considerations:*

- Plan on establishing controls and processes around recalcitrant investors (new or existing, individual or institutional)
- Determine the impact of recalcitrant account holders on an affiliated fund group
- Plan on establishing controls and governance structure to monitor and resolve FATCA issues

As currently proposed, FATCA will impact many aspects of the real estate fund management business that we know today. And although final regulations have not been issued, it is not too early to start planning for FATCA to determine where information and operational gaps may exist within your organization. (See timeline of expected implementation dates on page four.) Now is the time to begin an internal analysis to make sure when the final regulations are issued, you are ready.

***For additional information concerning this issue, please contact:***

***David Voss***

646-471-7462

david.m.voss@us.pwc.com

***Fatemah Alzindani***

646-471-4525

fatemah.alzindani@us.pwc.com

***For additional PwC News Alerts on FATCA, please visit:***

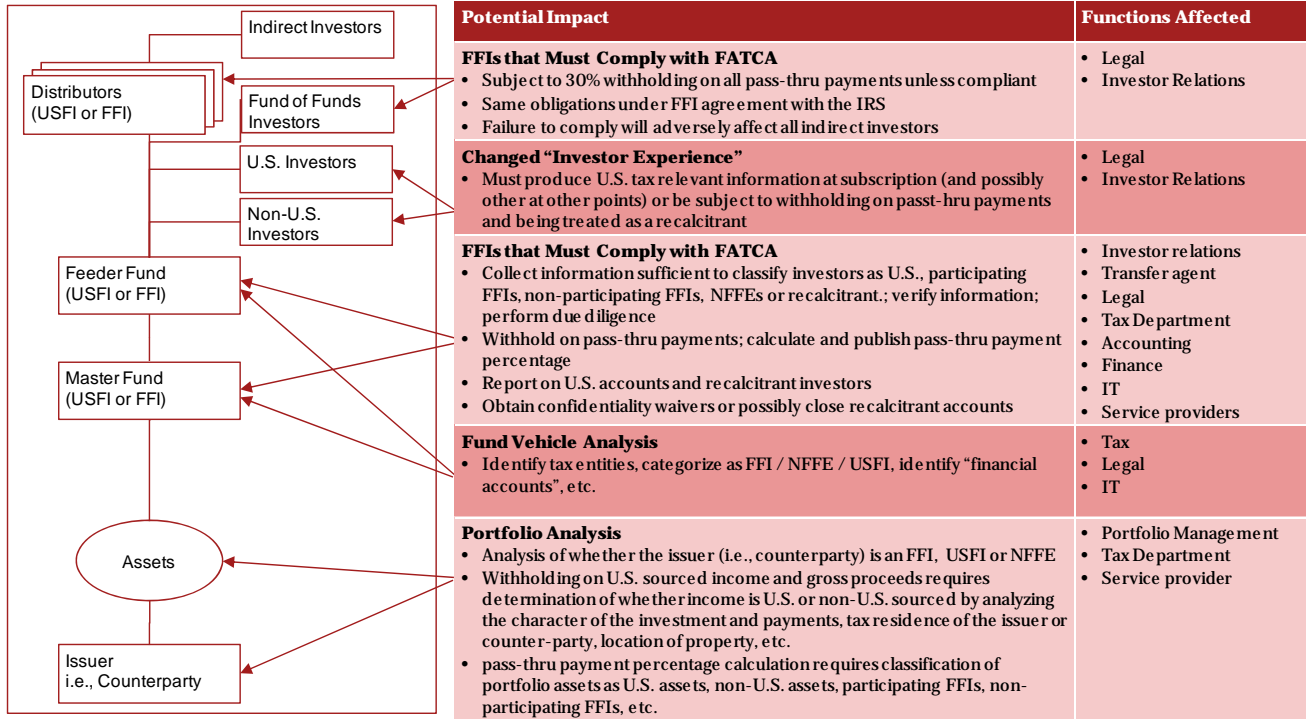
***<http://www.pwc.com/us/en/asset-management/investment-management/publications/fatca-publications.jhtml>***

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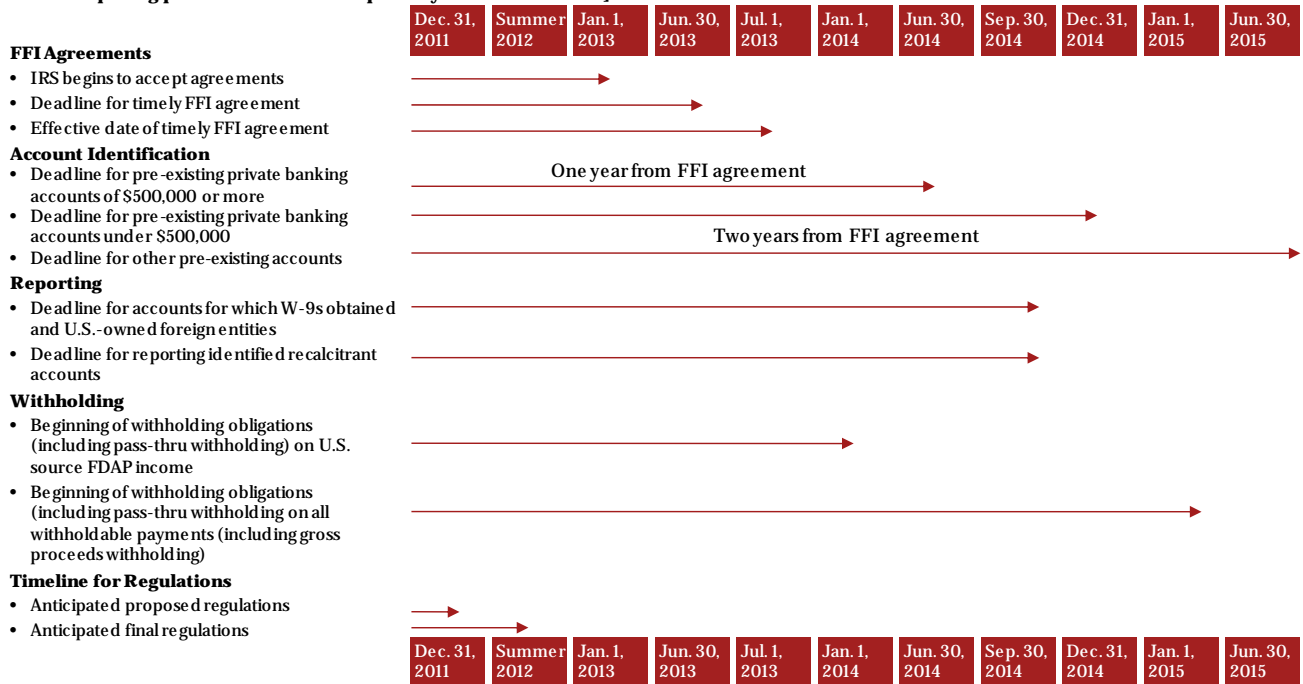
### Overview - FATCA Impacts on Real Estate Funds

U.S. or offshore funds



### Notice 2011-53 - FATCA Implementation Timeline

[Note: See full Notice for important details. All accounts opened after effective date of Participating FFI agreement are new accounts and account opening procedures must be in place by the effective date.]



## **5.** *PwC*

### ***The impact of FATCA on the real estate industry: Are you ready?***

*For more information, please contact your local PwC real estate tax service provider or one of the contacts below.*

#### **Nationally**

##### ***Gary Cutson***

U.S. RE Tax Technical Issues Leader  
New York  
646-471-8805  
gary.cutson@us.pwc.com

##### ***Paul Ryan***

U.S. RE Tax Leader  
New York  
646-471-8419  
paul.ryan@us.pwc.com

#### **Regionally**

##### **Atlanta**

###### ***Dennis Goginsky***

678-419-8528  
dennis.goginsky@us.pwc.com

##### **Boston**

###### ***Timothy Egan***

617-530-7120  
timothy.s.egan@us.pwc.com

###### ***Laura Hewitt***

617-530-5331  
laura.a.hewitt@us.pwc.com

##### **Chicago**

###### ***Jill Loftus***

312-298-3294  
jill.h.loftus@us.pwc.com

###### ***Alan Naragon***

312-298-3228  
alan.naragon@us.pwc.com

##### **Dallas**

###### ***Colin Stevenson***

214-756-1752  
colin.stevenson@us.pwc.com

##### **Los Angeles**

###### ***Adam Handler***

213-356-6499  
adam.handler@us.pwc.com

###### ***Phil Sutton***

213-830-8245  
philip.c.sutton@us.pwc.com

##### **New York**

###### ***Martin Doran***

646-471-8010  
martin.doran@us.pwc.com

###### ***James Guiry***

646-471-3620  
james.m.guiry@us.pwc.com

###### ***Christine Lattanzio***

646-471-8463  
christine.a.lattanzio@us.pwc.com

###### ***James Oswald***

646-471-4671  
james.a.oswald@us.pwc.com

###### ***Oliver Reichel\****

971 (2) 694 6946  
oliver.reichel@us.pwc.com

##### **Steve Tyler**

646-471-7904  
steve.tyler@us.pwc.com

##### **David Voss**

646-471-7462  
david.m.voss@us.pwc.com

##### **San Francisco**

###### ***Neil Rosenberg***

415-498-6222  
neil.rosenberg@us.pwc.com

##### **Washington DC**

###### ***Kelly Nobis***

703-918-3104  
kelly.s.nobis@us.pwc.com

###### ***Tim Trifilo***

703-918-3338  
timothy.j.trifilo@us.pwc.com

\* Currently resident in Abu Dhabi