



FATCA: Why all Cayman Islands domiciled Investment Entities should act before the registration deadline of 31 December 2014

Registration with the IRS

The broad scope of the Foreign Account Tax Compliance Act (“**US FATCA**”¹) introduced by the United States (“**US**”) and the implementation of that broad scope of application into Cayman Islands law means that it is very important for Cayman Islands domiciled entities to each undertake an assessment of whether or not it is a Financial Institution² under Cayman Islands law for the purposes of US FATCA. The vast majority of existing hedge funds, real estate funds, private equity funds, and venture capital funds, investment managers and investment advisors domiciled in the Cayman Islands are impacted by US FATCA.

Under Cayman Islands law, all Cayman Islands Reporting Financial Institutions are required to apply for registration with the US Internal Revenue Service (“**IRS**”) to obtain a Global Intermediary Identification Number (**GIIN**) before 31 December 2014 in order to avoid 30% withholding tax being imposed on US source income and to avoid possible fines and penalties under Cayman Islands law. **This registration requirement applies even for those investment entities which have no US based investors and receive no US source income.**

Additionally, there are ongoing due diligence and annual reporting obligations which have been introduced by Cayman Islands law for the purposes of US FATCA which impact directly on Cayman Islands Financial Institutions, including investment entities.

¹ The Cayman Islands Government has also entered into an intergovernmental agreement with the United Kingdom (“**UK**”) and introduced domestic implementing legislation to implement the UK’s own version of US FATCA (UK FATCA). Investment Entities should also assess the extent to which UK FATCA applies to them. Unlike US FATCA, UK FATCA does not require Foreign Financial Institutions to register with the UK Tax Authorities.

² Definition of “Financial Institution” under Cayman Islands law is set out below.



What is US FATCA?

Background³

US FATCA was introduced by the US in 2010 as part of the Hiring Incentives to Restore Employment (HIRE) Act with the purpose of reducing tax evasion by US citizens. US FATCA requires financial institutions outside the US (“**Foreign Financial Institutions**” or “**FFIs**”) to report information on Financial Accounts⁴ held by their US customers to the IRS. These requirements are contained in the relevant US Treasury Regulations (“**US Regulations**”). The information to be reported by Foreign Financial Institutions is equivalent to that required to be reported by US citizens in their US tax returns.

If Foreign Financial Institutions do not comply with the US Regulations, a 30% withholding tax is imposed on US source income of that Foreign Financial Institution. FFIs are also required to close accounts where their US customers do not provide information to be collected by the FFIs.

US FATCA: Why is it relevant to Cayman Islands Investment Entities?

The US recognised that in some jurisdictions there are legal barriers to implementing US FATCA as well as some practical difficulties for FFIs in complying with US FATCA. Two model intergovernmental agreements (Model I IGA and Model II IGA) were developed to overcome the legal issues and to reduce some of the burden on the Foreign Financial Institutions.

On 29 November 2013, the Cayman Islands and the US signed an intergovernmental agreement (“**US IGA**”) to, among other things, implement US FATCA based on the Model I IGA. To accommodate

³ See section 1.1 of the Guidance Notes on The International Tax Compliance Requirements of the Intergovernmental Agreements between the Cayman Islands and the United States of America and the United Kingdom.

⁴ For the purposes of the US IGA, a Financial Account is an account that is maintained by a Financial Institution. The Guidance Notes referred to below states that ‘maintained’ in respect of an Investment Entity includes: any Equity or Debt Interest in a Financial Institution, where that Equity or Debt Interest constitutes a Financial Account, is treated as being maintained by that Financial Institution where that Financial Institution is an Investment Entity.



the non-direct tax system in the Cayman Islands, the US IGA is a model 1B (non-reciprocal) IGA. As an IGA partner jurisdiction, Cayman Islands based Financial Institutions will not be subject to a 30% withholding tax on US source income, unless they fail to meet the requirements set out in the US IGA and in Cayman domestic implementing legislation. Under the terms of the US IGA, Cayman Islands Financial Institutions are required to provide the Cayman Islands Tax Information Authority (“**Competent Authority**”) with information in relation to Financial Accounts held by Specified Persons⁵ on an annual basis. The Competent Authority will then forward that information to the IRS.

The Tax Information Authority Law (2013 Revision) as amended and the Tax Information Authority (International Tax Compliance) (United States of America) Regulations, 2014 (the “**Cayman Regulations**”) are now in force in the Cayman Islands and together they constitute Cayman’s domestic legislation for implementing US FATCA requirements set out in the US IGA into Cayman Islands law. In July 2014, the Cayman Islands government also released guidance notes concerning the compliance requirements of the US IGA (the “**Guidance Notes**”). The Guidance Notes are intended to provide practical assistance to businesses, their advisers and the Competent Authority in interpreting the US IGA.

[Scope of the US IGAs application in the Cayman Islands](#)

The US IGA and the Cayman Regulations are extremely broad in scope and apply to all Cayman Islands Financial Institutions, regardless of whether they hold any Financial Accounts for Specified Persons. A Cayman Islands Financial Institution is any Financial Institution organised under the laws of or resident in the Cayman Islands.

For these purposes, organised under the laws of the Cayman Islands means the following:

⁵ A “**Specified Person**” is generally defined as a US Person that is not otherwise; (a) a corporation listed on an established stock exchange; (b) a member of an expanded affiliated group (of the Financial Institution); (c) a US federal or state agency; (d) any tax exempt organization (entity or other arrangement) under the IRS tax Code; and (e) an entity registered with the Securities and Exchange Commission. A “**US Person**” is defined as including: (a) A US citizen or resident individual; (b) A US partnership or corporation; (c) A trust if: (x) a US court has jurisdiction over the administration of the trust, and (y) one or more US Persons have the authority to control all substantial decisions of the trust.



- (a) For a company, if the company is incorporated in the Cayman Islands.
- (b) For trusts, if any of the trustees are incorporated, registered or licensed in the Cayman Islands.
- (c) For partnerships, if the partnership is established in the Cayman Islands.

The Cayman Regulations states that “*Financial Institution*” means a person who carries on business in the Cayman Islands as:

- i. a **custodial institution**;
- ii. a **depository institution**;
- iii. an **Investment Entity**; or
- iv. a **specified insurance company**.

For the purposes of this Briefing Note we are focusing exclusively on the definition of Investment Entity which is defined in the US Regulations as including:

“any entity that conducts as a business (or is managed by an entity that conducts as a business) one or more of the following activities of operations for or on behalf of a customer:

- (a) trading in money market instruments (cheques, bills, certificates of deposit, derivatives etc.); foreign exchange; exchange, interest rate and index instruments; transferable securities; or commodity futures trading;**
- (b) individual and collective portfolio management; or**
- (c) otherwise investing, administering or managing funds or money on behalf of other persons.”**

In practice, when applying this definition, an entity that is professionally managed will generally be



an Investment Entity, by virtue of the managing entity being an Investment Entity.⁶

All Cayman Islands Financial Institutions will be “*Reporting Financial Institutions*” unless an exemption is provided in Annex II of the US IGA and applies to classify the Financial Institution as a “Non-Reporting Financial Institution”. This Briefing Note focuses principally on whether an investment entity is a Reporting Financial Institution. However a brief overview of investment entities that qualify as Non-Reporting Financial Institutions is set out below.

If an Investment Entity is a Reporting Financial Institution, what action is it required to take?

All Cayman Islands Financial Institutions that maintain Financial Accounts are required to take action. The extent of that action depends on a number of factors including whether account holders are Specified Persons and the value and nature of the Financial Account.

1. Registration

A Reporting Financial Institution is required to register with the IRS (through the IRS online registration portal) on or before 31 December 2014. Successful registration will lead to the Reporting Financial Institution being issued a GIIN by the IRS. US withholding agents (e.g. US banks) will be required to verify the GIIN (against lists that are published by the IRS) on payments made from 1 January 2015 onwards where the payment from withholding agents will be to a Reporting Financial Institution in the Cayman Islands. Prior to 1 January 2015 US withholding agents are not required to verify GIINs but many US withholding agents have commenced doing so.

2. Due Diligence

In respect of all Financial Accounts maintained by a Reporting Financial Institution, that Reporting Financial Institution is required to:

⁶ See section 2.9.1 of the Guidance Notes.



- i. establish and maintain arrangements that are designed to identify Reportable Accounts⁷;
- ii. establish and maintain arrangements that are designed to establish the jurisdictions of residence and, where applicable, the US citizenship of an account holder;
- iii. establish and maintain arrangements that are designed to identify payments made by the Reporting Financial Institution to a Non-Participating Financial Institution⁸ in 2015 and 2016;
- iv. implement arrangements to obtain the US federal taxpayer identifying number and date of birth (as applicable) of every Specified Person who holds a Reportable Account;

3. Reporting

The Reporting Financial Institution will be required to report annually to the Competent Authority regarding every Reportable Account that it maintains at any time during the calendar year in question (if it maintains no Reportable Accounts during the calendar year in question, the report should state that fact).

Non-Reporting Financial Institution

As stated above, all Cayman Islands Financial Institutions will be Reporting Financial Institutions which are required to report to the Competent Authority on an annual basis unless an exemption is provided in Annex II of the US IGA or the US Regulations or one which otherwise qualifies as:

- i. **a Deemed Compliant Financial Institution** – Examples in this category include:

⁷ A Financial Account is a US Reportable Account where it is held by one or more Specified Persons or by a non-US Entity with one or more Controlling Persons that are Specified Persons.

⁸ A Non-Participating Financial Institution is a Financial Institution that is not compliant with US Regulations by virtue of either: (x) the Financial Institution is located in a jurisdiction that does not have an Intergovernmental Agreement with the US and the Financial Institution has not entered into an agreement with the IRS, or, (y) the Financial Institution is classified by the IRS as being a NPFIs following the conclusion of the procedures for significant non-compliance being undertaken as set out in Article 5(2)(b) of the US IGA. Payments made by a Cayman Islands Financial Institution to a NPFIs, whether resident in the Cayman Islands or otherwise, must be reported by the Cayman Islands Financial Institution.



- a. Financial Institution with a client base almost entirely within the Cayman Islands, subject to certain conditions;
 - b. Financial Institution with only low-value accounts (no financial accounts with a balance in excess of US\$50,000) and no more than US\$50m in assets provided it is not an Investment Entity;
 - c. Sponsored Investment Entity, where a sponsor of the Investment Entity is registered with the IRS, and where required, the sponsor has registered the sponsored entity with the IRS and the sponsor performs all due diligence and reporting obligations of the sponsored entity;
 - d. Investment advisors and investment managers⁹ which are Investment Entities solely because they render investment advice to, and act on behalf of, or 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 Financial Institution; and
 - e. Collective investment vehicle, subject to certain conditions.
- ii. **an Owner Documented Financial Institution¹⁰**; or
 - iii. **an Exempt Beneficial Owner** (e.g. the Cayman Islands Government, and certain participation retirement funds and pension funds).

⁹ This category may include entities that undertake obligations for investment management and advisory services, but typically delegate those services onto third party service providers, e.g. a general partner of a limited partnership.

¹⁰ This category is intended to reduce the burden of meeting the obligations under the US IGA for closely held passive investment vehicles that fall within the definition of Investment Entity. It is not however restricted to those cases. In order to qualify under this category the Investment Entity must satisfy the following: (A) It must not maintain a Financial Account for any Non-Participating Financial Institution; (B) It must not be owned by, nor be a member of, a group of Related Entities with any member that is a Depository Institution, Custodial Institution or Specified Insurance Company (i.e. it can only be affiliated to other Investment Entities); and (C) It must provide the required documentation regarding its owners and agree to notify any changes in its circumstances to the Financial Institution that is undertaking the reporting obligations on its behalf.



Some Non-Reporting Cayman Islands Financial Institutions (referred to as “Certified Deemed Compliant Financial Institutions”) will not need to register and obtain a GIIN, or carry out the due diligence and reporting requirements under the US IGA. Instead they will need to provide certain documentation to withholding agents to certify their status. Other Non-Reporting Cayman Islands Financial Institutions (referred to as “Registered Deemed Compliant Financial Institutions”) are required to register with the IRS to obtain a GIIN, or be registered by another entity.

Careful consideration should be taken and guidance should be sought when undertaking an assessment of whether or not a Cayman Islands Financial Institution qualifies as a Non-Reporting Financial Institution. There are a myriad of rules and factors that must be taken into account in making the determination.



The information in this FATCA Update has been prepared to provide a general overview of US FATCA as it applies to Investment Entities under Cayman Islands law. Parties seeking specific legal advice regarding their status as a Reporting Cayman Islands Financial Institutions and the requirement to register with the IRS before 31 December 2014 should contact their usual Loeb Smith & Brady contact, or:

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