

FATCA: Impact on BVI Entities

Preface

This publication provides a brief overview of the expected impact on entities incorporated in the British Virgin Islands (the “**BVI**”) of the foreign account tax compliance provisions (“**FATCA**”) of the *Hiring Incentives to Restore Employment Act, 2010* of the United States of America (the “**US**”).

This publication is not intended to be a substitute for legal advice or a legal opinion. It deals in broad terms only and is intended to merely provide a brief overview and give general information. Conyers Dill & Pearman is only able to advise as to the BVI law aspects of the US IGA (as defined herein), and its BVI enabling legislation. Advice should be sought from US counsel as to the interpretation of FATCA under US law.

Conyers Dill & Pearman

TABLE OF CONTENTS

1.	BACKGROUND	4
2.	WHAT DOES FATCA MEAN FOR YOUR BVI ENTITY?	4
3.	WHEN WILL A BVI ENTITY BE CLASSIFIED AS A FOREIGN FINANCIAL INSTITUTION?	5
4.	BVI ENTITIES THAT ARE NOT FFIS	7
5.	WHAT DOES A BVI FFI NEED TO DO TO COMPLY WITH FATCA?	7
6.	SIMPLIFIED REPORTING FOR GROUPS OF FFIS	9
7.	CONCLUSION	9

1. BACKGROUND

FATCA is a US federal law that aims to reduce tax evasion by US persons. FATCA has significant extra-territorial implications and, most notably, requires foreign financial institutions ("**FFIs**", discussed further below) to report information on accounts of US taxpayers to the US Internal Revenue Service ("**IRS**"). If an FFI fails to enter into the necessary reporting arrangements with the IRS, a 30% withholding tax is imposed on US source income and other US related payments of the FFI.

In order to facilitate reporting under, and reduce the burden of compliance with FATCA, the BVI has signed a Model 1B intergovernmental agreement with the US (the "**US IGA**"). The US IGA allows BVI entities that are FFIs to comply with the reporting obligations imposed by FATCA without having to enter into an agreement with the IRS. Instead, a BVI FFI may report directly to the International Tax Authority of the British Virgin Islands (the "**BVI Reporting Authority**") and, provided it complies with the relevant procedures and reporting obligations, will be treated as a deemed compliant FFI that is not subject to automatic withholding on US source income and other US related payments.

In addition, the BVI has implemented the OECD's Common Reporting Standard ("**CRS**"). The CRS, which is based on FATCA and requires the automatic exchange of information on assets and income of citizens or tax residents of all signatory countries, came into force in over 100 countries in 2017. Please see our publication "The BVI and the Common Reporting Standard issued by the OECD", which may be found on our website, for further details of the CRS and its application to the BVI.

2. WHAT DOES FATCA MEAN FOR YOUR BVI ENTITY?

The impact FATCA will have on a BVI entity fundamentally depends on one key question: is the BVI entity an FFI?

While FATCA has significant implications for BVI entities that are FFIs - such as banks, custodians, hedge funds, private equity funds, trust companies, trusts and other regulated entities - a typical BVI holding company or joint venture vehicle will not generally be an FFI and should not be materially affected by FATCA.

Accordingly, the first step a BVI entity needs to take is to determine its FATCA classification and in particular whether or not it is an FFI. A broad summary of how to determine whether your BVI entity is an FFI, and a description of the steps that must be taken if the BVI entity is an FFI, are addressed in sections 3 and 5 below.

Any BVI entity that is not an FFI – such as a typical BVI holding company - will be a non-financial foreign entity (a "**NFFE**") for the purposes of FATCA. BVI NFFEs are not generally subject to registration or reporting requirements under FATCA, but they will be required to self-certify their status to financial institutions and other withholding agents with whom they maintain accounts to avoid FATCA withholding. This is discussed further in section 4 below.

3. WHEN WILL A BVI ENTITY BE CLASSIFIED AS A FOREIGN FINANCIAL INSTITUTION?

FATCA is very complex and a detailed analysis is required in each case to determine if a BVI company is in fact a financial institution. However, generally, the following four categories of BVI entities will be FFIs and be directly affected by FATCA's registration and reporting requirements:

- **Investment Entities:** Broadly, an entity that conducts (or is managed by an entity that conducts) trading or portfolio and investment management activities as a business on behalf of a customer or otherwise invests, administers or manages funds or money on behalf of other persons.
- **Custodial Institutions:** An entity that holds, as a substantial portion of its business (broadly, more than 20% of gross revenues), financial assets for the account of others.
- **Depository Institutions:** An entity that accepts deposits in the ordinary course of a banking or similar business and regularly engages in one or more of the following activities (a) provision of credit; (b) trading in receivables, notes or similar instruments; (c) issues letters of credit; (d) provides trust or fiduciary services; (e) finances foreign exchange transactions; or (f) deals in finance leases or leased assets.
- **Specified Insurance Companies:** An insurance company (or its holding company) that issues, or is liable under, certain cash value or annuity contracts.

Set out below are categories of BVI entities that Conyers Legal and Conyers Client Services frequently deal with alongside some basic guidance on whether such BVI entities will be FFIs. In cases where such entities may be FFIs, we also consider whether any exemption to registration and reporting may be available.

3.1. Hedge funds and private equity funds

Almost all hedge funds and private equity funds will be Investment Entities and therefore qualify as FFIs under FATCA. The one exception is that funds where more than 50% of the gross revenues are from real estate (or other non-financial assets) will generally fall outside the definition of Investment Entity (and therefore FFI) for the purposes of FATCA.¹ There are some other limited exemptions available to hedge funds and private equity funds, but these are expected to be of limited practical utility for the vast majority of such funds.

It is important to note that, where a master-feeder structure is used, both the master fund and the feeder fund will be FFIs. Furthermore, a subsidiary BVI trading entity of a hedge fund is also likely to be an Investment Entity and therefore an FFI.² In section 6 below, we discuss the possibility of using a "Sponsoring Entity" to facilitate FATCA compliance for structures with multiple FFIs.

3.2. BVI managers and advisers of hedge funds and private equity funds

¹ In the private equity context, this "gross revenues" test may also exempt BVI portfolio companies from being Investment Entities.

² The position is more complex for BVI subsidiaries of private equity funds and advice should be sought.

BVI entities that act solely as managers and advisers of hedge funds and private equity funds will typically not need to register and report as FFIs.

Although BVI managers and advisers fall within the definition of Investment Entity (and therefore FFI), the US IGA contains an exemption for a BVI FFI that qualifies as an Investment Entity solely because it (a) renders investment advice to, and acts on behalf of, or (b) 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 participating FFI. Accordingly, BVI managers and advisers will generally not be required to register with the IRS and report on their own account.

3.3. BVI holding companies and joint ventures

As noted above, a typical BVI holding company or joint venture vehicle that owns assets on its own account and does not operate as an investment fund would not generally be expected to be an FFI for the purposes of FATCA. Rather, this type of BVI holding company will generally be an NFFE (discussed in section 4 below).

However, the directors of a BVI holding company that has or wishes to open a bank or securities account will still need to consider its FATCA classification carefully. Such a BVI holding company will likely be required to certify its status to the relevant financial institution to avoid withholding, as discussed in section 4 below.

3.4. BVI securitization vehicles

A typical BVI securitization vehicle will normally be an Investment Entity and therefore an FFI for the purposes of FATCA, subject to limited transitional relief for pre-existing vehicles.

3.5. Financing SPVs

BVI entities that are established solely for the purpose of borrowing or granting security in relation to the provision of debt finance to an underlying business typically will not be FFIs. Similarly, BVI entities which are established to own and finance aircraft, ships or other form of moveable asset of a similar nature would not typically fall within the definition of an FFI.

3.6. Trusts with a BVI trustee

The treatment of trusts under FATCA is complex. BVI FATCA rules only apply to a trust if a trustee is a BVI entity or is an individual resident in the BVI. Subject to some complex optionality for trustees, the majority of trusts that have a BVI trust company acting as trustee will likely be FFIs for FATCA purposes.

Private trust companies (“**PTCs**”) are also likely to be FFIs for the purposes of FATCA, although this needs to be considered in each case. In particular, if the PTC and its directors are not remunerated for acting as trustee, the PTC and the underlying trust may conclude that it does not meet the definition of an FFI on the basis that the PTC is not conducting business.

Clients with trusts that have a BVI trustee or a BVI PTC are advised to liaise with their advisers to determine the most appropriate course of action for their trust.

3.7. Insurance companies

Only insurance companies that issue or are required to make payments with respect to a cash value insurance contract or an annuity contract will be FFIs pursuant to FATCA. Captive insurers and insurance companies that do not write annuities or whole life insurance products will generally be NFFEs.

3.8. Branches and foreign subsidiaries

Branches of entities are treated separately for FATCA purposes. An overseas branch of a BVI FFI will not be covered by the BVI IGA and must consider the rules applicable in that branch's jurisdiction, whether under an IGA or the US regulations. A foreign subsidiary of a BVI FFI must also comply with the FATCA rules in its home jurisdiction.

4. BVI ENTITIES THAT ARE NOT FFIS

As noted above, any BVI entity that is not an FFI – such as a typical BVI holding company - will be an NFFE. Although NFFEs are not generally subject to registration or reporting requirements, they will still be required to self-certify their status to financial institutions with which they maintain financial accounts to avoid FATCA withholding.

In this regard, the US W8-BEN-E form has recently been amended to require entities to confirm their FATCA classification to US withholding agents and provide related information with respect thereto. BVI entities that hold accounts with financial institutions can certainly expect to complete these W8-BEN-E forms and provide other FATCA-related certifications.

There are two categories of NFFE:

- **Active NFFE:** The criteria which would qualify an NFFE as being an Active NFFE are numerous, and include where less than 50% of its gross income for the preceding calendar year is passive income (such as dividends, interest, royalties, annuities and rent) and less than 50% of the assets held during the preceding calendar year or other appropriate reporting period are assets that produce or are held for the production of passive income. For Active NFFEs, completion of the W8-BEN-E Form essentially only requires completing the information on the first page, ticking "Active NFFE" on question 5 and then certifying that the entity is an Active NFFE in question 39.
- **Passive NFFE:** Broadly, a Passive NFFE is an NFFE that is not an Active NFFE. For Passive NFFE's, the W8-BEN-E also requires the NFFE to certify whether or not it has any substantial US owners (broadly, a US person with a 10% or more interest). To the extent it has substantial US owners, the name address and US taxpayer identification number of each substantial US owner must be provided.

It is important each BVI NFFE establishes which category it falls into so it can provide the necessary certification to financial institutions with which it maintains accounts.

5. WHAT DOES A BVI FFI NEED TO DO TO COMPLY WITH FATCA?

If your BVI entity is an FFI for which an exemption is not available, you will need to take the following steps:

- (1) Obtain a Global Intermediary Identification Number (“**GIIN**”): Any BVI reporting FFI (or “registered deemed-compliant” FI required to be registered with the IRS) should liaise with its primary US FATCA advisers to register via the IRS portal (<https://sa2.www4.irs.gov/fatca-rup/>) and **obtain a GIIN as soon as possible**, to minimize any risk of incurring US withholding tax on payments it receives and, in the case of a BVI Reporting FFI, to qualify for the benefit of the US IGA as regards FATCA withholding.
- (2) **Identify Reportable Accounts:** FATCA and the US IGA impose an obligation on BVI Reporting FFIs to identify and report details of “reportable accounts” to the BVI Reporting Authority. “**Reportable accounts**” are financial accounts where the account holder is either a “**Specified US Person**” (broadly, any US person or person liable to pay US tax with some exceptions) or is a non-US entity the controlling persons of which include one or more Specified US persons. Financial accounts include any depositary or custodial accounts and also, in the case of certain Investment Entities, any debt or equity holdings in the FFI. In the case of BVI funds, the relevant account is the shares each investor holds in the fund.

Identifying Reportable Accounts involves two separate processes, one for existing accounts and one for new accounts:

- (a) **Existing accounts:** FFIs need to perform due diligence on “financial accounts” that they maintained as at 30 June 2014 (subject to certain de minimis thresholds for small accounts). Specifically, accounts that are reviewed must be searched for prescribed US indicia, including US place of birth and US address. If the account holder is a Specified US Person, details of their account must be reported (as described below). If the account holder is not a Specified US Person but there are US indicia in relation to its account, the BVI FFI must take steps to “cure” the US indicia. In particular, self-certification by the account holder and further documentation evidencing the person is not a Specified US Person is likely required. If the account holder does not respond or it is not otherwise possible to cure the US indicia, the account should be treated as reportable. The deadline for completing due diligence on existing accounts depends on a number of factors, including the balance of the account. Most critically, remediation of US indicia needed to be completed on all accounts over US\$1 million by **30 June 2015**.
- (b) **New account procedures and due diligence:** For new accounts opened with the FFI **after 1 July 2014**,³ it is necessary to carry out due diligence and obtain self-certification regarding whether the account holder is a Specified US Person. If US Indicia are found that suggest the person may be a US taxpayer, prescribed steps will need to be taken to confirm this. For accounts opened by another participating FFI, the FFI’s GIIN should be obtained and verified against the publicly available IRS FFI list. In general terms, all BVI FFIs should be revising their account opening forms and/or subscription agreements to ensure they comply with FATCA rules in relation to new accounts. For funds, it is also

³ Although it should be noted that IRS Notice 2014-33 generally allows FFIs to treat new accounts opened before 1 January 2015 as “pre-existing”, subject to certain modifications of the compliance rules for such accounts.

important to update offering and constitutional documents to ensure FATCA is appropriately addressed.

- (3) **Reporting:** On or before 31 May 2015, BVI FFIs had to make their first report to the BVI Reporting Authority in relation to accounts held by Specified US Persons or a non-US entity with one or more controlling persons that are Specified US Persons. The US IGA prescribes the information that needs to be reported. Most significantly, it requires the balance of value of the relevant account held by the Specified US Person to be reported. Expanded information was required for the subsequent reporting period ending 31 May 2016. Upon receipt of a report, the BVI Reporting Authority will pass the reported information to the IRS.

6. SIMPLIFIED REPORTING FOR GROUPS OF FFIS

If a group has one or more eligible Investment Entities, the group may elect to register one “Sponsoring Entity” for FATCA reporting purposes. The appointment of a Sponsoring Entity effectively allows all FATCA compliance and reporting to be delegated to one entity in the group. To appoint a Sponsoring Entity:

- (a) The Sponsoring Entity must be authorized to act on behalf of the sponsored Investment Entities and agree to carry out all due diligence and reporting obligations on behalf of the sponsored Investment Entities.
- (b) The Sponsoring Entity has to register and obtain a sponsoring GIIN.
- (c) If the sponsored Investment Entities hold reportable accounts, the Sponsoring Entity will ultimately be required to register each sponsored Investment Entity that it manages.

A Sponsoring Entity must report to the BVI Reporting Authority all reportable accounts of its sponsored BVI Investment Entities.

7. CONCLUSION

FATCA is a controversial piece of legislation, not least because it imposes a significant compliance burden on FFIs. However, with the entry into force of the CRS in 2017, the automatic exchange of information and increased transparency introduced by FATCA is becoming the global standard. Accordingly, the implementation of robust systems by BVI FFIs to comply with FATCA can be viewed as important preparation for a new global standard on information exchange.

For the majority of BVI companies which are not FFIs, it is very much a case of “business as usual”. Other than having to determine their FATCA classification and certify/evidence their status to financial institutions with which they hold accounts, FATCA should have a limited impact on day-to-day operations.

If you have any queries regarding FATCA, please get in touch with your regular contact at Conyers Dill & Pearman who can advise further, or if required, refer you to appropriate US advisors.

This publication should not be construed as legal advice and is not intended to be relied upon in relation to any specific matter. It deals in broad terms only and is intended merely to provide a brief overview and give general information.

© Conyers March 2019