Talking. Secondaries.

Demystifying the secondaries market

Part 6: US tax rules – ECI & FIRPTA

Getting the US tax right is key to many secondary transactions. It should be considered at an early stage – if not, the risk of unexpected US withholding taxes and filing obligations could derail your transaction.

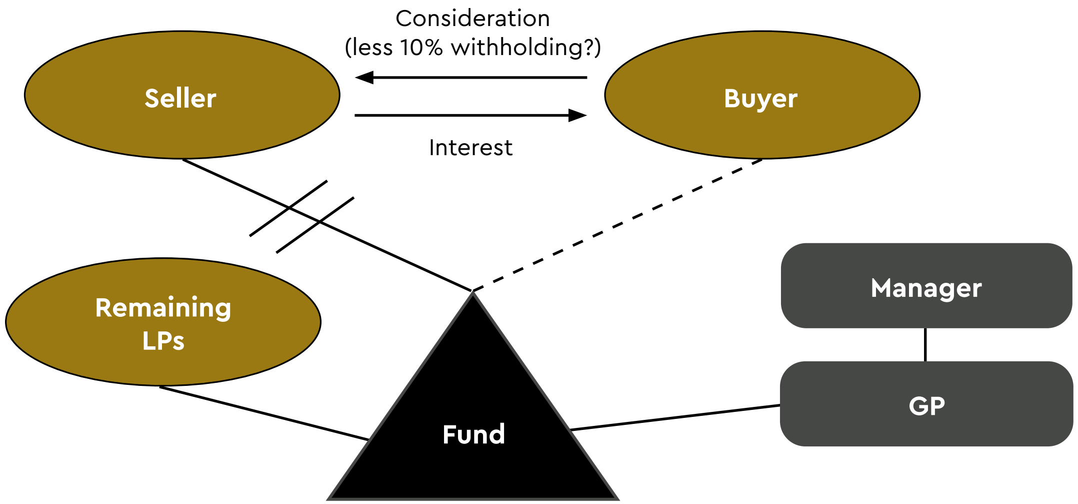
The US ECI rules can tax a non-US person selling a partnership interest, if the gain realised is "effectively connected to a US trade or business" ("ECI"). To enforce this, the buyer may operate ECI withholding tax on the purchase price, unless the seller demonstrates that no withholding is needed.

When do the rules apply?

- The US rules apply to all transfers of partnership interests (or interests in entities treated as partnerships for US tax purposes), regardless of the jurisdiction of the underlying partnership or entity.
- The rules do not require a US Buyer, a US Seller or any nexus to the US to apply.

Why does it matter?

- For the Seller, if a certificate is not provided, the Buyer will generally be required to withhold on 10% of the purchase price (although it can be more).
- For the Buyer, the GP can withhold on future distributions to the Buyer if it does not provide evidence of proper withholding/reason for not withholding.



This will clearly be a very important issue for both parties so should be addressed as soon as possible. Detailed provisions relating to ECI are usually contained in the SPA and relevant transfer documents.

What are the most common exceptions relied upon?

Exception	Certificate provided by	Evidence required
Fund is a corporation for US tax purposes	No certificate required	Form 8832
Seller's share of gross ECI from the fund is (i) less than $1m and (ii) less than 10% of the Seller's total share of the fund's gross income for the previous three years	Seller*	K1s issued by the fund to the Seller for each of the three years prior to the transfer
Seller is a US person	Seller*	Form W-9
If the fund sold all of its assets at market value either (i) the net gain that would be ECI is less than 10% of total net gain or (ii) Seller's share of net gain that would be ECI is less than 10% of Seller's total net gain.	GP*	No specified evidence but the GP likely to conduct DD, whether this will be provided will be a point of negotiation with the underlying GP

*Certificates are given under **penalties of perjury** so it will be key to make sure they are correct.

Timing

Certificates must be signed and dated within 30 days prior to the transfer.

There are other certificates that can be provided, for example if the transfer would not result in a gain for the Seller or if the Seller is not required to recognise any gain or loss on the transfer. These certificates are not common on a third-party transfer of partnership interests, but may be relevant, for example, for a pre-sale reorganisation on a GP-led secondary.

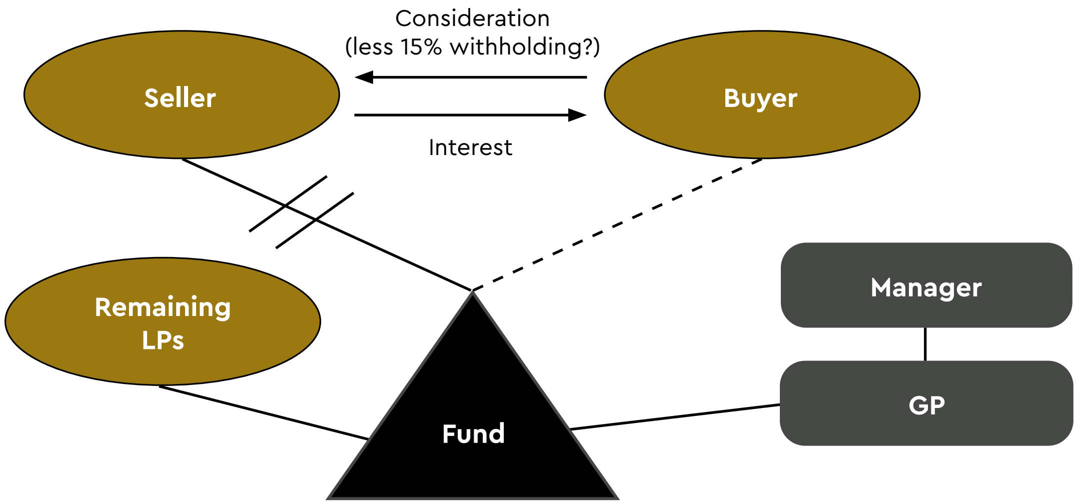
The US 'FIRPTA' rules seek to impose US tax on the gain realised by a non-US person on the sale of US real property interests.

When do the rules apply?

- The rules apply where (i) the Seller is a non-US person and (ii) the Buyer acquires a US real property interest (which could be a direct interest in US real property or an interest in a US real property rich entity).
- Again, the rules should be considered for all transfers of partnership interests.

Why does it matter?

- For the Seller, if the rules apply, the Buyer will generally be required to withhold on 15% of the purchase price.
- There is no provision equivalent to that under the ECI rules which requires the GP to withhold on future distributions to the Buyer in respect of FIRPTA.



As with ECI, this will clearly be a very important issue for both parties so should be addressed as soon as possible. Detailed provisions relating to FIRPTA are usually contained in the SPA and relevant transfer documents.

What are the most common exceptions relied upon?

Exception	Certificate provided by	Evidence required
Seller is a 'qualified foreign pension fund' ("**QFPF**"), or the wholly owned subsidiary of a QFPF (we would generally expect most UK pension funds to fall within this definition but they will want to have advice on the point)	Seller*	Signed QFPF certificate
Seller is a US person	Seller*	Form W-9
Either (i) less than 50% of the gross assets of the Fund consist of US real property interests OR (ii) less than 90% of the gross assets of the Fund consist of US real property interests plus cash or cash equivalents.	GP*	No specified evidence but the GP likely to conduct DD
Warranty from the Seller	No certificate required	It is more common to rely on a warranty in respect of FIRPTA as there is no equivalent requirement for the GP to withhold on future distributions to the Buyer and there are limited certificates that can be provided by the Seller.

*Certificates are given under **penalties of perjury** so it will be key to make sure they are correct.

Timing

Certificates must be signed and dated within 30 days prior to the transfer.

If the Fund is a corporate for US tax purposes, other evidence can be provided by the corporate that the transfer of the interest would not be a transfer of a US real property interest.

Our secondaries platform

Travers Smith has extensive experience in complex private markets transactions, with a focus on liquidity solutions across the private markets capital structure with exposure across all asset classes.

70+

We advise over 70 GPs across our firm.

£92bn

In transaction value during the last c.five years.

$4tn+

Assets managed by our clients in the private capital sector.

150+

Specialists focused on private equity, infrastructure, financial sponsor and M&A transactions. 30 of these dedicated specialists are partners in the business.

$5bn+

In 2022 we advised on the deployment of $5.1bn+ in commitments across more than 100 primary, co-investment and fund-of-one transactions.

400+

M&A transactions acted on since 2016.

Advisory/Consultancy: Tax Team of the Year
The Drawdown Awards
2023

Private Equity Team of the Year
Legal Business Awards
2022

Legal Fund Formation Team of the Year
The Drawdown Awards
2020, 2021 & 2022

IFLR 1000
Financial Services regulatory: Non-contentious
Tier 1

Emily Clark
Head of Asset Management

Elena Rowlands
Partner

Tosin Adeyeri
Partner

Phil Bartram
Partner

Victoria Bramall
Partner

Jeremy Elmore
Head of Funds

Will Normand
Acting Head of Asset Management

Aaron Stocks
Partner

Sarah Stewart
Senior Counsel

Tom Margesson
Senior Associate