

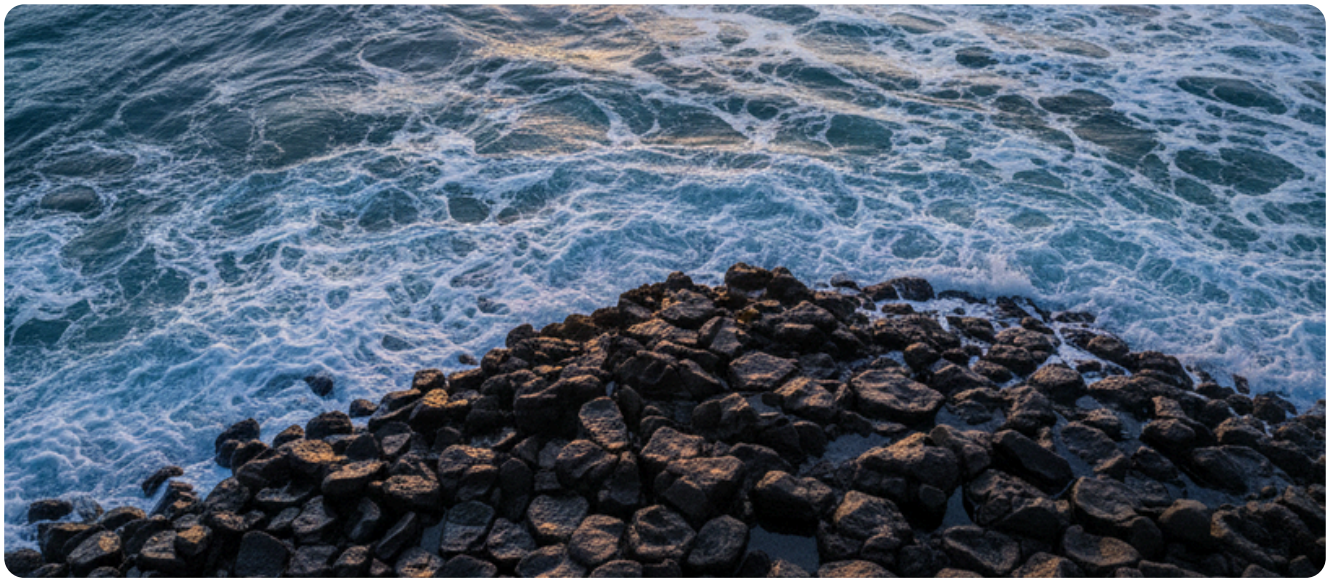
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Portfolio Interest Exemption (PIE) Structuring and Compliance Overview (IRC §871(h) and §881(c))

www.unityinvestments.com

0 Introduction

At Unity, we often receive tax-related questions about private credit investments. We realized that the best way to communicate with, and educate, investors is through writing. We aim to publish a series of technical memos that will hopefully accomplish two things: 1) address decision-critical questions regarding U.S. tax implications and 2) inform investors so that they can optimize their post-tax investment returns. This memo describes the structure used by Unity's affiliated private credit platform, Unity Investments.



Introduction

This memorandum addresses the critical U.S. tax challenge for Foreign Investors (Non-Resident Aliens and foreign corporations) in the U.S. private credit market: the 30% U.S. federal withholding tax on U.S.-source interest income. This significant tax, which is imposed on the gross interest amount, applies because U.S.-source interest is generally classified as Fixed, Determinable, Annual, or Periodical (FDAP) income taxed under IRC §871(a)(1) and §881(a)(1) and collected through withholding under §1441 and §1442.

Unity's core objective is to deliver the maximum possible after-tax return by structuring investments so that interest income qualifies for the Portfolio Interest Exemption (PIE), codified under IRC §871(h) and §881(c). The remainder of this document details the structural necessity and rigorous compliance methodology designed to support this exemption.

I Structural Mandate: Leveraging the U.S. Partnership Vehicle

Unity's platform has been systematically refined to focus on debt instruments designed to avoid the tax burden associated with contingent interest and Effectively Connected Income (ECI). The current strategy mandates the use of traditional, pure debt instruments (e.g., fixed-interest asset-backed loans).

A. The Dedicated Special Purpose Vehicle (SPV)

Each Unity private credit investment opportunity is structured through a standalone, dedicated SPV, consistently organized as a U.S. Delaware Limited Liability Company (LLC).

- **Tax Classification:** The LLC is treated as a partnership for U.S. federal tax purposes under the default entity classification rules; no election is required.
- **Flow-Through Principle:** This classification is a non-negotiable prerequisite, facilitating the transparent and direct flow-through of the PIE status of the underlying debt instrument to the Foreign Investor, who is treated as a partner. This structure circumvents the complexities and potential tax friction associated with foreign corporate blocker entities.
- **Control over Covenants:** The deal-by-deal SPV model grants Unity the ability to review the loan documentation and require the covenants needed for PIE compliance.

B. ECI Mitigation and Passive Status

If the interest income is determined to be effectively connected with the conduct of a U.S. trade or business (USTB), it is taxed under IRC §871(b) or §882(a), and PIE does not apply. Under IRC §875(1), the establishment of a USTB at the SPV level flows directly to the partners.

- **Prohibited Activity:** The primary risk is characterization as actively conducting a banking, financing, or similar business in the United States.
- **Unity's ECI Shield:** SPV activities are strictly limited to those consistent with a passive investor model, focusing only on holding and monitoring debt. This strategic operational restraint is designed to maintain the critical legal distinction necessary for interest income not to be deemed ECI. A standalone SPV does not resolve this on its own: activities carried out in the United States by managers or agents on the SPV's behalf, such as negotiating and originating loans, are also taken into account.

II Mandatory PIE Requirements (IRC §871(h) and Treasury Regulation §1.871-14)

The qualification of interest as portfolio interest necessitates strict adherence to the following conditions, namely: A) contingent interest exclusion, B) registered form obligations, C) 10% shareholder limit, D) administrative documentation mandate, and E) additional exclusions for foreign corporate investors. Below, we explain them in detail.

A. Contingent Interest Exclusion (§871(h)(4))

Interest is ineligible for PIE if the amount is contingent on, or determined by, reference to the debtor's (or a related person's) financial performance.

- **Prohibited Metrics:** This includes, but is not limited to, receipts, sales, cash flow, income, profits (or proxies thereof, such as EBITDA), change in value of property, or dividend/distribution payments.

- **Structural Discipline:** Unity's loan agreements are meticulously drafted so that interest is purely fixed or formulaic and explicitly exclude any interest rate mechanism linked to the borrower's operating success, thereby excluding contingent interest elements.

B. Registered Form Obligation

The exemption applies only to obligations issued in registered form. This is required to identify the recipient and facilitate accurate information reporting.

- **Definition (Treas. Reg. §1.871-14(c); §5f.103-1(c)):** An obligation is in registered form if ownership is registered with the issuer (or its agent) and transfer is effected only by surrender and reissuance, or if ownership is transferable only through a book-entry system that identifies the owner.

- **Compliance:** Unity mandates that all underlying debt instruments be issued in registered form, and the SPV or its administrator maintains the requisite lender register or approved book-entry system.



C. The 10% Shareholder/Partner Limitation (§871(h)(3))

Interest does not qualify as portfolio interest if the recipient is a 10% shareholder or partner of the borrower, defined by either voting power (corporate obligor) or capital/profits interest (partnership obligor).

- **Attribution Rules:** Complex constructive ownership rules (attribution rules based on IRC §318, as modified by §871(h)(3)(C)) apply when testing for the 10% threshold.

- **Partner-Level Testing:** Pursuant to Treas. Reg. §1.871-14(g)(3)(i), the 10% shareholder test is applied at the partner level (the Foreign Investor), not the partnership (SPV) level. This technical application is leveraged by Unity to maintain PIE eligibility for individual investors where the SPV's collective equity interest in the borrower might exceed 10% while each investor's share does not. The test measures ownership of the borrower, not the size of the loan.

D. Administrative Documentation Mandate

The U.S. withholding agent (typically the borrower or the SPV) must receive valid certification of the beneficial owner's non-U.S. status.

- **Required Forms:** Form W-8BEN-E (foreign entity) or Form W-8BEN (non-resident individual). Entity investors must also document their FATCA (Chapter 4) status.

- **Operational Risk:** The Forms W-8 have a finite validity period (typically expiring on the last day of the third succeeding calendar year, or earlier upon a change in circumstances). A lapse in documentation triggers the automatic default to the 30% withholding tax. Unity implements a proactive 36-month renewal cycle protocol to mitigate this critical administrative compliance failure risk.

E. Additional Exclusions for Foreign Corporate Investors (§881(c)(3))

For foreign corporations, portfolio interest also excludes interest received by a bank on an extension of credit made in the ordinary course of its business, and interest received by a controlled foreign corporation (CFC) from a related person.



III Multi-Channel Compliance and Partner Platforms

Unity ensures consistency in PIE compliance across its direct syndicate model and its co-investment platform.

A. Syndicate Model

Holding each loan through a dedicated SPV provides the firm with the authority to require PIE-specific language in the loan agreements, so that tax compliance is built into the deal structure.

B. Co-Investment Structures (Regulation S Wrapper)

When co-investing, partner platforms may utilize a Regulation S ("Reg S") wrapper, which is a securities law exemption. It is imperative to note that the Reg S wrapper does not automatically confer PIE status, as it is solely a securities law exemption from U.S. registration requirements.

- **Operational Mechanism:** Under this partner framework, the U.S. entity simultaneously purchases the underlying Reg D notes from the borrower while issuing mirror Reg S notes to the foreign investors. The Reg S notes are backed on a one-to-one basis by the underlying Reg D loans.

- **PIE Qualification:** For Unity's Foreign Investors, the Reg S notes can only serve as a PIE-eligible vehicle provided that both the Reg S notes themselves and the underlying debt instrument satisfy all PIE tax requirements outlined in Section II (registered form, non-contingent interest, non-disqualified recipient).

- **Operational Efficiency:** This model allows a single U.S. entity to administer the structure, reducing the necessity of creating a separate SPV for every co-investment transaction, thereby lowering administrative and accounting overhead.

- **Tax Diligence Requirement:** Unity's internal legal due diligence covers both the Reg S notes and the underlying debt instrument to confirm they satisfy all PIE criteria (registered form, non-contingent interest, non-disqualified recipient) before participation.

- **Contagion Mitigation:** Unity's investment SPV acts as the intermediary, acquiring the relevant note or loan interest. This positioning secures control over the PIE eligibility at the Unity SPV level, insulating the investors from structural contagion risk inherent in third-party platform documentation. Purchasers must satisfy the applicable Regulation S eligibility and offering restrictions, as confirmed by securities counsel.

IV

Summary of Technical Commitments

Unity's tax structuring is predicated on the following commitments:

- **Exclusion of Contingent Interest Risk:** Total exclusion of performance-linked interest metrics.
- **ECI/USTB Avoidance:** Maintaining a passive investor posture at the SPV level.
- **Partnership Conduit:** Utilizing the U.S. LLC partnership for favorable partner-level application of the 10% shareholder test.
- **Operational Rigor:** Systematic W-8 certification management to prevent withholding agent default obligations.

If you have any further questions, please email us at **tax@unityinvestments.com.**





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