FATCA: How far? How fast?

Has the delay in FATCA's implementation brought relief or uncertainty to those firms seeking to comply?

The US Internal Revenue Service (IRS) has always been single-minded in its pursuit of tax avoidance, but FATCA (Foreign Account Tax Compliance Act) goes a lot further than any of its previous attempts to recoup undeclared monies. Ambitious by design, FATCA enlists the help of international tax authorities and foreign financial institutions (FFIs) to help the IRS extend its all-encompassing reach to non-compliant US taxpayers with foreign bank accounts. "FATCA is being used to lift the corporate veil," explains Rob Smith, a senior tax manager in the tax investigations and disputes team at DLA Piper, a global law firm.

But enlisting the cooperation of foreign tax authorities to help the IRS achieve its heady ambitions is perhaps one of the most challenging aspects of FATCA. It is also one of the main reasons for the recent delay in the far-reaching legislation's implementation, alongside the fact that banks too were not ready for the original 1 January 2014 implementation deadline, which was pushed back to the 30 June 2014.

Reetu Khosla, global director, financial crime, risk and compliance solutions at Pegasystems, says there has been a lot of confusion in the industry as to the wider implications of the new regulation for their business. However, she says the six-month extension should give FFIs the opportunity to implement more flexible technologies that easily integrate new compliance rules into KYC, onboarding and reporting systems for a fully integrated approach.

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as an acknowledgment of this," remarks Josh Fine, senior vice president and head of global tax services, Brown Brothers Harriman. "At the same time, while the tax industry supports the delay as much-needed relief, there is a risk that FATCA fatigue may set in, particularly for firms with less familiarity with FATCA and its scope."

For the legislation really to work as intended, the IRS requires intergovernmental agreements (IGAs) to be established, but so far only nine IGAs have been signed. "The delay in concluding IGAs is probably one of the main reasons for postponement this time," says Smith of DLA Piper. "FATCA is pretty unworkable without an IGA. There is no way the IRS would have the legal reach to force a FFI to hand over information directly to them as it may be in contravention of local data protection laws, regulatory codes, terms and conditions and / or banking secrecy. The whole purpose of the IGA is to try and overcome local legal hurdles."

Practical implementation

There are two models for IGAs under FATCA. Under model one, which seven countries have signed (Denmark, Germany, Ireland, Mexico, United Kingdom, Norway, Spain) FFIs must report US account holder information to domestic regulators who will then pass it on to the IRS. Information exchanged under model one between national tax authorities can be either reciprocal or non-reciprocal. Under model 2, FFIs report specified information about their US accounts directly to the IRS, which is the model Switzerland initially opted for. However, the Swiss National Council voted down the IGA legislation when it was put before it in June. "Signing an IGA is only the first part of the process," Smith explains. "The domestic legislation needs to be introduced in order to implement the agreement."

According to Smith, the IRS is now publishing model IGAs with the country's name to be inserted to try and industrialise the process. "With only seven model one and two model two agreements in place in 12 months the pace needs to accelerate. Other countries need to see the benefits for them." Smith says China is now looking at entering into an IGA, and possibly also Russia. "There is pressure on those economies that are holding out," he adds.

Georges Bock, chairman of the Tax Technical Committee at ALFI [the Association of the Luxembourg Fund Industry] and a managing partner at KPMG Luxembourg says industry and market preparations for FATCA depend on IGAs being implemented into national law. "It is a chicken and egg situation," he says. "If these things are not happening you cannot progress further." →

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Reetu Khosla | Pegasystems

Bock says Luxembourg is close to finalising an IGA. "The expectation is that by the end of September or the beginning of October an agreement will be signed," he says.

Multiple challenges

Although an IGA provides legal certainty, the situation becomes a lot more complex for global FFIs that are active in a number of jurisdictions. "If you have a situation where one country has a model one IGA, another country has a model two agreement, and in other countries there is no agreement at all, that is a nightmare for global FFIs," explains Bock. "For local players it is much easier as they only have to worry about the particular country they do business in." Certainty around IGAs is critical, says Fine of BBH, since the specific due diligence rule set that a financial institution must apply will vary depending on whether an IGA is in place or not.

One good thing about the delay is that it has given FFIs more time to implement customer due diligence (CDD) requirements under FATCA. But while the extra six-months are largely welcomed by industry, Smith says the delay is likely to cause issues for larger multinational FFIs that have a series of projects and IT upgrades being rolled out in conjunction with FATCA, though he adds, "Some are continuing with their preparations to ensure that compliance procedures will be in place when FATCA goes live." Bock says global FFIs cannot continue in a wait-and-see scenario. Those firms that are on track, he adds, have started to conduct scenario analyses to assess how they will respond in certain situations.

FFIs need to evaluate how underlying funds are categorised and how to monitor, evaluate, classify, and/or exempt for FATCA compliance. "Many firms have evaluated and identified preliminary processes to classify underlying investors that may require FATCA evaluation," explains Khosla at Pegasystems. "But they are still evaluating with their internal and external teams to identify what these rules mean from an IGA versus

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non-IGA perspective and what systems can be implemented as part of their long-term strategy to minimise the impact on the firm and their clients." A particular areas of focus for funds and assets managers is share-holder servicing – customer onboarding and reporting. According to Fine at BBH, "That will likely represent the primary compliance demands for most non-US asset managers."

Who's targeted?

Individuals who were born in the US or are US green card holders, as well as those who have a US address and phone number, are subject to compliance checks. Even account holders who have standing orders to a US bank account need to be checked against FATCA compliance requirements, says Khosla. "This will require investor onboarding and KYC systems to perform a new set of due- diligence checks to identify, evaluate, classify and monitor customers and entities where there is an indication that one of the parties or underlying parties might be a US party." Fine says the industry still needs considerable guidance from the IRS to define the due diligence requirements under FATCA, including the release of final tax forms and instructions, harmonisation rules to marry FATCA with the existing US tax regime for non-resident investors, and a draft FFI agreement.

Issues may also arise when firms are looking through their back book of existing customer accounts. "Historically, a lot of Know-Your-Customer-type data that is collected today and will be relied upon for FATCA identification purposes, may not have been required when the account was originally opened," explains DL Piper's Smith. FATCA compliance must also include branches and subsidiaries. "If you are a branch or subsidiary, the lead organisation will need to register first," he says. "FFIs will need to map the various entities in the group and decide which branch or subsidiary needs to register by when, depending upon where they are based. There is a planning exercise that needs to take place and it is not advisable to wait until the last minute."

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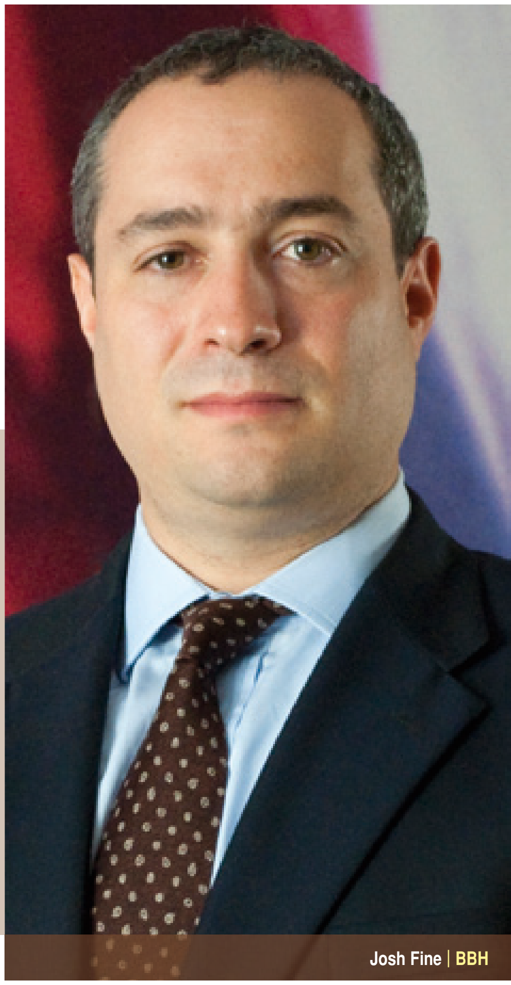

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For non-US residents that receive income from US investments, US paying agents will need to report to the IRS that they are paying these individuals and pass that information through to the relevant national tax authority where that person is resident. Smith says institutions need to ensure the information they report is accurate as if it does not match the information maintained by the local tax authority it could result in an enquiry being instigated into that individual's tax affairs.

Regional progress

Bock says banking groups in the US are well advanced in their FATCA preparations and European firms have also responded quickly. In Asia, however, FATCA is less of a priority for some governments, he suggests, and where there is no financial or political leadership there may be a gap in preparations.

While FATCA has been receiving a large share of media attention, it is, however, only the tip of the iceberg. Smith says firms should be gearing up for other agreements that are being put in place. In addition to FATCA, the UK has signed MOUs with Bermuda, the Isle of Man and Guernsey for the reciprocal sharing of information on residents who are not fully disclosing income in other jurisdictions. With governments in Western countries strapped for cash, other authorities are expected to sign similar agreements. "FATCA is just the catalyst; institutions gearing up for it also need to look at the potential for similar arrangements, so they can more easily accommodate change." Khosla says Japan and Germany are also considering similar tax evasion rules. "FATCA is only the first of a number of similar regulations that are likely to come into force in the foreseeable future," she warns. •