

Foreign Account Tax Compliance Act: a challenge for banks

Background

The Foreign Account Tax Compliance Act (FATCA) became law on March 18th 2010. This new US-regulation requires foreign banks and other financial institutions outside the US to deliver information relevant for tax purposes on US clients to the Internal Revenue Service (IRS). The amount of information to be provided exceeds current Qualified Intermediary (QI) rules by far. Most of the FATCA rules will be put in force on January 1st 2013. The detailed implementation rules are yet to be defined by the IRS, but already today it is foreseeable that the compliance with the new rules will pose some big challenges to banks and financial institutions.

In this newsletter we provide an overview of the new FATCA rules. Further newsletters will deal with more specific issues.

What is the purpose of FATCA?

The goal of FATCA is to close tax loop holes and gaps in the existing QI-system. The new rules represent a considerable tightening of the existing rules.

Expansion of the QI-system

The QI-rules cover only US-securities which are held directly by US-persons that have disclosed themselves as such to their bank and the IRS. FATCA additionally covers the following areas:

- Non-US-securities held by US-persons
- So far undisclosed US-Persons
- All securities held by Non-US, Non-financial-entities with substantial US-ownership
- At banks not complying with the new rules, also the interest and dividend payments as well as the proceeds from sales of US-securities that are held by Non-US-persons are affected by the regulations

The key points of FATCA

- All Foreign Financial Institutions (FFI) are required to enter into a FATCA-compliance agreement with the IRS in order to avoid a withholding tax on US-source dividend and interest payments as well as sales proceeds
- The withholding tax rate is 30% and it will be deducted on all US-source interest and dividend payments as well as sales proceeds to a Non-compliant FFI or a recalcitrant account holder
- The definition of US-securities is extended, a securities lending with US-securities for example is also covered by FATCA
- The definition of a FFI is also more far-reaching compared to the existing QI-rules. FFI according to FATCA are not only banks but also brokers, custodians, investments funds and in some cases even insurance companies
- New and extensive rules concerning the identification and documentation of clients; the burden of proof is partially on the FFI
- New and extensive reporting to the IRS

Strategic challenges

To begin with, the FFI have to assess the impact of the FATCA-rules on their strategy and their business model. At the focal point is the future positioning in the business with US-clients and US-securities. The following questions have to be answered:

- Should US-persons and Non-US-entities with substantial US-ownership still be among the clients of the FFI in the future?
- Should the clients of the FFI still be able to hold positions in US-securities in the future?

If an FFI answers already one of the two questions with yes, it will have to enter into an agreement with the IRS. Otherwise the FFI will have to exit the business with US-clients and the business with US-securities for Non-US-clients will loose a lot of attractiveness due to the new withholding tax.

Challenges on operative level

If the FFI decides to comply with FATCA, there are numerous challenges on an operative level:

- Identification and documentation of clients
- Review of the product offering concerning US-securities
- Review of own products in respect to sales restrictions for US-clients
- Reporting to the US-authorities
- Training of all relevant employees
- Adaption of IT-systems

Should an FFI choose to exit the business with US-clients and US-securities, this exit has to be planned and executed.

Schedule for the FATCA-implementation

Based on our experience with the implementation of new tax regulations such as US-QI, EU savings directive or German final levy taxation, we assume that the affected financial institutions will need 1 to 2 years to make their processes and systems compliant to the new regulations. Ideally the basic strategic questions should be dealt with until the end of 2010, so that the work to implement the new rules or to exit the US-business can start in 2011.

The next FATCA-newsletter, which will be published at the end of September 2010, will deal with the links between the existing QI-status and the future FATCA-status of financial institutions.

Banking Concepts AG
Hohestrasse 204
CH-4104 Oberwil / Basel
Tel.: +41 61 403 9080
Fax: +41 61 403 9083
Internet: www.bankingconcepts.com

Contact persons regarding the implementation of FATCA:

André Schwarz
Partner
Mobile: +41 79 600 85 74
andre.schwarz@bankingconcepts.com

Karl Baumgartner
Partner
Mobile: +41 79 276 22 75
karl.baumgartner@bankingconcepts.com

Paul Stiffler
Senior Consultant
Mobile: +41 79 794 56 60
paul.stiffler@bankingconcepts.com