The mist is lifting…

UNCERTAINTIES OVER US LEGISLATION TO ENFORCE TAX LAWS MORE RIGOROUSLY ARE BEING ADDRESSED, BUT NOT QUICKLY ENOUGH FOR MANY, REPORTS **GRAHAM BUCK**.

This magazine has already reported on the implications of the Foreign Account Tax Compliance Act (FATCA) – an "unprecedented piece of legislation" that the US is about to unleash on financial institutions worldwide (see Cash Management Supplement, Summer 2011, page 12). Many expect the cost of implementing FATCA to be substantial and efforts are being made to try to reduce the burden.

On 8 February this year the US Department of Treasury and the Internal Revenue Service (IRS) published their long-awaited draft regulations to provide guidance on the application of FATCA.

It was also announced that the US has agreed an information exchange programme with five EU members – the UK, France, Germany, Italy and Spain – under which the financial institutions of these countries will not have to report directly to the IRS on their US clients but to their local tax office as part of their FATCA compliance. As was noted at the time, the move "changes FATCA from a piece of unilateral US legislation to the start of an extensive multilateral reporting system".

The publication of the draft was followed by a consultation period, and the final regulations will be issued this autumn.

A recent online webinar held by Marketforce, which assembled a panel of experts to discuss FATCA issues, polled viewers on whether other countries were likely to join the EU five in becoming FATCA partners with the US. Did they agree with the panel members' view that an "international information of exchange" on the clients of financial institutions was likely to become a reality in the near term, as part of concerted efforts to stamp out tax avoidance? The poll of webinar viewers showed that 70% believed that other countries would "follow the template" that had now been established, and apply to become FATCA partner countries.

One panel member noted that, so far, moves to introduce FATCA had been seen as very one-sided, with benefits accruing solely to the US as it attempted to crack down on its tax evaders.

However, governments around the world are realising the potential benefits of reciprocity, as they can identify their own tax dodgers through the exchange of information. Other EU members are likely to quickly join the initial

group of five – the major fund centres of Ireland and Luxembourg may well be the first. Even China and Russia, both likely to prove much more resistant, may ultimately recognise the benefits of becoming FATCA partner countries.

The webinar panel discussing this and other FATCA-related issues were: Jon Griffin, chairman of the European Fund and Asset Management Association (EFAMA) FATCA working group at JP Morgan Asset Management; Andy Roberts, FATCA project leader for the Prudential and chair of the Association of British Insurers' FATCA working group; Ed Cole, associate director, operational taxes and the FATCA technical expert for Barclays; and Chris Tragheim, EMEA head of FATCA at Deloitte.

The session commenced with the observation that FATCA's requirements will place a heavy burden of compliance on financial institutions around the world. However, although the draft clarifies a number of issues surrounding the regulation, exactly what the final version will be is still not known. Panellists agreed that probably the biggest challenge is continuing uncertainty over much of the detail in what is a complex set of regulations – the preamble to the draft contradicts some of the finer detail that comes later in the document.

A poll of the online audience found that 47% believed that their corporate costs would increase as a consequence of complying with FATCA, while 33% expected no change and 20% a reduction.

Roberts expressed the hope that low-value, high-volume insurance products would not come within the scope of the regulations, as they are of little interest to the tax evaders that FATCA aims to bring to heel. The draft regulations released in February demonstrated that the IRS has already been listening to feedback from the industry and had addressed some of the issues causing greatest concern. Nonetheless which products fall within the scope of FATCA and which fall outside will only be known when the regulation in its final form appears this autumn.

He added that the figures being quoted as the full cost of implementing FATCA are way above the extra tax revenue that the regulation would generate, which has been estimated as no more than $1bn per year over the next 10 years.

CUSTOMER IDENTIFICATION AND ONBOARDING COSTS These costs will fall on financial institutions in areas such as identifying customers and onboarding. Another major cost could be incurred if financial institutions need to develop an engine to comply with FATCA withholding tax obligations – but as the regulations are still draft, this particular requirement may be removed.

The recent changes have already shown the IRS and HM Treasury responding to many of the financial services industry's concerns. Among the concessions – FATCA's "grandfathering" period has been extended to 1 January 2013, the effective date for withholding on foreign-source "passthru payments" has been delayed, a number of potential exemptions from FATCA have been offered and greater detail released on the withholding and reporting obligations to be applied to financial institutions.

Despite these concessions, Cole warned that "the devil is in the detail" (a phrase that still applies to many of FATCA's other features). The latest proposals introduce several new categories, which the industry will either have to lobby on in order to secure amendments or reluctantly accept and factor into its response. The thorny issue of passthru payments in particular remains "a potential minefield" and is still under review. Nor is it entirely clear how withholding will work in practice, so financial institutions will delay work on developing any withholding engine until there is confirmation that they actually need one.

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Tragheim noted that the "central spine" of the proposed legislation remained intact despite the recent revisions, which centre mainly on the withholding and reporting requirements. "Don't underestimate the amount of work that stills needs to be done," he warned. Roberts added that HMRC and the Treasury could assist UK financial firms by declaring exactly how they envisaged FATCA working when the regulations came into effect as much work was still needed to ensure that the new regime had a smooth passage.

REGISTER DIRECT OR CERTIFY? Among the questions that financial institutions wishing to become FATCA-compliant must decide is whether they wish to register with the IRS, or achieve compliance through certification. This decision may be a complex one for global financial organisations that have a range of different affiliates. Know your customer (KYC) procedures may need to change, to ensure that each financial institution understands and codifies its client base

While non-US financial institutions have until the end of June 2013 to collect information on both their new and existing customers, panel members stressed that the FATCA programme should already be up and running – or started immediately if this is not the case. "You should be well into the analysis stage by now – and have secured the necessary funding," suggested Griffin. With managing costs a top priority, having both governance and a sponsor in place for the project were also essential, added Tragheim.

With the proposals still at the draft stage, financial institutions should now be working to reduce the number of their products that come within the scope of FATCA, and communicating with both their customers and third-party suppliers to ensure they are also FATCA-compliant, the panel suggested.

The general rule for insurance products appears to be that the greater the element of protection they contain, the more likely it is that they fall outside the scope of FATCA; the greater the investment element, the more likely that a product is within the scope.

Roberts added: "We don't want to be unnecessarily pestering our customers, so we need to do as much remediation work as possible in-house before we approach them."

Fund managers are very likely to encounter problems with recalcitrant stakeholders, who decline to cooperate. The only realistic option, it was suggested, was to try and minimise the number as far as possible. Although much work remains to be done, the various deadlines for implementing FATCA are unlikely to be put back and HMRC has stated its intention to be ready for the new regime later this year.

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