



# FATCA: the Foreign Account Tax Compliance Act

**ACAMS New York Chapter**

Tuesday, 12 April 2011  
6:00–8:00 p.m.

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# Agenda

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- ▶ What is FATCA?
- ▶ How does Tax work today?
- ▶ Why are you here?
- ▶ What does FATCA require of companies?
- ▶ What are some of the differences between KYC and FATCA?
- ▶ What is the industry doing?
- ▶ Questions

# What is FATCA?

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## What is the Foreign Account Tax Compliance Act (FATCA)?

FATCA is a new US tax law designed to prevent US taxpayers from avoiding US tax on their income by investing in the US through non-US financial institutions and offshore investment vehicles.

- ▶ FATCA was enacted on 18 March 2010, and becomes effective 1 January 2013.
- ▶ FATCA requires third-party information reporting to the IRS regarding offshore accounts and investments held by US persons.
- ▶ Notice 2010-60 provides preliminary guidance on how the IRS will administer FATCA.
- ▶ Notice 2011-34 provides further clarity on Notice 2010-60.

## How will FATCA impact companies?

FATCA generally requires US financial institutions (USFIs) to classify all foreign account holders as either individuals, Foreign Financial Institutions (FFIs) or non-financial foreign entities (NFFEs).

- ▶ FFIs must become “participating FFIs” by entering into agreements with the IRS to identify US accounts and report certain information about those accounts to the IRS on an annual basis.
- ▶ FFIs must notify US institutions making payments to them of their participating FFI status.
- ▶ USFIs and FFIs must report certain information to the IRS about substantial US owners of NFFEs.

## What is the cost of non-compliance?

Thirty percent withholding will apply to all US source dividend and interest payments plus the gross sales proceeds resulting from the sale of an asset that gives rise to US source income if paid to either a “non-participating FFI” or an NFFE that has not disclosed its substantial US owners.

- ▶ A USFI and an FFI will always be liable for any tax that they should have withheld but did not, plus interest and potential penalties.

# How does the current US tax regime work today?

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- ▶ Income earned by US persons is reported on Forms 1099
- ▶ Income earned by non-US persons reported on Forms 1042-S:
  - ▶ Income is generally subject to 30% withholding
  - ▶ Dividends eligible to treaty rate relief
  - ▶ Interest eligible to an exemption from withholding
  - ▶ Gross proceeds from the sale of a security not subject to reporting or tax
- ▶ US persons certify on a Form W-9.
- ▶ Non-US persons certify on a Form W-8.

# Why are you here?

## Overview

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### Notice 2010-60

- ▶ “... with respect to new entity accounts, FFIs must determine how to treat such accounts using all information collected by the FFI including **anti-money laundering/know-your-customer (“AML/KYC”)** requirements.”
- ▶ “Information collected by the FFI for purposes of opening and maintaining the account, corresponding with the account holder, and complying with regulatory requirements, including **AML/KYC** ...”
- ▶ “Treasury and the IRS understand that for compliance purposes in connection with various countries’ **AML/KYC** and similar laws, regulators typically place some degree of reliance on verification procedures and reviews performed by public accountants engaged by financial institutions or by the internal audit function of financial institutions.”
- ▶ “Treasury and the IRS request comments about the procedures performed by public accountants or other external auditors when conducting an **AML/KYC** audit or similar engagement ...”

# Why are you here?

## Overview (cont'd)

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### Notice 2011-34

- ▶ “Private banking department is a private banking department under the anti-money laundering or know-your-customer (**AML/KYC**) requirements to which the FFI is subject ...”
- ▶ “Documentary evidence” with respect to an account maintained in a jurisdiction with **AML/KYC** rules that have been approved by the IRS in connection with a QI agreement.
- ▶ “... collected in connection with a financial account (e.g., for purposes of maintaining the account, corresponding with the account holder, or complying with regulatory or **AML/KYC** requirements).”
- ▶ “For this purpose, ‘electronically searchable information’ refers to information that an FFI maintains in its tax reporting files, or customer master files or similar files ...Customer master files include an FFI’s primary files for maintaining account holder information, such as information used for contacting account holders and for satisfying **AML/KYC** requirements.”
- ▶ “The **chief compliance officer** or another equivalent-level officer of the FFI (responsible officer) must certify to the IRS when the FFI has completed the above procedures ...”

# What does FATCA require?

## Overview

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- ▶ An entity is a financial institution (either US or foreign) if it:
  - ▶ Accepts deposits in the ordinary course of a banking business
  - ▶ Holds financial assets for the account of others as a substantial portion of its business
  - ▶ Is engaged in the business of investing, reinvesting or trading, which is interpreted broadly

# What does FATCA require?

## Overview (cont'd)

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- ▶ Notice 2010-60 provides preliminary guidance on how USFIs and FFIs are to identify accounts that will require special handling because they are US accounts, accounts owned by other FFIs or accounts owned by NFFEs.
- ▶ Four sets of rules are provided for account due diligence, covering:
  - ▶ Pre-existing accounts owned by individuals
  - ▶ Pre-existing accounts owned by entities
  - ▶ New accounts owned by individuals
  - ▶ New accounts owned by entities

# What does FATCA require?

## USFI client identification

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For “pre-existing” accounts opened before 1 January 2013:

- ▶ Account holders who are individuals: USFIs must determine whether to treat as US persons or other (non-US) persons.
- ▶ Account holders that are entities: USFIs must determine whether to treat as US entities, FFIs, NFFEs or excepted NFFEs
  - ▶ Account holders that are FFIs are either participating FFIs, deemed-compliant FFIs or non-participating FFIs.
  - ▶ Account holders that are NFFEs are either excepted NFFEs or NFFEs whose substantial US owners must be reported to the IRS.

# What does FATCA require?

## USFI client identification (cont'd)

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For “new” accounts opened after 1 January 2013:

- ▶ Similar procedures as for pre-existing accounts apply, except USFI must determine how to treat new accounts using **all** information it has on the account regardless of whether it is electronically searchable.
- ▶ Includes information collected for AML/KYC purposes.
- ▶ All such information is treated as “known” for determining whether FFI should treat documentation provided by an entity as unreliable.

# What does FATCA require?

## FFI client identification

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For “pre-existing” accounts opened before 1 January 2013:

- ▶ Exemption for individual depository accounts with (in aggregate) less than \$50,000 average balance.
- ▶ FFI has one year to review documentation and “electronically searchable information” for indicia of US status, and request documentation of US or non-US status if such indicia is found:
  - ▶ Account holder has one year to comply.
  - ▶ Within two years of Agreement date, non-US accounts in excess of \$1m are subject to re-evaluation.
  - ▶ Within five years, **all** accounts determined to be non-US are subject to re-evaluation.

# What does FATCA require?

## FFI client identification (cont'd)

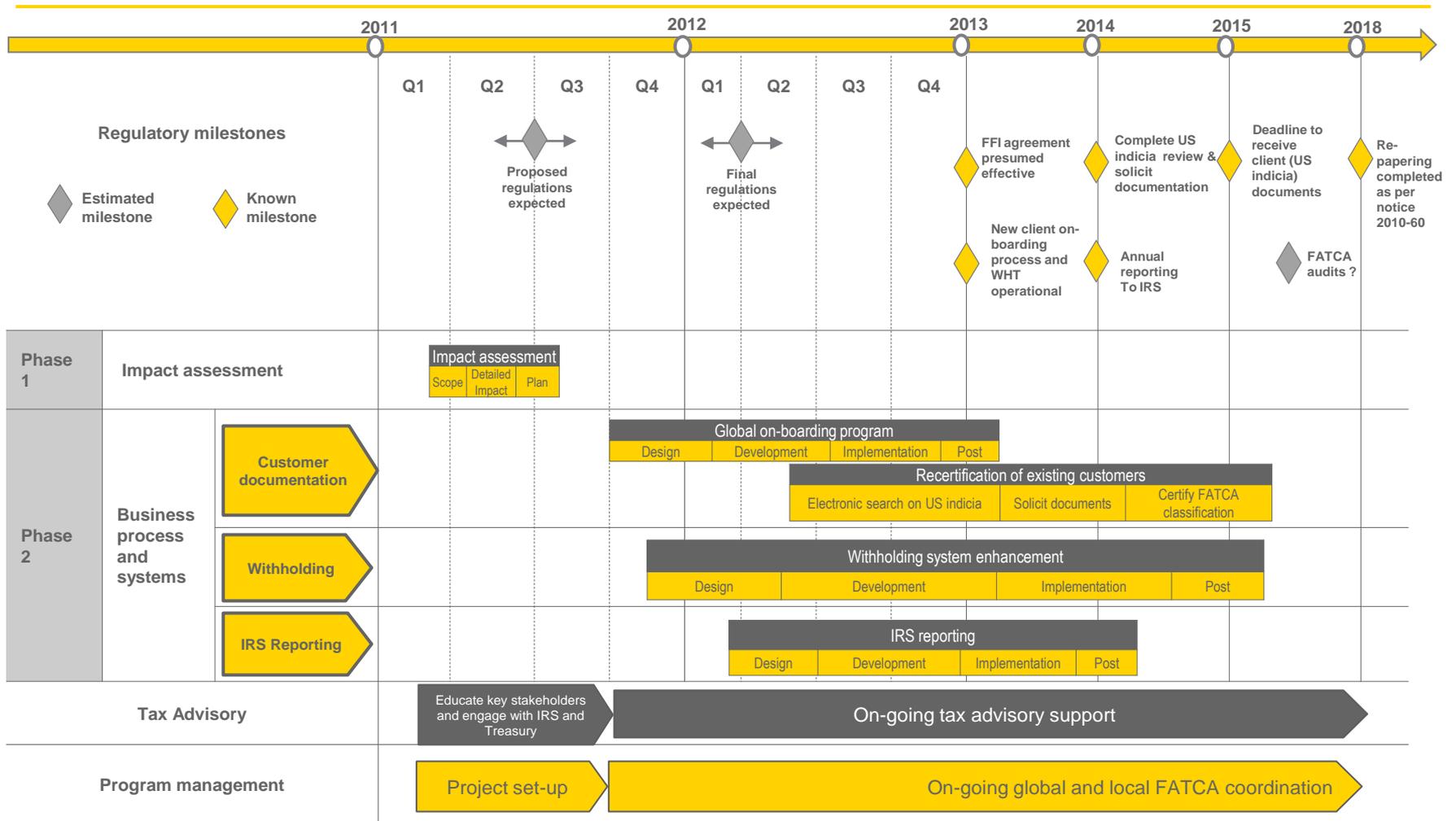
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For “new” accounts opened after 1 January 2013:

- ▶ Exemption for individual depository accounts with (in aggregate) less than \$50,000 average balance.
- ▶ FFI must obtain documentary evidence of US or non-US status from account holders.
- ▶ If account holder provides documentary evidence of non-US status, FFI must examine all other information on the account for indicia of potential US status.
- ▶ If indicia of potential US status are found, FFI must obtain “curative” documentation on account holder.

# What does FATCA require?

## Common FATCA implementation timeline



# What does FATCA require?

## Common FATCA challenges

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Challenge	Description
1. Program governance/ownership	The enterprise-level effort requires allocation of people, budget and project ownership across the businesses, operations, compliance and tax.
2. Legal entity analysis	Determining the status of each XYZ entity for FATCA purposes may be challenging.
3. Existing account information	There may currently exist a misplaced confidence in the extent to which existing KYC information is readily available and/or could be leveraged.
4. Lack of central customer data	Very few organizations have a single source of necessary information to readily make the required determinations with respect to account holders.
5. Timing	The short time frame for implementation requires immediate focus on key start-up tasks while the Treasury Department and the IRS develop additional guidance as the final regulations are not yet released.
6. Technology	Numerous unrelated systems must be assessed and modified to enable new required information reporting and withholding at the FFI and USFI levels.
7. Education	Generally, there is not a full awareness of FATCA, its requirements and resulting impact to the businesses, which will necessitate early, senior-level commitment and communication.
8. Vendors	Vendors' FATCA readiness and capabilities will need to be assessed.
9. FFI agreements	Based on location of information, local law, etc., determining how many FFI agreements XYZ will require careful consideration.

# What does FATCA require?

## Common phase 1 structure

### Program management

Assist in setting up and structuring the FATCA program office, defining governance and stakeholder management

### Tax

- ▶ Support regulatory interpretation, education and lobbying
- ▶ Provide FATCA orientation to staff
- ▶ Provide continuing support and guidance to all workstreams and processes at all levels

### FATCA impact assessment

High-level assessment of a business's current processes against FATCA requirements

### Legal entity and business unit analysis

Assessment of your legal entity structure and identify where FATCA applies (e.g., which are FFIs, where assets are being held)

### On-boarding and KYC processes

Assessment of your current on-boarding (e.g., account opening) and KYC processes and documentation

### Customer and counterparty data

Assessment of current customer data infrastructure, quality and rationalization

### Withholding and reporting systems

Identification of your payment systems where information reporting will be required and withholding will apply

### Planning for implementation

Define and gain consensus around a road map for implementation of FATCA, including scope, budget, high-level design approach and timeline

### FATCA implementation road map

# What are some of the differences between KYC and FATCA?

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- ▶ Compliance/AML will not likely be the “owner” of the effort to comply, but will be a substantial source of information for compliance.
- ▶ Current KYC information is housed in multiple repositories, and in some cases is distributed broadly across relationship managers.
- ▶ There remains open questions regarding the fully effective uses of existing KYC information if it were available. This may require urgent remediation and validation.
- ▶ Existing, fully papered KYC files may still require bolstering related to beneficial ownership and validation of citizenship.
- ▶ FATCA will require numerous operational and technology changes and efforts, which are to be prioritized against other urgent demands.

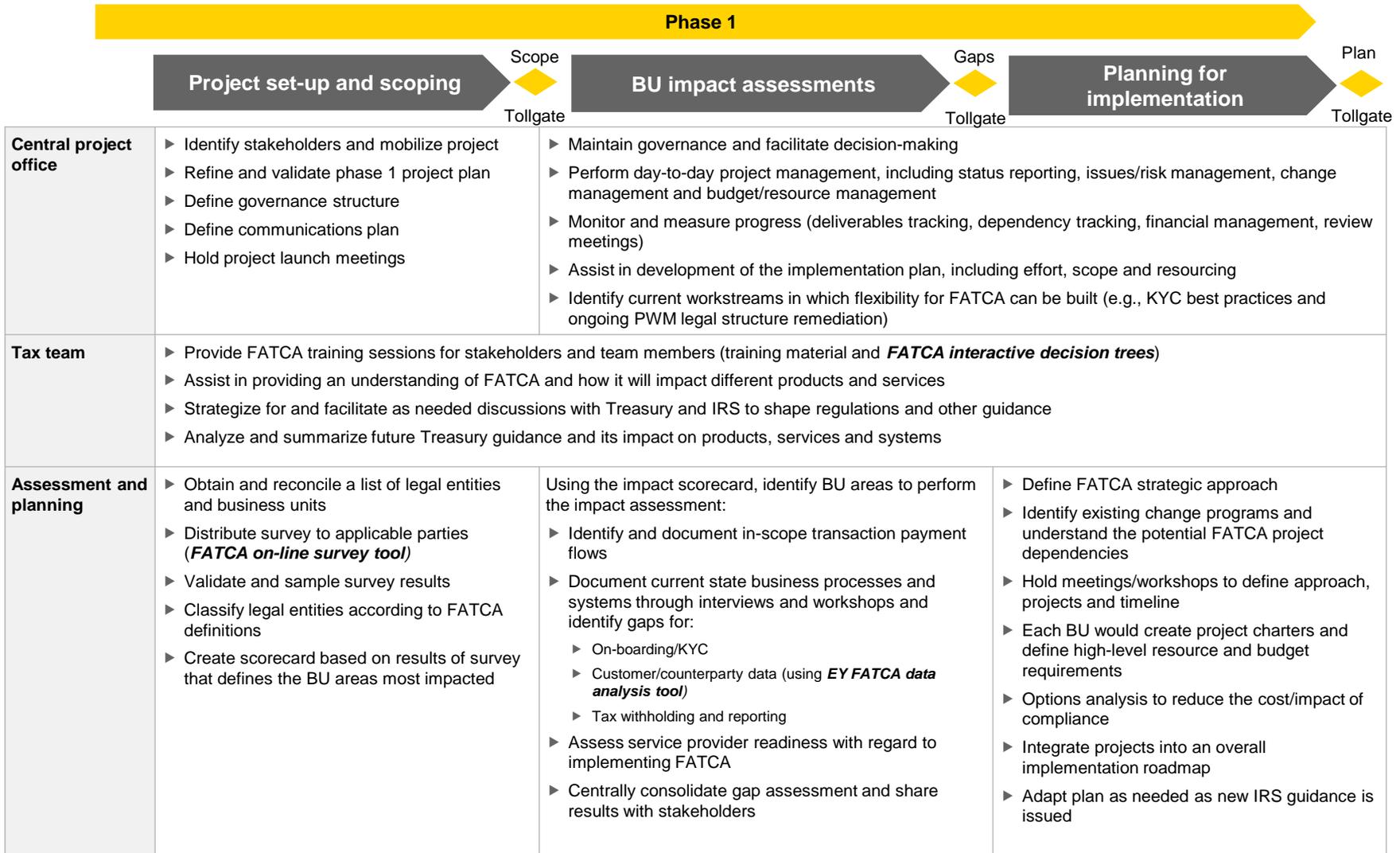
*In summary, while Tax may provide technical guidance, and the business units ultimately will likely fund the effort, the foundation of information and effort will likely fall to Compliance/AML and technology.*

# What are some of the differences between KYC and FATCA?

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- ▶ Different documentation collection and identification requirements given KYC's risk assessment approach
- ▶ Lack of automated KYC information at many FFIs and wide variety of ways to capture information
- ▶ Grandfathered accounts formed before applicable KYC standards were formed
- ▶ Substantial variation in KYC standards
- ▶ Potential shortcomings in KYC compliance (anecdotal evidence from third-party citations)
- ▶ Lack of central depository of KYC data in some instances
- ▶ Privacy laws and limitations on sharing
- ▶ Frequency with which data is refreshed
- ▶ Some KYC standards not requiring citizenship or tax residence information to be given (e.g., dual citizens, legal residents,  $\geq 10\%$  shareholders)

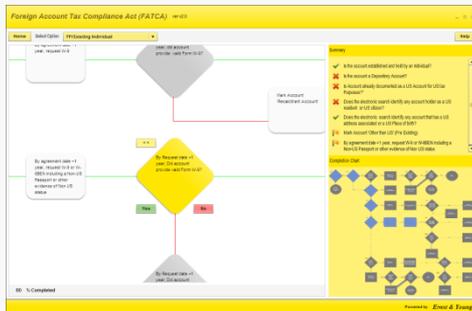
# FATCA detailed phase 1 approach



# Ernst & Young's FATCA tools overview

We've developed a suite of tools, specific to FATCA, that will help you get up to speed, analyze your organization and make educated decisions about the way forward.

## EY FATCA Decision Tree Application



Web-based tool that provides an interactive way to assess different FATCA situations across customer, product and legal entity parameters

## EY FATCA Data Classification Tool



Tool that provides analytics and visualization of client and legal entity data

## EY FATCA Online Survey Tool

Scalable, customizable tool that provides a robust infrastructure to accomplish global FATCA surveys

# What is the industry doing?

Dimensions	Questions	The range of FATCA practices				
		Basic	Developing	Established	Advanced	Leading
<b>FATCA program mobilization</b>	How operational are the FATCA global and divisional programs?	<p>Establishment of centralized FATCA program is underway.</p> <p>Limited resources have been allocated to the global program.</p> <p>Program sponsorship has not been clearly defined.</p> <p>Global program struggles to secure business line support.</p>	<p>Program sponsor role has been clearly defined and communicated throughout the company.</p> <p>A cross-functional steering committee has been established, and a dedicated program manager has been appointed.</p> <p>Clear roles and responsibilities have been defined.</p>	<p>The global FATCA program is fully resourced with a dedicated budget to drive standardization across divisions and regions.</p> <p>A global PMO that reports into the program manger has been established and fully staffed.</p>	<p>The establishment of line of business and regional PMOs are underway.</p> <p>Program leads are being identified and the workstream teams are being assembled.</p>	<p>The global, line of business and regional PMOs are fully operational with adequate resourcing and clear roles and responsibilities.</p> <p>Two-way communication between global and divisional/regional PMOs is functioning effectively.</p>
<b>Training/awareness</b>	What is the company's level of understanding/knowledge of FATCA?	<p>Key stakeholders are unaware of FATCA and its impacts.</p> <p>The majority of stakeholders view FATCA as a tax regulation issue.</p>	<p>Training material has been developed.</p> <p>Training of key stakeholders and project team members is ongoing on an ad hoc basis.</p>	<p>Key stakeholders and project team members have been fully trained on FATCA.</p>	<p>Training is being disseminated across the company.</p> <p>Training is ongoing as additional guidance and regulations are issued.</p> <p>Training webcasts are available online.</p>	<p>FATCA training is mandatory for key positions in the company.</p> <p>Training material has been tailored by line of business.</p>

Legend	 US banks and brokers	 UK, German, French and Swiss banks	 Furthest Ahead (US/Foreign)
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# What is the industry doing?

Dimensions	Questions	The range of FATCA practices				
		Basic	Developing	Established	Advanced	Leading
Impact assessment	How much progress has the company been making in identifying FATCA compliance gaps and implementation plan?	The company is in the planning stages of completing the scoping assessment phase.  Resource requirements and approach options are being drafted.	The legal entity and scoping assessment phase is underway.	Identified and prioritized legal entities and business units most impacted by FATCA.  Key legal entity data gaps are known.	Detailed impact assessment is underway.  Current state process and systems are under review and key FATCA compliance gaps are being documented.	Detailed impact assessment is completed based on best understanding of guidance.  Identified synergies across business lines, geographies and legal entities.  Identified existing change programs and their impact on Implementation of FATCA.  Developed and integrated FATCA implementation roadmap.  Defined resourcing and budget requirements at global/divisional level.
			◆		■ ▲	
Client communication	How effective is the company in communicating FATCA to external clients?	There is no formal communication strategy or processes in place to guide external client communication on FATCA.	Client communication strategy has been defined.  Communication processes and templates are under development.  Communication is still reactive and on an ad hoc basis.	Client communication strategy processes and templates have been clearly defined.  Customer communication templates have been tailored by client type.  Client communication manager role has been established in the company.  Training of key client serving contact points is underway.	Client communication strategy, processes and templates have been disseminated throughout the company.  Key account relationship managers and client services contact points have been fully trained on the impacts of FATCA and how to effectively communicate to clients.  Technology is being used, but not fully leveraged to support external client communication.  Client communication is evolving from a reactive to proactive basis, moving from a pull to push model of information dissemination.	Technology is fully leveraged to disseminate client communication on FATCA.  Two-way open communication is actively encouraged, and updates on FATCA are frequent and timely.
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Legend	◆ US banks and brokers	■ UK, German, French and Swiss banks	▲ Furthest Ahead (US/ Foreign)
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# Questions and thank you

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