

## A Short Guide To FATCA

Law360, New York (March 15, 2011) -- The U.S. government's efforts to combat tax evasion have culminated in the Foreign Account Tax Compliance Act (FATCA), which mandates that a foreign financial institution (FFI) identify U.S. taxpayers with accounts at the FFI worldwide or suffer a 30 percent withholding on certain U.S.-sourced income payments (withholdable payments) to the FFI. In other words, FATCA would require FFIs to obtain and report information on its accounts used in whole or in part by U.S. taxpayers ("U.S. Accounts") to the IRS.

Although FATCA will begin enforcement in January 2013, strategic efforts are being taken now to avoid the 30 percent withholding tax. Recent events point to the growing implications of FATCA. In the past two years we have seen:

1. UBS AG enter into a deferred prosecution agreement and pay \$780 million to the U.S. government for maintaining hidden offshore accounts for U.S. taxpayers;
2. More than a dozen U.S. taxpayers plead guilty or be charged with tax fraud for maintaining undisclosed accounts and many others still under criminal investigation;
3. Thousands of U.S. citizens disclose to the Internal Revenue Service their secret bank accounts through a voluntary disclosure program,
4. A second voluntary disclosure program announced by the IRS in February 2011 which allows for additional individuals to disclose their offshore bank accounts.

### The Goal of FATCA:

The goal of FATCA seems simple and to the point: to combat offshore tax evasion. When put into practice, however, it becomes an extremely complicated process requiring coordination by personnel not only across business lines of the FFI but also across the globe. Even though FFIs have until Jan. 1, 2013 to comply, these complexities necessitate that the first steps of preparation should begin immediately.

This article will address the three steps that all FFIs should start now prior to identifying their U.S. Accounts: (1) create an awareness program; (2) identify the information collected by the FFI through the Customer Identification Program ("CIP"), Know Your Customer Program ("KYC"), tax, on-boarding or other relevant programs and (3) start to develop policies and procedures and a corporate governance structure.

## **A Looming Uncertainty of Terms:**

The definition of a FFI is extremely broad. FATCA generally defines an FFI as a foreign entity that (1) accepts deposits in the ordinary course of its business; (2) holds financial assets for the account of others; or (3) is engaged primarily in the business of investing, reinvesting or trading securities commodities or partnership interests. The U.S. government, in its examples of entities that would be covered by FATCA, includes savings and commercial banks, broker-dealers and custodial banks, and mutual funds, hedge funds and private equity funds, among others.

The IRS's first piece of published guidance, IRS Notice 2010-60 (the "Notice"), "Notice and Request for Comments Regarding Implementation of Information Reporting and Withholding Under Chapter 4 of the Code," is over 60 pages long and contains new acronyms, workflows and requirements for financial institutions.

It is important to note that a substantial portion of the Notice relates to the analysis of the FFI's accounts. The Notice separates the analysis into four categories: (1) pre-existing individual accounts; (2) pre-existing entity accounts; (3) new individual accounts; and (4) new entity accounts. The analysis for each category is different.

One main difference is that for accounts maintained by the FFI prior to the FFI entering into the information-sharing agreement with the IRS, the FFI is initially allowed to rely on its ability to search electronically searchable files to begin to identify its accounts maintained for the benefit of U.S. taxpayers. For new individual and entity accounts, FATCA requires a new on-boarding process and the request for additional information and documentation. It's also through the analysis of entity accounts that the FFI has to determine if other financial institutions it does business with are also FATCA compliant.

The analysis of accounts is of the utmost importance for FATCA compliance. While the Notice provides many of the steps necessary to analyze the FFI's accounts, proposed regulations have not been issued and more guidance is expected.

Among other potential changes in scope, FATCA allows for an exclusion of entities that are believed to pose a low risk for tax evasion, so it is premature to invest a substantial amount of money to build technology to analyze accounts at this point in time. Even without building a new system or leveraging your current systems to identify U.S. Accounts, the steps proposed here could be completed to initiate the building of the FFI's FATCA compliance program.

## **Worldwide Coordination: Key to Building a Strong FATCA Compliance Program**

After reading and analyzing the Notice, it is important that each FFI takes the following three preliminary steps: (1) create an awareness program, (2) identify the information already collected by the FFI on its customers, and (3) start to develop policies and procedures, and a corporate governance program.

## **Publicity, Publicity, Publicity: Create an Awareness Program**

It is important that everyone in the organization is aware of the changes that will need to be made to comply with FATCA. There will not be a “one-size fits all” solution, as each business entity of the FFI may collect different information on their customers.

Additionally, the awareness program has to start early as U.S. personnel may have to persuade their counterparts and executive level business line personnel at foreign branches of the FFI of the importance of the foreign branch’s compliance with FATCA.

Although much of the program implementation will likely fall on operations, compliance and tax personnel, it’s important to spread awareness of FATCA to all relationship managers and client facing employees overseas as these employees will likely be receiving client questions.

## **More Responsibilities for Key Personnel: Developing a FATCA Task Force**

As part of the awareness program, the FFI should create a “FATCA Task Force” to identify all affected stakeholders and create an internal and external awareness program. The FATCA Task Force should include individuals with tax, client on-boarding, anti-money laundering (“AML”), Know your Customer Program (KYC) and operations responsibility.

Most of the FFI’s initial compliance with FATCA will be driven by information the FFI already maintains. A member of the information technology software development team should also be included because identifying the FFI’s U.S. accounts will necessitate building a new database of electronic information or leveraging current systems.

## **Parties Affected by FATCA**

The FATCA Task Force must identify all stakeholders that may be affected by FATCA. This should include domestic and foreign entities and branches, subsidiaries, and business lines that will likely have FATCA reporting requirements.

Special attention should be paid to FFI operations in jurisdictions with enhanced secrecy rules. It may require extra effort to comply with FATCA in these jurisdictions given that KYC information may not be as abundant in these areas and foreign law may prevent the reporting of information by the FFI to the IRS but for a waiver by the account holder.

According to FATCA, the FFI should obtain a valid and effective waiver from the account holder if foreign law prohibits the reporting of certain information. Research regarding the secrecy laws of jurisdictions where the FFI operates should begin immediately to determine how it will affect the FFI’s ability to comply with FATCA including the transfer of data across borders.

## **Get Ready: The Internal Awareness Program**

An internal awareness program should be developed to teach FFI employees about FATCA and its importance to the FFI. The internal awareness program should start at the highest levels of the company, both domestically and abroad, to establish the necessary “tone at the top,” and trickle down through the company to compliance personnel and finally to client-facing relationship managers.

## **Prepare for Questions from Clients: External Awareness**

A list of questions that will likely be asked by clients along with sample answers should be drafted and shared with client facing personnel. This list, the “FAQs of FATCA,” should be designed to ensure that the clients of the FFI, no matter where they are located, receive consistent answers regarding FATCA and its importance to the FFI.

The FATCA Task Force should also assess whether it is prudent to send a mailer to clients that describes FATCA. An informed client base could lead to greater compliance.

## **Current Client Information versus Collection of Additional Information**

After identifying all potentially affected groups and business lines, it is important to find out what previously collected information each group has regarding its client base. According to the Notice, for pre-existing individual and entity accounts and for only a specified period of time, the FFI is allowed to rely on the information it already maintains in electronically searchable files to identify potential U.S. accounts.

In addition to reviewing information available in electronically searchable files, it is also important to inventory and to assess client information not maintained in electronically searchable files as any changes to the collection of the information of account holders will likely take a considerable amount of time to implement. For example, the FATCA Task Force may want to determine:

- Whether there is a copy of a passport in every customer’s file;
- If all addresses associated with the account are maintained in a single system; and
- Whether the account opening questionnaire needs to change to address the potential identification of U.S. Accounts and indicia of potential U.S. status of the account holders, including green card holders.

The account opening process may change significantly because of FATCA reporting requirements and the FFI’s ability to provide accurate information to the IRS is dependent on account opening documentation.

## **Procedural Updates and Policy Integration Plans**

Essentially, the FFI needs to incorporate the guidance provided by the Notice into its current policies and procedures. An initial draft of the additional procedures should, at a minimum, outline the steps to determine if individual and entity account holders are reportable to the IRS. The policies and procedures will likely be updated each time the IRS publishes additional guidance or regulations are proposed or finalized.

From a corporate governance perspective, the FFI may decide to integrate the FATCA compliance program with compliance programs relating to CIP and KYC. This function may also be placed in operations, tax compliance, a branch network or elsewhere, but no matter where ultimate responsibility resides, it is obvious that business line and worldwide coordination is key.

## **Conclusion**

FATCA has the ability to change the way the FFI does business across the globe, so it is important to ensure the correct resources are leveraged to build the FATCA compliance system. Although FATCA does not go into effect for more than 18 months and the IRS will likely issue more guidance with proposed regulations forthcoming, the FFI should begin preparing for FATCA now.

While some of the details relating to implementation may change between now and Jan. 1, 2013, the steps proposed here are necessary and important to not only set the correct tone for the FFI's compliance, but also for beginning the assessment of its FATCA readiness.

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