

Foreign Account Tax Compliance Act for South African financial institutions

To accelerate the ongoing crack down on US persons thought to be hiding assets overseas, the Foreign Account Tax Compliance Act ("FATCA") imposes a 30% withholding tax on income and capital payments from the US unless financial institutions enter into an agreement with the IRS to report all US customers and obtain certification from non-individual customers (i.e. companies or trusts) confirming that no US persons hold an interest of at least 10% in that non-individual, or holds *any* interest if the non-individual is a trust. Where a US person does have such an interest, then details (name, address and TIN) must be passed to the IRS. The IRS has been clear that withholding is not an alternative to collecting the required information.

The agreement would cover all entities in which the financial institution has a 50% interest as part of an expanded affiliated group. Therefore although for example the South African parent, branch or subsidiary of a financial institution is not in receipt of income and capital payments from the US itself, it may be required to enter into an agreement with the IRS where in an expanded affiliated group.

FATCA requires foreign financial institutions to obtain information about every holder of every account across all of their affiliated entities, to comply with verification and due diligence procedures to identify US accounts and to report annually with respect to any US account or suffer the new 30% withholding. If an FFI enters into such an agreement, the reporting requirement would apply even if a US person only holds non-US assets.

A reclaim process will be available but to date the US has been a predominantly relief at source jurisdiction without the need for reclaims. Thus, it is likely that the imposition of any withholding tax will have serious cash flow consequences.

Relief via exemption from the legislative requirements is limited but includes:

1. Where low risk of tax evasion is determined and there are adequate documentation standards within the country of tax residency of the beneficial owner of the obligations in question
2. Regularly traded interests on an established securities market (which will not be treated as a financial account)
3. A financial institution which does not maintain US accounts
4. Depository accounts which are not treated as United States accounts for these purposes if (1) each holder of the account is a natural person and (2) the aggregate value of all depository accounts held (in whole or in part) by each holder of the account maintained by the financial institution does not exceed \$50,000.

Although further clarification with respect to the legislation is clearly needed, valuable concessions may be negotiated with the US Treasury and before the regulations which will give the legislation practical effect are issued. This may be both either on an individual basis or through recognition of industry and country specific requirements. For example to the latter effect, as foreign exchange transactions in South Africa are subject to exchange control regulations, would this be considered a low risk of tax evasion for the purposes of the legislation?

Should you wish to discuss the current lobbying efforts and/or your requirements please do not hesitate to contact Nazrien Kader (details below).

Practical considerations

If a financial institution enters into an agreement with the IRS there are some immediate considerations, including:

- How will US persons be managed? Will they be held in specific entities, jurisdictions and will they be offered all products?
- How will US persons be identified? FATCA does, in effect, require checking the whole of the customer base to identify a relatively small population.
- What are the systems implications? There are likely to be system enhancements required to flag and track US persons as well as linking to Know-Your-Customer information.
- Will account opening procedures be changed in order to positively identify US persons in accordance with the IRS definition?
- How will the project be managed throughout a group? The IRS will expect common compliance benchmarks and it may be effective to open a dialogue with the IRS to discuss plans and scope etc.
- What controls will be put in place to ensure compliance? There is a separate independent audit requirement and the IRS could terminate the agreement with the consequent 30% withholding tax applied on all proceeds from financial investments in the US.

- What exemptions and possible negotiations with the US Treasury should be considered?

Timeline

The legislation applies to payments made on or after 31 December 2012, however the regulations are yet to be drafted to give practical effect.

Most institutions have concluded that extent of the changes demanded by the legislation means that the time available to become compliant is insufficient.

A practical approach

Financial institutions need to act now in order to understand the scale of the compliance challenge they face and to have the best chance of an orderly and cost effective implementation of the required process and procedures. Many institutions are looking to engage in negotiations with the US Treasury in an effort to influence the effect of the Regulations and to seek to reach agreement on a workable compliance standard. To have the best chance of reaching a workable agreement, institutions are:

- Undertaking FACTA communication programs, including workshops, to increase the awareness and understanding of the new requirements within the business
- Undertaking risk assessments, including a gap analysis for existing compliance processes which need to be scalable to accommodate the demands of other potential disclosure regimes, for example OECD
- Negotiating with the US Treasury, either individually or through trade associations, to request concessions around the application of the legislation to existing accounts, the information to be obtained, the verification and due diligence procedures and the agreement of transitional provisions (for South Africa please contact xxx)
- Developing compliance strategies and establishing effective project management structures to implement those strategies effectively
- Understanding the associated systems, data and process implications
- Specifying and implementing the required systems, data and process enhancements

Our experience

Our team of experts, drawn both globally and locally in South Africa from Corporate Finance, Forensic, Information & Technology Risk and Tax, can support institutions through all aspects of the compliance implementation. Deloitte has extensive experience of working with global and national financial institutions to address a wide variety of regulatory related issues, including AML policies and procedures, single customer view and tax disclosure requirements. Our work encompasses related technologies and processes, testing of the tools implemented by clients and benchmarking.

We have over 400 financial services professionals who have performed large scale regulatory investigations for major banks. As well as program management and technical advice, these projects utilise a diagnostic approach to identify risk and then detailed data analysis and investigation to filter transactional and account information. Our tax team is experienced in all aspects of US cross border activities and in particular international information reporting and withholding regimes. Deloitte has outstanding relationships with US Treasury and the Internal Revenue Service and is uniquely placed to provide advice on good practice.

Team Leaders

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