



The Foreign Account Tax Compliance Act (FATCA)

And its impact on technology and operations

WHITE PAPER

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FATCA is a complex regulatory area concerning tax avoidance, and SAS advises all financial institutions to seek professional guidance from a qualified tax adviser when considering their response to FATCA requirements. SAS is not a tax adviser and does not offer tax advice.

The contents of this paper are subject to change, and clients are advised to conduct their own independent due diligence in the areas and topics addressed by this paper.

Foreword

Enacted by the US government and designed to target tax noncompliance by US taxpayers with foreign accounts, the first regulatory requirements of the Foreign Account Tax Compliance Act (FATCA) are due to come into force in 2014, and financial institutions across the world need to be prepared for the new reporting and withholding requirements ahead.

Calling for non-US financial institutions worldwide (referred to as foreign financial institutions, or “FFIs”) to enter into an agreement with the US Tax Authority (the “IRS”) to identify, document and report on US accounts maintained by US tax-liable entities, FATCA will have a significant impact on the operational activities and technology landscape of FFIs. They will be required to install and maintain new operational systems designed to identify US tax-liable entities at the point of on-boarding.

Additional milestones include requiring FFIs to periodically complete a sweep of their existing client and account base to identify entities that appear to be potentially US tax liable. This will be a challenging exercise, with FFIs needing a holistic view of their client base in order to run the appropriate FATCA scoring of a full client relationship.

This white paper takes a look at both the immediate and long-term implications of FATCA and outlines how SAS can help FFIs prepare for the challenges ahead.

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Overview

FATCA is firmly on the horizon

With the first wave of FATCA regulatory requirements coming into effect in July 2014, FFIs are fast running out of time to prepare themselves. While some institutions are well advanced in their efforts to deploy an operational model to cater for the on-boarding of new clients, many others are lagging behind – typically waiting for guidance and specific instructions from their local regulators.

In some cases the intergovernmental agreements (IGAs) cater to the sharing of client information with the United States only, while in others the potential for reciprocal sharing has been included. While the governments of certain countries have reached conclusion in their discussions concerning this legal framework for the sharing of private banking data, in many other countries IGA negotiations have not yet finished. Where IGAs are in place, regulatory guidance can be more precise, but where IGAs remain unsigned, regulatory guidance is limited or absent.

The resultant situation is an environment which makes planning very difficult for many participating FFIs. A lack of precision and guidance from local regulators, compounded by an uncertain – or, at the least, a very new and unproven – legal environment has made the design of a compliant “Target Operational Model” very difficult to achieve.

BANKING	INVESTMENT & INSURANCE	ASSET MANAGEMENT & FUND INDUSTRY
Savings banks	Broker dealers	Mutual funds
Commercial banks	Clearing organizations	Funds of funds
SL associations	Trust companies	Exchange traded funds
Thriffs	Custodial banks	Hedge funds
Credit unions	Retirement plan custodians	Private equity
Building societies	Annuity contracts	Venture capital
Co-op banks	Cash value insurance contracts	Investment vehicles

Figure 1: Industries affected by FATCA

The Challenges Ahead

It's so different from AML

It is difficult not to compare this FATCA compliance with the anti-money laundering environment that FFIs typically have to deal with. Regulatory precision, international standards and a largely unambiguous legal environment help FFIs build and maintain fully compliant operational solutions. However, these attributes are largely absent for FFIs facing the challenge of FATCA compliance.

And it's only the start

The United States has taken the lead in the broad fight against tax evasion with the enactment of FATCA. However, while discussions may still be at an early stage, several other governments have also expressed an interest in clamping down on cross-border tax evasion. In 2013, both the G8¹ and G20² summits included the subject of tax evasion on their agendas, and many points of common agreement center on this area.

While recognizing that the introduction of far-reaching anti-tax evasion legislation is some way off in many countries, a prudent FFI may form the view that it is only a matter of time before it is faced with new client identification regulations that share a common theme with FATCA. If an FFI concedes this point, it would also be prudent to view FATCA compliance not wholly through the prism of cost minimization, as inflating budgets at this stage to cater to a compliance solution that can be quickly and easily expanded over time may actually be the best way to minimize total cost of ownership (TCO).

¹ www.gov.uk/government/topical-events/g8-2013

² www.g20.org/docs/g20_russia/priorities.html

The IRS starts to walk the talk

FATCA was first introduced in 2010 as part of the Hiring Incentives to Restore Employment (HIRE) Act in the United States, with a central aim of identifying US tax-liable entities with assets and income overseas, reporting them and, where appropriate, making tax-related deductions at the source.

As a result, banks are now faced with the challenges of having to design, test and implement upgraded client due diligence (CDD) platforms in order to accommodate the FATCA requirements associated with identification of US tax-liable entities. Not only do these upgraded CDD platforms have to integrate with upstream source systems containing client data, but they are now required to also verify data quality, engage external reference data and complete indicia searches. These requirements greatly stretch existing CDD solutions and represent a significant challenge for institutions wishing to deploy a FATCA-compliant platform quickly and economically.

The IRS has also introduced significant client reporting obligations, with institutions now facing the reality of having to generate, verify and file a series of client reports to their local regulator, the IRS or both.

Specific reporting requirements are typically governed by IGA arrangements, but local reporting requirements under IGA 1 and IGA 2 are likely to vary by jurisdiction. This further complicates FATCA compliance for institutions operating across multiple countries, as the requirements of one regulatory agency may differ from those in another. Finally, many regulators have yet to formalize their reporting requirements, leaving institutions in a difficult position of not knowing – with precision – their specific reporting obligations.

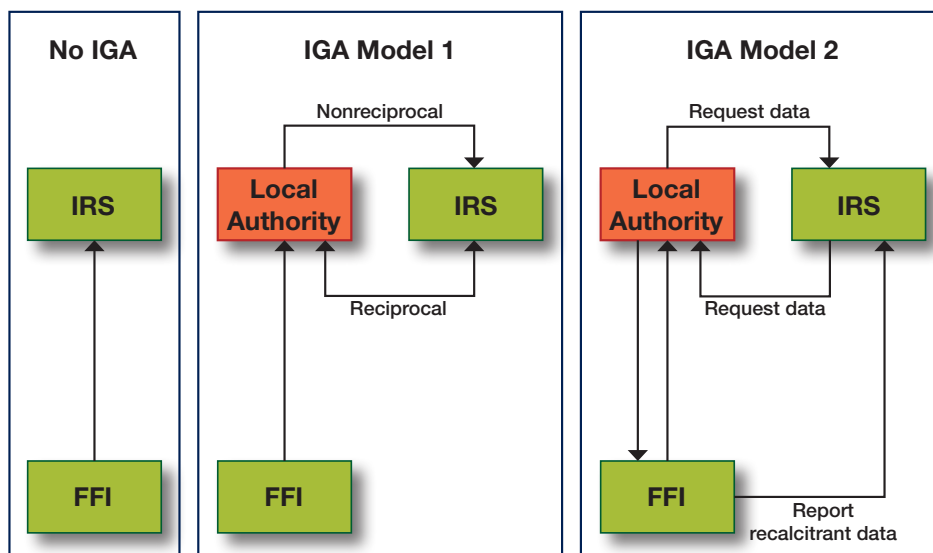


Figure 2: IGA Summary

And the stick it carries is big

As a stimulus to force FFI compliance, FATCA makes provision for the withholding of 30 percent of income originating from a US asset that is owned by an FFI, and the details of this are widely published.

Going beyond the broad area of withholding, FFIs have only to look at the events unfolding in Switzerland – “ground zero” in the history of FATCA – to get a taste of what else might occur in the event of the deliberate shielding of US tax-liable clients.

As in the world of AML, regulatory authorities are not shy in imposing significant fines on institutions found to have been noncompliant. For individuals personally involved in attracting US clients on to a Swiss banking platform, the consequences have been arguably worse – with the imprisonment of banking officers and several criminal investigations involving Swiss banks ongoing.

The \$780 million fine levied against UBS³ was the first indication of the seriousness with which the IRS treats the subject of tax evasion. The imprisonment of Bradley Birkenfeld, a UBS relationship banker and whistle-blower, further drove this point home and more was to come. In 2013, the IRS indirectly forced the closure of Wegelin⁴ – Switzerland’s oldest bank and the 13th oldest in the world – after the bank assisted US clients in hiding \$1.2 billion from the IRS for almost 10 years. It used to be said at Wegelin that the only way a relationship banker would leave the company was due to retirement or death – the old adage that the only certainties in life are death and taxes proved true once again.

The FATCA Milestones

As things currently stand, almost all of the regulatory requirements that an FFI is obligated to achieve follow on from one central task: the identification of US tax-liable entities. Everything else – documentation, withholding, reporting and monitoring – flows naturally from this conceptually simple task. It follows, therefore, that the key task is to develop a capability that ensures that US tax-liable entities are identified promptly.

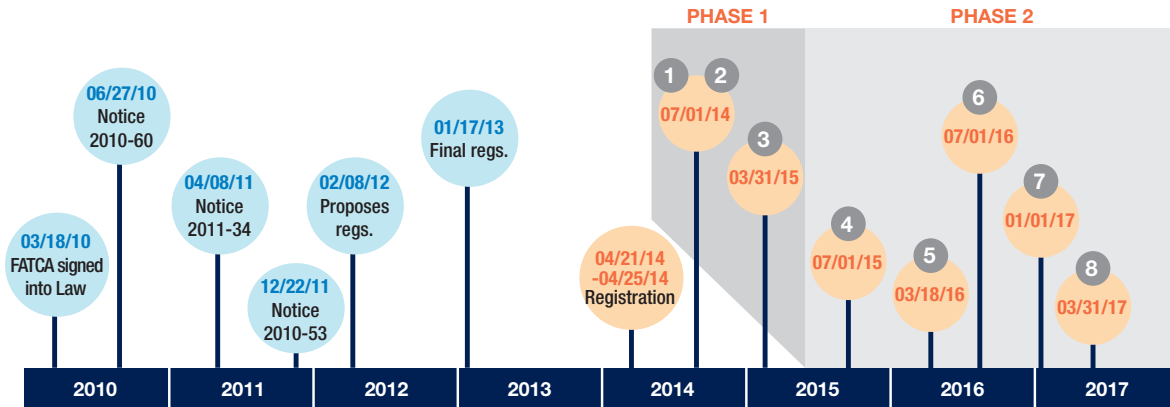
FATCA can be broken down into two distinct phases:

Phase 1: Taking effect on July 1, 2014, Phase 1 concerns the identification of US tax-liable entities at the point of on-boarding. In other words, it involves FFIs amending or enhancing their process of new client take-on (NCTO) and the associated due diligence applied to clients that have indicia suggesting a relationship with the United States.

Phase 2: Commencing mid-2015, Phase 2 concerns the identification of US tax-liable entities through the examination of existing client data. An FFI will be required to conduct periodic sweeps of its enterprise data to identify, link and score clients and accounts for the purposes of identifying US indicia that may lead to a US tax-liable entity. This is a particularly challenging task given typical data quality issues that exist at most FFIs.

³ UBS coughs up names and cash in US tax probe: <http://www.managementtoday.co.uk/news/882821/>

⁴ Swiss bank Wegelin to close after US tax evasion fine: <http://www.bbc.co.uk/news/business-20907359>



Requirements:

- | | | | |
|---|--|---|---|
| 1 | New account opening procedure | 5 | Complete due diligence of all accounts |
| 2 | Withholding (FDAP) on new noncompliant accounts | 6 | Annual IRS reporting, including aggregated recalcitrant accounts |
| 3 | Reporting for 2014 accounts only | 7 | Withholding, including gross proceeds and pass-through payments |
| 4 | Complete due diligence on pre-existing high-value accounts | 8 | Annual IRS reporting, last year of reporting on accounts held by NPFFIs |

Figure 3: FATCA Timeline

Identifying a potential (“tentative”) US tax-liable client during Phase 1 is, however, only the first step toward achieving FATCA compliance. An FFI will be required to complete subsequent steps centered on the collection of supporting documentation, the assignment of a “final” US tax-liable classification and the reporting of such to the IRS. Withholding follows, the details of which are typically governed by the specifics of an IGA. Where IGAs are absent, withholding involves the direct remittance of funds to the IRS.

In order to provide some guidance for FFIs, the IRS has published a series of indicia which it seeks to apply to the identification of natural persons potentially liable for US taxes. It has also provided guidance on the number and types of supporting documentation that an FFI is required to gather from a client in order to support the client’s correct classification. Finally, the IRS has also provided details of the reports that it requires an FFI to generate and file concerning specific US tax-liable clients.

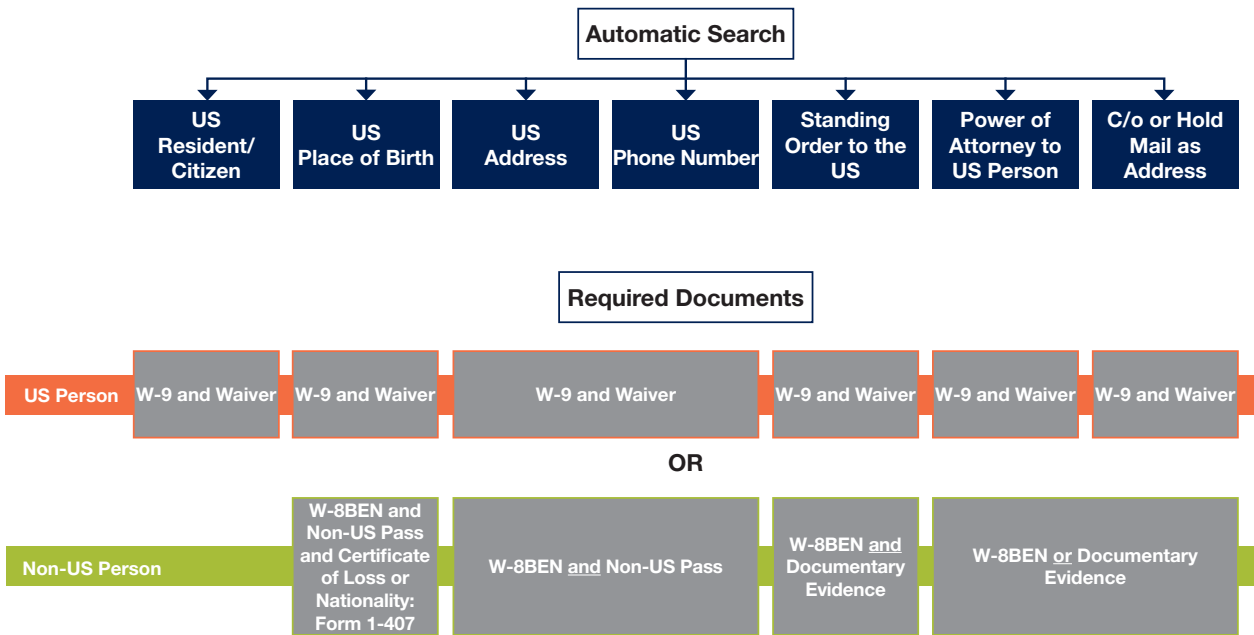


Figure 4: Indicia for Natural Persons

Capabilities

To help support organizations in their FATCA compliance initiatives, SAS has focused much of its initial efforts on tackling the immediate operational and technology challenges for Phase 1 – primarily the NCTO process.

SAS has a number of solutions that can help an FFI become FATCA compliant. These solutions are based on SAS’ extensive experience in dealing with enterprise data quality challenges and in the design and development of innovative analytical techniques that can be applied to that data in order to generate high-quality alerts at low false-positive rates. SAS has also collaborated with leading organizations to develop a prebuilt operations workbench to ensure that all potential US tax-liable new clients are correctly processed with the correct documentation being obtained at the point of on-boarding. SAS believes significant operational efficiencies can be delivered together with FATCA compliance.

In addition to the interrogation of client data and the provision of an operations workbench SAS has also developed extensive IRS, regulatory and internal reporting capabilities. IRS reports are programmatically generated, and SAS® supports e-filing requirements.

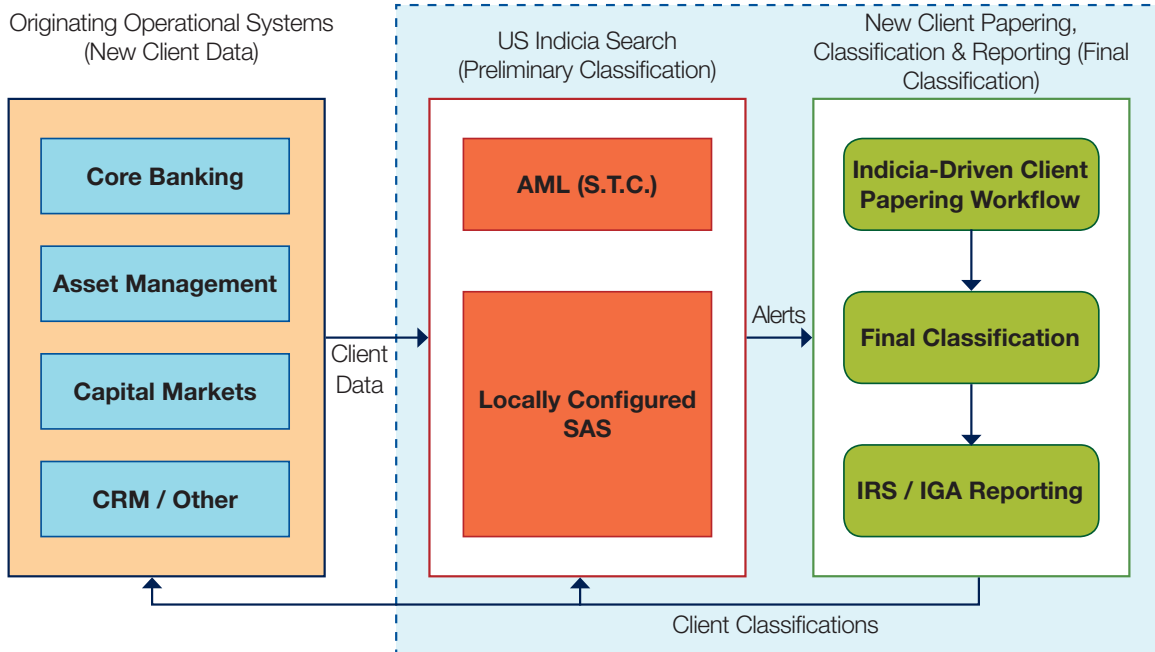


Figure 5: SAS® Solution for FATCA Components

The Benefits

The SAS® solution for FATCA provides SAS' clients with:

- Best-in-class data quality and data integration solutions to address real-world shortcomings in enterprise source systems.
- Advanced analytical capabilities capable of interrogating client data to identify potential US tax-liable entities at the point of on-boarding.
- Generation of high-quality client alerts at low false-positive rates.
- An integrated operations workbench with pre-packaged FATCA best-practice industry workflows.
- Prebuilt IRS report generators and e-filing capabilities.
- A future-proof solution catering for the easy and rapid reconfiguration of the operations workbench to meet both client customization and future regulatory requirements.
- An easy, quick and low-cost business intelligence environment to develop and maintain custom reports and queries.
- A Phase 1 infrastructure that also provides a platform for Phase 2 compliance.

SAS® solutions can be customized to work with the legacy environment of an FFI in order to drive down TCO. The SAS prebuilt operations workbench helps reduce the time to value and deliver proven operational practice to an area where ambiguity currently exists.

SAS® Professional Services teams, together with SAS industry partners, provide professionals with international experience to help you get up and running. SAS' aim is to help FFIs achieve FATCA Phase 1 compliance quickly, and in an economically sustainable manner, while creating a road map for the ongoing FATCA challenges ahead.

Why SAS?

A proven track record

SAS has worked closely with top financial institutions for more than 35 years, creating solutions to address critical business needs. In the financial services industry alone, SAS data integration, fraud detection, risk management, regulatory compliance and other software is used by more than 3,000 financial institutions worldwide, including 97 percent of banks in the Fortune Global 500®. SAS award-winning solutions handle the challenges specifically associated with the volatile financial services industry, and SAS can help institutions better manage their strategy, risk, customers and channels to maximize profitability, achieve greater shareholder value and gain a clear competitive advantage.

About SAS

SAS is the leader in business analytics software and services, and the largest independent vendor in the business intelligence market. Through innovative solutions, SAS helps customers at more than 65,000 sites improve performance and deliver value by making better decisions faster. Since 1976 SAS has been giving customers around the world THE POWER TO KNOW®. For more information on SAS® Business Analytics software and services, visit sas.com.



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