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FATCA and its Impact on Wealth Management Systems

White Paper

FATCA an overview

The Foreign Account Tax Compliance Act 2009 (FATCA) is primarily aimed at bolstering reporting and withholding tax compliance for US citizens who invest through and/or in non-US entities. The Internal Revenue Code will, as of payments made after 31 December 2012, demand the disclosure of new and different information of US citizens who use Foreign Financial Institutions (FFI). Non Financial Foreign Entities (NFFE) must also comply or be subject to a 30% withholding tax.

The scope of the application of FATCA is broad, and the requirements are widely regarded as onerous and essentially a revenue raising provision Thus, those Weath Managers impacted by the the act will be required to undertake exhaustive reviews of their current processes and procedures in order to accommodate FATCA requirements.

At the time of writing this White Paper, the final details of FATCA have still not yet been published – the planned date for release of the ***draft*** proposals is May 2011 - the available project window is now only 18 months – this may seem more than adequate, however projects such as this invariably require the participation of many stakeholders. Our own view is that FATCA is already putting Wealth Managers under great pressure to assess, plan, and execute any FATCA IT and operational change projects. The predicted outcome of the imposition of these stringent regulations is that those US citizens previously using foreign financial entities to mask their tax status will be exposed to the same tax laws as fellow citizens using US financial entities.

FATCA, Foreign Financial Institutions (FFI)

FATCA, under section 1471 will impose demanding changes to all FFIs. Section 1471(c) establishes that an FFI is a foreign entity that:

- Accepts deposits in the ordinary course of banking or similar business;
- Holds financial assets for the account of others as a substantial part of its business; or
- Is engaged (or holds itself out as being engaged) primarily in the business of investing, reinvesting or trading securities, partnership interests, commodities, or any interest in these mentioned items.

Thus, foreign private equity firms, hedge funds and so forth all fall under the FFI definition.

FATCA, Imposition of withholding tax on FFI

Under Chapter 4, FATCA has burdened FFIs with a 30% withholding tax. This tax is to be applied to any witholdable payment made to either a FFI or a non-financial foreign entity (NFFE). Those burdened with responding to this new regulation are the withholding agents; under FATCA, the withholding agent would include private equity firms, hedge funds, QIs etc. Moreover, as withholding payments include a expansive range of payments, the potential impact of this tax is indisputably destructive.

FATCA, how FFI's can avoid a withholding tax

In order to avoid the imposition of a 30% withholding tax, FFIs are required to enter into an agreement with the Internal Revenue Service (IRS) to undertake a number of reporting duties. These duties include the need to report to the IRS the personal details of all US clients with accounts larger than $80,000. Whilst the exact requirements are yet to be unveiled, it is expected that they will include the IP address of any computer the account holder logs on with, the average balance per annum, maximum account balance, as well as all withdrawals and receipts.

FATCA, how FFI's can avoid a withholding tax

As stated above, those entities that fall under the FFI definition will face onerous reporting requirements. Whilst previous Know Your Customer legislation may have set the groundwork for many institutions, there is an undeniable need for FFIs to undertake systematic reviews of their internal systems. Chief compliance officers, tax reporting heads and other key players within FFIs will need to evaluate the requirements in order to remediate any possible risk associated with FATCA non-compliance. It is widely acknowledged that these evaluations will uncover the need for robust changes to internal systems, control frameworks, processes and procedures. Ultimately for FFIs, the new reporting and withholding regime will have an effect on current account opening processes, transaction processing systems and Know Your Customer procedures. As the aim of the act is to banish secrecy and enable the IRS to claim what it believes should be paid in tax by US citizens, the full extent of technological enhancements required by many, if not most FFIs is understood to be extensive.

Conclusion

Although the Internal Revenue Codes Sections 1471-1474 do not become effective until 1 January 2013, many FFIs have embarked on assessing the impact of FATCAfrom an operational and IT perspective. Moreover, whilst anxiety surrounding the current lack of Treasury guidance on the implementation of FATCA has manifested itself amongst FFIs, the performance of comprehensive compliance risk assessment now, alongside the evaluation of necessary modifications to existing systems should provide FFIs with a sufficient level of risk intelligence required to address compliance with FATCAs new withholding and reporting regime.

Financial Institutions should not assume that rules do not apply to them. It is crucial that in order to effectively manage the new provisions, financial institutions must begin assessing their needs and associated costs for compliance. By performing the proper compliance risk assessment now and evaluating necessary modifications to your existing systems, your organisation will be armed with the level of risk intelligence required to address compliance with FATCA's new withholding and reporting regime. <<can this paragraph be moved to the "Conclusion" section?>>

FATCA, how can 3i Infotech help?

As an IT solutions and services provider, 3i Infotech is working with clients and the wider Wealth Management industry to help them increase their overcome this operational challenge and understand how best to support them. All Tier 1 global Banks have invariably embarked on strategic global programs relating to taxation compliance. And Tier 2 UK/European Wealth Managers with a significant US customer base are also reviewing their support for FATCA. In the UK, many clients are currently upgrading their operational and systems capabilities in order to comply.

We have a range of FATCA focused IT services – like some listed below (based on clarity on FATCA requirements):

1. FATCA IT compliance assessment, impact and gap analysis
2. FATCA IT implementation planning and Roadmap
3. FATCA Business and Management Information around KPIs and internal SLAs
4. FATCA IT implementation program management and execution oversight
5. FATCA IT project implementation execution support
6. FATCA IT Compliance Testing and Validation
7. Any other relevant FATCA IT related consulting / execution aspects will be a great help.
8. Hosting and managed services around any legacy / retired systems

About 3i Infotech

3i Infotech (www.3i-infotech.com) is one of India's leading IT companies and among the top 3 Indian Software Products Companies.* The Company provides software products, IT services and BPO services (Managed IT Services, Application Software Development & Maintenance, Payment Services, Business Intelligence, Document Imaging & Digitization, Operations Outsourcing and IT Consulting) for the Insurance, Banking, Capital Markets, Mutual Funds, Wealth Management and Government verticals. The Company services customers in over 50 countries across 5 continents.

The Company's quality certifications include SEI CMMI Level 5 for Software business, ISO 9001:2008 for BPO, ISO/IEC 27001:2005 for Data Center Operations and ISO/IEC 20000-1:2005 for Data Center Management Services. The Company has embarked on re-appraisal under SEI CMM ML 5 for all of its major software development centres in India.

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