

## Comment

# FATCA- A disproportionate administrative burden

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The U.S. Congress estimates that the United States currently lose \$100 billion annually to offshore tax abuses. In his endeavor to halt the perceived abuse, President Obama signed a law, named Foreign Account Tax Compliance Act (FATCA) on March 18, 2010. The new law will require non-U.S. financial institutions to make additional efforts in identifying and reporting U.S. beneficiaries. In Luxembourg, banks, investment funds, insurance companies as well as wealth managers will be impacted. Given that the new regime starts on the 1st of January 2013, there is limited time left for the affected institutions to prepare and implement the burdensome requirements. Under the FATCA rules, a foreign financial institution (FFI) would need to enter into an agreement with the U.S. Treasury to provide information about its U.S.

account holders each year. Failure to conclude that agreement would result in a 30% withholding tax applying to U.S. source payments made to the FFI. These payments would include dividends, interest and sales of U.S. securities. The agreement will require that an FFI obtains information from each account owner to determine whether the account is a U.S. account and submit an annual report of information with respect to its U.S. accounts to the U.S. tax authorities. This includes those accounts of non-U.S. entities that are substantially held by U.S. persons. For payments to so-called recalcitrant account holders, the FFI would need to apply a 30% withholding tax. For U.S. account holders who would not grant a banking secrecy waiver, the FFI would need to close the account after a certain period of time.

## Huge scope of the law

It is clear that a major motivation of the drafters of FATCA was to make the system as watertight as possible. Indeed, over the last two years U.S. investigators discovered that U.S. tax cheats used foreign banks to evade taxes. For this reason, the new regime has been set up so broadly that almost no financial sector escapes. Banks, investment funds, insurance companies, wealth managers, trusts, partnerships, private equity and other vehicles will be FFIs and required to apply FATCA. What makes the regime so burdensome is that it requires specific documentation to be collected for virtually all account holders of an FFI. Some retail banks in Europe have millions of accounts; therefore it is not difficult to imagine that investigating all these accounts is a huge task.

"The estimated number of impacted financial institutions, investment funds and insurance companies (several hundred thousand worldwide) is potentially higher than U.S. tax evaders"

### Key Luxembourg financial sectors impacted too

Luxembourg banks that offer the possibility to their customers to invest in U.S. securities will need to apply the new documentation and reporting procedures imposed by FATCA. Accounts will need to be analyzed to ensure they are not U.S. accounts, IT systems will need to be upgraded, procedures need to be created or adjusted... all within 24 months. Another key Luxembourg industry that will be impacted is the investment fund industry. However, the question is as to whether the FATCA provisions are feasible at all for Luxembourg investment funds, given the European investment funds distribution model. Indeed, UCITS vehicles are typically sold through various intermediaries who do not pass on the information regarding the investors to the

fund. Finally, it is expected that insurance companies selling the very popular unit-linked life insurance contracts will also be captured by FATCA. Certain wealth managers might also be inside its scope.

### Comments and suggestions from the industry

The new FATCA law left significant discretion to the Treasury with regard its implementation. For this reason, representatives of different industry associations entered into dialogue with the U.S. Treasury. With the aim to provide further guidance regarding the implementation of the FATCA provisions, the Treasury released Notice 2010-60 on August 27, 2010. The Notice has the objective to set forth the general framework for implementing FATCA. In particular, the Notice provides for certain exemptions from the withholding obligation,

the definition of an FFI and details with regard to the documentation and reporting obligations. Nevertheless, there is much disappointment that the Notice left many questions unanswered. As an example, the Notice did not contain the broad-based carve-outs for widely held investment vehicles that many had hoped for.

However, even though there are still uncertainties, all potentially impacted institutions should quickly start investigating how they will be affected and what they can already do now. Although no official statement has been made yet, it is expected that draft regulations with clear guidance will only be published in summer of next year. However, as the new rules will start in 2013, it would certainly be imprudent to wait until the draft regulations are issued before beginning with an impact analysis.

### Conclusion

The U.S. Government introduced the FATCA provisions with the clear intention of closing possible loopholes of its current tax system. At present, however, the FATCA provisions seem to put a disproportionate administrative burden upon foreign financial institutions. Remarkably, it is expected that FATCA generates an additional 300 million U.S. dollars in tax revenues annually. Compared to the estimated 100 billion of estimated annual total tax abuse, this seems rather insignificant. It is also interesting to note that some commentators estimate the number of impacted financial institutions, investment funds and insurance companies to several hundred thousand worldwide—than U.S. tax evaders.