Foreign Account Tax Compliance Act (FATCA)

Proposed regulations create new challenges

April 2012
On 8 February 2012, the US tax authorities (IRS) published the long-awaited draft version of the FATCA implementation guidelines. Nearly two years after adoption of the Foreign Account Tax Compliance Act, the IRS, with its proposed regulations, has provided selective forms of relief for the institutions concerned and has extended the implementation deadlines for certain requirements. Some parts of the Act are not yet sufficiently specific. For instance, there is still no model agreement for financial intermediaries, and the rules for passthru payments remain vague.

Financial institutions ought not let themselves be deceived: the USA has not altered its aim of involving all financial service providers worldwide in collecting information on the accounts of American citizens abroad, starting from July 2013. The timeframe remains tight. Banks must quickly seek solutions and adapt their processes in such a manner, for instance, that new account openings from July 2013 onward are compliant with the new Act. Meanwhile, internal controls must also be established to ensure lasting adherence to the regulations.

We have been following the FATCA regulatory process closely from the start and, for the purpose of facilitating your implementation of FATCA, have already issued two publications with the aim of providing clarity and drawing attention to the strategic and operational challenges to be faced in the future. That is also the objective of this, our third publication.

Although the timely implementation of FATCA is important, banks cannot rely solely on this aspect in interactions with the USA. The Act only relates to future banking business. It does not address past dealings with US persons. For this reason, a global solution is needed between Switzerland and the USA to settle any problematic cases arising from past business. However, the outcome of that discussion will not alter the fact that institutions conducting business with US securities in the future will need to implement FATCA. The sooner financial institutions begin this process, the more flexibility they will have in implementation.

On that note, we hope you find the brochure an interesting and informative read. If you have any further FATCA-related questions, please do not hesitate to contact a member of our team for assistance.
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1. Executive summary

Proposed regulations: Strong pressure persists
The draft FATCA implementation guidelines (“proposed regulations”) published on 8 February 2012 do provide selective forms of relief for the institutions concerned: with regard to checks on existing clients, the proposed regulations specify significantly higher thresholds, and the electronic review process has been given more importance, thus reducing the effort involved. But for the most part, the IRS is adhering to its approach and the original timeframe: the registration of participating FFIs (foreign financial institutions) is to commence at the beginning of 2013. 1 July 2013 is the first possible date on which FFI agreements may enter into effect. Of special significance for Swiss financial institutions is the concept of the “expanded affiliated group” (EAG), which requires all majority-controlled FFI members of a group to conclude FATCA agreements. With this regulation, the IRS aims to pressure countries into creating legal bases for the conclusion of FATCA agreements, thus enabling the release of client information.

Unresolved issues: Continuing uncertainty surrounding FFI agreements and passtru payments
The proposed regulations leave some important questions unresolved. For instance, there is still no model agreement for financial intermediaries. There is also uncertainty regarding passtru payments. The rules outlined previously are considered impracticable in the industry, and the proposed regulations fail to give a precise definition of passtru payments. It is proposed that the withholding requirement be introduced no earlier than 1 January 2017. The “final regulations”, expected in summer 2012, should provide further clarity.

Regulatory environment: Harmonization with other projects
Financial institutions are currently facing numerous additional regulatory initiatives. It is advisable to harmonize the various projects carefully to generate synergies between them, thus minimizing the costs for institutions.

Need for action from a project perspective: Focus on key areas
Many financial institutions have so far limited their activities to an analysis of FATCA’s impact on the business model. The draft implementation guidelines have eliminated some areas of uncertainty, which means that institutions should now begin to examine closely the operational implications, and adapt their processes and IT landscapes accordingly. In view of the phased schedule for introducing FATCA and the remaining areas of uncertainty, we recommend a focused approach. The primary emphasis should be on the analysis of existing clients and adaptation of the new account opening process. Particular attention should be paid to examining data quality. If the data is of sufficiently high quality, the indicia search for existing clients can be performed on a largely automated basis. Other topics, not least pertaining to reporting and passtru payments, should be addressed as a second priority, in our view.

Certification: New tasks for the internal control system
The implementation guidelines indicate in numerous places that participating financial institutions must take measures to ensure lasting compliance with the FATCA provisions. The responsible officer to be appointed by the FFI is charged with confirming this to the IRS, including in the context of self-certification. Financial institutions must therefore expand their internal control systems to encompass this aspect. In addition, within one or two years of the effective date of the FFI agreement, the responsible officer must also certify, among other things, that all information on existing clients has been properly clarified. This means that self-certification requirements must be taken into account from the very beginning of FATCA projects; formal evidence records must not be forgotten.

All statements in this publication are interpretations made by Ernst & Young to the best of its knowledge. They are based on the draft implementation guidelines (“proposed regulations”) and do not relate to the definitive implementation guidelines (“final regulations”) to be issued in the future.
2. Current regulations

2.1 FATCA overview
FATCA has been on the agenda of financial institutions ever since the President of the United States signed the HIRE Act in March 2010. With this Act, the USA aims to obligate financial institutions worldwide to support its fight against tax evasion and to disclose the assets of persons liable to pay US taxes. Although the IRS has published numerous guidelines since FATCA’s entry into force, there are still many unresolved questions regarding implementation.

The regulations now incorporate some of the feedback provided to the IRS by the financial industry and various associations with relation to the previously published Notices. The most important changes relevant for banks and the fund industry are described below.

Global solution with the USA – Review of the past
Even if Swiss financial institutions implement FATCA, this will not automatically settle the tax dispute with the USA. The rules established by FATCA relate to future business, while any possible past breaches by institutions or their employees remain unresolved. A global solution is therefore needed to settle any US legacy cases throughout the financial center. Such a solution must aim to release both the banks and their employees from criminal liability in connection with cross-border banking activities. Ideally, clients would also be released, as in the withholding tax agreement with Germany and the United Kingdom. It would be good to clarify this soon and end the uncertainty, particularly as the USA does not shy away from unpopular measures directed at banks without a presence in the USA, as recent examples show. A global solution would also allow the banks to acquire new business with US clients once again.

FATCA regulations timeframe overview
Figure 1

| 18 March: FATCA enters into force, HIRE Act is signed. |
| 27 August: Publication of the first IRS Notice (2010-60); includes definition of FFIs and certain exceptions and requirements related to documentation and reporting. |
| 8 April: Second IRS Notice (2011-34); amendments to certain requirements, further guidelines, e.g., regarding passthru payments. |
| 14 July: Third IRS Notice (2011-53); provides additional time for the conclusion of FFI agreements, identification, reporting and withholding. |
| 8 February: Proposed regulations issued by the IRS (REG-121647-10); further specifications regarding client identification, extended implementation deadlines. |
| 30 April: Deadline for submitting input to the IRS. |
| Summer: Publication of the definitive final regulations. |
| Fall: Binding FFI agreement with instructions. |
| 1 July: Deadline for introducing the new account opening process. |

| 2010 | 2011 | 2012 | 2013 |
2.2 Implementation guidelines
(proposed regulations, REG-121647-10)
The implementation guidelines consist of nearly 400 pages, so this brochure is no substitute for a detailed examination of the draft itself. In the following, we concentrate on the areas of greatest urgency and those with particularly far-reaching consequences:

- Client identification
- Clarification of deadlines
- Definition of “deemed-compliant” financial institutions
- Expanded affiliated groups (EAGs)

There are no changes to the basic principle of operation of the FATCA regulations: The participating FFI (foreign financial institution) must (I) identify its clients, (II) request a waiver from any US persons who maintain direct or indirect account relationships, (III) report certain account details of these clients to the IRS on an annual basis, and (IV) penalize recalcitrant clients who do not allow themselves to be sufficiently identified, as well as any non-participating financial institutions, with a 30% withholding tax on US source payments.

How FATCA works
Figure 2
Client identification – Due diligence process

New individual accounts: For individual accounts opened after the agreement is concluded with the IRS (effective date of the FFI agreement), the participating financial institution, in addition to reviewing the information it has collected in line with the current Anti-Money Laundering (AML) provisions and Know Your Customer (KYC) rules, must also check all other account opening information for US indicia and request further documentation if necessary. In Switzerland, the AML and KYC areas are primarily covered by the Agreements on the Swiss banks’ Code of Conduct with regard to the exercise of due diligence (CDB 08), the Anti-Money Laundering Act and the associated Ordinance.

The following table shows the various indicia for individual accounts, and the relevant documents to be requested:

### Documentation requirements for new clients

#### Figure 3

<table>
<thead>
<tr>
<th>US resident / citizen</th>
<th>US place of birth (unambiguous)</th>
<th>US address, US mailing address</th>
<th>US telephone number</th>
<th>Standing order to the USA</th>
<th>Power of attorney granted to person with US address</th>
<th>c/o or „hold mail“ as sole address</th>
</tr>
</thead>
<tbody>
<tr>
<td>W-9 and waiver</td>
<td>W-9 and waiver</td>
<td>W-9 and waiver</td>
<td>W-9 and waiver</td>
<td>W-9 and waiver</td>
<td>W-9 and waiver</td>
<td>W-9 and waiver</td>
</tr>
</tbody>
</table>

**Not a US person**


It is likely that the IRS will not provide a waiver, as this should be based on local law.
New entity accounts: For entity accounts opened after the agreement has been concluded with the IRS, the participating financial institution must check such accounts, regardless of their amount, to determine whether they feature a US person as a direct or indirect substantial owner. The account holder must issue an independent confirmation for this purpose. The only exemption from this duty of confirmation concerns those accounts opened by another participating financial institution or by account holders verifiably active in trade and commerce outside the financial sector. This means that the duty of confirmation is essentially limited to passive investment units (passive NFFEs). It remains unclear whether the IRS intends to create a specific form for this type of confirmation.

Preexisting individual accounts: As is generally known, the first stage of FATCA requires participating financial institutions to examine all preexisting client relationships for the presence of US accounts. The proposed regulations adhere to the “de minimis” threshold of USD 50,000 for individual accounts that are only cash accounts. Participating financial institutions may opt to omit the identification procedure for these accounts. For all remaining accounts, the new regulations abandon the distinction between “private banking” and other accounts, instead specifying a threshold of USD 1 million (high value accounts), and release the client advisor from certain review obligations. The IRS aims for client identification to be performed on a predominantly centralized and electronic basis: after all accounts are electronically checked for US indicia, a paper-based review (“enhanced review”) is also to be conducted for accounts containing the equivalent of over USD 1 million. Certain aggregation regulations must be observed in this context: all accounts within the expanded affiliated group of the financial institution must be grouped together. The list of indicia corresponds for the most part to Notice 2011-34, now with the additional criterion of a US telephone number.

Alternative identification procedure: For accounts below USD 1 million, the electronic search need only be performed with reference to the available indicia. The IRS does not indicate whether additional clarifications are required if the data for such accounts, such as the US telephone number, is not available in electronic form.

Additional enhanced review: If the electronic search of high value accounts does not reveal any US indicia, this must then be followed by a paper-based search (“additional enhanced review for high value accounts”). The IRS has yielded to pressure from the financial industry to the extent that this additional paper-based search can be omitted if the CRM system or other database entries allow for electronic searches and if search criteria are available and suitable for evaluation. The only exception is the “US place of birth” criterion. In all cases, however, client advisors must confirm that they are not aware of any US indicia for the relevant client.

Accounts that have already been identified as belonging to non-US persons under the QI provisions need not undergo further searches. This does not apply to high-value accounts, for which the client advisor must at least be questioned. Experience has shown, however, that such documentation is only available for account / portfolio relationships, but not for pure cash accounts.

The enhanced review essentially relies on documents received by the financial institution during the previous five years. The financial institution must also ensure that any change of circumstances (e.g. if residence is acquired in the United States or if the threshold limit of USD 1 million is exceeded) can be traced and the documents reviewed accordingly.
The following graphic provides a schematic illustration of the review process for preexisting individual accounts:

**Identification of preexisting individual accounts**

Figure 4

<table>
<thead>
<tr>
<th>US account</th>
<th>US-Cash account ≤ USD 50'000</th>
<th>Foreign a/c in QI doc.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Account ≤ USD 1 million</strong></td>
<td><strong>Account &gt; USD 1 million</strong></td>
<td></td>
</tr>
</tbody>
</table>

- Alternative identification procedure ¹
- Additional enhanced review ²

1. Alternative identification procedure for preexisting individual accounts that are offshore obligations (§1.1471-4(c)(7))
2. Additional enhanced review for high value accounts (§1.1471-4(c)(8))

**Preexisting entity accounts**: The identification procedures for entity accounts have also been simplified in some respects. For instance, a new “de minimis” threshold of USD 250,000 has been introduced. Accounts falling below this balance are not mandatorily subject to an indicia search. For accounts between USD 250,000 and USD 1 million, the participating financial institution may essentially base identification on the information collected for AML and KYC purposes. If the balance of such accounts exceeds the threshold of USD 1 million at any later point in time, a more detailed indicia review must be carried out. The IRS places special emphasis on passive investment units (passive NFFEs). If such accounts feature an aggregate balance of over USD 1 million, the participating financial institution must request additional information on all US persons who are substantial owners (with over 10%), or must have the account holder confirm that the account holder and any beneficial owners are not substantial US owners.
Clarification of deadlines
For the most part, the IRS is adhering to its original timeframe: the registration of participating FFIs is to commence at the beginning of 2013, with 1 July 2013 remaining the first possible date on which FFI agreements may enter into effect (effective date). However, the IRS is planning a phased introduction of withholding tax and reporting requirements, i.e., in those areas necessitating changes to the system environments of financial institutions. The following overview summarizes the deadlines; the information is based on the scenario of entry into force on 1 July 2013.

Timetable for FATCA implementation

<table>
<thead>
<tr>
<th>Registration (FFI agreement)</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Registration with IRS (FFI agreement)</td>
<td>effective date</td>
<td></td>
<td></td>
<td></td>
<td>01.01.2016</td>
<td></td>
</tr>
<tr>
<td>Registration of all members of the EAG</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Client identification</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New accounts</td>
<td>01.07.2013</td>
<td>30.06.2014</td>
<td>30.06.2015</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Preexisting individual accounts</td>
<td></td>
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<tr>
<td>High value accounts &gt; USD 1 million</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Other accounts ≤ USD 1 million</td>
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<td></td>
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<tr>
<td>Pre-existing entity accounts</td>
<td></td>
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<td></td>
<td></td>
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<tr>
<td>Prima facie FFIs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other accounts</td>
<td>30.06.2014</td>
<td>30.06.2015</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Withholding on</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FDAP payments</td>
<td>01.01.2014</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sales proceeds</td>
<td></td>
<td>01.01.2015</td>
<td></td>
<td>01.01.2017</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign passthru payments</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reporting / exchange of information</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reporting of identification and account balances for US accounts</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>+ Income flows (div. / interest)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>+ Sales proceeds</td>
<td>30.09.2014</td>
<td>31.03.2015</td>
<td>31.03.2016</td>
<td>31.03.2017</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Summary reporting of recalcitrant clients</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reporting of passthru payments to NFFIs</td>
<td>30.09.2014</td>
<td></td>
<td></td>
<td>31.03.2016</td>
<td>31.03.2017</td>
<td></td>
</tr>
<tr>
<td>Confirmation / certification by the FFI officer</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Identification of high value accounts and good conduct by the FFI</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>01.07.2014</td>
<td></td>
</tr>
<tr>
<td>Identification of other accounts</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>01.07.2015</td>
</tr>
</tbody>
</table>
With regard to withholding, the IRS is aware that the establishment of a withholding tax function requires changes to computer systems and databases. For this reason, it is planning a phased introduction. The withholding requirement applies if the participating financial institution makes a withholdable payment to a recalcitrant account holder or a non-participating financial institution. An initial fixed deadline is 1 January 2014, after which withholding tax must be collected on all regularly recurring or determinable US source payments. Starting from 1 January 2015, proceeds from the sale of financial instruments will also be subject to withholding tax. The third stage, in which foreign passthru payments also become subject to withholding, will enter into effect no earlier than 1 January 2017.

A phased introduction of reporting procedures is also planned. The first key deadline is 30 September 2014. From that date, all participating FFIs must provide information on accounts they have identified as US accounts or recalcitrant accounts by the end of June 2014, at the latest. Accounts held by recalcitrant clients must be reported on an aggregate basis, but subdivided into accounts with and without US indicia and dormant accounts. For the first report, it is sufficient to provide the identifiers (name, address, TIN and account number) and the account balance in USD or in the account currency. For subsequent calendar years, reports must be submitted by the end of March of each following year.

Starting from 31 March 2016, income flows (particularly interest and dividend payments) must also be reported. The final reporting phase will commence in 2017: from the end of March 2017, sales proceeds from securities transactions must also be reported, in addition to all other information previously required.

**Expansion of the “deemed compliant” rules**

For certain financial institutions which, in the view of the IRS, do not show much potential for being abused as a means of tax evasion, the implementation regulations allow for the status of “deemed-compliant FFI” (DCFFI). These institutions need not enter into an agreement with the IRS and are also not subject to withholding on US source payments.

The regulations specify three categories of DCFFI:

1. **Registered DCFFIs**: These entities must demonstrate to the IRS that they transact business only with local and non-US clients, that they use distribution channels consisting solely of participating financial institutions, and that they transfer any US clients to participating FFIs. These include, among others, locally active FFIs, qualified investment vehicles and restricted funds. They must register with the IRS and renew this registration every three years.

2. **Certified DCFFIs**: These include, among others, small, locally active banks with a balance sheet volume of less than USD 175 million, non-profit organizations, and FFIs that only maintain accounts with less than USD 50,000. In Switzerland, not many institutions will fit this category.

3. **Owner-documented FFIs**: These are small entities, such as family trusts and investment units, which must inform the depositary institution from which they receive payments of whether they feature any US persons as owners or beneficial owners. There are some indications that trusts and similar structures could benefit from the status of owner-documented FFI, but this must be clarified by the IRS.
2. Current regulations

FATCA and internal control system requirements

Participating financial institutions must regularly confirm to the IRS that they are in compliance with the FATCA provisions. The IRS relies on self-regulation in this context. FATCA thus has a direct impact on the internal control system (ICS) and on compliance and internal audit functions. The IRS sees a key monitoring responsibility in the role of the FFI’s “responsible officer”. This officer must confirm to the IRS that compliance with the FFI agreement is ongoing. The IRS is thus requiring financial institutions to expand their relevant processes and internal directives to take account of FATCA requirements. As early as one or two years after the FFI agreement has been signed, the FFI’s responsible officer must confirm to the IRS that all FATCA requirements have been complied with regarding the analysis of existing clients. The IRS furthermore expects the responsible officer to conduct recurring checks and certifications. These requirements must be taken into account in all FATCA projects. There is no provision for a FATCA audit, e.g. by a certified external auditor. However, the IRS reserves the right to such audits if it has grounds for suspecting that the participating FFI has severely or repeatedly violated its contractual obligations.

Expanded affiliated groups (EAGs)

A special concept is used for the group-wide consideration of contractual obligations vis-à-vis the IRS. In this context, the IRS requires all directly or indirectly majority-controlled FFI members belonging to a legally established corporate group (expanded affiliated group, EAG) to conclude a separate FFI agreement and comply with FATCA. The IRS has received a great deal of input indicating that local laws (particularly including data protection provisions) conflict with the conclusion of such agreements. The new proposed regulations therefore set out transitional rules: FFI members of an expanded affiliated group located in a country with relevant legal obstacles have until 1 January 2016 to adopt the FATCA provisions and become compliant. A guillotine clause is applicable here: thus, if even a single member of an EAG is not FATCA-compliant by that date, the entire group will be considered non-compliant. It is clearly also the aim of the IRS, in this case, to pressure various countries into creating legal bases for the conclusion of FATCA agreements. This once again shows that the USA does not shy away from unpopular measures and wishes to see its legal interpretations applied to other countries.

For Swiss banks, the concept of the expanded affiliated group is pertinent for two reasons: First, Swiss banks have numerous subsidiaries in other countries. If these countries do not introduce legal regulations in the foreseeable future allowing agreements to be concluded with the IRS, a decision will have to be made as to whether such subsidiaries can remain within the expanded affiliated group. Second, there is the far more fundamental question of whether Switzerland itself has sufficient legal bases to allow financial institutions to conclude a private-law agreement with the IRS, particularly as such an agreement is effectively designed to permit an extensive exchange of information and withholding taxation for the benefit of foreign tax authorities. The existing QI agreement does constitute a precedent, but it has no domestic legal basis, as is the case for EU interest taxation, for example. These unresolved questions need to be addressed by policy-makers.
2.3 FATCA and the fund industry

In the European distribution system, it is generally the case that neither the fund nor its management know the relevant unit holders, so it is not possible for them to conduct a search for US indicia. For this reason, both the input and the lobbying directed at the IRS focus on the aim of achieving “deemed compliant” status for the fund. This status would allow the fund to collect US source income (and any passthru payments) without FATCA withholding. It was clear from the start that the IRS would only accept a solution that ensures that fund structures could not be used for tax evasion purposes. The IRS has decided to solve this dilemma by having the fund or fund management monitor the unit holders within the limits of the law (“qualified investment vehicles”) or by using a “secure” distribution channel (“restricted funds”).

Within the group of the “deemed-compliant” FFIs, “qualified collective investment vehicles” are used to monitor the unit holders. These are supervised funds in which all registered unit holders are essentially either participating FFIs or registered, “deemed-compliant” FFIs. These investors offer assurance that all indirect US investors have been identified and reported. “Restricted funds”, on the other hand, are characterized by a “secure” distribution channel. In principle, only other participating FFIs may market the units of such funds. In this way, the IRS ensures that these distribution partners prevent fund units from being sold to US persons. Furthermore, distribution agreements, fund prospectuses and advertising materials must be designed to indicate that no sales may be made to US persons, non-participating FFIs or entities with substantial US ownership.

On the surface, the granting of “deemed compliant” status to funds would appear to be a major form of relief for the fund industry. However, this picture is placed in perspective if one considers the more difficult role to be played by distribution partners: they must guarantee that no fund units are obtained by US persons (according to FATCA definitions) and a general sales restriction would appear to be insufficient for this purpose.
2. Current regulations

2.4 Unresolved questions and uncertainty
The implementation guidelines leave numerous questions unresolved. The following points, among others, require further clarification:

FII agreement and model forms: the implementation guidelines merely outline the FII agreement. The IRS intends to publish its key aspects in draft form in the near future, and a definitive FII model agreement by the fall of 2012, as well as form templates for electronic reporting to the IRS. The model agreement will contain, among other things, details regarding the required periodic internal reviews and the certification to be performed by participating financial intermediaries. The model agreement will also include a list of cases which constitute a violation of the FII agreement. The IRS has also announced that it will issue revised forms, specifically W8-BEN and W-9, in alignment with the FATCA and OI requirements. But it is not yet clear when these will be available.

Passthru payments: The passthru payment rules outlined by the IRS in previous guidelines are largely considered impracticable by the financial industry. These draft implementation guidelines do not provide any precise definition of passthru payments. The IRS has invited market participants to submit feedback on ways of making withholding on foreign passthru payments more practicable for the financial industry.

“FATCA light”: The intergovernmental approach
Simultaneously with the implementation guidelines, a declaration of intent was published on 8 February 2012, stating that the USA, Germany, France, the United Kingdom, Italy and Spain wish to negotiate a bilateral agreement regarding an alternative implementation of FATCA. With this intergovernmental approach, FATCA is to be implemented in national law. This means, among other things, that financial institutions in the various countries would report all identified US persons to the IRS via a central government office. This approach would result in certain forms of relief for financial institutions: for instance, it would not be necessary to conclude FII agreements and the handling of passthru payments would be simplified, as no withholding tax would need to be collected on payments to recalcitrant accountable holders. Little would change, however, with regard to client identification and reporting procedures. In return, the IRS asserts that US financial institutions would also provide partner countries with information about account holders and contracting parties based in these partner countries. Should these six countries reach agreement, it will amount to the introduction of an automatic exchange of information among them.

At first glance, these regulations appear to be a form of relief. However, for the time being, the simplifications under discussion would only affect business with account holders and counterparties within the five participating countries. In dealings with other countries, the general FATCA rules would still need to be applied. In concrete terms, this means that differing systems would be established for business with partner countries and other countries. This would be especially complicated for financial institutions that maintain operations both within and outside the partner countries. A system of bilateral agreements at government level would provide relief if as many countries as possible were to participate. For now, however, Switzerland and other key financial centers, such as Luxembourg, Hong Kong and Singapore, are not involved in the development of this intergovernmental solution.
3. Need for action from a project perspective

The implementation of FATCA comes at a bad time for Swiss financial institutions. The market environment in the financial industry is much tougher than it was. Declining margins and ever increasing costs are forcing financial institutions to implement FATCA in the most cost-effective way possible. Meanwhile, financial institutions are being confronted with numerous new initiatives, including the withholding tax agreement concluded with Germany and the United Kingdom, the planned introduction of the “paying agent” principle for withholding tax, and the package of measures to strengthen client protection recently published by FINMA. The ability to implement new regulatory requirements efficiently is thus becoming a key success factor.

Our experience shows that

- regulations relating to tax transparency, protection of investors and cross-border services increase requirements particularly in the areas of customer service and the handling of relevant client data
- work on projects to implement FATCA by the individual financial institutions are at very different stages
- there is considerable room for improvement in the coordination of transformation projects within the institutions.

The various projects for implementing the new regulations should not be viewed in isolation. Synergies can be realized, particularly in the creation of technical concepts and in IT implementation.

3.1 FATCA project activities: Current state of progress in the financial institutions

In recent months, most financial institutions have launched a FATCA project with the aim of examining implications and the options for action. Until the publication of the draft implementation guidelines, many institutions were primarily occupied with strategic considerations, and they have now begun to analyze the consequences of FATCA.

In coming to terms with the FATCA regulations, financial institutions are also being forced to review their business models with respect to the services offered to US persons and the management of assets belonging to persons domiciled in the USA. However, even if an institution fully eliminates business with US persons, it is not released from the FATCA regulations as long as it continues to conduct business involving US securities.

In the context of impact assessments, many institutions have analyzed the consequences of FATCA for their clients, products, processes and systems. However, financial institutions remain highly cautious when it comes to developing and implementing new IT requirements. This is due not least to the considerable uncertainty that until recently surrounded the anticipated regulations. Other priorities and cost pressures have resulted in FATCA project activities being postponed.

With the draft implementation guidelines, some areas of uncertainty have been eliminated, while other questions remain unresolved. Financial institutions must now plan their next steps against this background.

**Validation of the impact assessment**

*Figure 6*

<table>
<thead>
<tr>
<th>Status of project activities in most financial institutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mobilization</td>
</tr>
</tbody>
</table>

Ernst & Young Foreign Account Tax Compliance Act (FATCA)
3.2 Keep the big picture in mind and establish project focal points

Even if these proposed regulations have not resolved all questions, in some areas they do provide a sufficient basis for specific implementation activities.

For those in charge of projects, this raises the question of the appropriate project focal points. As a first step, we recommend validating the assumptions resulting from the impact assessment and reviewing the impact on previous results.

Focused approach leading up to FATCA compliance

Figure 7

<table>
<thead>
<tr>
<th>Strategic considerations / impact assessment</th>
<th>Design / implementation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Define business relevance</td>
<td>Validation of the impact assessment</td>
</tr>
<tr>
<td>Apply filters</td>
<td>Verify assumptions</td>
</tr>
<tr>
<td>Set priorities</td>
<td>Validate findings</td>
</tr>
<tr>
<td>Prioritize project content</td>
<td>Define certification requirements</td>
</tr>
<tr>
<td>High</td>
<td>Conceptual design</td>
</tr>
<tr>
<td>Medium</td>
<td>Validation of the impact assessment</td>
</tr>
<tr>
<td>Low</td>
<td>Key area 1</td>
</tr>
<tr>
<td>Business unit 1</td>
<td>Key area 2</td>
</tr>
<tr>
<td>Business unit 2</td>
<td>Key area 3</td>
</tr>
<tr>
<td>Business unit 3</td>
<td>Conceptual design</td>
</tr>
<tr>
<td>Business unit 4</td>
<td>Key area 1</td>
</tr>
<tr>
<td>Group entities</td>
<td>Key area 2</td>
</tr>
<tr>
<td>Identification (clients)</td>
<td>Key area 3</td>
</tr>
<tr>
<td>Products</td>
<td>Conceptual design</td>
</tr>
<tr>
<td>Reporting and withholding</td>
<td>Validation of the impact assessment</td>
</tr>
<tr>
<td>4 to 6 weeks</td>
<td>Key area 1</td>
</tr>
<tr>
<td>2-3 months</td>
<td>Key area 2</td>
</tr>
<tr>
<td>6-18 months</td>
<td>Key area 3</td>
</tr>
</tbody>
</table>

Project focal point

4 to 6 weeks

Validation of the impact assessment

- Verify assumptions
- Validate findings
- Define certification requirements
- Develop project plan

Prioritization and focus on key areas

- Conceptual design
- Validation of the impact assessment

Implementation

- Release 1: Clients
- Release 2: Withholding
- Release 3: Reporting

Project management

Central coordination, training, communication, status monitoring and budget control
For validation of the impact assessment, we suggest the following concrete project steps:

<table>
<thead>
<tr>
<th>Project focal point</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Verify assumptions</strong></td>
<td>Review assumptions made based on the proposed regulations and adapt them as necessary as part of overall planning</td>
</tr>
<tr>
<td><strong>Validate findings</strong></td>
<td>Validate the findings so far identified through the impact assessment</td>
</tr>
<tr>
<td><strong>Define certification requirements</strong></td>
<td>Specify requirements for FFI certification and incorporate these in the FATCA project</td>
</tr>
<tr>
<td><strong>Develop project plan</strong></td>
<td>Adapt project plans and set priorities:</td>
</tr>
<tr>
<td></td>
<td>• Specify key areas</td>
</tr>
<tr>
<td></td>
<td>• Coordinate the FATCA project with other regulatory projects</td>
</tr>
<tr>
<td></td>
<td>• Determine the critical path for design and implementation taking into account the available resources, anticipated development period and IT release cycles</td>
</tr>
<tr>
<td></td>
<td>• Define the work package, including anticipated results, allocation of responsibilities, and integration</td>
</tr>
</tbody>
</table>

In light of the numerous anticipated regulatory challenges, we recommend that projects such as those related to withholding tax be submitted to overall responsibility. Our project experience has shown that it is advisable to coordinate key persons on a comprehensive basis. In this way, FATCA implementation can be combined with other regulatory projects. Synergies can be realized, for instance, with relation to requirements analysis and system adaptation (including data architecture). In addition to the bundling of internal projects, there is also the option of entering into external cooperative arrangements or working groups with associations, partner banks or IT providers in order to minimize the time and expense needed for projects and implementation.

3.3 Implementation: Priorities and focus on key areas

The definitive implementation guidelines should be available in summer 2012. For this reason, it is still too early to begin the necessary adaptation of processes and systems. However, the time pressure in certain areas makes it impossible to wait any longer. We therefore recommend a focused approach. Emphasis should be placed on business-critical areas and those for which the proposed regulations provide sufficient information on requirements. Institution-specific factors should also be taken into account, of course, e.g. regarding the flexibility of IT systems, release cycles, and any reliance on third-party providers.

The key implementation areas are analyzed on the following page according to their business relevance and the likelihood of changes to the regulations (regulatory comfort).

This analysis shows that three key areas are currently at the forefront:

• Analysis of existing clients
• Adaptation of the new account opening process
• Preparation for FFI certification

We recommend focusing on these areas until the definitive implementation guidelines are available.
### Prioritization of project steps

**Figure 8**

<table>
<thead>
<tr>
<th>Selected key areas</th>
<th>Business relevance</th>
<th>Regulatory comfort</th>
<th>Possible project steps</th>
<th>Priority level</th>
</tr>
</thead>
</table>
| New clients (individual and entity accounts) | ![medium](image.png) | ![medium](image.png) | • Create transparency regarding the requirements for the opening process for individual and entity accounts  
• CRM adjustments must be taken into consideration at the same time (US indicia / FATCA status / documentation requirements) and incorporated in a technical concept | High           |
| Existing clients (individual and entity accounts) | ![medium](image.png) | ![medium](image.png) | • Create (CRM) data transparency, validate data quality, and schedule data cleansing where necessary (Is the electronic search reliable?)  
• Implement the concept and test run for the electronic search based on known criteria  
• Identify any need for additional clarifications and repapering  
• Perform client analysis and segmenting based on the identification criteria | High           |
| Withholding and passthrough payments   | ![low](image.png)   | ![low](image.png)   | • Await the definitive regulations  
• Necessary range of functions depends on the overall compliance solution (recalcitrant client · yes/no, NPFFI · yes/no)  
• Identify any need for additional clarifications and repapering  
• Perform client analysis and segmenting based on the identification criteria | Low            |
| Reporting                              | ![low](image.png)   | ![low](image.png)   | • Conduct feasibility study regarding reporting content requirements (client name, TIN, address and assets in USD or in the account currency)  
• Depending on the complexity of the IT infrastructure and data availability, begin early with the technical concept  
• Await the definitive regulations: analysis of electronic reporting files (generation of IRS form) | Low            |
| Product classification and distribution chain | ![medium](image.png) | ![medium](image.png) | • Analyze the value chain with respect to incompatible product providers and distribution partners - determine need for action  
• Analyze own products, issuers, distribution channels and custody function (business-to-business aspects)  
• Review sales restrictions (e.g., disclaimer for investors who are not US persons) | Medium         |
| Group-wide perspective (EAG)          | ![low](image.png)   | ![low](image.png)   | • Validate relevance for all legal entities within the group and validate integration in group project vs. stand-alone project  
• Prepare roll-out concept; theme-based roll-out may be possible (esp. client analysis) | Low            |
| Certification / internal control system | ![medium](image.png) | ![medium](image.png) | • Create certification requirements; prepare concept for incorporating the certification requirements as a permanent part of the FATCA project  
• Appoint the FFI’s responsible officer and clarify responsibilities  
• Ensure early involvement of compliance and internal audit areas | Medium         |
4. Conclusion

Although the FATCA implementation guidelines offer concrete forms of relief, the Act, which is to apply from mid-2013, requires large-scale efforts on the part of banks. By the time it enters into force, processes must be adapted, a new account opening process must be established, and IT systems must be extensively modified. A withdrawal from US business is not an option for reducing the compliance risks associated with FATCA. Even if institutions do not themselves have any US persons among their clients, the Act applies to them as long as they do any business involving US assets.

The sooner a financial institution addresses the challenges resulting from FATCA, the more flexibility it will have in implementation. Significant time and resources are needed to adapt processes and IT systems so that the necessary information is available for identification and reporting. An analysis of the regulations and resulting changes shows that this is a tax area where implementation must be handled by practitioners. Coordination among the relevant competences is of key importance for efficient and cost-effective implementation.

An early start to the project also makes it possible to align FATCA processes with other regulatory projects. Comprehensive overall management allows for the efficient implementation of all ongoing transformation projects. Complexity can thus be reduced in a way that promotes synergies, shared milestones and overarching implementation decisions.
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