FATCA for South African Financial Institutions

Information document

June 2013
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Introduction and Background to FATCA and the Intergovernmental Agreements

FATCA COMPLIANCE

- The Foreign Accounts Tax Compliance Act ("FATCA") is here, and is set to have a material impact on the operational and strategic activities of South African Financial Institutions (in terms of FATCA, entities that qualify as Foreign Financial Institutions will have certain client identification and reporting obligations imposed upon them).

- We set out in this information document a brief overview of FATCA and the steps that the South African Government is taking to implement it in South Africa ("SA"). We outline the obligations that FATCA and the Intergovernmental Agreement ("IGA") imposes on Foreign Financial Institutions and the steps that these Foreign Financial Institutions should take in becoming FATCA compliant.

Background to FATCA and the IGA

- The United States ("U.S") has enacted what is generally termed FATCA, which introduces an onerous reporting regime for all Foreign Financial Institutions (as defined) with respect to certain accounts, in an effort to combat tax evasion by U.S persons with offshore accounts and thereby to ensure tax compliance by U.S citizens and residents. In essence, FATCA imposes a compliance monitoring and reporting obligation on Foreign Financial Institutions, by requiring them to identify and report information to the U.S Internal Revenue Service (IRS) on all clients that are U.S persons or non-US entities with substantial U.S ownership.

- Failure to comply with FATCA will result in the imposition of a punitive 30% withholding tax on U.S source income payable to Foreign Financial Institutions.

- FATCA Regulations have been published by the IRS, which provide technical detail regarding the obligations of Foreign Financial Institutions under FATCA. The implementation of FATCA under the Regulations raised a number of issues, with the primary issue being that Foreign Financial Institutions in certain jurisdictions may not be able to comply with certain aspects of FATCA due to domestic legal impediments, such as data privacy law conflicts, and certain issues relating to duplicative reporting.

- The U.S, having recognized these concerns, was of the view that an intergovernmental approach would facilitate a more effective and efficient implementation of FATCA in a manner intended to address the legal impediments and reduce the burdens placed on Foreign Financial Institutions in jurisdictions in which an IGA had been entered into. As such, the U.S made the decision to draft two model IGA’s, namely Model 1 and Model 2 IGAs, as an alternative means to complying with FATCA.
Impact of SA’s decision to enter into IGA and potential impact on SA Financial Institutions

Impact of SA’s decision to enter into an IGA

- On 8 February 2013, National Treasury and the South African Revenue Service ("SARS") announced that they were entering into negotiations with the U.S Department of the Treasury with a view to concluding a proposed South African IGA ("SA IGA"), which will be based on the Model 1 IGA.
- National Treasury and SARS are currently in the process of negotiating the final SA IGA and drafting the local FATCA laws, which will be phased in from January 2014. The date by which the SA IGA must be entered into is 25 October 2013, failing which the full FATCA Regulations will be applied.
- The SA IGA imposes various obligations on SA Financial Institutions. Broadly, these include depository institutions (like banks), custodial institutions (for example, CSD Participants, brokers and nominees), investment entities (CISs, private equity funds, hedge funds, securitization vehicles and asset managers) and certain specified insurance companies (as defined). As is evident, the obligations are imposed on a wide variety of institutions and will have a significant impact of the South African financial services industry as a whole.
- The SA IGA contemplates that all SA Financial Institutions will be required to identify and report certain information to SARS on clients that are U.S Persons, that the SA Financial Institutions would otherwise have had to report directly to the IRS. SARS will then exchange the information with the IRS on an automatic basis.
- Another benefit of the SA IGA approach is the removal of the withholding obligations that apply under the FATCA Regulations. We would note, however, that the SA IGA does still impose certain reduced withholding obligations in respect of Non-Participating Financial Institutions.
- The decision to enter into a Model 1 IGA will have far-reaching consequences for SA Financial Institutions. The SA IGA is a treaty entered into between the governments of SA and the U.S, and will be given force and effect by local enabling legislation ("local FATCA law"). This means that compliance with FATCA is now a statutory obligation under local law and no longer envisages a contractual arrangement with the U.S. As such, it will be necessary for each SA Financial Institution to determine what the effect of these local FATCA laws will be on its operations, and to take necessary steps to fully comply with any obligations that may be so imposed. Failure to comply with the SA IGA may result in violation of SA law.
- In terms of the SA IGA, all entities are required to ascertain their FATCA status, and the status of their contracting parties and account holders. With respect to all accounts identified as being reportable for FATCA purposes, there is an obligation to obtain and provide certain information specified in the SA IGA to SARS. The SA IGA also sets out various further obligations for SA Financial Institutions. These include:
  - implementation of changes to on-boarding procedures;
  - application of enhanced SA IGA due diligence obligations, including remediation of pre-existing accounts;
  - identification of reportable accounts and annual reporting of certain information in respect of those accounts to SARS;
  - reporting in respect of payments made to Nonparticipating Financial Institutions;
  - identification of Related Entities and compliance with certain obligations in respect of Related Entities that are Nonparticipating Financial Institutions;
- All SA Financial Institutions will be required to register with the IRS, and will receive certain registration numbers (referred to as GIIN) to evidence their status. The IRS registration portal will open on 15 July 2013, and Financial Institutions will be required to register by 25 October 2013 in order to ensure their status and evidence their compliance with the local FATCA laws.
Impact of SA’s decision to enter into IGA and potential impact on SA Financial Institutions

- 1 January 2014 is the effective date for the on-boarding of all new clients (this means that clients existing before this date will be “preexisting” for IGA purposes whilst the new IGA procedures will have to be applied to client on-boarding after 1 January 2014).

- The due diligence obligations may vary depending on whether the account is that of an individual or an entity, or is pre-existing as at 1 January 2014, or a new account, or is of a high or low value accounts and this process could become quite onerous as a result. It will very likely be necessary for a SA Financial Institution to consider amendment and/or enhancement of its client on-boarding processes and reporting systems in order to fulfill these identification and reporting obligations.

- Please see below a timeline setting out the key milestones in this regard. With approximately 4 months until all Financial Institutions are required to register, the 25 October 2013 deadline is fast approaching!
**IGA Timeline**

- **15 July 2013**
  IRS Portal opens

- **25 October 2013**
  Last date to register with IRS Portal to ensure inclusion on FFI list

- **1 January 2014**
  Treat account opened on or after this date as a new account

- **30 September 2015**
  SARS must provide required information to the IRS for 2013 and 2014

- **30 September 2016**
  SARS must provide required information to the IRS for 2015

- **2013**
  - Treat Accounts opened on or before this date as pre-existing accounts
  - Complete due diligence for pre-existing high value individual accounts
  - Complete due diligence for pre-existing lower value accounts and pre-existing entity accounts

- **2014**
  - Complete due diligence for pre-existing high value individual accounts

- **2015**
  - Complete due diligence for pre-existing lower value accounts and pre-existing entity accounts

- **2016**
  - SARS must provide required information to the IRS for 2015

- **2017**
  - SARS must provide required information to the IRS for 2015
Important Next Steps

Important next steps

With the SA IGA’s requirements set to be phased in from 1 January 2014, it is critical that SA Financial Institutions be prepared to prioritize the impact assessments and where impacted, the project planning and implementation, during the remainder of 2013. We highlight below some of the key action steps to be contemplated by SA Financial Institutions to ensure compliance with the SA IGA.

Identify and Classify Financial Institutions

- It is imperative that each SA Financial Institution be classified for purposes of the SA IGA, which will determine the obligations, if any, of the SA Financial Institutions in terms thereof.
- It is also necessary to determine whether or not there are any Related Entities (as defined) within any non-IGA jurisdiction. This will require a classification of each entity within a SA Financial Institution's expanded Financial Group.
- These classifications may be of strategic relevance – particularly where a SA Financial Institution has Related Entities in a jurisdiction that has elected not to comply with FATCA. In these circumstances, certain additional obligations are placed on the SA Financial Institution.

Registration on IRS Portal

- Financial Groups are required to appoint a Lead Financial Institution (“Lead FI”) to coordinate the registration of SA Financial Institutions within the Group. This Lead FI is required to register as such on the IRS Portal.
- All SA Financial Institutions that are Reporting Financial Institutions and Deemed Compliant Financial Institutions must register with the IRS and receive the appropriate identification numbers (referred to as GIIN numbers). These numbers are important as they will serve as evidence of the SA Financial Institutions FATCA status, and may be requested by business or contractual partners.

Identify Financial Accounts

- SA Financial Institutions must identify whether or not they have any Financial Accounts in order to determine whether these are reportable accounts for the purpose of the SA IGA.

Perform Client Classification

- SA Financial Institutions should perform a comprehensive client classification, to identify any U.S. Persons, Non-Participating Financial Institutions and any entities classified as passive NFFEs under the SA IGA, which will provide them with a high-level view of the scale of the FATCA impact on their operations. We would point out that there may be an IGA impact even where an SA Financial Institution has no U.S. Persons as clients.

Systems and process updates by 1 January 2014

- The effective date for on-boarding of new clients is 1 January 2014. In this regard, it will be necessary to adopt robust new on-boarding (document collection, account identification and due diligence) procedures.

Reporting

- Financial Institutions are required to report on U.S Reportable Accounts and payments made to Non-Participating Financial Institutions. Systems may have to be developed or adapted to allow for this reporting.

As you will see, there are a number of steps that SA Financial Institutions are required to take in order to ensure compliance with the local FATCA laws (we have touched on only a few of these). It is advisable that SA Financial Institutions commence this process as soon as possible, as the deadlines are fast approaching.
KPMG tools and experience

The KPMG South Africa FATCA team is currently supporting a number of large SA Financial Institutions with their FATCA compliance programmes and FATCA impact assessments. KPMG has developed a proven FATCA methodology and various tools that can be tailored to support clients in their FATCA programmes. KPMG is able to support clients with, amongst others:

- the own entity classification, client classification and account classification stages of a FATCA impact assessment;
- providing SA Financial Institutions with guidance in respect of registration on the IRS Portal;
- The KPMG FATCA team is also uniquely placed through its industry engagements to provide industry insight to clients, as well as updates regarding the SA IGA negotiations with SARS, and the SA specific issues identified with IGA compliance;
- identification of Related Entities and advising in respect of strategic considerations thereon;
- an analysis of current on-boarding procedures and support on implementing enhancement to these procedures, as necessary, in order to comply with SA IGA obligations;
- assessing existing capabilities and advising on implications to systems and processes of the ongoing reporting obligations.

As briefly mentioned above, the local KPMG FATCA team has been closely involved in facilitating comments by the financial services industry on the SA IGA, and is well placed to advise SA Financial Institutions regarding their obligations in this respect.

The local KPMG FATCA team is also able to draw on a wealth of knowledge from the experienced multi-disciplinary global KPMG FATCA team, which consists of tax, legal and advisory experts. This is particularly useful as the SA IGA contains certain concepts which are foreign to South African law.
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