



Implementing FATCA by German banks: Challenges and Issues

Praxisprobleme deutscher Banken mit der Umsetzung von FATCA

Dr. Carsten Schmidt

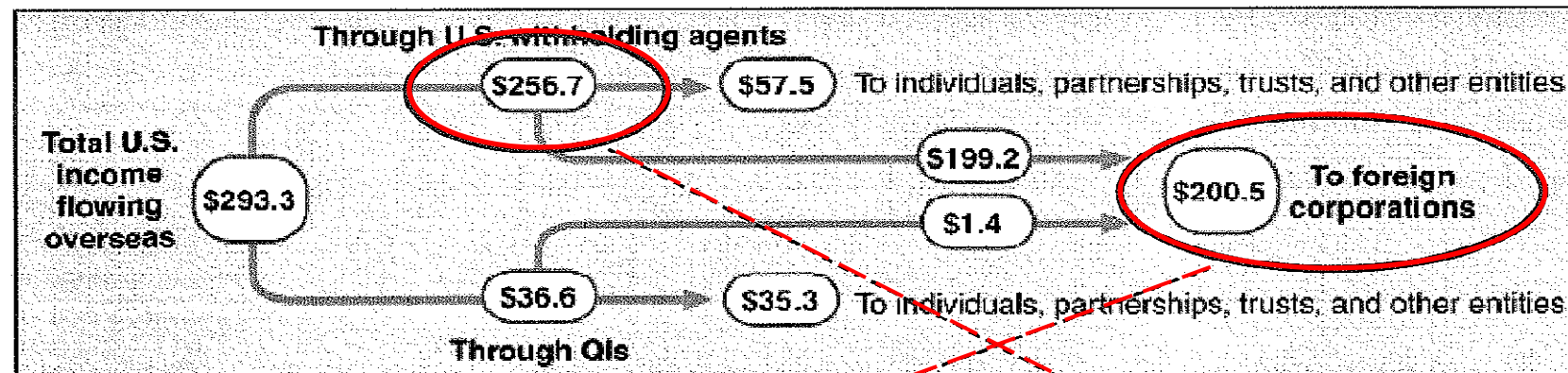
Agenda

1. Background
2. How German banks are affected
3. Strategic options and implementation aspects
4. Special issues and outlook

1. Background

U.S. Source Income Flowing through Intermediaries and to Foreign Corporations, 2003

Dollars in billions



Source: GAO analysis of IRS data.

Note: Numbers do not add to totals due to rounding.

- Nur 12,5% der Ausländer-Erträge flossen über QI, aber 87,5% über US Withholding Agents
- 68,4% der Ausländer-Erträge flossen an ausländische Kapitalgesellschaften, deren Gesellschafterkreis dem IRS unbekannt ist

Source: PricewaterhouseCoopers

1. Background

Table 2: U.S. Withholding Agents' and QIs' Withholding Rates by Jurisdiction, Tax Year 2003

Dollars in billions

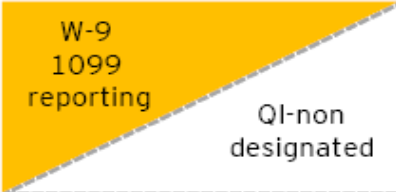
	U.S. withholding agents			QIs		
	Gross income	Withholding	Withholding rate (percentage)	Gross income	Withholding	Withholding rate (percentage)
Treaty countries	\$212.7	\$2.9	1.3%	\$22.0	\$0.9	4.0%
TIEA countries	\$24.9	\$0.7	2.7%	\$3.0	\$0.1	2.3%
OECD committed jurisdictions	\$1.2	\$0.1	5.4%	^a	^a	2.6%
OECD uncooperative tax havens	\$0.2	^a	9.3%	^a	^a	6.9%
Other countries	\$9.9	\$0.2	1.6%	\$0.3	^a	1.2%
Undisclosed	\$7.8	\$0.1	1.4%	\$11.3	\$0.4	3.5%
Not listed	^a	^a	24.2%	\$0.1	^a	2.1%
Unidentified	\$7.5	^a	1.1%	\$11.1	\$0.4	3.5%
Unknown	\$0.3	^a	8.6%	\$0.1	^a	12.1%
All countries	\$256.7	\$3.9	1.5%	\$36.6	\$1.4	3.7%

Source: GAO analysis of IRS data.

Source: PricewaterhouseCoopers

1. Background

Current situation, covered through the US QI regime:

	US Personen	Nicht-US Personen	Nicht US Gesellschaften mit US Beherrschung
US Wertpapiere	 W-9 1099 reporting	DBA-Inanspruchnahme (Pooling)	Behandlung wie Nicht-US Personen
Nicht-US Wertpapiere	Momentan nicht erfasst	Momentan nicht erfasst	Momentan nicht erfasst





Loopholes of the US QI regime:

- › Assets held indirectly by US persons via intransparent entities/structures
- › Principally no reporting of US persons without any US assets in their portfolio

1. Background

What the US want to cover additionally through FATCA:

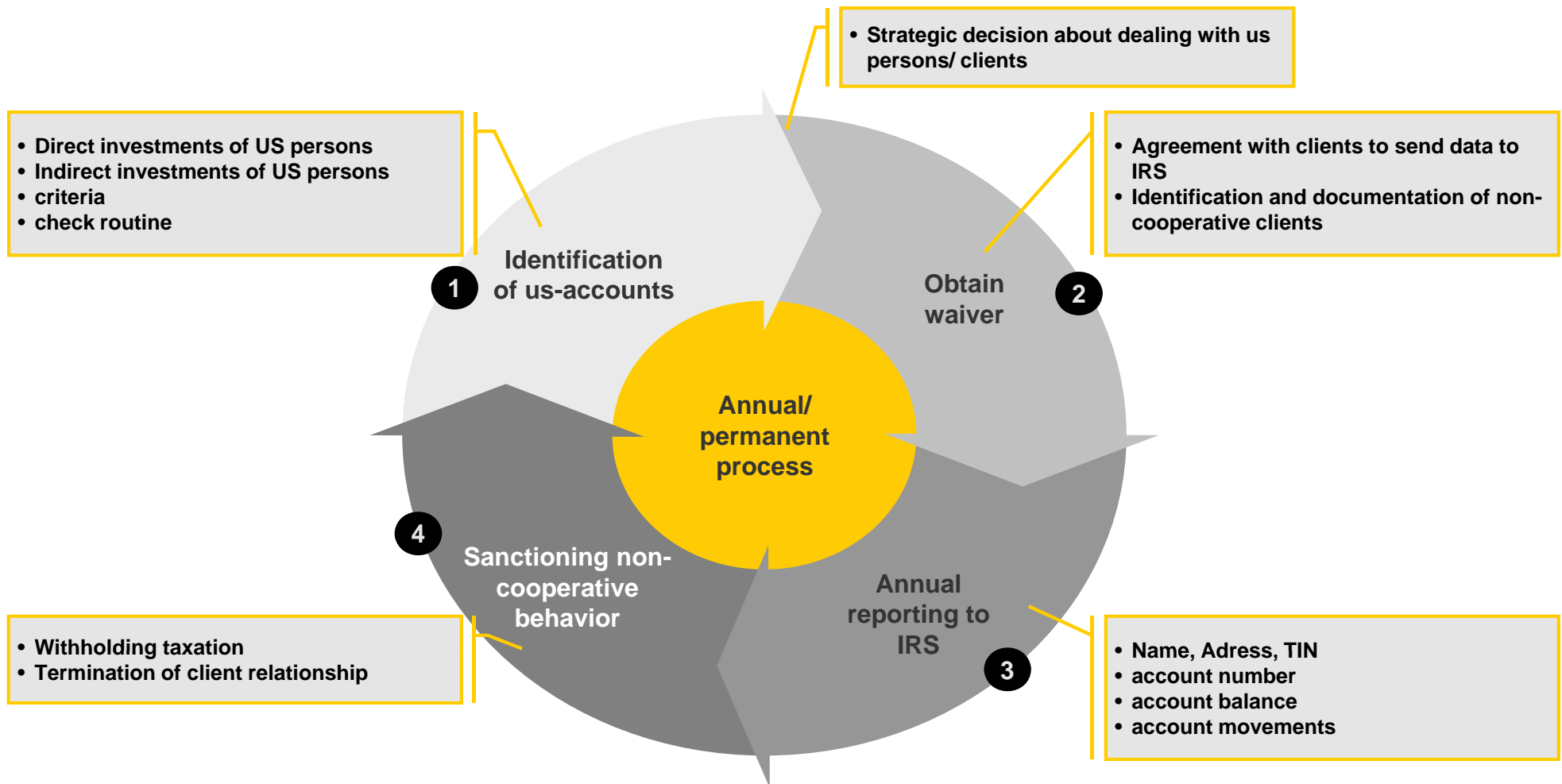
- › Reporting of US accounts/deposits held indirectly by US persons
- › Reporting of all investments (US and non-US)

	US Personen	Nicht-US Personen	Nicht-US Gesellschaften mit US Beherrschung
US Wertpapiere	W 9 1099 Reporting  FATCA	DBA-Berechtigung durch Pooling	 FATCA
Nicht-US Wertpapiere	 FATCA	Nicht erfasst	 FATCA

1. Background

- › The Foreign Account Tax Compliance Act of 2009 („FATCA“) became law in the United States as part of the Hiring Incentives to Restore Employment („HIRE“) Act.
- › FATCA has an enormous impact on the information reporting and withholding regime which is focused on strengthening information reporting and withholding compliance with respect to US persons who invest through and/ or in non-US entities.
- › A new 30 % withholding tax will be imposed on certain payments (including gross proceeds on the sale of certain assets) made to non-compliant or non-participating entities whereby participating banks will in many cases take the role of the withholding agent.
- › Avoidance of the 30 % withholding tax at the bank level is achieved through entering into an agreement with the Internal Revenue Service („IRS“) and complying with information reporting on US accounts.
- › Generally, payments made prior to January 1, 2013 will not be covered. Withholding will be required in 2013 with the annual reporting of account information related to 2013 due in 2014. For pre-existing accounts certain transition periods apply.

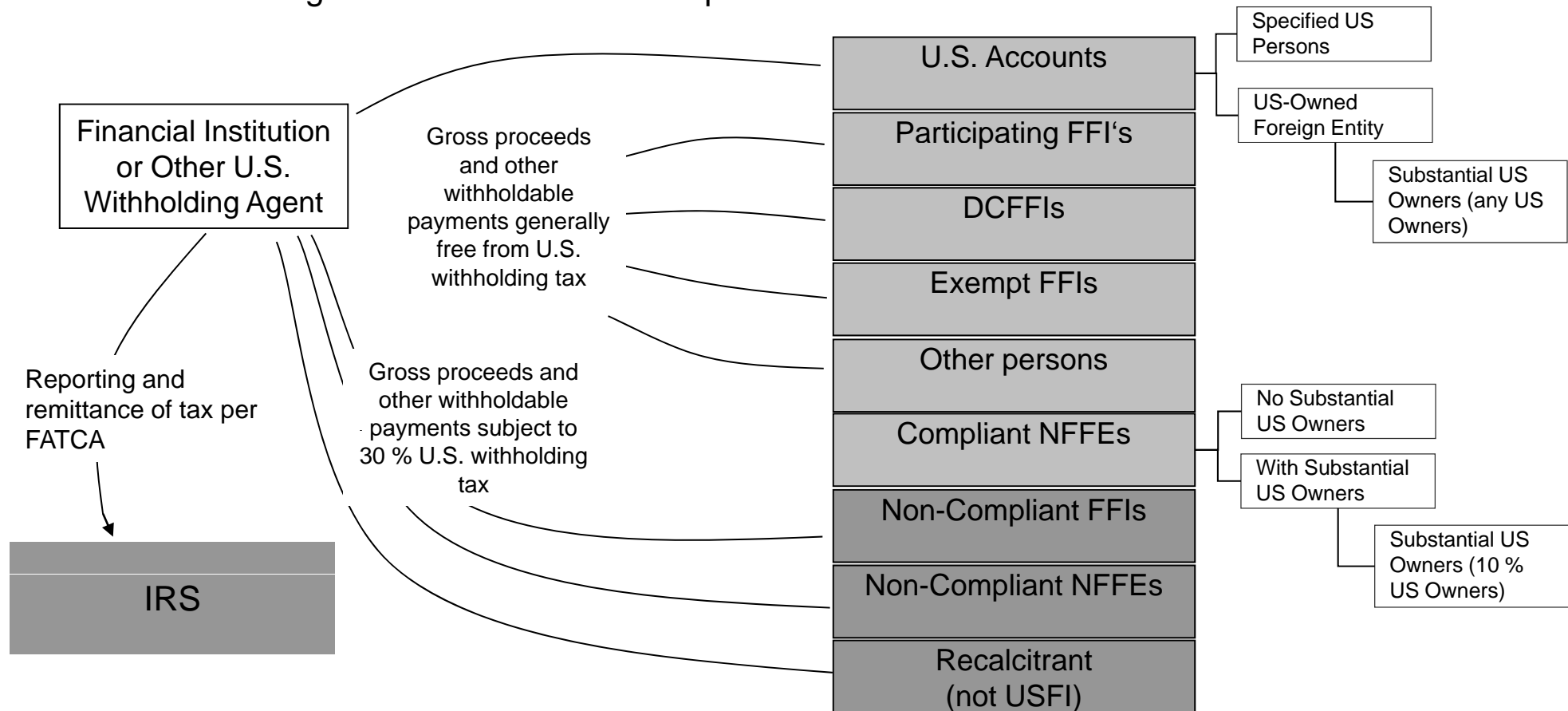
2. How German banks are affected



Source: Ernst & Young

2. How German banks are affected

Processes and categories of clients and other parties

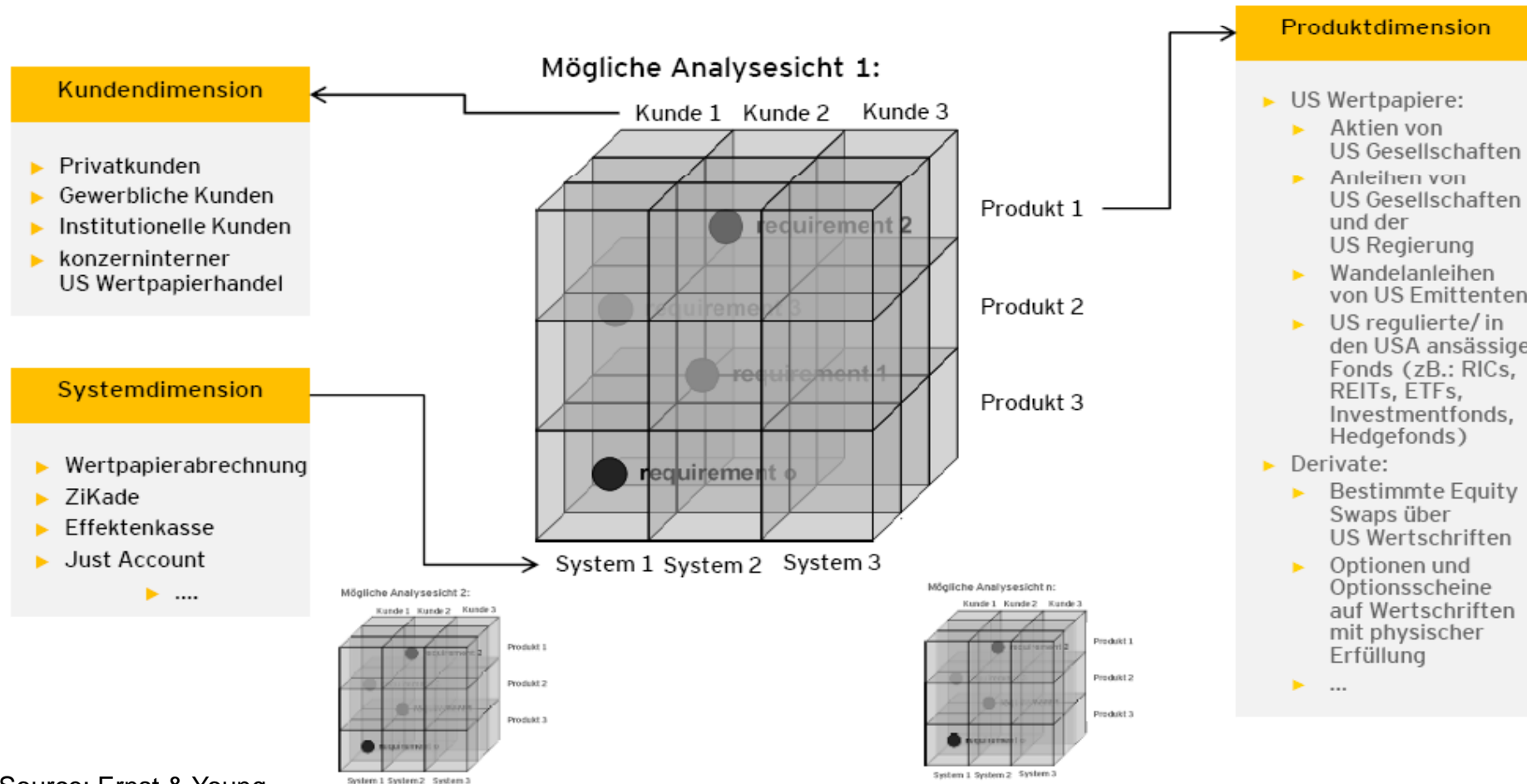


Source: PricewaterhouseCoopers

2. How German banks are affected

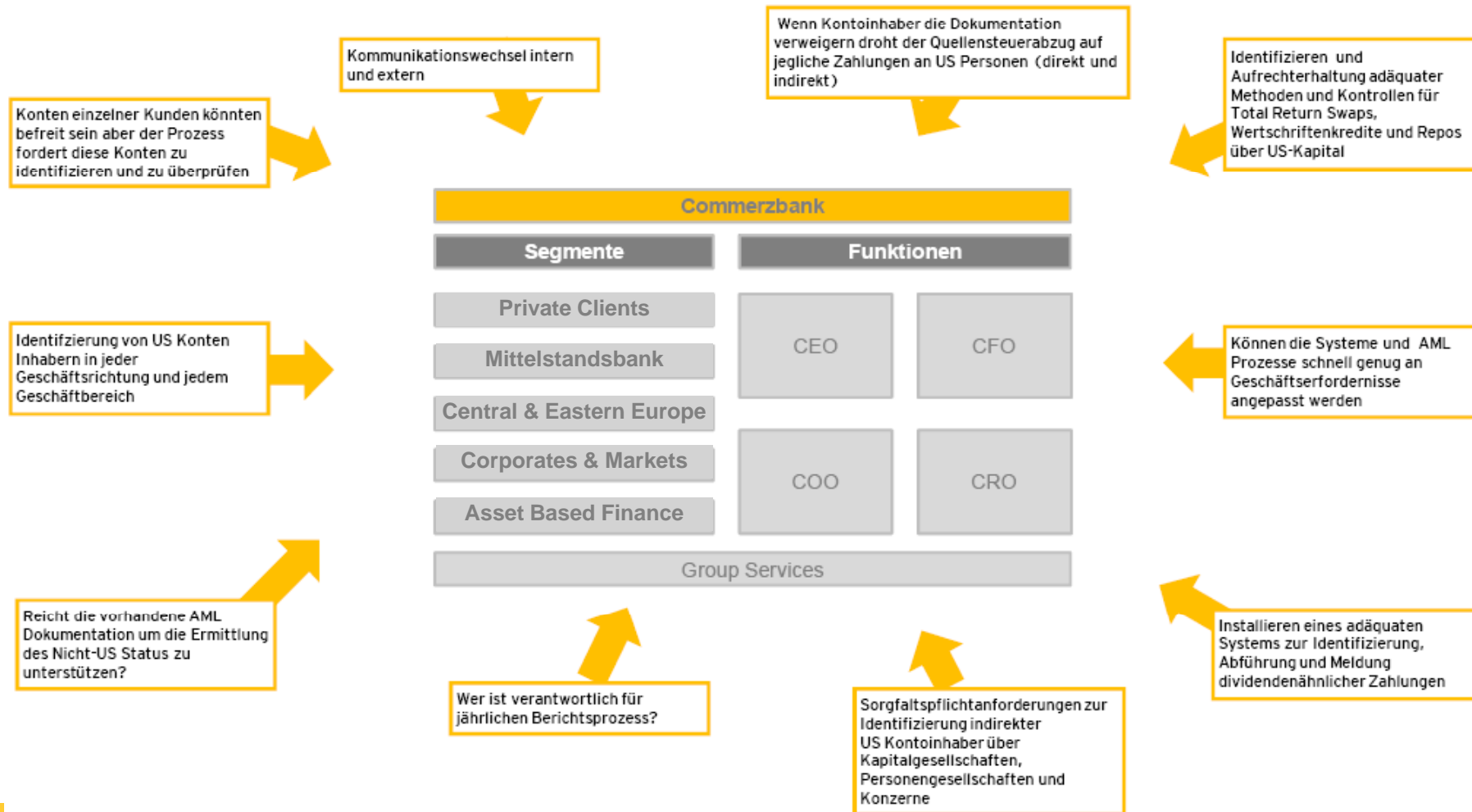
Tasks	Impacts	Key challenges
Client identification	<ul style="list-style-type: none"> › KYC & AML › Client Data Management/ Client Data Repository 	<ul style="list-style-type: none"> › Variety of systems involved › Variety of parties involved › Manual steps involved › Client communication
Withholding	<ul style="list-style-type: none"> › CoreBanking Systems › Market Data Interfaces/ Logic › Client Data Interfaces › Accounting 	<ul style="list-style-type: none"> › Change requests › Availability of resources › 3rd party collaboration › Documentation
Reporting	<ul style="list-style-type: none"> › Client Reporting/ Account Statements › Tax Reporting systems 	<ul style="list-style-type: none"> › Variety of Core Banking systems › Availability of data › 3rd party collaboration

2. How German banks are affected

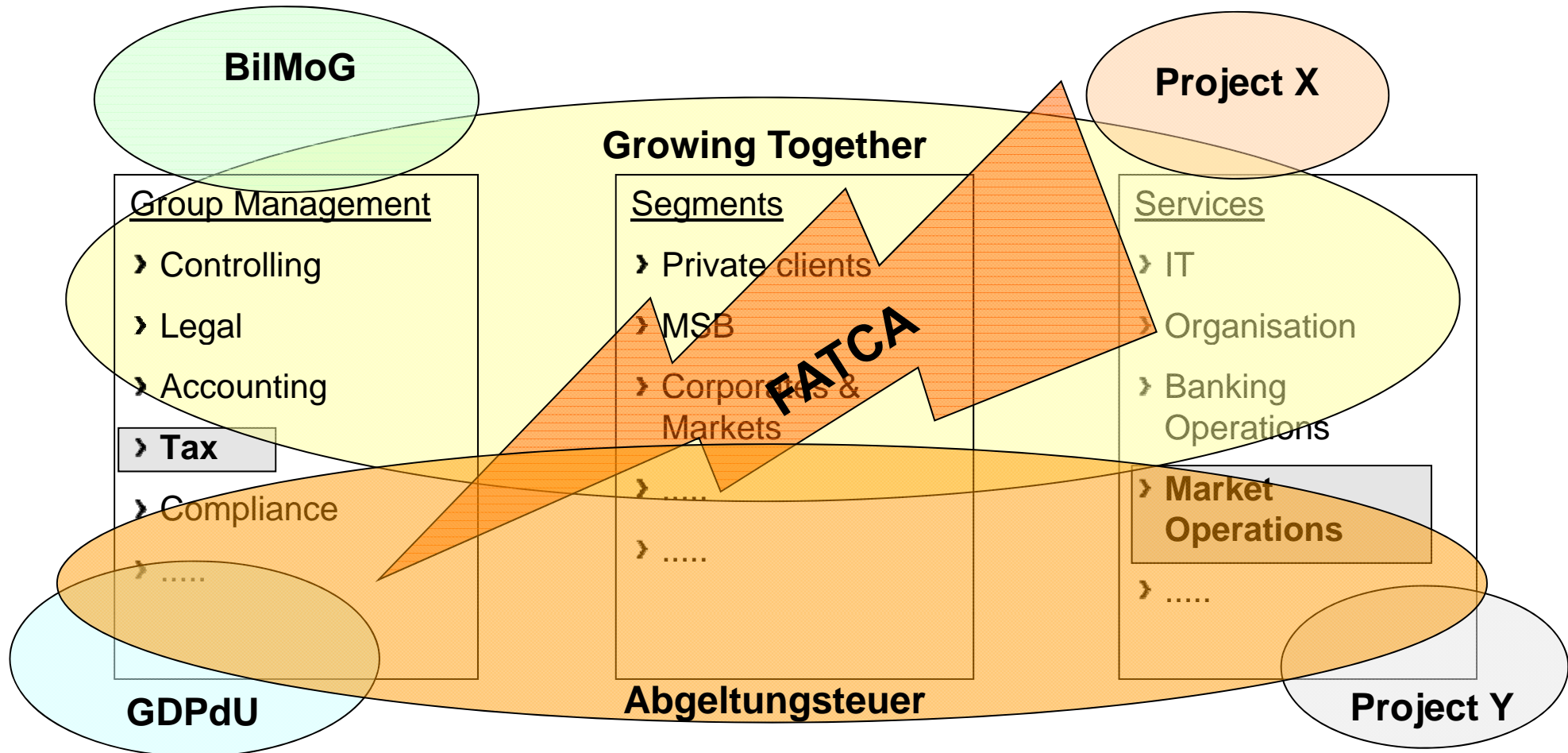


Source: Ernst & Young

2. How German banks are affected



2. How German banks are affected



3. Strategic options and implementation aspects

	PCC	MSB	CM	ABF	CEE	GS	GM
Understanding FATCA	X	X	X	X	X	X	X
Analysing impacts	X	X	X	X	X		
Strategic position	X	X	X	X	X		X
Analysing processes & costs	X	X	X	X	X	X	
Implementing / Adapting processes	X	X	X	X	X	X	
Communication	X	X	X	X	X	X	X

3. Strategic options and implementation aspects

- › Signing FATCA agreement & complying
- › Not signing FATCA agreement
- › Good-bye forever to all US clients („US Persons“)
- › Centralising all US clients in one entity
- › Joint ventures
- › Outsourcing vs. insourcing

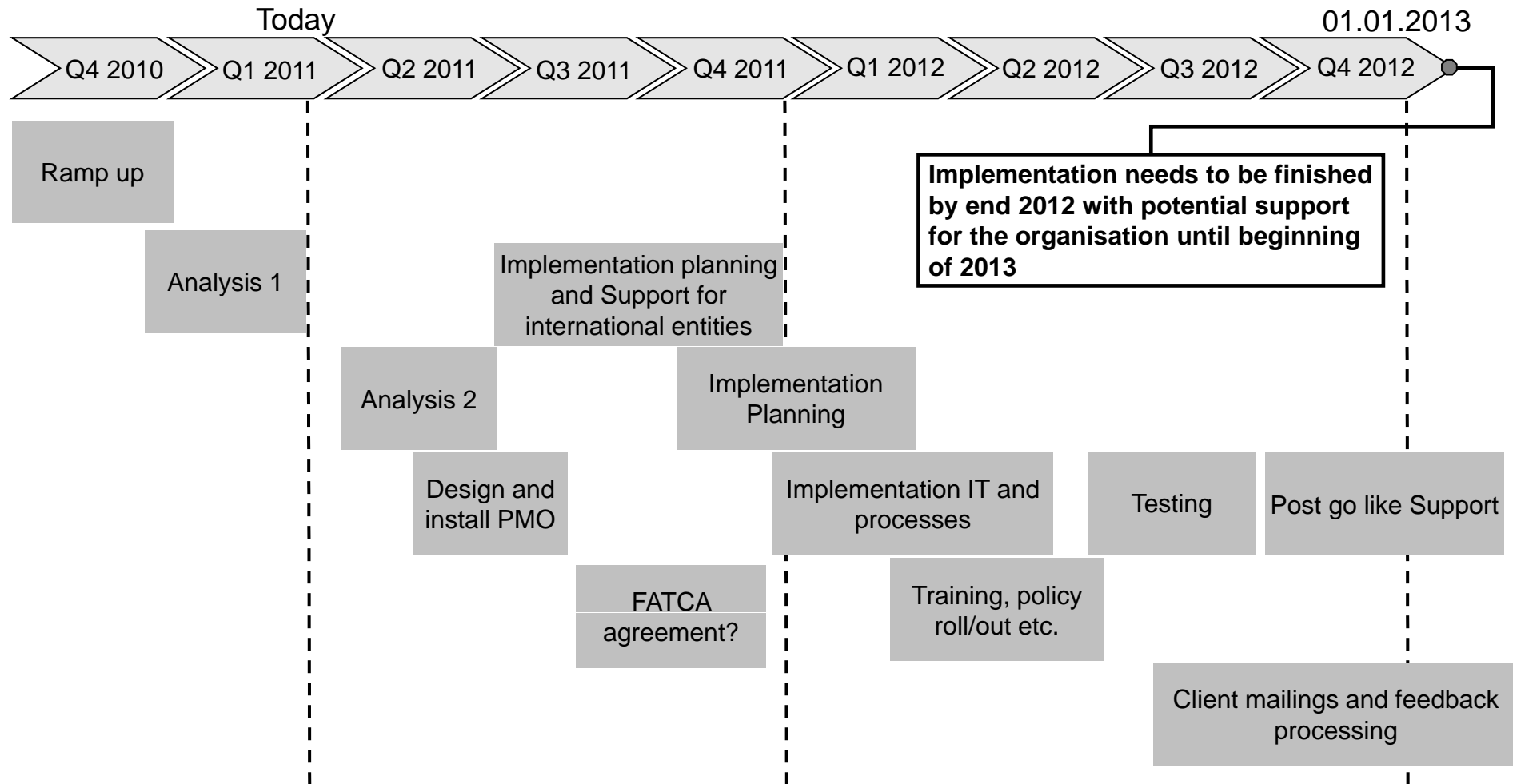
3. Strategic options and implementation aspects

Important Technology and Operations Considerations

- › Legal entity analysis and repository
- › Customer Data analysis and remediation
- › Aggregation of deposit and investments data
- › Eight entity and account classifications
- › Product analysis (e.g., trusts, PICs, investment vehicles)
- › Chapter 3 withholding vs. Chapter 4 withholding
- › Reporting to the IRS and customers

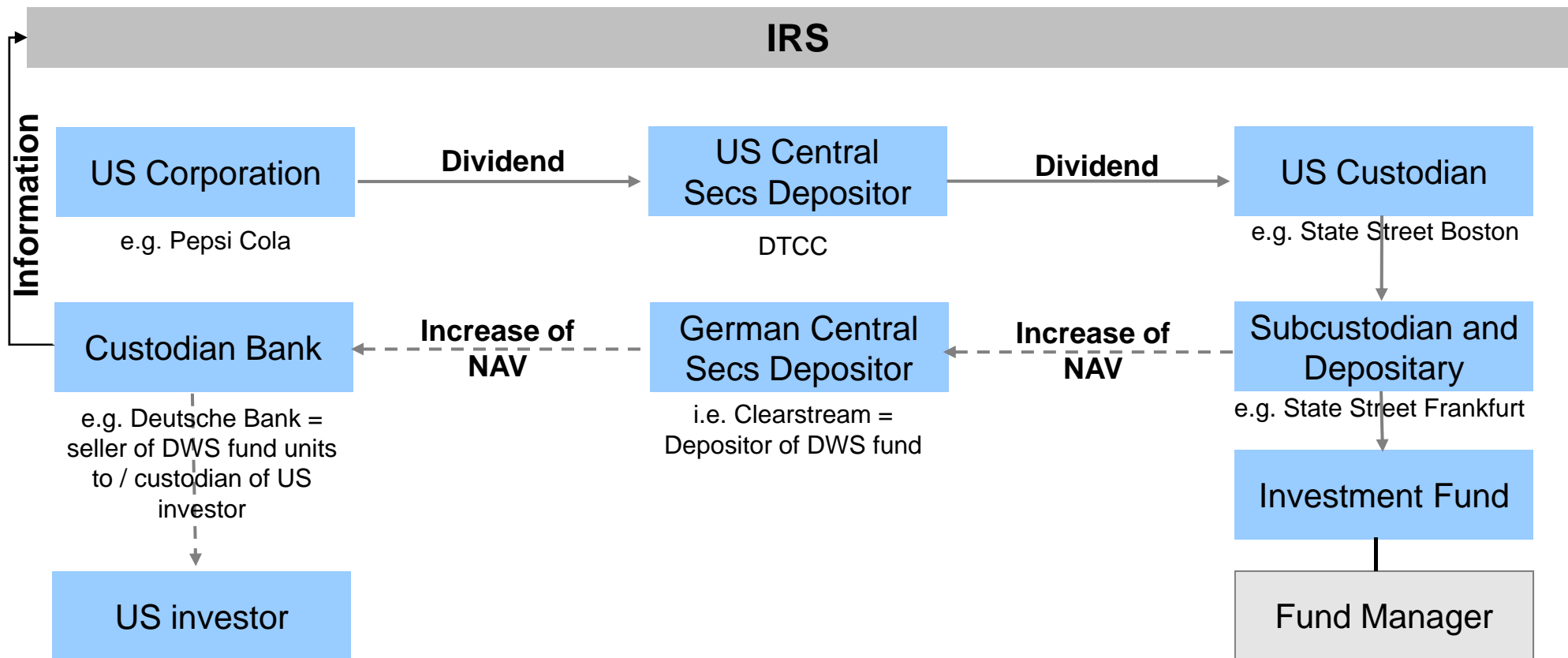
Source: PricewaterhouseCoopers

3. Strategic options and implementation aspects



4. Special issues and outlook

Receipt of dividends by investment fund



Source: BVI

4. Special issues and outlook

„Qualified securities lender“-status (1/2)

US rules regarding withholding tax on substitute payments from US stock lending/ repo transactions with US equities as underlying have significantly changed

› Principle:

- All substitute dividends from stock lending/ repo transactions with US equities paid to a foreign person are subject to 30% US withholding tax („WHT“). A Double Taxation Treaty („DTT“) may provide for a lower rate.

› Former exemptions:

- Former withholding exemptions for the avoidance and simplification of the withholding obligations (Notice 97-66; chain of stock lending/ repo transactions) no longer apply

› QSL status

- Going forward (January 2012), German banks will receive dividend equivalent payments free of withholding only if it qualifies as QSL. Whether the bank has an obligation to withhold on dividend equivalent payments depends on whether the counterparty is a QSL. Only financial institutions may qualify as so-called QSL.
- Transition rules apply between 14 September 2010 and 1 January 2012.

4. Special issues and outlook

„Qualified securities lender“-status (2/2)

Any stock lending/ repo transaction with a US equity underlying will require QSL status and/ or QSL documentation and reporting by the bank

- › Incoming substitute payments
 - Without QSL-status, the bank would suffer a 30 % (respectively 15 %, depending on the DTT) withholding tax deduction, i.e. receive 70 % (respectively 85 %) only
- › Outgoing substitute payments
 - For any outgoing payment, the QSL status of the counterpart must be checked and documented, even if the bank itself does not qualify as QSL (not optional)
 - Depending on counterparties' status, withholding tax may be withheld and remitted to the IRS.
- › Consequence:
 - As long as the bank engages in stock lending/ repo transactions with US equities the new QSL regime must be followed.

4. Special issues and outlook

Treasury guidance – what we are still waiting to hear

- › Definition of „pass-thru payment“
- › What other entities (i.e., low risk funds and financial assets identified by industry) will be exempted or deemed compliant.
- › Respond to industry comments, including:
 - Foreign privacy concerns;
 - Concerns regarding legal impediments to closing accounts of recalcitrant account holders; and
 - Concerns regarding the requirement that entire expanded affiliated group comply with FFI Agreement.
- › Details on the terms of the (Draft) FFI agreement and how will it be effected.
- › Draft of the new forms under development.
- › No withholding, but reporting; sanctions?
- › Views of other governments.