

FATCA proving to be a headache for FIs

BY **ADELINE PAUL RAJ**

Only 514 financial institutions (FIs) in Malaysia have so far registered to comply with the Foreign Account Tax Compliance Act (FATCA), a controversial US tax law which kicked in last July that compels FIs across the world to disclose their American clients.

The number falls substantially short of the over 1,000 FIs that are estimated to come under the FATCA scope, says FATCA expert Ong Ching Chuan, a partner at PricewaterhouseCoopers (PwC) Malaysia.

While the larger entities, including Malaysia's eight anchor banks such as CIMB Bank and Maybank, have already registered with the US Internal Revenue Service (IRS), many others seem to be waiting for the Malaysian government to ink an intergovernmental agreement (IGA) with the US first, he says.

An IGA would result in FATCA compliance being made mandatory in the country.

"The second tier FIs — some development FIs and the local insurers — and quite a few trustee, nominee, private equity and venture capital companies haven't registered with the IRS yet. They are saying they are not sure it (the IGA) is going to happen, and so they are just waiting for certainty before putting in the necessary effort and cost," Ong, who is PwC's assurance financial services leader, tells *The Edge*.

FIs here are none too pleased with having a US law imposed on them as the cost and effort to comply with FATCA could be high, ranging from RM100,000 to several million, he says. "That's just IT cost. We're not even talking about the resources and procedures you have to put in place."

The additional costs come at a time when FIs, particularly banks, are bracing for tougher times ahead with the economy expected to be more challenging and competition, intense.

The fact of the matter, however, is that FIs are unlikely to be able to ignore FATCA whether an IGA is inked or not, or even if they have few or no American clients at all.

As at Dec 1, 2014, 48 countries, including key ones such as the UK, China and Singapore, as well as tax havens like Switzerland, already inked IGAs. Malaysia is one of 64 other countries that have agreed in principle to comply with the Act. It was originally to have inked an IGA by the end of 2014, but was given an extension.

"I expect the IGA to be signed well before Sept 30 this year, as that's when Malaysia must start reporting the information [on US taxpayers] to the IRS," Ong says.

It is understood that Malaysia is also in the process of trying to see whether it can have a reciprocal arrangement with the US, whereby the US also reports Malaysian tax residents' information to Malaysia, he adds.

The US came up with FATCA with the intention of being able to better detect tax evaders who hide money outside the US. (The US taxes its citizens and permanent residents, including green card holders, on their worldwide incomes, regardless of where they live.)

Under FATCA, FIs must identify and provide information on the financial assets of their American clients, be they individuals or entities. The FIs are expected to report the information either directly to the IRS or, in Malaysia's case, through the local tax authority, Inland Revenue Board.

The argument for such a far-reaching Act is that it makes banking transparent worldwide.

However, critics call it a "bullying" law as FIs that choose to ignore FATCA will be penalised — through a 30% withholding tax that they will be subject to on any US-sourced income. This essentially means that if the FI invests in US bonds or shares, for example, 30% of any income it receives from those investments will be held back by the US.

"So, in a way, that 'encourages' you to comply with the Act. Assuming no IGA is signed, some FIs might say, 'I don't have any US-sourced income, so you can't force FATCA on me.' But, the fact is, the US has something called the Foreign Pass Through Mechanism which they have deferred to 2017, which will still affect these FIs," says Ong.

Under the mechanism, FIs that are not registered with the IRS will be penalised through their dealings with registered FIs.

"For example, from 2017, if unregistered Bank A earns US\$1,000 from placing a deposit with Bank B which is registered, a certain portion of this income will be held back, the quantum of which is determined through a technical formula," says Ong.

Given that, FIs don't really have a choice but to comply with FATCA. The Act defines FIs as not just banks and insurers but also entities that perform custodial services like nominee companies and trustees, and investment companies such as stockbrokers, unit trusts and private equity firms. Therefore, one big banking group would have to make multiple registrations for the different businesses that come under it.

Interestingly, the FI definition also includes holding companies or treasury centres. Industry players say this means some government-linked companies and public-listed conglomerates like Sime Darby Bhd could be affected. Ong, nevertheless, says it remains to be seen if such entities will

be included in the FATCA scope when Malaysia signs the IGA.

He says it is hard to estimate the size of the American client base of FIs in Malaysia. "It ranges from FI to FI. In our dealings with some of the local banks, the number could range from 500 customers to slightly more than 1,000, while for others, they hardly have any, probably less than 100. But generally, local FIs' exposure to US customers is very small."

However, he points out that, whether an FI has 10 or 1,000 US customers, it will still have to go through the same hassle of due diligence on the customers, to identify if they are US persons. As at July 1 last year, many of the FIs already required new customers to make declarations or fill questionnaires to aid the identification process. The US is not expected to take action against FIs that have not complied with FATCA until January next year.

"Compliance and IT costs will definitely go up for FIs. How significantly they go up depends on how extensively they want to automate their processes. It becomes expensive when you have a big IT infrastructure, like the regional players. If you're just a local player, then it could mean just a simple modification of your systems," Ong says.

As if FATCA is not going to be enough of a headache for FIs, there is also something similar that Organisation for Economic Co-operation and Development (OECD) countries plan to implement among themselves.

"OECD countries have agreed in principle to share information among themselves, and Malaysia, as a country, has committed to start reporting in 2018. It is expected to leverage the FATCA platform. This will further increase the IT and compliance costs for FIs," says Ong. ■