White paper on the Foreign Account Tax Compliance Act (FATCA)
(Version 4.0, September 2011)

Note: Relevant regulations and any applicable legislation take precedence over the guidance notes issued by this body. These guidelines represent an industry's best effort to assist peers in the interpretation and implementation of the relevant topic(s). The PMPG - or any of its members - cannot be held responsible for any error in these guidelines or any consequence thereof.

1 Introduction

The Payments Market Practice Group (PMPG) is an independent body of payments subject matter experts from Asia Pacific, Europe and North America. The mission of the PMPG is to:

- take stock of payments market practices across regions,
- discuss, explain, and document market practice issues, including possible commercial impact,
- recommend market practices, covering end-to-end transactions,
- propose best practice, business responsibilities and rules, message flows, consistent implementation of ISO messaging standards and exception definitions,
- ensure publication of recommended best practices,
- recommend payments market practices in response to changing compliance requirements

The PMPG provides a truly global forum to drive better market practices which, together with correct use of standards, will help in achieving full STP and improved customer service.

2 What is FATCA?

FATCA is US legislation introducing new customer identification, documentation, reporting and withholding procedures with the objective of targeting perceived tax abuse by US citizens through the use of offshore bank accounts. Under the FATCA regime, all foreign (non-US) financial institutions (FFIs) are encouraged to enter into an agreement with the US Internal Revenue Service (IRS).

FFIs that enter into a FATCA Agreement are deemed to be "Participating FFIs" and must then implement the following procedures:

1. Undertake certain steps to identify and assess all new and existing individual and entity account holders (including substantial owners) to verify if they are US persons
2. For any confirmed US persons, disclose their identity to the IRS through a waiver of privacy rights, as might be necessary

3. Withhold on any 'pass-through payment' made to the account of any identified potential US customer who does not confirm their US or non-US status or agree to waive their privacy rights, as well as any "pass-through payment" made to a Non-Participating FFI
4. And, ultimately, close the account of any US customer who does not confirm US status or agree to waive privacy rights

FFIs that do not sign up to FATCA will be classified as "Non-Participating FFIs" and penalized with a 30% withholding tax on all:

1. US-sourced payments ("withholdable payments") received either as principal or intermediary (i.e. any US-sourced payments made to their customers would be subject to withholding)
2. "pass-through payments" which are attributable to withholdable payments (currently defined as "other payment made by an FFI" which could include non-US payment types and be extensive in coverage). IRS guidance Notice proposes a "pass-through payment percentage" for calculation of a resultant amount which is then subjected to the withholding

FFIs must enter into a FATCA agreement by 30 June 2013 to avoid such withholding. The implementation of FATCA obligations is staggered, starting with the identification of new customers from 1 July 2013. Withholding on payments commences from 1 January 2014 for US source FDAP payments1 and 1 January 2015 for all other payments. Draft rules are not expected until late December 2011. Based on current guidance, the impacts of FATCA are far-reaching, with significant impact on banks' on-boarding processes, reporting procedures and payments systems.

3 Key concepts / definitions

Recalcitrant Account Holders: any account holder that fails to comply with reasonable requests for information and documentation to confirm their US or non-US status and/or who does not agree to a waiver of privacy rights, so the FFI can report details to the IRS.

Participating Foreign Financial Institution (P-FFI): a non-US Financial Institution which has entered into an agreement with the IRS and undertakes certain assessment, reporting, withholding and other requirements to ensure compliance.

Non-Participating Foreign Financial Institution (NP-FFI): a non-US Financial Institution, which has decided not to undertake an agreement under the FATCA regime.

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1 Fixed, Determinable, Annual, or Periodical (FDAP) income is all income, except:
- Gains derived from the sale of real or personal property (including market discount and option premiums, but not including original issue discount)
- Items of income excluded from gross income, without regard to the US or foreign status of the owner of the income, such as tax-exempt municipal bond interest and qualified scholarship income.

Deemed-Compliant Foreign Financial Institution (DC-FFI): a certain category of FFI (e.g. local Bank trading in one country only) able to sign an agreement with the IRS without undertaking the full compliance steps required of a P-FFI.

Withholdable Payments:

1. any payment of interest (including any original issue discount), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income, if such payment is from sources within the United States, and
2. any gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources within the United States

Pass-through Payments: any withholdable payment or "… other payment to the extent attributable to a withholdable payment." The second point is currently defined as "Other Payment made by an FFI".

Pass-through Payments Percentage ("PPP"): P-FFIs are required to calculate a PPP and apply this % to relevant payments i.e. "other payment made by such P-FFI" to NP-FFIs and recalcitrant.

Withholding agents: all persons having control, receipt, custody, disposal or payment of any withholdable payment.

4 End-to-end payments value chain issues / implications

The points below detail the key "touch points" for US and non-US FFIs in implementing FATCA, and highlight where end-to-end payments value chain issues – e.g. customer payment instructions and payments message standards, market practice, data availability – are a concern. In all circumstances, the information, practices and processes utilized by the national and international payments value chain (from the customer payments instruction process to bank-to-bank settlement) do not have the capability to identify transactions and/or parties to a transaction as being subject to or exempt from FATCA requirements. This means that all the customer payment instructions and payments between FFIs would be affected worldwide.

Current global payment market practices do not provide an effective method of complying with these key elements of FATCA:

1. Identify country of source for the payment
   - The payments value chain standards do not have a mandatory method of identifying the originating source country through a chain of multiple financial institutions, enabling identification at each financial institution processing touch-point. Each FFI in the payment chain must be able to identify the source country consistently

2. Assess the type of transaction, as to whether pass-through or withholdable
   - A common understanding at the worldwide level (and not only at the US one) of the different transaction types will be required to enable an unambiguous and automatic identification of the transaction type, for example, interest, income, dividend, etc. Refer to Annex A for a full harmonized list of withholdable payment types
   - "Other payment types" made by an FFI are yet to be defined
   - Payments instruction and payment messages do not contain industry standards that readily identify the type of payment being transacted

3. Assess status of next FFI in the payment chain: P-FFI, DC-FFI, or NP-FFI?
   - Each FFI must be able to assess the FATCA status of the next financial institution or non-financial foreign entity in the chain, and in the event the next payee is non-compliant (eg NP-FFI), the payer FFI must be able to deduct the appropriate withholding, depending on the country source and transaction type
   - The payment must be able to carry withholding information related to the original amount from origination through the entire transaction lifecycle, and in a suitable format for receipt into local payment systems. This will enable customer enquiries to be handled at the final recipient bank, including updates to transaction history and customer statements, etc.
   - A payment message (whatever national or international standard is used) does not provide information concerning the FATCA designation of downstream FFIs nor about the potential withholding of FATCA taxes made from any payment

4. Determine the status of the ultimate beneficiary: FATCA compliant or non compliant i.e. Recalcitrant or NP-FFIs
   - Responsibility for this sits with the beneficiary FFI (i.e. the final FFI in the payment chain responsible for making the funds available to their account holder/account)
   - A payment message does not contain the identification of the beneficiary as someone who is or is not compliant with FATCA
   - Each transaction needs to carry the full information (as above) through to the receiving bank
   - In a number of national/regional jurisdictions, customer FATCA compliance could not be transported throughout the payment value chain because of potential interaction with local law issues

The identification of final destination NP-FFI or non-compliant customers is not feasible at the instructing party level and potentially any exempt beneficiary types may also not be able to be identified.

5 Payments Market Practice Group Assessment

The Payments Market Practice Group acknowledges these practical and compliance issues, and recognizes the significant challenges the payments industry faces in resolving them. The PMPG does not believe that the international, regional and national standards communities can amend the end-to-end payments value chain standards necessary to achieve compliance with FATCA requirements and nor can they implement these amendments starting at the instructing party business applications by the 1 January 2014 target date. Similarly, it may be important to consider the impact of two implementation dates on payment systems globally, resulting in two updates to systems to cater for the different transaction types on different implementation dates. A further delay to commencement with a single start date is preferred.

Significant changes will need to be made to the Pass-through/Withholding proposal made by the US to ensure a workable solution can be implemented. This includes a more practical method of development, tighter transaction definitions (to ensure a global standard can be followed) and clarity around transaction exclusions. Practical clarity to these key details will need to commence with US Financial Institutions and their customers as the originators of US-sourced withholdable payments. Other details cannot be determined until a more practical interpretation is provided on pass-through payment types.

Even if some of these changes are documented within draft regulations due to be published by US officials end-December 2011, a multi-year, worldwide effort (including instructing customers) will be required to support implementation. Current timelines for agreement of change require a lead time of 18 months from final regulations to even commence assessment work. This would involve assessment of requirements and determination of the best method for modification of end-to-end payments value chain standards and practices, to ensure effective global compliance with FATCA. The engagement activity alone will be significant.

Annex A

Withholdable Payment Types under FATCA:

- dividends
- rents
- salaries
- wages
- premiums
- annuities
- compensations
- interest (including any original issue discount)
- remunerations
- emoluments and other fixed or determinable annual or periodical gains, profits, and income

If such payments are ***from sources within the United States***, and any gross proceeds from the sale, or other disposition of any property of a type which can produce interest or dividends from sources within the United States.

In addition, FATCA Withholding Tax can also apply in relation to other Pass-through Payments, being "… other payments to the extent attributable to a withholdable payment". The IRS has proposed a Pass-through Payment Percentage to artificially derive an amount "attributable" and the banking associations worldwide are opposing this artificial methodology.