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FATCA

Where is FATCA in South Africa now?

The intergovernmental agreement between the governments of the Republic of South Africa and the United States of America to improve international tax compliance and to implement FATCA ("the SA IGA"), which was signed on the 9th June 2014, has now been ratified by Parliament. The significance of this is that the SA IGA is now binding on the Government of South Africa as an international treaty (the date of entry into force of the SA IGA is 28 October 2014). Further, the SA IGA is given force and effect in local law through provisions in the Tax Administration Act, 2011.

At a practical level this doesn't really change much for South African financial institutions, in that there is already understanding and awareness in the industry of the requirement to comply with the SA IGA. At a technical regulatory level though, this means that there is no question of whether or not to comply with the SA IGA, the aspect of willingness and choice that applied under the FATCA Regulations regime has wholly disappeared. The SA IGA is considered to be local law and compliance with FATCA by South African financial institutions is now a statutory obligation.

So what exactly is FATCA and what does the SA IGA require of South African financial institutions?

Very briefly, The Foreign Account Tax Compliance Act ("FATCA") was signed into United States ("U.S.") law in March 2010. It was enacted in an effort by the U.S. Government to target non-compliance, and curb perceived tax abuses by U.S. taxpayers using foreign accounts and earning income offshore and not declaring this income to the United States Internal Revenue Service ("IRS"). In order to achieve this objective the US effectively passed the burden onto the global financial services community by imposing client identification, monitoring and reporting obligations on foreign financial institutions ("FFIs"), requiring them to identify and report information to the IRS on account holders that are U.S. Persons, including non-U.S. entities that have substantial U.S. owners. In addition to the onerous client identification, monitoring and reporting obligations that are imposed on FFIs, FATCA also introduced a 30% punitive withholding tax on U.S. source income payable to non-participating FFIs ("NPFFI"), as a deterrent against the non-compliance with its provisions by these NPFFIs. And why pass the burden onto FFIs? - the U.S. Treasury considered global co-operation to be critical in effectively combating offshore tax evasion, primarily on the basis that FFIs would generally be best placed to identify and report on U.S. Persons with offshore accounts where those U.S. Persons are in fact the FFIs own clients. One of the primary challenges with FATCA is that it is effectively the unilateral imposition of international law on FFIs. FATCA (in its initial form) only contemplates a contractual arrangement between an FFI and the IRS (as opposed to a statutory obligation), requiring that FFIs must enter into an FFI Agreement directly with the IRS, which agreement will then incorporate the specific requirements imposed on the FFI under FATCA. This raised a material issue around conflict of laws. In many jurisdictions local laws (including local data privacy laws and regulations) prevent FFIs reporting on confidential client information directly to the IRS. And so the question was, do FFIs comply with FATCA and risk contravening local law, or do they continue to comply with local law and risk contravening FATCA? This dilemma gave rise to the intergovernmental agreement ("IGA") as an alternative means to complying with FATCA in a manner intended to avoid these conflict of laws issues. The IGA still imposes a client identification, monitoring and reporting obligation on Financial Institutions (FFIs are referred to as Financial Institutions in the IGA), the main difference is that Financial Institutions do not have to report information directly to the IRS, but instead they must report it to their local competent authority (SARS in the case of South Africa). The Competent Authority will then exchange the information with the IRS on an automatic basis. This effectively removes the data privacy concerns around the disclosure of information, in that once the IGA obligations are given force and effect in local law and properly aligned with local data privacy legislation, Financial Institutions will be authorized to pass personal information on U.S. Persons and NPFFIs the relevant Competent Authority.

Importantly, a Financial Institution (in an IGA jurisdiction) shall be treated as fully compliant with FATCA, and not subject the FATCA Regulations, where such Financial Institution fully complies with the IGA obligations.

South Africa is an IGA jurisdiction and all South African Financial Institutions (as defined) must comply with the requirements of the SA IGA. Easier said than done! The SA IGA imposes a significant regulatory burden on Financial Institutions, which is exacerbated further by the fact that there are a number of key interpretational issues in the SA IGA that are still outstanding and which are impeding Financial Institutions' implementation of, and compliance with, the requirements laid out in the SA IGA (which compliance is required in accordance with dates set out in the SA IGA).

Why do these interpretational issues exist at all?

A view is that it goes back to the fact that the IGA is essentially a pro forma agreement prepared by the US Treasury and IRS and rolled out globally. Certainly they did not allow for much, if any, amendment to the IGA and we have seen that the IGAs were signed in their original form (aside from certain amendments being allowed to Annex II thereof). Add to this the fact that the US Treasury and the IRS would have drafted the IGA based on their understanding of financial regulation and of investment structures – they would definitely not have been able to consider and cater for the many diverse regulatory frameworks and complicated investment structures that occur across the many global jurisdictions. In South Africa, SARS and Financial Institutions alike are finding it very challenging to overlay the SA IGA on the South African regulatory framework and the complicated investment structures we have in South Africa.

SARS are endeavouring to provide guidance on the SA IGA and the interpretational issues contained therein and have in fact already issued their draft SA IGA Guide for public comment (comment due 27 February), however, the question might be raised as to the value of the this Guide in resolving any interpretational issues, on the basis that the SARS guide is

"not an official publication as defined in section 1 of the Tax Administration Act 28 of 2011 and accordingly does not create a practice generally prevailing under section 5 of that Act. It is also not a binding general ruling under section 89 of Chapter 7 of the Tax Administration Act".

What should Financial Institutions be doing about FATCA and the SA IGA, notwithstanding the challenge of the outstanding interpretational issues?

The first step is for Financial Institutions to identify their FATCA status and determine whether they are impacted by the SA IGA or not, and to what extent. Then, and where they are identified as Reporting Financial Institutions, they are required to register themselves on the IRS Registration Portal and receive a global intermediary identification number ("GIIN") which will serve to evidence their status as a Reporting Financial Institution. They also have an obligation to identify all their clients in accordance with the procedures stipulated in the SA IGA and report certain prescribed information on clients that are identified as US Persons and/or non-US entities with substantial US ownership, to SARS. This reasonably requires Financial Institutions to enhance their client onboarding processes and procedures and to amend client onboarding documentation, to bring it in line with the client identification obligations set out in the SA IGA. It also requires Financial Institutions to develop the necessary financial reporting tool to facilitate the transfer of information to SARS, which must be developed in line with the SARS business requirement specification ("BRS"). We are also seeing US Withholding Agents and counterparties requesting Reporting Financial Institutions to furnish them with relevant US withholding certificates to evidence their own FATCA status and often the FATCA status of their underlying clients too. Processes will also need to be implemented to cater for this.

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