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Dear Sir / Madam

Intergovernmental Agreement to Implement FATCA

Abacus - Australian Mutuals is pleased to provide the following submission to Treasury's consultation regarding an Intergovernmental Agreement to Implement FATCA.

Abacus is the industry association for Australia's mutual banking institutions, representing 88 credit unions, seven mutual building societies and six mutual banks.

Abacus members provide the full range of retail banking services and products to more than 4.5 million customers.

Our members are Authorised Deposit-taking Institutions (ADIs) regulated by the Australian Prudential Regulation Authority under the Banking Act 1959.

The mutual banking sector has $83 billion in assets. Our members hold 8.4% of the new home loan market and 11.4% of household deposits, making them the fifth largest holder of household deposits in Australia.

Individually, when compared to the larger banks, our members are relatively small. Of our 101 mutual members, around half have total assets of less than $200 million, two-thirds have less than $1 billion, and our largest member has total assets of less than $10 billion. In contrast, each of the "big four" banks holds over $400 billion in assets.

In addition to a size difference, mutuals have an alternative business model to the broader banking sector. The mutual sector's customer-owned business model focuses on the needs of its members and mutual ADIs consistently outperform the major banks in customer satisfaction rankings. Mutuals also typically have a strong presence within a specific sector or region, and target their membership accordingly. This tends to make their activities more focussed than the larger banks.

Abacus respects the decision of the US to introduce the FATCA legislation in an effort to reduce tax evasion by its residents. We recognise that tax evasion undermines the integrity of the tax system, and should be prevented where possible. At the same time, we note that anti-evasion measures often impose additional compliance

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burdens, and that these burdens should be minimised to ensure policy objectives can be met in the most efficient fashion.

As domestic retail institutions, Australian mutuals have little to do with US taxpayers, and our members do not seek US taxpayers as customers. As such, on the face of it, it would appear that FATCA was of little relevance to the sector. Unfortunately, this is not the case. While some mutuals could choose not to participate, FATCA places additional obligations on compliant institutions that deal with "non-compliant" institutions. The practical result is that most large (and compliant) financial institutions will not want to deal with other institutions that choose to be "non-compliant," effectively forcing mutuals to comply with FATCA unless they are able to be deemed to comply.

For this reason, we see the Government's decision to "explore the feasibility of an intergovernmental agreement with the US" as a welcome development. An IGA has the capacity to reduce the compliance burden that FATCA creates for Australian financial institutions, without undermining the capacity of FATCA to achieve the US Government's policy objectives around reducing tax evasion.

We note that any IGA entered into by the Australian Government is likely to be very similar in content to the Model IGA published by the US Department of Treasury on 26 July. The Model IGA can ease the compliance burden on Australian financial institutions in two ways:

- the IGA framework reduces or streamlines a number of the requirements set out in the current draft regulations, and extends the existing deadlines for compliance; and
- Annex II of the Model IGA provides the Australian Government with an opportunity to seek FATCA exemptions for particular classes of low risk financial institution.

Compliance benefits under the Model IGA

The Model IGA would reduce the compliance burden on Australian financial institutions in a number of areas. In particular:

- *Reporting processes are simplified by dealing with the ATO.* While financial institutions will still have a reporting obligation under the Model IGA, they will be able to report to an Australian authority (presumably the ATO) rather than the IRS. The Model IGA also allows reporting on a financial year basis, consistent with the existing reporting frameworks of Australian financial institutions. By aligning FATCA reporting with existing ATO reporting requirements, and using existing infrastructure, the compliance burden can be significantly reduced.
- *Conflicts between FATCA and local laws are addressed.* In the absence of an IGA, obligations under FATCA will conflict with existing legal obligations, such

as those around privacy and anti-discrimination. Dealing directly with the ATO can overcome many of these issues, and the IGA provides a framework for addressing any other legal conflicts. As such, the IGA provides greater legal certainty for financial institutions, and makes it easier for the Government to deal with any residual legal inconsistencies.

- *Due diligence arrangements are simplified and streamlined.* Article I sets out the due diligence requirements which would be applied under the IGA. These revised requirements allow financial institutions to make greater use of their existing AML/KYC information collection processes, and also allows account holders to self-certify whether they are US residents.
- *Additional relief is provided around implementation timeframes.* The Model IGA provides financial institutions with some welcome additional time in which to prepare for FATCA.
- *Improved treatment of recalcitrant accounts.* Under the model IGA, recalcitrant accounts can be managed in an effective manner without creating potential legal conflicts.

While not removing the compliance burdens of FATCA altogether, the improvements set out in the Model IGA will nonetheless provide Australian financial institutions with some welcome relief.

In the absence of an IGA, the costs of FATCA compliance will be significant. For Australian mutuals, complying with the current FATCA regulations would mean establishing new infrastructure and processes, and putting in place new compliance frameworks. In many cases, these systems would operate more or less in parallel to existing ones, resulting in a duplication of effort which would be highly inefficient and lead to additional costs being borne by the sector. These additional costs are not trivial - according to the Australian Bankers' Association, complying with the FATCA framework (without an IGA) would cost each of the major banks more than $100 million.[1]

For Australia, the additional compliance costs imposed by the current regulations are likely to far outweigh any benefits from reduced rates of tax evasion. While some of the additional costs may be absorbed, much of it is likely to be passed on to consumers, driving up the cost of banking in Australia. Furthermore, the costs of compliance will fall disproportionately on smaller ADIs, undermining the capacity of Australian mutuals to operate as a competitive "fifth pillar" against the "Big Four" banks.

In addition to avoiding additional costs, entering into an IGA with the US also ensures Australian financial institutions are well placed if other countries decide to follow the path of the US in future. Should FATCA prove to be an effective policy intervention, it is entirely possible, (or even likely) that other large countries may

[1] ABA, *Submission to the United States Internal Revenue Service,* Nov 2010, p. 4.

seek to impose similar compliance burdens on Australian financial institutions. If this were to occur, the existence of an Australian IGA, and a framework for reporting through the ATO, would ensure Australia was well placed to adapt to any such development.

With so many other countries currently seeking to negotiate their own FATCA IGAs, for the Australian Government to follow the same path would be a logical step.

Exemptions under Annex II of the model IGA

In addition to the benefits set out above, Annex II provides the Australian and US Governments with an opportunity to negotiate a set of country-specific financial institutions, products and beneficial owners that would be exempt or deemed compliant under the FATCA legislation. This provides scope for the model IGA to be customised in recognition of the particular circumstances of the Australian financial sector.

Abacus believes that, ideally, the Australian Government should seek to have all Australian mutuals deemed compliant under Annex II, in recognition of the fact that their small scale, local focus, and existing compliance framework means they present a minimal risk of tax evasion to the US. For example:

- Australia already has strong anti money laundering and know your customer (AML/KYC) laws, and this has been recognised by the Financial Action Task Force (FATF).
- Australia's income tax regime has rates similar to those in the US, providing little motivation to, or opportunity for US residents to evade tax.
- Australia has strong mutual understanding and information sharing arrangements, supported by double tax treaties with a number of countries, including the US.
- Account holders must provide information identifying them as either residents or non-residents, and failure to do so results in withholding at the top marginal tax rate.
- Australian credit unions, building societies and mutual banks are entirely focused on the domestic market and do not solicit deposits from individuals outside of Australia.

However, if a complete exemption for the sector cannot be achieved, we would propose two partial exemptions, each of which is modelled on existing exemptions which have been agreed with the US:

- All mutuals should have the option of being registered deemed compliant as a "Local FFI;" and

- Small mutuals should be exempted in line with the existing "non-registering local bank" exemption.

Local FFIs exemption: The recently finalised UK/US FATCA IGA included an Annex II exemption for all credit unions and building societies, in recognition of the low risk that these entities present to meeting the objectives of FATCA. Under this IGA, all credit unions and building societies are able to be registered as "Financial Instituions with a Local Client Base," provided that more than 98% of their accounts (by value) are held by residents. While institutions in this category still face some additional obligations, they are less onerous than full FATCA compliance.

This is an encouraging development, and a demonstration of US willingness to include reasonable exemptions in Annex II. It is hoped that the decision in the case of the UK IGA sets something of a precedent which would provide the scope for Australia to negotiate a similar outcome in any IGA we enter into.

We would propose that the wording for any Australian Annex II exemption be modelled on the existing exemption in the UK IGA, taking into account Australia's mutual banks.

Non-registering local banks exemption: We believe a compelling argument can be made that, in addition to the local FFI exemption, small Australian mutuals should be certified deemed compliant under Annex II, using a similar mechanism to the current arrangement under the draft regulations which exists for "nonregistering local banks."

We note that this approach is already being pursued at a global level directly with the US Treasury by the World Council of Credit Unions, and we are strongly supportive of this advocacy. However, the US Government's ultimate decision with respect to the issue won't be made clear until the final regulations are released, which may not occur for some time. Furthermore, the US Government may not wish to provide a global exemption for small credit unions, but could instead be amenable to the provision of an exemption for the sector in low risk countries which enter into an IGA (such as Australia). It would therefore be prudent for the Australian Government to concurrently seek an exemption for small Australian mutuals under Annex II of the IGA.

Under the draft regulations, nonregistering local banks can be "certified deemed-compliant," in recognition of the lower tax evasion risk that these institutions present to the US Government. These "deemed compliant" institutions face a significantly lower compliance burden than other foreign financial institutions (FFIs). In particular, "deemed compliant" institutions avoid FATCA obligations around registration, identification and reporting of account information. Abacus strongly supports the existence of the "deemed compliant" category, and believes that any Model IGA should not undermine the existing concessions put in place for this group of institutions.

In order to be categorised as a nonregistering local bank, six criteria must be met, which generally require that the financial institution demonstrate its operations are contained within the one country, and that the overall size of the financial institution

falls below a certain threshold. However, of particular relevance to Australian mutuals is sub-paragraph (f)(2)(i)(A), which states that:

> *"The FFI must operate and be licensed solely as a bank (within the meaning of section 581, determined as if the FFI were incorporated in the United States) in its country of incorporation or organisation and engage primarily in the business of making loans and taking deposits from unrelated retail customers."*

While many Australian credit unions and building societies would be able to meet the remaining 5 criteria at paragraphs (f)(2)(i)(B)-(F), it is unlikely that they fall within the scope of the term "bank" as defined by this first criteria. Subsection (A) explicitly defines "bank" with respect to section 581 of the US Internal Revenue Code – and while this section covers banks in the US, it does not cover credit unions, which are separately captured by sections 501(c)(1) and 501(c)(14) of the same legislation. While the regulations provide no further clarity as to the intended scope of this definition, it appears probable that the current wording cannot be read broadly enough to encompass Australian mutuals, even though Australian mutuals are comprised of credit unions, building societies and mutual banks.

It is unclear why the draft regulations would seek to provide an exemption for small scale local banks, but not provide a similar exemption for similar scale credit unions and building societies which perform the same function. Given that the two sectors operate under the same prudential framework in Australia, and that both sectors present the same low level of risk in relation to tax evasion, it would appear sensible for the two sectors to receive the same treatment under the FATCA regulations.

Many of Australia's credit unions and building societies would benefit from this change – around 45% of them would fall within the current $175 million cap applied to nonregistering local banks.[2]

Such an exemption would be consistent with the US Treasury's policy intent not to impose these compliance burdens on organisations where the risk of tax evasion is low, and their desire to "develop an implementation approach that achieves an appropriate balance between fulfilling the important policy objectives of [FATCA] and minimising the burdens imposed on stakeholders."

We would propose that the wording for the Annex II exemption match, as far as is practical, the existing wording in the draft regulations for the exemption of nonregistering local banks (s1.1471-5(f)(2)(i) of the draft regulations at page 307). This would ensure that small banks and small mutuals received consistent treatment under the FATCA regulations. A draft section prepared on this basis is set out below:

<u>Local credit unions, building societies and mutual banks:</u> An FFI is a certified deemed-compliant FFI if the FFI meets the requirements of paragraphs (A) through (F) below.

> *(A) The FFI must operate and be licensed solely as a building society, credit union or mutual bank, (consistent with the meaning of section 501(c)(1) or*

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[2] Assumes an exchange rate in line with the 1 year average of USD$1.03

501(c)(14)(A) of the Internal Revenue Code, determined as if the FFI were incorporated in the United States) in Australia and engage primarily in the business of making loans and taking deposits from unrelated retail customers.

(B) The FFI must be licensed to conduct business in Australia and must have no fixed place of business outside Australia.

(C) The FFI must not solicit account holders outside Australia. For this purpose, an FFI will not be considered to have solicited account holders outside Australia merely because it operates a website, provided that the website does not specifically state that non-residents may hold deposit accounts with the FFI, advertise the availability of US dollar denominated deposit accounts or other investments, or target US customers.

(D) The FFI must have no more than US$175 million in assets on its balance sheet and, if the FFI is a member of an expanded affiliated group, the group may have no more than US$500 million in total assets on its consolidated or combined balance sheets.

(E) The FFI must be required under the tax laws of Australia to perform either information reporting or withholding of tax with respect to resident accounts.

(F) With respect to an FFI that is part of an expanded affiliated group, each FFI in the expanded affiliated group must be incorporated or organised in Australia and must meet the requirements set forth in this paragraph.

In the absence of such exemptions, some mutuals may seek to exclude all dealings with US customers in order to meet their FATCA obligations. It is important that existing antidiscrimination legislation does not prevent Australian financial institutions from pursuing this approach if they are of the view that this is the optimal method of FATCA compliance.

Coverage of the IGA

The Model IGA applies to "Financial Institutions," which are defined under the Agreement as any "Custodial Institution," "Depository Institution," "Investment Entity," or "Specified Insurance Company." This differs slightly from the draft FATCA regulations.[3]

Given the differences of definition, there is a risk that some entities may fall within the scope of the definition for the purposes of the draft regulations, but not within the definition as set out in the Model IGA. If this were to occur, these institutions would be subject to FATCA regulations, and would not be able to make use of the more favourable treatment available under the IGA.

[3] See draft FATCA regulations, p. 293.

In the case of Australian mutuals, the sector appears to be well captured under the "Depository Institution" definition in the Model IGA, which includes "any entity that accepts deposits in the ordinary course of a banking or similar business." However, greater clarity could be achieved if the "Depository Institution" definition in our IGA was amended to explicitly note that all ADIs fall within its scope.

Timing of implementation

While we support the Australian Government seeking an exemption in the model IGA for mutuals, we also recognise that the most important priority is for Australia to conduct and complete negotiations around the IGA in a timely fashion. We understand that there are a significant number of countries currently seeking an IGA with the US, and that it will be a challenge for the US Government to complete all of these negotiations before FATCA obligations start to take effect. Negotiating special exemptions or changes to the Model IGA should only be undertaken where this will not compromise Australia's capacity to have an IGA in place prior to FATCA becoming operational.

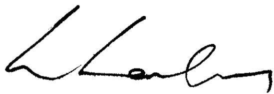
Furthermore, we appreciate that negotiating and entering into an Intergovernmental Agreement with the US will take time, and that even with the best efforts from the Australian Government, it is entirely possible that the process will not be completed before the existing obligations under FATCA start to come into effect. In such a scenario, it would be beneficial if a Memorandum of Understanding could be entered into as an interim measure, which allowed Australian financial institutions to continue their operations as if an IGA had been agreed to (and under the assumption that such an outcome would occur at some stage). This approach would provide greater certainty to Australian financial institutions, which is an important consideration, given that many of them are currently working through the process of putting FATCA compliance systems in place. If institutions are left uncertain about which course of action the Government will pursue, there is a significant risk that businesses will need to implement two separate sets of compliance processes. This would be an inefficient, costly and undesirable outcome, which would be of no benefit to Australian consumers, the Australian Government or the US Government. Timely clarity is in everyone's best interests to ensure compliance.

In conclusion, Abacus reiterates its strong support for the Australian Government entering into an IGA with the US to implement FATCA. While an IGA will not remove the compliance burdens associated with FATCA, it will help to reduce the compliance burden in a number of areas.

In the absence of an IGA, it is likely that the costs FATCA compliance will impose on Australian financial institutions will significantly outweigh any benefit the US Government can hope to gain from reduced tax evasion by US taxpayers in Australia.

Please contact me on 02 6232 6666 or Micah Green, Senior Policy Adviser, on 02 8299 9032 to discuss any aspect of this submission.

Yours sincerely



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