

28 September 2012

Mr Tony McDonald
Manager
International Tax Treaties Unit
International Tax and Treaties Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Tony

RE : Invitation to Comment on the model FATCA intergovernmental agreement

The Financial Services Council (*FSC*) thanks Treasury for the opportunity to comment on an intergovernmental agreement (IGA) between Australia and the United States of America (“U.S.”) in relation to FATCA based on the published U.S. Model IGA, as an alternative to individual agreements between Australian financial institutions and the U.S. Internal Revenue Service.

The FSC represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advisory networks. The FSC has 130 members who are responsible for investing \$1.9 trillion on behalf of more than 11 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Stock Exchange and is the fourth largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

FSC supports Australia entering an IGA

The FSC fully supports the Australian Government entering into an IGA with the U.S. in relation to FATCA. Our members advise us that the published U.S. Model IGA (“Model 1 - Reciprocal” version), has significant advantages when compared to individual agreements between Australian Financial Institutions (FI's) and the U.S. Internal Revenue Service (IRS), or the Model 2 versions.

We see the main benefits of the Model 1 – Reciprocal IGA as:

- decreasing the cost of complying with FATCA for Australian FI's;
- eliminating the need for withholding on FI's in Australia; and
- ensuring a level playing field between Australia and its trading partners in other FATCA partner countries.

An IGA will lead to a significant reduction in the overall cost of complying with FATCA for Australian FI's, which in turn will mean that Australian consumers will not be burdened with unnecessary increases in the costs of wealth management products and services. Decreasing the compliance burden of FATCA will also allow our members to better focus on the core business of servicing clients.

Details of the advantages of an IGA

We have outlined further details on the advantages of the IGA in Appendix A.

Next steps for an IGA

We see the next steps for Australia in progressing an IGA as:

- A Government announcement regarding an intention to enter the IGA – to provide certainty vital to the industry's preparations for compliance with FATCA;
- Agreement to consult widely with industry regarding implementation issues and development of enabling legislation;
- Clarifying the discrepancies between the Model 1 – Reciprocal IGA and the draft Regulations (e.g. discrepancies between definitions);
- Broad consultation with industry regarding the entity types and financial products to exempt via Annex II; and
- Determining a timeframe for signing the IGA and implementation of the enabling legislation.

If an IGA is entered into between Australia and the U.S., with the intention of enabling legislation to follow at a later point in time, the FSC strongly encourages the Government to make an announcement confirming this. An announcement will signal a clear intention by the Government and will prevent members having to plan for alternate scenarios. The timeliness of this announcement is therefore critical to minimising the impact of FATCA on our members.

We note that the U.S. Treasury has advised that relief will only be provided to countries once they have finalised and signed an IGA. Once an IGA is signed, compliance with the IGA will be sufficient in the interim period until enabling legislation is enacted. Until an IGA is signed, industry will not be able to rely on the terms of the IGA for protection. Achieving this commercial certainty is an important consideration for our members, many of whom are currently in the process of building compliance systems and processes to address FATCA obligations.

The FSC has had the benefit of seeing the comments of both the Australian Bankers Association (ABA) and the Association of Superannuation Funds of Australia (ASFA) and support the additional arguments outlined in these submissions.

If you would like further information in relation to FSC's submission please do not hesitate to contact me on (02) 8235 2519.

Yours sincerely



CARLA HOORWEG
Senior Policy Manager, Global Markets & Tax

Appendix A - Comments

1. Ability to exempt retirement plans

Under the FATCA draft Regulations Australian superannuation schemes and retirement products were not exempted, despite a stated intention by the U.S. Treasury not to capture them. Many superannuation schemes may not be able to fully comply with FATCA under the requirements outlined in the draft Regulations. This is due to an inability to track down and identify the owners of some super accounts who have not their updated address or other contact details with their providers. The result will be that these superannuation schemes will be withheld against under the penalty withholding provisions.

The IGA provides the ability to exempt complying¹ superannuation entities and products, including self-managed superannuation funds, through Article 4, paragraph 3 and the Annex II. In comparison to the draft Regulations this is a significant benefit as it largely removes the need for superannuation entities to comply with FATCA.

The FSC sees advantages in superannuation being treated consistently across jurisdictions. From our discussions with U.S. Treasury we understand that it will be difficult to draft final Regulations with the necessary specificity to provide for the exemption of Australian retirement plans. We see the mechanism provided through the IGA as the only effective way to ensure that Australian superannuation schemes and retirement products are exempted from FATCA.

Importantly, the structure of Annex II in the Model 1 – Reciprocal IGA allows for retirement plans to be carved out of FATCA at three levels, namely Exempt Beneficial Owner, Deemed Compliant and Exempt Product.

The relevance of the carve-outs at each level is summarised below:

- **Exempt Beneficial Owner:** This exemption relieves financial institutions that issue financial accounts to complying superannuation entities from the need to perform due diligence on these entities;
- **Deemed Compliant:** This exemption relieves the complying superannuation entity from the requirement to register with the U.S. IRS and identify/report on/withhold against specified U.S. persons;
- **Exempt Product:** This exemption removes the requirement for complying superannuation entities to perform due diligence on their customers for FATCA purposes on the basis that the accounts issued by superannuation entities are not considered to be “financial accounts.”

The FSC notes that it will be essential to ensure that the wording in Annex II covering Australian superannuation entities and products is sufficiently wide for self-managed superannuation funds to be included in the exemptions.

2. Ability to exempt other “low risk” products

The IGA provides the ability to exempt other entities and products that present a low risk of tax evasion through Annex II. As more countries sign up to partner with the U.S. through IGAs it will become important for Australian investment products to be treated comparably under FATCA on a global basis.

¹ Where complying means “complying with Australian law”

Allowing “low risk” products to be exempt through Annex II will reduce the compliance costs for Australian FI’s and means that consumers will not be burdened with unnecessary increases in costs.

At this stage, the FSC would encourage Treasury to consider inclusion of the following products, at a minimum, under Annex II:

- Tax-paid, ordinary money life insurance policies;
- Deposits received from a related governmental or government-supported entity by a Foreign Government;
- Employee share plans;
- Managed Funds, Exchange Traded Funds (ETFs), and Structured Products admitted under the AQUA Rules.²

The FSC expects that as awareness of FATCA grows, additional “low risk” products will be identified with strong policy reasons for inclusion under Annex II.

We therefore encourage Treasury to consult widely with industry regarding the products and entities to be included under Annex II.

3. Overcomes domestic legal impediments

The IGA requires the Australian Government to ensure that Australian FI's do not suffer domestic legal impediments.

There are significant privacy and disclosure impediments to Australian FI's complying with the FATCA Regulations. Without resolution of these issues it will be difficult and costly for Australian FI's to comply.

Existing impediments include:

- Inability of Australian FI's to close accounts of recalcitrant account holders due to conflicts with existing account documentation (including services agreements and constitutions, trust deeds etc)
 - an IGA relieves Australian FI's of the requirement to close recalcitrant accounts under Article 4, paragraph 2;
- Breaches of Australian privacy laws through the reporting of client data without consent
 - Australian privacy rights are not infringed under the IGA as it would utilise ratified tax treaties already established for the purpose of tax transparency, and would require the Australian Government to enact enabling legislation;
- Inability of some Australian FI's to enter into legally binding individual agreements with the IRS due to their non-legal entity structure (for example managed investment trusts)
 - an IGA alleviates Australian FI's of the need to enter into individual agreements.

It is anticipated that the Australian Government may need to include provisions within existing legislation that recognises the Model 1 – Reciprocal IGA for FATCA as a means of overcoming domestic legal impediments.

4. Reduces compliance burden for Australian FI's and consumers

The compliance requirements for customer identification under the IGA are considerably less onerous than those required under the draft regulations.

² See the Aqua Rules: http://www.asx.com.au/about/aqua_product_quotation.htm

In particular:

- Initial customer identification procedures are more efficient and allow for self-certification;
- Reliance on information held in the public domain or in the possession of an Reporting FI as the basis of determining the “FATCA status” of a customer;
- Onerous customer re-identification procedures have been removed;
- Reporting via the ATO already occurs through the AIRR process, by using an established reporting process it will be less costly to implement than new systems for reporting to the IRS;
- Individual agreements with the IRS are not required, thus reducing internal legal costs associated with assessing terms and conditions of these agreements, and with developing internal compliance procedures to ensure adherence to these terms and conditions (the FSC estimates that if an IGA is not agreed then at least 55,000 entity agreements across the Australian financial industry will need to be entered into directly with the IRS);
- Reduced withholding obligations, as under the Model 1 - Reciprocal IGA Australian FIs will generally not be subject to FATCA withholding and are not required to withhold on recalcitrant accounts and Non Participating Foreign Financial Institutions (Article 4).

Whilst there will be some costs associated with implementing the IGA we believe the costs of implementing the draft Regulations are far greater. Overall, we expect that the costs savings which result from the advantages of the IGA over the draft Regulations will far outweigh the implementation costs under an IGA.

5. Leverages existing Anti-Money Laundering/Counter Terrorism Laws (AML-CTF) laws

The IGA will allow the industry to leverage Australia’s Anti-Money Laundering and Counter Terrorism Laws (AML/CTF) without additional requirements that are inconsistent with the existing AML/CTF regime. This will reduce the cost of compliance and unnecessary impacts on customers that are not likely to be subject to FATCA requirements.

6. Improves tax information exchange with the U.S. and other countries

The Australian Government will receive additional information on Australian Taxpayers under the Model 1 – Reciprocal IGA.

As a FATCA Partner country, Australia is likely be involved in future developments for reporting and due diligence standards for FI’s. By participating in FATCA through an IGA Australia will be part of a global network committed to combating tax evasion which would enable Australia to be involved in future discussions with the U.S., and other OECD countries, in the development of future automatic information exchange frameworks and joint efforts in combating tax evasion.

7. Other advantages

Quarantining Mechanism

Under the draft FATCA Regulations, in order for an Expanded Affiliated Group (EAG) to be characterised as “Participating” it is necessary that all branches or entities within the group are also participating. The draft regulations provide that if a member of the EAG is in a jurisdiction where FATCA compliance is not permissible due to local legal and/or regulatory conflicts, the EAG is effectively given two years to cure such impediments or all entities within the entire EAG is treated as Non-Participating.

Given the multitude of jurisdictions in which Australian-headquartered financial institutions operate, and the different legal and regulatory regimes that operate in these jurisdictions, it is the FSC's expectation that achieving participating status in many jurisdictions will not be possible within the two year time frame, if ever. Accordingly, the financial institution may be required to either close operations in the non-compliant jurisdictions or assume non-participating status for FATCA, neither of which may be palatable.

The Model 1 – Reciprocal IGA addresses this concern by allowing a financial institution to quarantine a non-participating branch on an enduring basis without affecting the status of entities within the EAG, subject to the adherence to certain conditions. This allows a financial institution to participate with FATCA to the extent possible with comfort that its participating status will not be tainted.

Development of a Workable Passthru Mechanism

The draft FATCA regulations countenance the formulation of "passthru withholding" to commence in 2017, notwithstanding that the particular rules have not been drafted as yet. Broadly stated, passthru withholding will require a financial institution that holds financial accounts for recalcitrant account holders or non-participating financial institutions to determine their proportion of U.S. income to total income and apply this percentage to withhold on all payments to such account holders.

The passthru withholding rules have the potential to impose significantly onerous administrative burdens on Australian financial institutions. Accordingly, it is the FSC's view that Australian Treasury be able to consult extensively with the U.S. Treasury regarding the development of these rules.

Under Article 6(2) of the Model 1 - Reciprocal IGA, the U.S. and the FATCA Partner are committed to work together to "develop a practical and effective alternative approach to achieve the policy objectives of foreign passthru payment...that minimizes burden." Hence, entry into an IGA would give Australia a "seat at the table" in terms of the formulation of the passthru withholding rules to ensure that they are drafted in a way that mitigates the impact on Australian financial institutions.

Ensures compliance by smaller entities

Many smaller Australian FI's may not be aware of FATCA, or may be intending not to comply with the obligations by not entering a separate FFI agreement with the IRS. Entering an IGA removes the option for Australian FIs to participate in FATCA.

However, we believe that once FATCA commences, even smaller organisations would eventually need to participate in FATCA because of the globalised nature of the financial services and the multiple dealings which will occur between smaller FI's and FATCA compliant FI's.

Accordingly, entering an IGA is advantageous for Australian industry as it ensures that all financial services organisations will be implementing and participating in FATCA at the same time. This removes uncertainty within industry as it results in more consistent application of FATCA across Australia.