

PwC Alert

Foreign Account Tax Compliance Act (FATCA)

The US federal law
affecting local
financial institutions

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institutions' obligation
under Model 1 IGA*

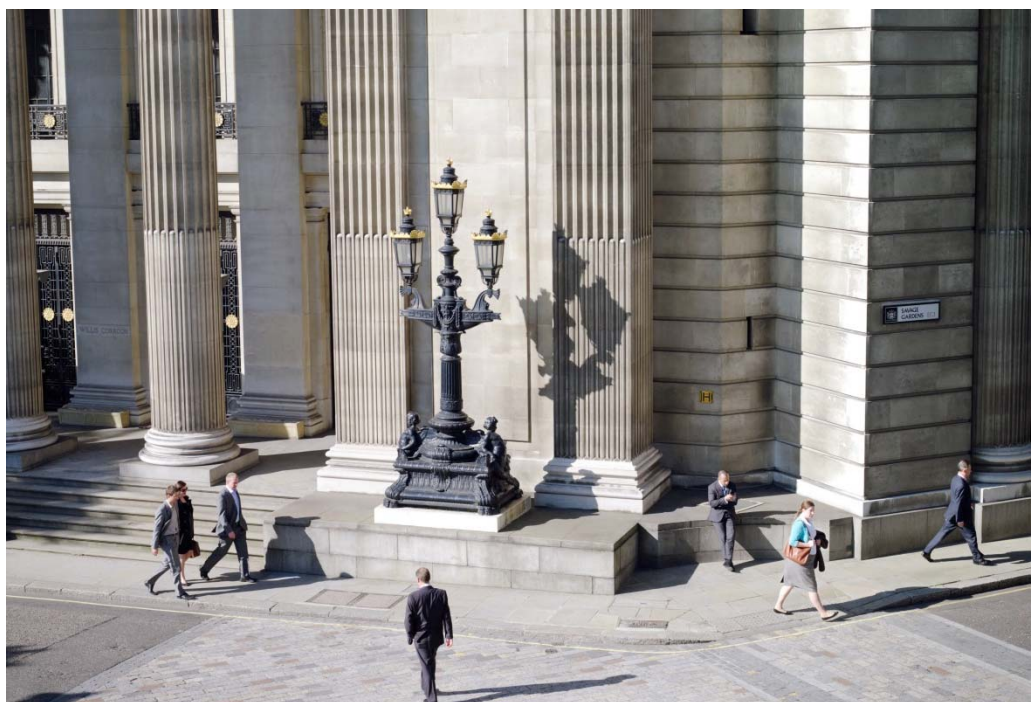




About FATCA

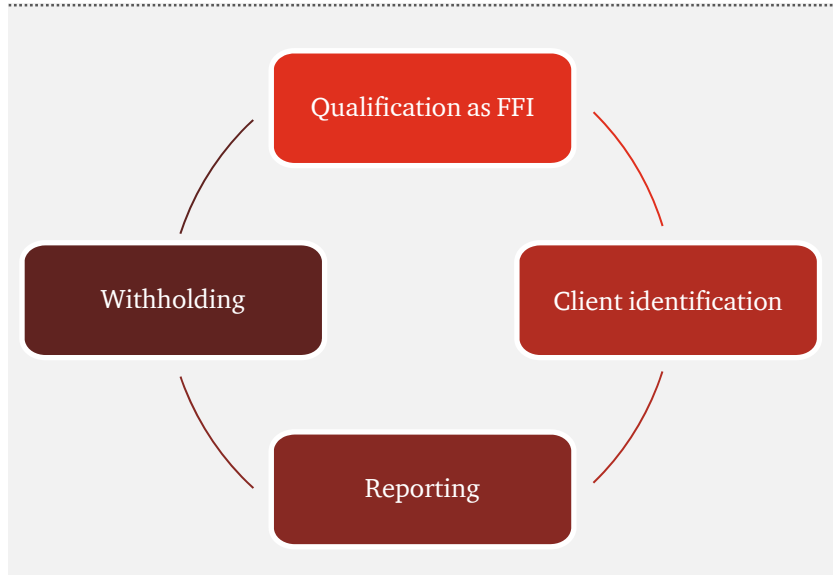
Introduction - What is FATCA?

- A federal law intended to **detect and deter the evasion of US tax** by US persons who hide money outside the US.
- It is **primarily a reporting system** of information to the US.
- Creates **greater transparency** for tax authorities and respective governments by strengthening information reporting and compliance through rules around the processes of documenting, reporting and withholding on a payee.
- Other than the financial services sector, it **affects many entities** outside the traditional financial services sector with operations both in and outside the United States.
- Effective date of FATCA is **1 July 2014**.



FATCA overview

The cornerstones of FATCA



Objective

- Complete declaration of income from US tax payers.

Implication

- Foreign Financial Institutions (FFI) need to identify clients who are US persons and report information to US Inland Revenue Services (US IRS).

Effective date

1 July 2014

Penalty for non-compliance

Withholding of 30% on US sourced FDAP income (see note below).

Note:

FDAP income means **fixed or determinable annual or periodic income (FDAP)**.

Examples of FDAP income include:

- Interest, dividends, rents and other fixed or determinable annual or periodical gains, profits, and income

Qualification as FFI

- Entities that meet the definition of a Financial Institution under FATCA terms.
- If met, the following obligations will apply – Client identification, Reporting and Withholding.

Client identification

- A FFI is required to perform due diligence on customers to determine their FATCA status.
- It covers both individual and entity customers.

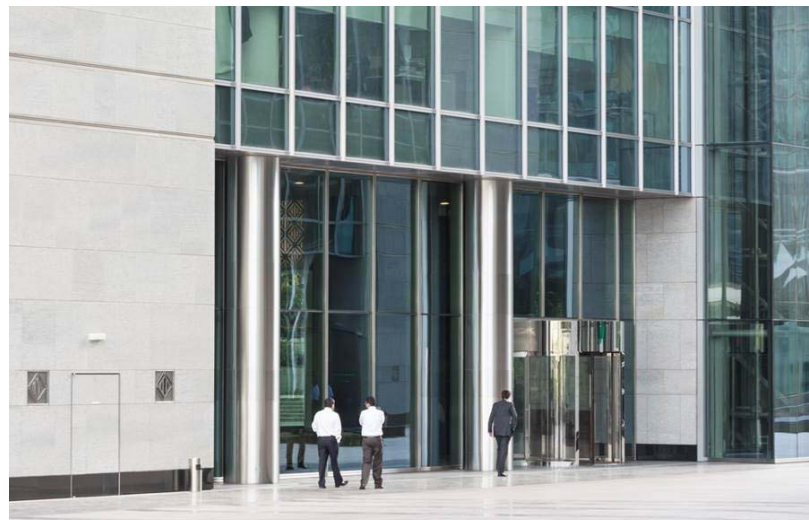
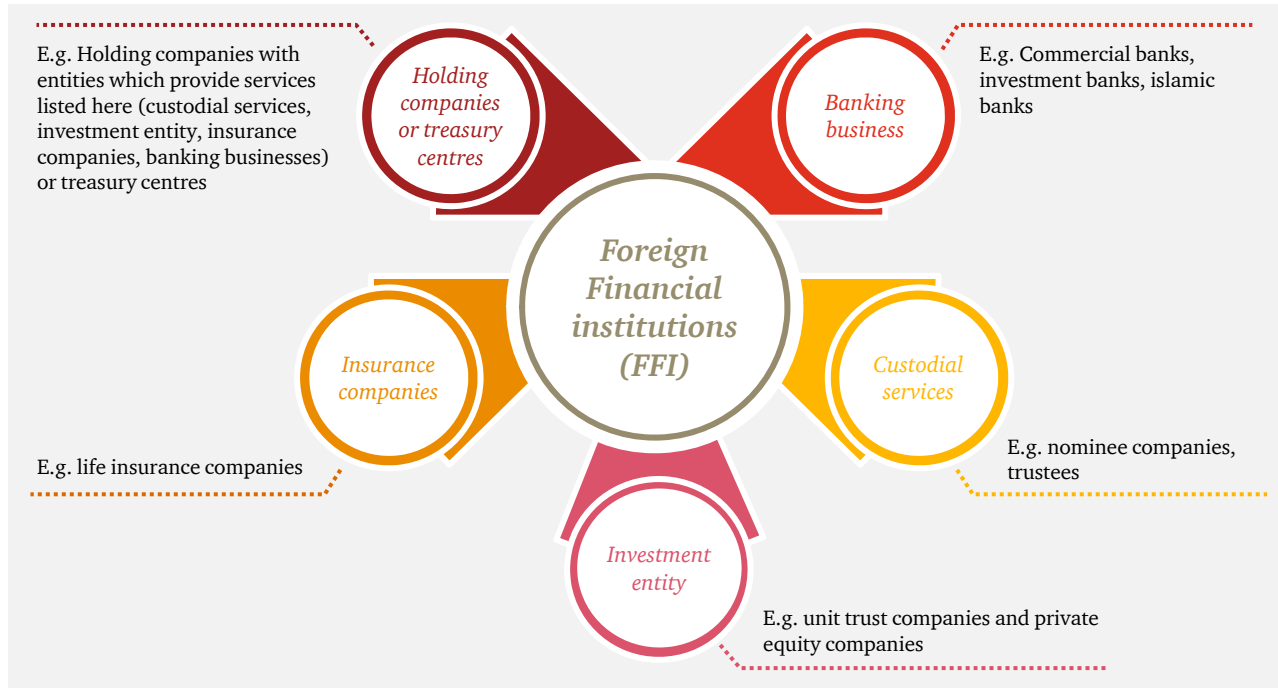
Reporting

- Reporting is required on financial account balance and income paid on these financial accounts held by reportable persons.
- Reportable persons are based on the customers' FATCA status identified as described above.

Withholding

- FFIs which do not comply with FATCA, will be subject to penalty of full withholding of 30% on US sourced income by the US payor bank making payment.
- For customers who refuse to reveal their FATCA status to the FFIs (i.e. “recalcitrant”), the FFIs are obligated to withhold 30% on US sourced income paid to them.

Scope of FATCA



What is FFI under FATCA requirements?

Banking business

- An entity which accepts deposits in the ordinary course of banking or similar business.
- E.g. savings banks, commercial banks, savings and loan associations etc.

Custodial services

- An entity which holds financial assets or related financial services for the benefit of other persons.
- E.g. Broker-dealers, clearing organisations, trust companies, custodial banks, and entities acting as custodians with respect to the assets of employee benefit plans.

Investment entity

- An entity which is involved in any of the following activities for or on behalf of a customer:
 - Trading in financial instruments;
 - Individual or collective portfolio management; and
 - Investing, administering or managing funds on behalf of other persons.
- An entity which functions as a collective investment vehicle, mutual fund or any investment vehicle established with an investment strategy. E.g. Mutual funds, funds of funds, hedge funds, private equity and venture capital funds etc.

Insurance company

- An entity which is obligated to make payment for a cash value insurance or annuity contract.

Holding companies or treasury centres

- Holding companies of the above-mentioned entities.
- Treasury centre which primarily enters into an investment, hedging and financing transaction, manages risk exposure and capital management for its group of companies.

Certain products are within the FATCA scope – **Financial Accounts**



Depository accounts

- Placement of funds by customers or FFIs or a credit balance in an account/ facility.
- Examples: Savings accounts, current accounts, fixed deposits.



Custodial accounts

- An account for the benefit of another person that holds any financial instrument or contract for investment.
- Examples: Assets held-in-trust.



Investment in equity or debt instruments

- The product/instrument which meets either one of the following criteria:
 - Issued by an investment entity and is not regularly traded on Bursa Malaysia or its equivalent.
 - Issued by a FFI, not regularly traded on Bursa Malaysia or its equivalent, and its value is in reference to assets that give rise to US source income.
- Examples: Unit trust funds, structured products issued by FFI.



Insurance contracts with cash value

- An insurance contract/ annuity contract with cash value which is issued/maintained by a FFI.
- Examples: Investment-linked insurance, endowment insurance plans.



Impact to Malaysia

Intergovernmental agreement (IGA)

- Reporting of customer information to third parties will breach local privacy laws.
- In response, the US has since published intergovernmental model agreements (IGA). IGA aims to solve legal and local law issues, by involving local authorities in the FATCA process.
- 2 types of model agreements are available to be signed between the US and other foreign governments – Model 1 and Model 2.
- Key differences between Model 1 and Model 2:

Requirements	Model 1	Model 2
Compliance with FFI Agreement	No requirement to sign FFI Agreement	FFI to sign separate agreement with the US IRS
Reporting to the US IRS	FFIs to report to the local competent authority who will then report to the US IRS.	Direct reporting to the US IRS.
Withholding on payments to recalcitrant	No withholding required.	Withholding is required where account holder information requested by the US IRS is not provided by the local competent authority within six months from the receipt of the request.



Countries that have signed the IGA and that have reached agreements in substance



How does it affect Malaysia?

Malaysia updates

- As at 30 June 2014, Malaysia has reached agreement in substance (Model 1).
- Malaysia must demonstrate its 'firm resolve' to sign the IGA as soon as possible in order for its status to be continued without interruption.
- Potential changes are expected in the local law to accommodate FATCA compliance.

Impact to local financial institutions

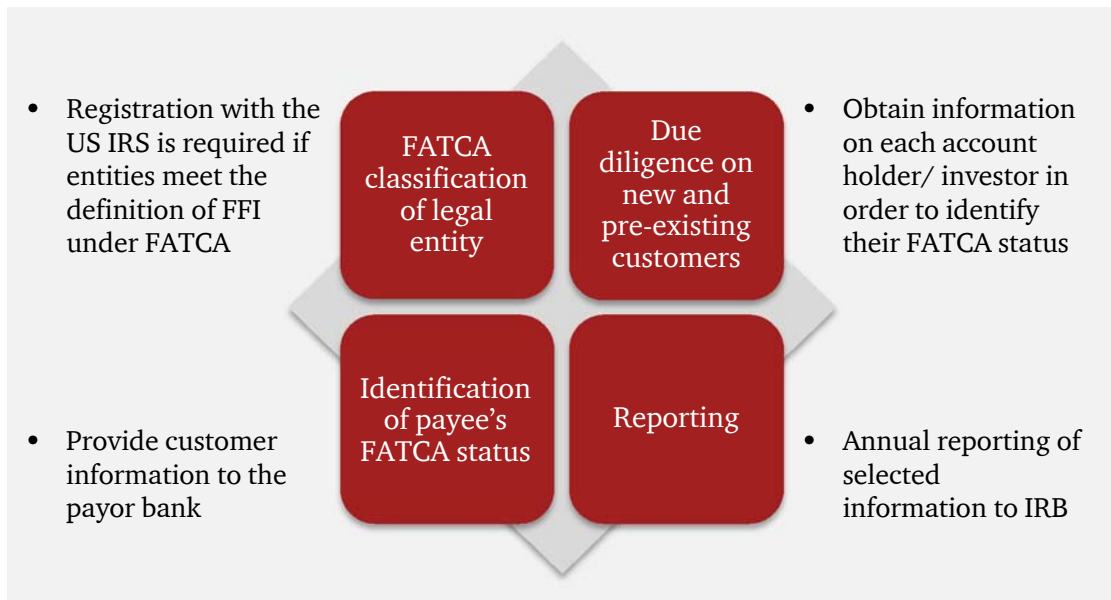
- Mandatory for all FFIs in Malaysia to comply with FATCA.
- Entities assessed to be FFIs must register on the US IRS website.
- Entities must report financial account holders' information to Malaysia's Inland Revenue Board (IRB).
- No withholding required – only provide information of its customers to the withholding agent.

Transitional relief by US IRS

- Calendar years 2014 and 2015 will be regarded as a transition period for purposes of IRS enforcement and administration.
 - **Only if** a financial institution has made a "Good faith effort".
- Definition of 'Good faith effort':
 - Written compliance policies and procedures; internal controls showing that the procedures have actually been followed.
 - Roles and responsibilities for compliance and oversight have been adequately allocated to the appropriate personnel within the organisation.



Malaysian financial institutions' obligation under Model 1 IGA

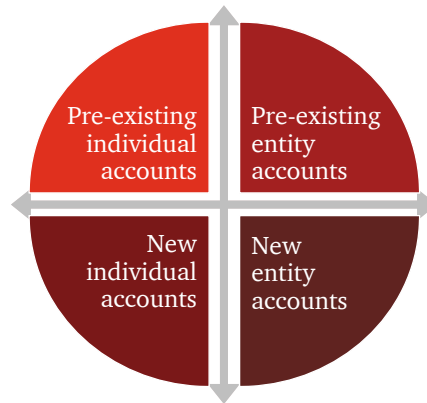


Malaysian financial institutions' obligation under Model 1 IGA

1. FATCA classification of legal entity

- **Entities are required to carry out assessments** to determine if they meet the definition of being a FFI.
- Definitions of FFIs are as shown on page 5.
- Entities which **meet the definition of FFIs** are required to register with the US IRS, indicating **FATCA compliance**.
- Monitoring of any **changes in FATCA classification** of the legal entities which will require updates to the registration status.
- As at 21 November 2014, there are **498 Malaysian Financial institutions (Malaysian FIs)** which **have registered** with the US IRS.

2. Due diligence on new and pre-existing customers

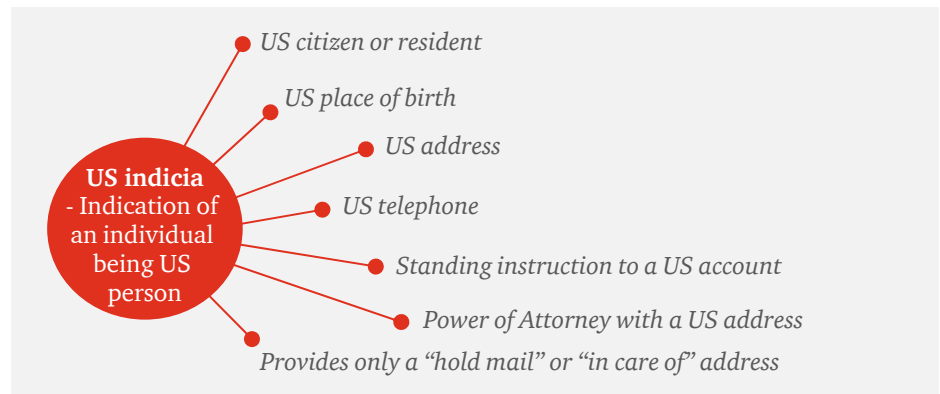


Critical timeline

- July 1 2014 – Commence identification of new accounts' FATCA status
- June 30 2015 – Complete identification and review of pre-existing high value (>USD1 million) individual accounts
- June 30 2016 – Complete identification and review of all remaining pre-existing individual and entity accounts

Individual

- The US indicia is used as an indication in determining the FATCA status of an individual – US person or non US Person.
- If any of the US indicia is met, additional documentation is required to confirm their FATCA status.





2. Due diligence on new and pre-existing customers (continued)

Entity

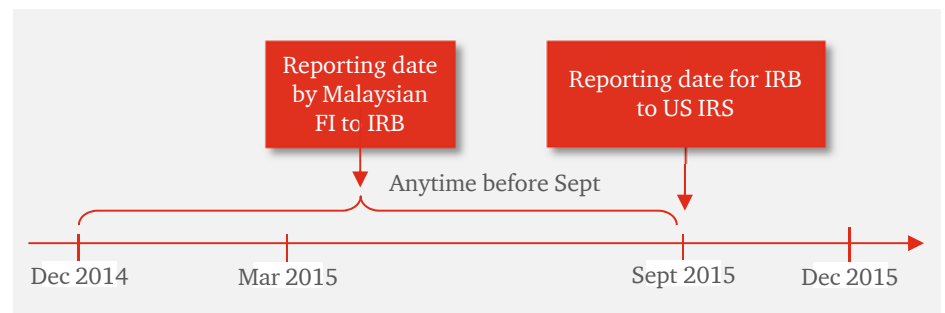
- Entity's FATCA status is based on its business activities.
- There are 38 categories of FATCA status for entities. The common categories are:
 - US Person – The entity is incorporated in the US.
 - Active Non-Financial Foreign Entity (NFFE) – The entity generates its revenue from its core business activities and non-investment activities.
 - Passive NFFE – The entity generates its revenue from its investment activities and receives investment income, such as interest, dividends etc.
 - Financial institution – An entity which meets FFI definition under FATCA requirements.
 - Public listed non-FI entity and its subsidiary – The entity is regularly traded on Bursa Malaysia or another stock exchange outside the United States and its subsidiary.



3. Reporting

Timeline

- Under the proposed Malaysia IGA, IRB will be appointed as the competent authority.
- IRB is required to report to the US IRS within 9 months after the end of the calendar year, for the financial position as at the end of the calendar year (i.e. December).
- However, IRB has yet to announce the reporting timeline by Malaysian FIs to IRB.



Malaysian financial institutions' obligation under Model 1 IGA

3. Reporting (continued)

Scope

Malaysian FIs are required to report the following FATCA status of their customers:

- US Person
- Substantial US owners
- Recalcitrant account holder
- Non-participating FFI (“NPFFI”)*

Reportable information

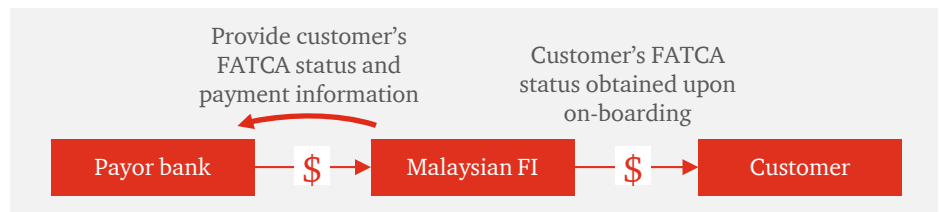
- The customer’s particulars such as name, address, US tax identification number and account number. ^
- Account balances (including closed account during the year). ^
- Payment made in respect of the account, such as total interest/ dividends paid, gross proceeds from the sale/redemption of assets.
- Gross amount of any other income.

* With effect calendar year 2015

^ First reporting – 2014

4. Identification of payee status

- Applicable to **transactions** relating to **US sourced FDAP income**.
- FDAP means **fixed or determinable annual or periodic income (FDAP)**. Examples of FDAP income include:
 - Interest, dividends, rents and other fixed or determinable annual or periodical gains, profits, and income



- Prior to making a payment, the Malaysian FI is required to **provide the customer’s FATCA status and transaction details** to the payor bank.



Key challenges faced by financial institutions in implementing FATCA

Impacts customer on-boarding experience - additional forms to complete

- Customers to provide self-declaration on their FATCA status.
- Customers may also be required to sign-off on US forms (W-8BEN, W8BEN-E and W9) as part of this self-declaration process.

Additional due diligence to be performed by customer-fronting officers on top of current 'know your customer' (KYC) procedures

- Customer fronting officers to:
- Perform reasonableness checks on self-declarations made by customers.
 - Explain to customers reasons for self-declaration.
 - May have to guide customers to complete the US forms.

Additional cost of compliance - IT enhancement to systems, etc.

- Printing of enhanced/new on-boarding forms for customers.
- IT enhancements to store FATCA status of customers.
- Additional reporting function to the competent authority (IRB).
- Compliance checks to ensure compliance with FATCA and to facilitate certification to authorities etc.

More guidance is required for the local industry to ensure consistency in FATCA implementation practices

- Based on interpretation by local authorities e.g. FFIs that are in scope, exempted products, etc.

Closing remarks



New wave of FATCA

Organisation for Economic Cooperation and Development (OECD)
– Common Reporting Standards (CRS)

- More information is required for CRS as reporting of customers is based on their tax residency etc.
- Framework is very similar to FATCA.
- Affects both individuals and non-individual customers.
- Reporting on an annual basis on financial accounts and income paid on these financial accounts to countries which have signed the agreement.
- Impact to Malaysia signing the agreement – procedures to be ready by 2017 for first reporting in 2018.

Immediate action points

1. Malaysian FIs to perform the following:
 - Assess FATCA classification of entities.
 - For entities that meet the definition of an FFI, to register with the US IRS.
 - Due diligence to identify customers' FATCA status.
 - On boarding processes and application forms will need to be enhanced.
 - System enhancements to store customers' FATCA status and to capture information for annual reporting.
2. Ensure policies and procedures, including the roles and responsibilities and internal governance structures are in place for the above tasks.
3. Consider incorporating CRS requirements – to leverage on the relevant FATCA due diligence processes.



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