

Taking control of FATCA

Building effective internal controls
and certifying compliance

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Introduction



In March of 2010 the provisions of the Foreign Account Tax Compliance Act (“FATCA”) were enacted as part of the Hiring Incentives to Restore Employment (“HIRE”) Act.

FATCA was enacted with a primary goal of providing the Internal Revenue Service (“IRS”) with an increased ability to detect US tax evaders concealing their assets in foreign accounts and offshore investment vehicles. It aims to accomplish this goal by requiring US and non-US entities to comply with a new set of tax information reporting and withholding rules as well as investor due diligence and documentation requirements, or suffer the consequences of non-compliance and become subject to or liable for excessive US withholding tax.

This paper is based on the proposed FATCA regulations, and its purpose is to highlight the need for entities impacted by FATCA to develop and maintain:

- Sufficient controls around operational and financial functions that are impacted by FATCA;
- Adequate infrastructure to ensure ongoing compliance with FATCA’s requirements; and
- A FATCA-compliant program sufficient to make periodic certifications to the IRS as needed.

Although the provisions of FATCA became law in March 2010, the statute provided only the basic framework for FATCA’s requirements. Much of the details about implementation were left to the discretion of the US Department of Treasury (“Treasury”) and the IRS. After issuing a series of Notices, the IRS and Treasury issued proposed regulations in February 2012. In addition, the IRS is working with foreign jurisdictions on Intergovernmental Agreements (“IGAs”) to improve international tax compliance and implement the provisions of FATCA. The IGAs may change how FATCA compliance activities are performed in certain jurisdictions and companies should monitor these changes.

FATCA’s requirements broadly include:¹

- **Enhanced due diligence on account holders and investors** – Financial institutions must employ prescriptive due diligence procedures on their account holders, investors and other persons and obtain additional documentation as required.

- **Tax reporting** – Financial institutions will be required to report more transactions and financial account relationships to the IRS.
- **Tax withholding** – Financial institutions will be required to withhold US tax from a variety of payments made to recalcitrant account holders and non-participating foreign financial institutions (“NPFIs”).²
- **Governance** – FATCA will require many foreign financial institutions (“FFIs”) to enter into an agreement with the IRS, referred to as an FFI Agreement, and appoint a so called responsible officer (“RO”) to make periodic certifications to the IRS about the FFI’s compliance with its agreement.

1 These provisions are being phased in over a number of years beginning in 2014.

2 A recalcitrant account holder is an account holder of a participating foreign financial institution (“PFFI”) who does not provide adequate documentation or information within a prescribed timeframe.

Focus on the role of the responsible officer



FATCA's tax information reporting, withholding and investor due diligence requirements are imposed on financial institutions both in the US and abroad.

However, FATCA has a larger impact on FFIs since it requires that many of them enter into an agreement with the IRS and thus become participating foreign financial institutions ("PFFIs"). PFFIs will be required to perform additional due diligence on account holders and investors, report certain transactions and financial account relationships to the IRS, and withhold a 30% US federal tax from certain payments made to recalcitrant account holders and NPFFIs.

To make certain that PFFIs comply with their FFI Agreements, the IRS will require PFFIs to appoint an RO who will make certain certifications to the IRS at periodic intervals regarding the PFFI's compliance with its agreement. Failure to enter into an agreement when required could result in a 30% withholding tax on certain payments received by an FFI. Additionally, failing to make the required certifications could constitute a default under the agreement, which may result in the IRS terminating the agreement. In that case, the entity could be considered an NPFFI and be subject to US tax withholding under FATCA.

Certifying compliance

The RO of each PFFI must make certain certifications to the IRS about the PFFI's compliance. It is expected that the following certifications will be required:

- 1. Preexisting High Value Accounts** – With respect to preexisting individual accounts, an RO must certify to the IRS **within one year of the effective date of the FFI Agreement** that the PFFI has completed the review of all High Value Accounts.³
- 2. Remaining preexisting accounts** – With respect to the remaining preexisting accounts, the RO of the PFFI must certify to the IRS **within two years of the effective date of its FFI Agreement** that it has completed the review for all remaining preexisting accounts.
- 3. Policies and procedures** – The RO must certify to the IRS **within one year of the effective date of the FFI Agreement** that to the best of the RO's knowledge, after conducting a reasonable

inquiry, the PFFI did not have any formal or informal practices or procedures in place from August 6, 2011, through the date of such certification to assist account holders in the avoidance of FATCA.

4. Compliance certification

– The FFI Agreement will require that the participating FFI **adopt written policies and procedures** governing its due diligence procedures for identifying and documenting account holders and its withholding and reporting requirements under the FFI Agreement. The FFI Agreement will further require that the participating **FFI conduct periodic reviews of its compliance** with these policies and procedures and its FATCA obligations. Based on the results of such reviews, an RO of the PFFI will periodically certify to the IRS the PFFI's compliance with its obligations under the FFI Agreement, and may be required to provide factual information and to disclose material failures.

³ In general, a High Value Account is a preexisting individual account maintained by a PFFI that has a balance that exceeds \$1,000,000 at the end of the calendar year preceding the effective date of an FFI's agreement with the IRS, or at the end of any subsequent year.

Based on the proposed regulations, the first FATCA certifications would be due January 1, 2015, which is based on one year from the earliest possible date that an FFI Agreement could be effective (January 1, 2014). However, FFIs with agreements effective on January 1, 2014 must have procedures in place to identify US accounts beginning on that date. With just a year to prepare, many FFIs will have much work to do to meet these initial deadlines.⁴

The role of the responsible officer and the need for effective controls

In addition to the certification requirements, FATCA's rules are far reaching and complex, affecting many legal entities, departments, and functions.

Among other things, FATCA will affect the operational areas of withholding and reporting; accounting, information technology and legal departments; customer relations and accountholder communications; product design and development, marketing, sales and distribution; and on-boarding, and many other business processes, all of which must be analyzed and potentially modified to achieve compliance. In a large organization, data sources and business processes can vary across products and geographies, only adding to the complexity.

While organizations are currently focused on becoming FATCA compliant by the impending deadlines, they must realize that FATCA compliance is an ongoing responsibility. Therefore, as US withholding agents ("USWAs"), FFIs and large multi-national organizations invest

in new processes and system enhancements to comply with FATCA, controls should be incorporated into future state models now to ensure that FATCA compliance is sustainable over the long term. As companies begin to refine their focus on controls related to areas requiring FATCA compliance, they may find that controls related to the tax, technology and operations required to support FATCA compliance may be less mature than areas of controls that have been a focus of regulators over the years. FATCA presents an opportunity to optimize controls and procedures and enable a sustainable compliance and certification framework. While the establishment of a robust controls framework is paramount for all entities with FATCA exposure, the four key certifications that must be made by the RO of each PFFI further emphasize its importance.

***FATCA checkpoint:
If your organization has multiple FFIs located around the world, how will you ensure that each FFI is in compliance?***

⁴ Dates are subject to change based upon the issuance of final regulations.

The IRS does not dictate who in the organization should fill the role of the RO, so financial institutions must make their own determination of who is best qualified for the job. Although FATCA's requirements are heavily focused on tax reporting, withholding and investor due diligence, many of the key procedures related to FATCA reside in areas outside of the tax function (e.g., account set-up, operations, technology, etc.), as such, the RO may not necessarily be someone within the tax department. However, the person chosen should be at a high enough level in the organization to have a broad view of the entity's operations and the ability to leverage resources across the organization. The RO will have ultimate responsibility to certify on behalf of the FFI. For this reason, the person chosen should be involved in the development of the company's FATCA compliance policies and procedures.

To complete point-in-time certifications related to due diligence on preexisting accounts, the RO must understand the organization's due diligence procedures, and be satisfied that the appropriate procedures were performed. For the point-in-time certification related to practices in place that may assist accountholders in evading identification, the RO must perform certain procedures in order to conduct a "reasonable inquiry." These may include obtaining an inventory of formal policies and procedures in place and reviewing them for any problematic practices. Additionally, a risk assessment should be performed to identify the jurisdictions or entities that could be of concern, and the RO should make inquiries of key client relationship managers within these entities.

For ongoing annual certifications, the RO must certify the organization's compliance with FATCA, including due diligence procedures, withholding, and reporting. A sound controls framework is essential to ensure that policies and procedures are in place in these areas and are being followed across the organization, as the RO cannot simultaneously be involved in all relevant areas at the required level of detail. Considering the significant financial impact that FATCA withholding can have, the responsibility of FATCA compliance may extend to additional members of management beyond the named RO(s).

***FATCA checkpoint:
Have you appointed the
responsible officer or officers
who will be charged with
certifying the compliance of
your organization?***

Key action items for the responsible officer

The RO may be involved in a range of activities related to FATCA compliance. These may include:

- Ensure that sub-certifying officers are in place across each relevant key process/jurisdiction, etc., and that they have the appropriate authority to execute their responsibilities.*
- Communicate FATCA policies and procedures across the organization, including a framework for designing and maintaining effective controls.*
- Ensure that FATCA-related compliance training on policies and procedures is conducted regularly for all impacted parties.*
- Leverage internal audit, risk management, or external parties to self-test compliance in each relevant territory/area.*
- Periodically review that the appropriate procedures have been performed across the organization, for all impacted legal entities. If key functions (e.g., account setup, reporting, income payment processing, tax withholding, etc.) have been outsourced to a third party service provider, develop/execute a program to ensure the provider is FATCA compliant with respect to the financial institution's accounts/processes.*
- Review all sub-certifications and follow up on any issues identified. Certify to the IRS in a timely manner and disclose any material failures. Ensure that schedules are in place to monitor required certifications to the IRS.*

Building a FATCA controls framework



When building an effective controls framework, organizations must begin with a detailed understanding of what is required under FATCA regulations.

A traceability matrix should be developed to detail the requirements across several key FATCA areas, including legal entity analysis (e.g., identifying USWAs or FFIs), client account due diligence, withholding, reporting, and certification/governance. A FATCA controls framework will then build off the traceability matrix to summarize these requirements and the risks of failing to meet them. The framework should contain

objectives aimed at mitigating these risks, and also provide “best practice” controls for organizations to follow. Within the framework, organizations should document their controls and assess if there are any gaps (e.g., no control to meet a particular objective or inconsistent controls across territories, etc.). The following is a limited excerpt of such a framework that demonstrates how this would be developed.

PwC FATCA controls framework (excerpt)

Area	FATCA summary requirement	Risk	Control objective	Sample key controls
Legal entity assessment	All legal entities are appropriately classified and registered based upon their activities and where they are organized.	The organization fails to identify or properly register all legal entities that are subject to FATCA.	Controls provide reasonable assurance that changes in legal entity listings and related classifications are appropriately updated in a timely manner and approved by the appropriate personnel.	Key data regarding legal entities is reviewed periodically versus established thresholds depending on the entity type, to identify and evaluate any changes in FATCA classifications.

PwC FATCA controls framework (excerpt)

Area	FATCA summary requirement	Risk	Control objective	Sample key controls
Client account assessment	New entity and individual accounts are appropriately classified based on data obtained during the account set up process.	US indicia search is not conducted adequately.	Controls provide reasonable assurance that the search for US indicia is properly performed.	<p>In the case of setting up a new account that is an individual account, the appropriate personnel reviews the documentation collected during the account opening process as well as documentation maintained in the participating FFI's customer master file.</p> <p>Documentation that supports this review is retained for six calendar years.</p> <p>Indicia search is subject to a secondary review and approval.</p> <p>Periodically, an exception report highlighting accounts without required approval is produced and reviewed for follow up by authorized personnel.</p>
Certification procedures	With respect to preexisting accounts, an RO must certify to the IRS within one year of the effective date of the FFI Agreement that the participating FFI has completed the review of all High Value Accounts.	The RO misrepresents the actions taken to meet FATCA requirements.	Controls provide reasonable assurance that FATCA processes and procedures are performed consistently across the organization to support applicable certifications to be made to the IRS.	<p>Internal audit or other testing mechanism (e.g., management self-testing, peer testing, etc.) performs sample testing throughout the year to validate that FATCA policies and procedures have been adhered to on a consistent basis.</p> <p>All issues identified during the testing are appropriately evaluated and remediated on a timely basis.</p>

Developing a certification framework



In addition to a controls framework, a certification framework should also be established to ensure that every relevant part of the organization is represented in the certification process.

The RO should consider appointing sub-certifying officers across each of the relevant businesses or functions and assign them the responsibility for providing sub-certifications of compliance for their respective areas.

A sample certification framework is illustrated on the next page. The framework will vary from one financial institution to the next, depending on the structure of the organization. For example, in organizations with a regional focus, the head of each region might be assigned the role of sub-certifying officer. In other organizations, this role might be filled by business unit leaders. Depending on the size and complexity of the organization, there may be several additional sub-certifying officers below these

levels – for instance, functional heads, or individuals assigned to legal entities. There must be enough sub-certifying officers assigned to ensure that all parts of the organization which are affected by FATCA are in compliance with its requirements. Because of the complexity of ensuring compliance, financial institutions may need to view their operations from several angles to determine who the most appropriate sub-certifying officers are. These officers must have the requisite expertise so that the RO has the confidence that all sub-certifications are correct. For companies with multiple ROs covering distinct business lines, a FATCA champion or sponsor should be appointed to oversee the activities of each RO.

FATCA checkpoint:

- ***Have you developed a sub-certification process to enable disparate reporting units to provide assurance to the responsible officer?***
- ***Are all sub-certifying officers well qualified for the position?***

Considerations for third party providers

Because so many functions fall within the scope of FATCA, it is possible that one or more will be outsourced to a third party (e.g., a custodian bank, transfer agent, etc.). ROs are required to certify compliance of all affected functions—including those performed by service providers—and outsourcing compliance activities to third parties does not alleviate the responsibility of those within the organization who are charged with certifying compliance. With that in mind, organizations should ensure

their FATCA governance includes consideration of services provided by third parties. The governance framework should include the appropriate oversight of relevant third parties and ROs may need to obtain documentation that gives the organization comfort that controls are in place to ensure compliance. PFFI's and their service providers will need to work together to determine the appropriate reporting to align to the compliance requirements and related confirmations required by the RO.

Sample responsible officer governance structure



Conclusion



Many organizations are now preparing for FATCA compliance, working through who within the organization should be assigned as the RO(s), if applicable, and who should be charged with evaluating, designing or executing FATCA controls. In our view, institutions should establish a cross-functional working group focused on FATCA governance to address this challenge, as key processes and controls exist at many levels of the organization and a coordinated approach is paramount. This governance work stream should sponsor the development of an effective sub-certification structure, and a robust control framework, to not only support the activities of the RO, but also to ensure that ongoing FATCA compliance is sustainable, efficient and effective.

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