Australian Government

The Treasury

Regulation Impact Statement

Implementation of the United States Foreign Account Tax Compliance Act in Australia

March 2014

CONTENTS

Department: Treasury

Proposal: For Australia to sign and ratify a bilateral intergovernmental agreement (IGA) with the United States to facilitate the implementation of the United States' Foreign Account Tax Compliance Act (FATCA) in Australia.

Executive Summary

This proposal is for Australia to conclude an intergovernmental agreement (IGA) with the United States (US) to facilitate the implementation of FATCA in Australia.

- FATCA is a US anti-tax evasion regime aimed at detecting untaxed income and assets held in foreign (i.e. non-US) financial institutions by US taxpayers.
- It will require foreign financial institutions (including Australian financial institutions) to report details of accounts held by their US customers to the US Internal Revenue Service (IRS). Non-compliant financial institutions will face a 30 per cent withholding tax on their US sourced income.
- FATCA will commence on 1 July 2014, irrespective of any action taken by Australia.

Australia's regulatory environment does not permit Australian financial institutions to comply with FATCA. Industry has advised that non-compliance would generate significant economic costs and would damage its reputation and international competitiveness.

This proposal seeks to redress the inability of the current regulatory environment to support industry compliance with FATCA by establishing a legal framework that will enable financial institutions to comply.

The Government has announced its intention to sign and enact a treaty-status IGA with the US to facilitate industry compliance and to minimise the economic impacts of FATCA in Australia more broadly. An IGA would remove domestic legal impediments that currently prevent Australian financial institutions from complying with FATCA.

This Regulatory Impact Statement compares three options for responding to FATCA:

- Option 1 is to conclude a Model 1 IGA with the US;
- Option 2 is to conclude a Model 2 IGA with the US; and
- Option 3 is no government intervention (i.e. maintain the status quo).

(Model 1 and Model 2 IGAs are alternate US model treaties designed to provide a bilateral framework for foreign financial institutions to comply with FATCA).

As with other major proposals of this kind, compliance burdens are likely to fall primarily on Australian financial institutions and their customers. Some customers will have to supply more information to financial institutions, and financial institutions will have to compile appropriate records and forward them either to the Australian Taxation Office (under option 1) or directly to the IRS (under option 2). In the case of no government intervention (under option 3), Australian financial institutions will bear the financial cost of the withholding tax on their US sourced income if the appropriate customer information cannot be supplied. However, customers would eventually bear the cost to the extent that it is passed onto them primarily in the form of higher account fees or higher borrowing costs.

All of the three options impose a compliance cost on the Australian financial sector. The details of how compliance costs are eventually borne by customers and their financial institutions is uncertain because industry-specific factors will play as much a part as overall capital market factors. The important distinctions between them is the amount of this cost and the degree to which financial institutions are exposed to wider market and legal risks.

In the event that Australia does not conclude an IGA, there is a real prospect that Australian financial institutions could face additional risks that would ultimately manifest as increased borrowing costs or the reduced availability of credit. The Australian Bankers' Association (ABA) has advised that in addition to bearing the financial cost of the US withholding tax, participation in the global markets by Australian banks and other financial institutions may be limited. Some financial institutions may decide to restructure their investments or reduce their reliance on US sourced funding so as to limit their exposure to FATCA withholding tax. In addition, FATCA-compliant financial institutions in other countries may be reluctant to conduct transactions with Australian financial institutions because of the associated FATCA reporting and withholding obligations.

Together, these factors are likely to limit potential offshore income streams of Australian financial institutions and therefore their ability to develop and grow their business. Such impact would be greater for Australian financial institutions that derive a larger proportion of their income from the US financial markets but also for those who have significant participation in the US capital markets.

Option 1 is the preferred option. It would enable Australian financial institutions to comply with FATCA without breaching Australian law and entails the lowest level of compliance costs for industry. This option is consistent with the approach that many peer countries have taken to FATCA and is consistent with the Government's long standing support for international cooperation to prevent tax evasion. It also reduces the need for Australian financial institutions to engage with US authorities in relation to their FATCA reporting obligations, thereby reducing their compliance burden.

Option 2 would also achieve FATCA compliance for industry but would generate higher compliance costs for industry and lower overall benefits. The principal differences between Option 1 and 2 relate to the need for industry to comply directly with the US under the Model 2 IGA approach, and the lack of administrative reciprocity that would be provided to Australia by the US.

Option 3 is not supported. It would not meet the Government's policy objective of enabling industry to comply with FATCA and expose industry and consumers to the economic costs of non-compliance. Despite representing the least amount of regulation, Option 3 would be the most expensive option for industry (with an expected start-up cost of $477 million and ongoing annual costs of $58 million). Option 3 would also generate significant economic losses for industry reputational risks and decreased international competitiveness.

Compliance Costs Comparison between Options

	Option 1		**Option 2**		**Option 3**	
	Annual ($M)	**Total (over 10 years) ($M)**	**Annual ($M)**	**Total (over 10 years) ($M)**	**Annual ($M)**	**Total (over 10 years) ($M)**
Start Up	25.54	255	31.90	319.08	47.74	477.47
Ongoing	22.72	227.2	24.63	246.37	58.84	588.45
Total	48.27	482.68	56.54	565.44	106.59	1065.92

The relative merit of these options is reflected in other countries' responses to FATCA. To date, 20 countries have signed Model 1 IGAs with the US, and 4 countries have signed Model 2 IGAs. Other IGAs are under negotiation.

In addition, the Model 1 IGA format has now been adopted by the Organisation for Economic Cooperation and Development as the international standard for the automatic exchange of taxpayers' financial account information between revenue authorities, to help prevent tax evasion. The G20 has endorsed the standard and called for its early adoption by those jurisdictions that are able to do so.

1. Introduction to FATCA

Overview

FATCA is a unilateral anti-tax evasion regime, enacted by the United States in March 2010, aimed at detecting US taxpayers who use accounts with offshore financial institutions to conceal income and assets from the US IRS. The relevant provisions are contained in the US *Internal Revenue Code 1986* (IRC) and are supplemented by extensive US FATCA regulations. FATCA will commence on 1 July 2014.

In broad terms, FATCA will require foreign (that is, non-US) financial institutions – regardless of their country of location – to periodically report directly to the IRS certain information about financial accounts held by US individuals or US-controlled entities.

To comply with these reporting requirements, foreign financial institutions (FFIs) would have to conclude special agreements with the IRS which would oblige them to:

- Undertake specified identification and due diligence procedures with respect to their account holders;
- Report specified information annually to the IRS on their account holders who are US persons or US-controlled entities; and
- Withhold and pay to the IRS 30 per cent of any payments of US sourced income, as well as gross proceeds from the sale of securities that generate US sourced income, made to:
  - (a) Non-participating FFIs;
  - (b) Individual account holders that fail to provide sufficient information to determine whether or not they are a US person; or
  - (c) Foreign entity account holders that fail to provide sufficient information about the identity of their substantial US holders.

Compliance with FATCA is not mandatory but non-compliance will expose FFIs to a 30 per cent US withholding tax on their own US sourced income.

While FATCA is not extra-territorial, the withholding tax rules make compliance very attractive from the commercial perspective of most affected Australian financial institutions. However, in the absence of Australian government intervention, Australia's privacy and anti-discrimination laws would generally preclude Australian financial institutions from fully complying with the FATCA requirements.

Australia's bilateral investment relationship with the US

The US remains an important bilateral investment partner for Australia in both direct and portfolio investment terms. In 2012, foreign direct investment from the US to Australia and from Australia to the US amounted to $131,255 million and $103,383 million respectively. Foreign portfolio investment from the US to Australia and from Australia to the US amounted to $486,312 million and $330,597 million respectively.[1]

Notwithstanding the economic significance of the bilateral relationship, it is not possible to readily quantify the scale of assets held by the Australian financial sector that generates US sourced income.

Australia's financial and insurance services sector

Based on data available from the Australian Bureau of Statistics (ABS), the financial and insurance services sector is an important part of the Australian economy. It currently employs over 400,000 people and is the largest industry in Australia when measured by Industry Gross Value Added (a measure of the economic worth of the goods and services produced). As a share of national Industry Gross Value Added, the industry has grown from around 6 per cent in 1990, to 8.7 per cent in 2013.[2]

FATCA will apply to a large part of the Australian financial services sector – particularly custodial institutions, depository institutions, investment entities and specified insurance companies. A broad range of Australian financial institutions, including banks, some building societies and credit unions, life insurance companies that offer insurance products that include an investment component, private equity funds, managed funds, exchange traded funds and some broker dealers are expected to comply with its requirements.

[1] Australian Bureau of Statistics Catalogue 5352.0 - International Investment Position, Australia: Supplementary Statistics, 2012 Table 1

[2] Australian Bureau of Statistics Catalogue 5204.0 - Australian System of National Accounts, 2012-13

The Reserve Bank of Australia in its most recent published statistics report that there are approximately 4000 Authorised Deposit-taking Institutions (ADIs), Non-ADI Financial Institutions, Insurers and Funds Managers in Australia. Together these institutions hold at least $5,000 billion in assets[3]. While certain entities are exempt from FATCA's reporting requirements, most entities will be exposed to its reporting requirements. The ABS publication of portfolio investment assets by country and sector also shows that in December 2013, Australian banks, insurance companies and mutual funds held approximately $70 billion of their assets in the US.[4] As such, these figures are indicative of the potential scope and scale of FATCA's potential impacts on the Australian financial institutions.

In preparing this Regulation Impact Statement (RIS), the Treasury consulted, in particular with the ABA, Financial Services Council (FSC) and Customer Owned Banking Association (COBA). The compliance cost estimates contained in this RIS are based on data supplied by industry.

The ABA represents 25 member banks. The banking industry in Australia collectively serves over 16 million customers, holds $1.9 trillion of deposits and has assets of $3.2 trillion, including loans and advances to customers of $2.0 trillion.

The FSC represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, trustee companies and public trustees. The FSC has over 125 members who are responsible for investing $2.2 trillion on behalf of 11 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the third largest pool of managed funds in the world.

COBA (formally ABACUS) represents Australia's mutual banking institutions, including credit unions, building societies and mutual banks. It has around 4.5 million customers and total assets of $85 billion.

The importance of US financial markets[5]

The US capital markets are a significant source of funding for Australia's banking industry. Australian banks have traditionally relied on offshore markets, including the US market, as an important source of funding. As at December 2013, around 68 per cent of Australian bank bonds outstanding were issued offshore. Of these, 50 per cent were denominated in US dollars.

---

[3] Reserve Bank of Australia website: Main Types of financial Institutions http://www.rba.gov.au/fin-stability/fin-inst/#adis
[4] Australian Bureau of Statistics Catalogue 5352.0 - International Investment Position, Australia: Supplementary Statistics, 2012 Table 8
[5] According to advice provided by the Reserve Bank of Australia to Treasury on 5 March 2014

Offshore funding has been mainly utilised by the major banks as it is cost effective for them to raise wholesale funds offshore, and it enables them to achieve a high level of diversity in their funding. Smaller lenders in Australia rely more heavily on domestic deposits and securitisation to fund their lending.

Any difficulty for the major banks in accessing funding from the US market is unlikely to have a direct impact on these smaller lenders. However, these small lenders may face increased competition for funding and potentially higher funding costs if the major banks seek to substitute their offshore funding with domestic funding.

FATCA's objectives

The following is an extract from the FATCA regulations.

> *U.S. taxpayers' investments have become increasingly global in scope. FFIs now provide a significant proportion of the investment opportunities for, and act as intermediaries with respect to the investments of, U.S. taxpayers. Like U.S. financial institutions, FFIs are generally in the best position to identify and report with respect to their U.S. customers. Absent such reporting by FFIs, some U.S. taxpayers may attempt to evade U.S. tax by hiding money in offshore accounts. To prevent this abuse of the U.S. voluntary tax compliance system and address the use of offshore accounts to facilitate tax evasion, it is essential in today's global investment climate that reporting be available with respect to both the onshore and offshore accounts of U.S. taxpayers. This information reporting strengthens the integrity of the U.S. voluntary tax compliance system by placing U.S. taxpayers that have access to international investment opportunities on an equal footing with U.S. taxpayers that do not have such access or otherwise choose to invest within the United States.*

Australian financial institutions that may be affected

The term ‘FFI’ covers a broad range of financial institutions and includes any entity that falls within the FATCA definitions of:

- *depository institution* (being an entity which accepts deposits in the course of a banking or similar business);
- *custodial institution* (being an entity which holds financial assets for the account of others as a substantial portion of its business);
- *investment entity* (being an entity which is engaged in the business of trading or investing in a variety of financial instruments or assets); or
- *specified insurance company* (being an insurance company which makes payments under a ‘cash value insurance contract’ or an ‘annuity contract’ as defined in the FATCA regulations).

In Australia, this would include banks, building societies, credit unions, life insurance companies, private equity funds, managed funds, exchange traded funds and some broker dealers.

Certain classes of persons are treated as ‘exempt beneficial owners’ under FATCA, meaning that they are generally exempted from FATCA due diligence, reporting and withholding. This is because the FATCA requirements do not apply to an entity that falls within the FATCA definition of ‘exempt beneficial owner’. The following classes of persons will be regarded as exempt beneficial owners provided that they meet all of the requirements prescribed for that class of exempt beneficial owner:

- any foreign government or its political subdivisions, or their wholly-owned agencies or instrumentalities;
- any international organisation or its wholly-owned agencies or instrumentalities;
- any foreign central bank;
- certain retirement funds;
- certain entities wholly owned by exempt beneficial owners.

FFI obligations

FFIs are expected to conclude individual agreements with the IRS, which will follow a template ‘FFI agreement’, by 1 July 2014. The FFI is required to register with the IRS and to agree to comply with the terms of an FFI agreement. An FFI that enters into an FFI agreement is referred to as a ‘participating FFI’.

Under an FFI agreement, participating FFIs are obliged to:

- Undertake specified identification and due diligence procedures with respect to their account holders

  - Broadly, a participating FFI must determine if the account is a US account or an account held by either a recalcitrant account holder or non-participating FFI. The due diligence requirements vary depending on whether the financial account is a pre-existing individual account, new individual account, pre-existing entity account or new entity account and the size of the account. A pre-existing account is one maintained as at 30 June 2014. There are also strict rules regarding the documentation which can be relied on, the retention of records and the FFI's standard of knowledge.

- Report specified information annually to the IRS on their account holders who are US persons or US-controlled entities

  - This includes the account holder's name, address, account number, US tax identification number, account balances or values (on individual and aggregate bases), debits and credits to the account and total deposits and withdrawals.

  - Some Australian financial institutions already report some of this information annually to the Australian Taxation Office (ATO), pursuant to existing Australian income tax requirements. Typically this includes: name, address, Australian tax file number(s), the amount of income derived and the amount of Australian tax withheld (if any).

  If foreign law would prevent the FFI from reporting the required information absent a waiver from the account holder, and the account holder fails to provide a waiver within a reasonable period of time, the FFI is required to close the account.

- Withhold and pay to the IRS 30 per cent of any payments of US sourced income, as well as gross proceeds from the sale of securities that generate US sourced income, made to:

  (a) Non-participating foreign financial institutions; or

  (b) Recalcitrant account holders (that is, individual account holders that fail to provide sufficient information to determine whether or not they are a US person, foreign entity account holders that fail to provide sufficient information about the identity of their substantial US holders, or account holders that fail to provide a waiver of a foreign law that would prevent reporting)

> A participating FFI may elect not to withhold on ‘passthru payments’, and instead be subject to withholding on payments it receives, to the extent those payments are allocable to recalcitrant account holders or nonparticipating FFIs. A passthru payment includes any withholdable payment or other payment to the extent attributable to a withholdable payment. A participating FFI must also withhold on any passthru payments it makes to any other participating FFI that has made such an election.

Number of customers affected

Industry-wide data is not available because financial institutions do not routinely record the country of origin of their customers. However, the ABA has estimated that in Australia each of the major banks have at least 30,000 accounts that display some US indicia (based on an analysis of data reported regularly by banks to the ATO).

Customer obligations

From 1 July 2014, financial institutions will be required to determine whether or not new accountholders (individuals and entities) are US persons, either at the time a new account is opened or if the account balance subsequently exceeds US$50,000.

For pre-existing accounts, some customers may be required to certify that they are not US persons, for example in cases where financial institutions’ customer records display US indicia. Failure to certify could result in customers being deemed to be US persons, with the result that their account information will be reported.

Generally, and in the absence of changes in customer circumstances, these requirements will apply on a once-only basis.

These requirements will impose some additional burdens on customers of financial institutions but those burdens will vary depending on individual customer circumstances and between financial institutions. These burdens cannot be accurately quantified but are expected to be minimal for the majority of customers. These burdens will be greater for customers who are US persons or whose accounts display US indicia.

FATCA withholding tax

Relevant income to which FATCA withholding tax applies generally includes any payment of US-sourced interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits and income; and gross proceeds from the disposal of any property of a type which can produce interest or dividends from US sources (collectively defined as ‘withholdable payments’).

Bank interest paid with respect to US taxpayers' offshore accounts is deemed to have a US source, as is income the source of which cannot be determined by the relevant withholding agent at the time of payment. The FATCA regulations generally rely on, but also expand, detailed source of income rules contained in US tax law.

FATCA withholding tax also applies to 'passthru payments' that a participating FFI makes to a recalcitrant account holder or non-participating FFIs.

The US FATCA regulations are supplemented by the US IRS requiring payers of US sourced income ('withholding agents') to certify that payees are FATCA-compliant or deemed compliant by operation of the rules before payments can be released free of withholding tax. Withholding agents are therefore required to withhold tax and are made liable for it.

Figures are not readily available for the quantum of US sourced income derived directly or indirectly by Australian financial institutions. However, large Australian financial institutions (such as banks) are expected to directly or indirectly derive high levels of US sourced income. Whereas, smaller Australian financial institutions are expected to only directly or indirectly derive low levels of US sourced income.

Tax treaty relief from FATCA withholding tax

FFIs that are entitled to the benefits of a bilateral tax treaty between their home country and the US are generally entitled to relief from FATCA withholding tax, by way of a full or partial refund from the IRS, where the treaty limits the US's taxing rights over US sourced income.

The Australia-US tax treaty[6] contains such limitations. For example, the treaty limits the US's taxing rights over US-sourced dividends and interest derived by Australian residents to a maximum rate of 15 per cent and 10 per cent respectively. It is permissible for the US to apply its domestic FATCA withholding tax rate at the time the US-sourced dividend or interest payment is made, however, Australian financial institutions may rely on the treaty to seek a refund from the IRS of any excess tax withheld in the US.

Australian financial institutions are only entitled to claim a foreign income tax offset in their Australia income tax returns for the amount of US withholding tax that has been paid in accordance with the tax treaty. They cannot therefore claim relief in Australia for the excess US tax withheld but must instead seek a refund or credit from the IRS. In seeking such a refund or credit, Australian financial institutions would be subjected to any relevant IRS procedures (including any waiting period for the refund).

---

[6] The *Convention between the Government of Australia and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, which entered into force on 31 October 1983, and its Amending Protocol which entered into force on 12 May 2003.

FATCA specifies that no interest will be paid on FATCA withholding tax refunds of credits. Consequently, an Australian financial institution will not have the use of the overpaid amount until the refund is received, nor will it receive any recompense for the loss of the use of the amount during that period. The Australian financial institution will also need to bear any costs associated with claiming the refund.

Exchange of tax information under the Australia-US tax treaty

The Australia-US tax treaty aims to avoid double taxation and prevent fiscal evasion. Importantly, the treaty expressly allows the US to tax its citizens regardless of whether they are also citizens or Australian tax residents.

The treaty avoids double taxation by allocating taxing rights between the two countries over various categories of income. Where the treaty permits both countries to tax the same income, the country of residence of the relevant taxpayer is required to provide appropriate relief.

Article 25 (*Exchange of Information*) of the treaty authorises the exchange of taxpayer information in order to prevent tax evasion. Information exchange can take three forms:

- on request — where either country requests information about a specific taxpayer or transaction;
- automatically — where both countries voluntarily provide bulk taxpayer information periodically; and
- spontaneously — where both countries voluntarily provide information considered to be relevant to the other country's administration of its tax system.

While Article 25 would permit the ATO to provide 'FATCA information' to the IRS on a case-by-case basis on request, the ATO is currently unable to provide bulk FATCA data to the IRS. Such information is not readily available to the ATO because neither the treaty nor domestic law obliges Australian financial institutions to report bulk data.

US Citizens in Australia

According to the 2011 Australian Census of Population and Housing, approximately 77 000 US citizens[7] live in Australia. Of these, approximately 54% are dual Australian-US citizens.

7 That is, born in the US, but reside on a permanent basis in Australia.

Australian Privacy Law

Australia's privacy laws[8] are broadly intended to provide a nationally consistent framework for the protection of privacy and the handling of personal information, and to implement Australia's international obligations in relation to privacy. In implementing these broad objectives, Australian privacy law recognises the need for the protection of the privacy of individuals to be balanced with the interests of entities in carrying out their functions or activities.

Australia's *Privacy Act 1988* (the Privacy Act) generally prohibits the use of personal information for a purpose other than for which it was originally collected. Such personal information can only be used for another purpose if that other purpose is a related purpose and the individual would reasonably expect the information's disclosure for that related purpose, or if the use or disclosure is required or authorised by law (see Australian Privacy Principle 6).[9]

Australian financial institutions' account holders would not have expected their personal information collected in respect of existing accounts to be used in the manner required by FATCA. It would also be impractical to expect every account holder to provide consent or respond to a request to provide consent. This means that unless the use or disclosure is required or authorised by Australian law, Australian financial institutions would not be able to fully comply with their FATCA obligations to examine and report on existing accounts.

From 12 March 2014, that is, upon commencement of the Australian Privacy Principles, an organisation will be prohibited from collecting personal information unless the information is reasonably necessary for one or more of the entity's functions or activities (see Australian Privacy Principle 3.2). There is uncertainty as to whether Australian financial institutions would be able to meet these tests in relation to FATCA requirements in relation to the opening of new financial accounts.

If Australian domestic law was implemented to require the disclosure for FATCA purposes, the Australian financial institutions would nevertheless be required to inform individuals as to why their personal information is being collected, to whom it may be disclosed, any law that requires the particular information to be collected, and the main consequences (if any) for the individual if all or part of the information is not provided (see Australian Privacy Principle 5)

---

[8] Other than the *Privacy Act 1988*, there are a number of other Australian laws that relate to privacy, for example, on telecommunications, data-matching, and anti-money laundering and counter-terrorism. This Regulation Impact Statement is only concerned with the Privacy Act.

[9] The *Privacy Act 1988* was amended by the *Privacy Amendment (Enhancing Privacy Protection) Act 2012*. From 12 March 2014, Schedule 1 of the amending Act, that is, the Australian Privacy Principles, replaced the former National Privacy Principles and Information Privacy Principles. The Australian Privacy Principles apply to the handling of personal information by most Australian and Norfolk Island Government agencies and some private sector organisations.

The Privacy Act allows an Australian financial institution to transfer personal information about an individual to the US tax authorities only if the individual consents to the transfer, or the financial institution has a reasonable belief that the US tax authorities are subject to a law which effectively upholds principles for fair handling of the information, and which is substantially similar to Australia's privacy law (see Australian Privacy Principle 8).

Again, it would be impractical to expect every account holder to provide consent or respond to a request to provide such consent; and establishing a belief that relevant US law is substantially similar to Australian privacy law would require Australian financial institutions to incur compliance costs by obtaining legal advice. In light of this, Australian financial institutions would not be able to fully comply with their FATCA obligations.

Australian anti-discrimination law

Australian Commonwealth law governing discrimination on the grounds of race is broadly intended to give effect to Australia's obligations under the *International Convention on the Elimination of All Forms of Racial Discrimination.* These obligations are to promote equality before the law for all persons, regardless of their race, colour or national or ethnic origin, and to make discrimination against people on the basis of their race, colour, descent or national or ethnic origin unlawful.

FATCA requires the interrogation or closure of customer accounts based on US citizenship. A person's citizenship refers to their nationality. The fact that FATCA specifically targets US citizens means that it is specifically targeting certain persons, based on their nationality.

It is unlikely that this would be inconsistent with Commonwealth laws governing discrimination on the grounds of race. For the purposes of the *Racial Discrimination Act 1975*, and under Australian courts' jurisprudence in relation to that Act, a distinction made on the basis of a person's citizenship is not a distinction based on race, colour, descent or national or ethnic origin.

A distinction based on nationality may, however, be inconsistent with some Australian State and Territory laws governing discrimination on the grounds of race, on the basis that, race is defined in these laws as including nationality (which would refer to citizenship). This means that, in contrast to Commonwealth laws governing discrimination on the grounds of race, it is generally unlawful to discriminate on the basis of a person's nationality in certain Australian States and Territories.

2. Problem to be addressed

FATCA will take effect from 1 July 2014, regardless of any action taken by Australia.

From that date, the US will expect Australian financial institutions to commence interrogating their customer records for US indicia for the purpose of reporting certain account data to the IRS.

Australian financial institutions have a strong desire to be classified by the US as FATCA-compliant. Being classified as non-compliant carries two significant risks:

- It would expose Australian financial institutions to the economic cost of the 30 per cent FATCA withholding tax on their US sourced income; and

- It would potentially exclude them from major international markets that restrict their dealings to FATCA-compliant financial institutions. This would result in reputational risks for Australian financial institutions and potentially increase their cost of capital.

In both cases, these risks could lead to Australian consumers of financial services bearing higher fees and/or higher interest rates.

The main in problem for Australian financial institutions is that Australia's regulatory framework will not permit them to comply with FATCA directly. Australian privacy laws would prevent them from undertaking the relevant FATCA due diligence and reporting requirements, thereby rendering them FATCA non-compliant. Some Australian State and Territory anti-discrimination laws would also prevent the interrogation or closure of customer accounts based on US citizenship.

As most major Australian financial institutions operate in the US financial markets or otherwise invest in the US, the financial burden of being classified as FATCA non-compliant has created a strong incentive for industry to comply with FATCA.

As a result, Australia's financial industry has sought the Government's assistance in creating a legal framework in Australia which would enable it to become FATCA-compliant. Industry considers that an IGA based on the US Model 1 IGA would best address industry's FATCA needs.

Concluding a bilateral IGA with the US is expected to address the risks identified above and reduce the compliance costs for both Australian financial institutions and the broader Australian community significantly.

The intergovernmental agreement (IGA) solution

In recognition of the fact that legal restrictions in many countries would prevent financial institutions from complying with FATCA, the US – in conjunction with France, Germany, Italy, Spain and the United Kingdom – developed the IGA approach as an alternative to direct compliance with the FATCA regulations.

Broadly, an IGA is a bilateral treaty-status agreement designed to assist countries in their implementation of FATCA and ease the compliance burden for their financial institutions. In particular, an IGA is intended to provide the legal authority for countries to permit their financial institutions to comply with the FATCA due diligence and reporting obligations (thereby addressing any domestic law impediments), as well as providing greater FATCA treatment certainty for those countries' entities and their financial products.

Essentially there are two types of model IGA (although there are variants of each model for use depending on whether or not countries have pre-existing taxpayer information-sharing agreements with the US):

- Model 1 IGA – a country will direct its financial institutions to provide FATCA information directly to its own revenue authority, which would subsequently transmit it to the IRS.

- Model 2 IGA – a country will direct its financial institutions to conclude individual agreements with the IRS and enable them to report directly to the IRS consistent with the US FATCA regulations. That country would also agree to provide the US with further taxpayer information in response to IRS requests.

Australian Government responses to FATCA

On 7 November 2012, the previous Government announced the commencement of formal discussions between Australian and US officials for an IGA with the US to minimise the impact of FATCA in Australia.[10] The key objectives of the proposed IGA would be to reduce the overall burden of FATCA on Australian business and to improve existing reciprocal tax information-sharing arrangements between Australia and the US.

- Industry welcomed this announcement and has prepared for FATCA on the understanding that a Model 1 IGA would be concluded with the US. In this regard, industry has already incurred significant irrecoverable costs.

- Negotiations with the US also proceeded on the understanding that a Model 1 IGA would be concluded.

On 6 November 2013, the Government affirmed this approach when it announced that it would proceed with signing and enacting an IGA to enable the financial sector to comply with US FATCA reporting rules.[11]

[10] Refer Press Release 2012/110 - Deputy Prime Minister & Treasurer, Wayne Swan – 7 November 2012.
[11] Refer joint press release 017/2013 – Treasurer, Joe Hockey and Assistant Treasurer, Arthur Sinodinos AO - 6 November 2013.

3. Objectives of Government action

The objectives of the Government action are to establish a legal framework which would:

- Protect Australian financial institutions' international competitiveness:
  - 24 countries have now entered into bilateral IGAs with the US to assist their financial institutions in complying with FATCA; [12]
- Enable the financial sector to comply with FATCA in the most cost effective way;
- Provide greater FATCA treatment certainty for a range of Australian entities and their financial products; and
- Enhance the integrity of the Australian tax system by improving existing reciprocal tax information-sharing arrangements between Australia and the US.

Enhancing tax system integrity

Australia is a long-standing supporter of international cooperation to prevent tax evasion and the ATO currently provides taxpayer information – on an automatic basis – to more than 40 of Australia's tax treaty partners, including the US.

Article 25 (*Exchange of Information*) of the Australia-US tax treaty (and corresponding provisions in other treaties) enables the ATO to provide bulk taxpayer data to the IRS without breaching Australian privacy or anti-discrimination laws. The IRS reciprocates by providing corresponding data to the ATO. These exchanges are subject to confidentiality rules and other safeguards contained in Article 25 that are designed to protect the rights of taxpayers.

The IGA approach to FATCA, which would rely on Article 25, would build on these arrangements by expanding the range and improving the relevance of financial account information currently exchanged. While the potential revenue gains to Australia of the IGA approach are not possible to quantify at this stage, all improvements in the volume and quality of information available to the ATO can be expected to enhance its administration of Australia's tax laws.

---

[12] Bermuda, Canada, the Cayman Islands, Chile, Costa Rica, Denmark, Finland, France, Germany, Guernsey, Hungary, Ireland, the Isle of Man, Italy, Japan, Jersey, Malta, Mauritius, Mexico, the Netherlands, Norway, Spain, Switzerland and the United Kingdom. Of these, only Japan, Switzerland and Bermuda have followed the Model 2 text.

The IGA approach to FATCA has focussed international attention on automatic exchange of information for tax purposes. In February 2014, the Organisation for Economic Cooperation and Development released the Common Reporting Standard (CRS) – that calls on jurisdictions to obtain information from their financial institutions and to automatically exchange that information with other jurisdictions annually. The CRS is essentially based on the FATCA Model 1 IGA.

The G20 endorsed the CRS in February 2014 and called for the early adoption of the standard by those jurisdictions that are able to do so[13].

4. Options to achieve objectives

There are three main options for dealing with FATCA in Australia:

1. Regulate to require financial institutions to report customer information to the Australian Government, instead of to the US Government, pursuant to a Model 1 IGA.

2. Regulate to require financial institutions to report customer information directly to the US Government, pursuant to a bilateral Model 2 IGA; or

3. Take no government action with regard to FATCA compliance (no additional regulation).

Options 1 and 2 would formally require the Government to make regulatory change.

4.1 Option 1 – Require Australian financial institutions to report to the Australian Government (Model 1 IGA)

Under this option, Australia would conclude an intergovernmental agreement with the US and enact enabling legislation to require Australian financial institutions to collect and report account holder information to the ATO. The ATO would subsequently transmit the information to the IRS under existing information-exchange arrangements permitted by the Australia-US tax treaty.

[13] G20 Communiquè Meeting of Finance Ministers and Central Bank Governors , Sydney 22-23 February 2014. https://www.g20.org/sites/default/files/g20_resources/library/Communique%20Meeting%20of%20G20%20Finance%20Ministers%20and%20Central%20Bank%20Governors%20Sydney%2022-23%20February%202014_0.pdf

4.2 Option 2 – Require Australian financial institutions to report directly to the US Government (Model 2 IGA)

Under this option, Australia would conclude an intergovernmental agreement with the US that would require Australia to direct and enable Australian financial institutions to collect and report accountholder information directly to the US IRS. The Government would need to remove the existing legal impediments (in particular, under Australian privacy and anti-discrimination laws) that currently prevent Australian financial institutions from complying with FATCA. This would require significant legislative change.

4.3 Option 3 – No Government Intervention

Under this option, the Government would not intervene and would expect Australian financial institutions to individually decide whether and to what extent they would comply with FATCA. The consequences of not complying would be borne by financial institutions. However, as explained below, Australian financial institutions would be expected to continue to press strongly for some regulatory change to enable them to fully comply with FATCA.

5. Analysis of Options

FATCA will impose significant compliance costs on Australian financial institutions and their customers regardless of any action taken by the Australian Government. This impact analysis considers each option in ascending order (of its compliance cost burden).

Options 1 and 2 are regulatory actions that the Government could implement to help limit those costs. The respective compliance cost savings produced by Options 1 and 2 represent the incremental change in avoided compliance costs under each option.

Option 3, is a non-regulatory option which will not resolve the fundamental problem faced by financial institutions, i.e. it will not assist them in legally complying with FATCA and avoiding the imposition of US withholding tax on their US sourced income. Option 3 would also expose financial institutions to reputational and other economic costs that are not strictly compliance costs.

Table 5.1 provides an overview of the impacts of each option in practice.

Parts 5.1, 5.2 and 5.3 consider the costs and benefits of each option individually, including up-front and ongoing costs. Further information about these compliance costs is provided in Part 6.

Table 5.2 summarises the relative costs and benefits in comparison with other options available. This should be read in conjunction with the individual option analysis and observations regarding compliance cost differences in Part 6.

Table 5.1 Options comparison for Australian financial institutions seeking to comply with FATCA		
No IGA (Option 3)	**With Model 1 IGA (Option 1)**	**With Model 2 IGA (Option 2)**
Entry into FFI Agreement with the IRS.	Not required; registration instead.	Not required; registration instead.
Identification and documentation of account holders. Australian domestic privacy and anti-discrimination laws may prevent compliance.	Required. The IGA, together with enabling legislation, will resolve the conflict with Australian law.	Required. The IGA, together with enabling legislation, will resolve the conflict with Australian law.
Reporting of US accounts. Australian domestic privacy law may prevent compliance.	Required, but information reported to the ATO instead of the IRS, thereby mitigating national legal impediments and risks of litigation against banks. Australia-US tax treaty confidentiality and use rules apply.	Required, but information reported directly to the IRS. Australia-US tax treaty confidentiality and use rules apply.
IRS information requests directed to Australian financial institution.	IRS information requests directed to ATO under Australia-US tax treaty – ATO then contacts Australian financial institution.	IRS information requests directed to Australian financial institution. New enabling legislation required to allow this. IRS group information requests also directed to ATO under Australia-US tax treaty
Deduct and withhold tax with respect to passthru payments made to recalcitrant account holders and non-participating FFIs.	Not required for recalcitrant accounts (reporting on these accounts is required instead); withholding only required if the Australian financial institution is acting as a qualified intermediary (or equivalent) on payments to non-participating FFIs; reporting required on payments to nonparticipating FFIs and to immediate payers of passthru payments.	Not required for recalcitrant accounts (reporting on these accounts is required instead); withholding only required if the ATO does not respond to an IRS group information request within 6 months; reporting required on payments to nonparticipating FFIs.
Close accounts of recalcitrant account holders.	Not required.	Not required.
FATCA exemptions for Australian entities and financial products determined under FATCA regulations.	FATCA exemptions for Australian entities and financial products specified in IGA Annex II.	FATCA exemptions for Australian entities and financial products specified in IGA Annex II.
No additional US financial account information provided from IRS to ATO.	Additional US financial account information provided from IRS to ATO.	No additional US financial account information provided from IRS to ATO.

5.1 Option 1 – Require Australian financial institutions to report to the Australian Government (Model 1 IGA)

Benefits of reporting to the Australian Government

Australia's financial industry has advocated Australian Government intervention by adopting the Model 1 IGA framework following the US announcement of the IGA approach in February 2012.

Concluding an IGA with the US (based on the US Model 1 IGA) – supported by relevant enabling legislation – would reduce the overall burden of FATCA in Australia. In particular, it would:

- Address the Australian privacy and anti-discrimination law impediments that currently prevent industry from complying with FATCA by providing the necessary legal authority for Australian financial institution to perform the due diligence and reporting obligations. The enabling legislation would authorise the collection and use of personal information for FATCA reporting purposes
- Enable information reporting and handling within the Australian legal framework
- Reduce the incidence of direct interaction between Australian financial institutions and the IRS
- Ensure that information is collected, handled and provided to the IRS in accordance with existing tax treaty rules, which contain safeguards with respect to the confidentiality and use of information
- Remove the need for Australian financial institutions to pursue individual FFI agreements with the IRS or to seek customer waivers to enable it to comply with those agreements
- Provide financial institutions with access to less onerous due diligence requirements compared to the FATCA regulations (for instance, unlike the FATCA regulations, the IGA does not prescribe documentation of record requirements)
- Ensure that US income derived by Australian financial institutions and other Australian entities (such as government investment funds) will not be subject to the 30 per cent US FATCA withholding tax
- Ensure that financial institutions will not be expected to close or withhold tax from recalcitrant accounts or from payments to other non-complying financial institutions
- Ensure that financial institutions will automatically receive the benefits of more favourable terms afforded by the US to foreign financial institutions in its IGAs with other countries

- Ensure that financial institutions will have the opportunity to contribute to the development of the proposed ATO FATCA reporting system

- Allow Australian financial institutions to be generally presumed compliant with FATCA if they report annually to the ATO. This will enable counterparties in financial dealings to easily verify Australian financial institutions' FATCA status

- Treat Australian financial institutions as FATCA compliant, and not subject to FATCA withholding tax, from the date of signature of the IGA, providing that Australia is using its best endeavours to bring the IGA into force before the first IGA reporting date of 30 September 2015

- Exempt certain categories of Australian financial institutions and financial products from the scope of FATCA. In particular, the following entities and financial products would be specifically excluded from the FATCA rules[14]:

  – All Australian superannuation entities and products, pooled superannuation trusts and entities that invest exclusively for or on behalf of Australian superannuation entities

  – Specified Federal and State Government entities (including the Reserve Bank) and investment funds (such as the Future Fund)

  – International organisations with an office in Australia

  – Small Australian financial institutions (including those with primarily Australian and New Zealand resident account holders)

  – First Home Saver Accounts (FHSAs) and FHSA life insurance policies

  – Most exempt life insurance policies

  – Employee share schemes and employee share trusts

  – Funeral policies

  – Scholarship plans

[14] These entities and products are generally considered to pose a low risk for US tax avoidance by US persons. While most of these entities and products would fall within the FATCA regulations exceptions for such entities and products, their specific listing in Annex II guarantees this (thereby removing any potential compliance costs associated with confirming their FATCA treatment). Securing exceptions for Australia's entire superannuation industry (including superannuation entities and superannuation products) and Australia's government investment funds are key objectives from an Australian compliance cost perspective. Adapting the exception for small financial institutions to take account of the Australian context (including the potential proportion of New Zealand resident account holders), as well as expressly naming low risk Australian financial accounts (such as first home saver accounts), are also key objectives for Australian industry.

- Australian equivalents to any financial products excluded under another country's IGA

- Enhance the integrity of the Australian tax system by broadening the scope of existing information sharing arrangements between the ATO and the IRS

- Reinforce Australia's support for international tax transparency and cooperation between revenue authorities to help prevent tax evasion

Furthermore, by signing the IGA, privacy outcomes are better protected as the Australian Government is involved in the control and sharing of information. Greater opportunities for accountability and scrutiny are provided than if individual FFI Agreements were to be signed.

Concluding an IGA based on the US Model 1 IGA would also be consistent with the approach taken by other countries. To date, only 4 countries (Bermuda, Chile, Japan and Switzerland) have adopted the US Model 2 IGA approach.

Costs of an IGA

Administration costs for the ATO

The information reported under the IGA would be in addition to the taxpayer information the ATO already exchanges on a reciprocal basis with the IRS pursuant to the Australia-US tax treaty. The ATO expects to meet the costs of adapting its systems to collect and report the relevant FATCA information to the IRS from its existing budget allocation.

Legislative requirements

The design of necessary law changes would be the subject to consultation with Australian stakeholders. It would be necessary to amend the taxation law to require Australian financial institutions to comply with the IGA's terms. Those legislative changes would either expressly or implicitly overcome any Australian privacy law and anti-discrimination law impediments.

Costs for Australian industry

An IGA would require all Australian entities that fall within the IGA definition of 'Australian financial institution' to comply with the IGA's requirements.

Australian industry estimates that the minimum upfront implementation costs for Australian banks, fund managers and life insurance companies totals just over $255 million. This includes project development and management, system development, legal advice and other costs that are non-ongoing. The proportion of compliance costs that relates to each of these components varies greatly across entities, and the size of the relevant entities. Australian financial institutions have already incurred over $110 million in FATCA compliance costs to prepare for their expected IGA obligations.

Ongoing compliance costs are estimated to total approximately $23 million per year. For wealth management entities, the ongoing compliance cost would depend on the fees charged by third parties (such as custodians) to perform the necessary due diligence and reporting requirements and, as such, this figure may be subject to change as these charges are incurred.

Collectively, the annual yearly costs for this option of both the start-up and recurring costs is $48.27 million per year. Throughout this document, 'annual yearly costs' includes the industry wide annualised start-up costs (over the ten year period) coupled with the ongoing yearly costs.

Annex II of the proposed IGA would provide FATCA treatment certainty for a range of Australian entities and financial products.

The majority of Australian customer owned financial institutions (such as credit unions) expect to fall within the IGA Annex II exemptions for small financial institutions. The IGA would therefore largely eliminate compliance costs for such customer owned financial institutions.

The IGA would also effectively eliminate compliance costs for the other entities and products specified in its Annex II, which includes Australia's entire superannuation industry.

Costs for US citizens

The IGA does not alter existing US tax obligations and filing obligations for US citizens. However, the IGA increases the chance of detecting US citizens who have not complied with their US tax obligations in respect of income held in Australian accounts. This is consistent with the objective of FATCA, and is consistent with the terms of the Australia-US tax treaty which expressly recognises the US's right to tax US citizens even if such individuals are also Australian tax residents.

Privacy

In a submission to Treasury, the Office of the Australian Information Commissioner (OAIC) noted that '*Entering into an IGA with the US would create an opportunity to bring the IGA and its information sharing obligations within the scrutiny of Parliament. This will provide Parliament with an opportunity to examine, among other issues, the privacy impacts of the implementation approach contained in the IGA and any enabling legislation.*' [15]

'The OAIC suggests that, if information is to be exchanged on the basis of the proposed IGA, specific domestic legislative authority should be the basis on which an Australian Government agency is authorised to collect the personal information from domestic entities and to disclose that personal information to the US Government.' [16]

Treasury considers that an IGA would adequately address Australian privacy concerns while meeting FATCA's tax system integrity objectives. Allowing Australian financial institutions to review accounts based on US citizenship would be also be consistent with the Australia-US tax treaty which preserves the US's taxing rights over income derived by US citizens.

5.2 Option 2 – Require Australian financial institutions to report directly to the US Government (Model 2 IGA)

Benefits of Reporting to the IRS

Under this approach, the Government would conclude an IGA with the US Government (based on the US Model 2 IGA) which would require the Australian Government to direct and enable affected Australian financial institutions to register with the IRS and confirm their intention to comply with the US FATCA regulations, including:

- Applying the due diligence rules to identify US accounts
- Annually reporting in the time and manner prescribed by the FATCA regulations

Many of the benefits of the Model 1 IGA are replicated in the Model 2 approach, including that the Model 2 IGA would become the legal authority to make the necessary Australian law changes.

Amending Australian law to remove the Australian privacy and anti-discrimination law impediments would enable Australian financial institutions to report accountholder information to the US Government, and would remove the need for Australian financial institutions to conclude individual FFI agreements with the US or seek customer waivers.

[15] See OAIC submission to the Treasury, paragraph 20.
[16] See OAIC submission to the Treasury, paragraph 21.

Drawbacks

While concluding a Model 2 IGA would adequately enable industry to comply with FATCA it would present a number of significant drawbacks. For example:

- Amendments to non-tax laws, such as privacy and anti-discrimination laws, would be required;
- The terms of a Model 2 IGA would not require the US to provide reciprocal account information to Australia. In this regard, concluding a Model 2 IGA would not meet the Government's objective of enhancing the integrity of the Australian tax system.
- This option could be perceived as being inconsistent with the Government's long-standing position in relation to international cooperation to prevent tax evasion, and its commitment, through the G20, to the implementation of the OECD's Common Reporting Standard for the exchange of financial account information between revenue authorities.

In view of these drawbacks, it is considered that concluding Model 2 IGA would be an inferior option from a tax transparency policy perspective.

Costs for Australian industry

Australian industry estimates that the minimum upfront implementation costs for Australian banks, fund managers and life insurance companies totals just over $319 million. This represents approximately $64 million more than for Option 1.

Ongoing compliance costs are estimated to total approximately $25 million per year. This represents approximately $1.9 million more per year than for Option 1.

Collectively, the annual yearly costs for this option of both the start-up and recurring costs is $56.54 million per year. This represents approximately $8.27 million more spent per year than for Option 1.

Costs for US citizens

These costs are unchanged from Option 1.

5.3 *Option 3 No Government Intervention*

Benefits of no Government intervention

In the absence of Government intervention, individual Australian financial institutions would be free to decide whether and to what extent to comply with FATCA. That is, they would face no additional Australian regulatory burden and could choose to either ignore FATCA or attempt to comply with it directly.

- If they chose to ignore FATCA – a foreign law that has no legal standing in Australia – they would not be required to undertake any interrogation of their customer accounts to search for US indicia.
- If they attempted to comply directly with FATCA, they would need to do so consistently with Australian privacy and anti-discrimination laws.

Some Australian stakeholders may prefer this option. These could potentially include for example:

- small Australian financial institutions that either do not invest in the US or believe that their FATCA compliance costs would exceed the 30 per cent FATCA withholding tax imposed on their US sourced income. It is expected there would only be a small number of Australian financial institutions with FATCA reporting obligations that would fall within this category; most of the financial institutions that do not invest in the US are likely to fall within the FATCA exemptions for small financial institutions or local banks;
- brokers that may be required to assist Australian financial institutions complete the necessary FATCA due diligence for account holders; and
- US citizen account holders who have not complied with their US tax obligations.

Costs of no government intervention

The majority of Australia's financial institutions do not support this option because ignoring or attempting to comply with FATCA directly is likely to impair their competitive position in relation to financial institutions from countries that have concluded IGAs with the US. .That is, their exclusion from the IRS register of financial institutions entitled to exemption from the 30 per cent FATCA withholding tax could limit the number of counterparties they deal with and effectively deny them access to some financial markets. Industry is of the view that some counterparties may be attracted to the simplicity of restricting their dealings to transactions that would not require them to withhold and remit tax to the IRS.

Without Government intervention, industry representatives have outlined various concerns, including exposure to legal risk, increased capital provisioning and potentially being locked out of FATCA compliant jurisdictions. This would have an effect on the types of products that Australian financial institutions could provide and would reduce their global competitiveness. Financial institutions that would not be caught under the FATCA regulations are in the minority and, as such, the effects of a non-compliant jurisdiction would have an impact on the majority of the Australian financial sector as a whole.

Beyond the associated costs that would be incurred by industry, this approach would be inconsistent with Australia's standing as a global leader on exchange of information, and furthermore would be inconsistent with the approach advocated by the OECD and the G20 in relation to the Common Reporting Standard.

Choosing to ignore FATCA

While the US FATCA regulations provide a number of exemptions that would apply to certain Australian entities and financial products, the majority of Australian financial institutions would face difficulties in their dealings with financial institutions in other jurisdictions and US payers. These other institutions would seek confirmation of their FATCA status from the IRS. Without such confirmation, these Australian entities may have the FATCA 30 per cent withholding tax incorrectly withheld from their US sourced income, which would generate significant costs in seeking redress. In addition, there would be reputational costs to Australia's financial industry.

Other affected financial institutions with FATCA reporting obligations that chose to ignore those obligations would be deemed FATCA non-compliant by the US and become liable for the 30 per cent withholding tax on their US sourced income, to be withheld at source by US payers and by participating FFIs on their passthru payments to non-participating Australian financial institutions. Notwithstanding Australian financial institutions' ability to rely on the Australia-US tax treaty to seek a refund of any excess withholding tax, this would nevertheless have a significant impact on their liquidity (particularly on those financial institutions participating in the US capital markets or deriving income from the US financial markets) and add complexity to their dealings with foreign counterparts, which would assume withholding obligations.

Industry has indicated that most affected Australian financial institutions (especially banks, fund managers and life insurance companies) would not choose the option of ignoring FATCA, as that choice would ultimately impede their ability to operate effectively in international financial markets – especially in the US and in those jurisdictions that are generally FATCA compliant.

Australian entities that consider that they or their products fall within the scope of the exemptions provided by the FATCA regulations may need to incur legal costs to confirm this with the IRS, in order to protect themselves from the FATCA 30 per cent withholding tax on their US sourced income.

Choosing to comply directly with FATCA

Affected Australian financial institutions could attempt to comply directly with the FATCA regulations. This would require each affected financial institution to enter into a binding FFI agreement with the IRS to collect and report account holder data. As FFI agreements would be required for each affected subsidiary within a group, industry estimates that several thousand FFI agreements would be required.

Each of these would generate significant costs with regard to:

- obtaining legal advice on the interpretation and application of complex US law;
- signing and registering the FFI agreement with the IRS;
- assuming legal liability (including personal liability for officials) in relation to the obligations imposed by those agreements;
- developing systems to accommodate direct information reporting to the IRS, i.e. systems to accommodate unfamiliar technical IRS specifications;
- identifying 'recalcitrant' account holders and segregating them for special treatment;
- building capability to meet their own withholding obligations in relation to non-compliant counterpart financial institutions and recalcitrant account holders;
- maintaining an ongoing relationship with the IRS in relation to reporting requirements, data transmission, data quality and dispute resolution.

Few, if any, affected Australian financial institutions could fully comply with the FFI agreement obligations without some form of Australian government (Federal and State) intervention to overcome Australian privacy and anti-discrimination law barriers. Australian financial institutions would incur substantial costs in advocating for necessary changes, but would also need to operationalise a legal solution for the intervening period while a legislative solution was reached.

In addition, with a first reporting date of 31 March 2015 (the date that applies in the absence of an IGA), Australian financial institutions would be unlikely to be able to comply with FATCA as the withholding and waiver systems would be both time-consuming and costly to build. Based on Australian Government announcement to date, Australian financial institutions are expecting a Model 1 IGA that would negate the need to build such withholding and waiver systems.

As FATCA targets US citizens, it is likely that its reporting and account closure requirements are inconsistent with some State or Territory anti-discrimination laws. There would be no breach of such laws, however, if Commonwealth legislation was enacted to override the relevant State or Territory discrimination laws or amendments were made to the relevant State or Territory laws themselves.

Consequently, it is likely that affected Australian financial institutions would press for such amendments to give them sufficient legal protection, at a significant cost. If the Federal and State governments were persuaded to make such amendments, a coordinated national plan may need to be negotiated and this would need to be done without a treaty status document to rely on as authority for the amendments.

Under Australia's privacy law, Australian financial institutions can generally only disclose information with the relevant individual's consent or if required by Australian law. Under Option 3, affected Australian financial institutions would therefore need to obtain their customers' consent to interrogate accounts and report the required FATCA information to the IRS. Industry has indicated that contacting every customer and establishing procedures for handling customer responses, enquiries and complaints would not serve the purpose of effective information exchange. The ABA has indicated that this approach would be costly as millions of account holders would need to be contacted (Australian banks have more than 16 million accountholders). It would also be unlikely to be effective based on previously ineffective response rates to customer mail-outs.

In that event, it is very likely that affected Australian financial institutions would press for Australian Government intervention to amend Australian law to allow them to legally perform the FATCA due diligence and to report the required information to the IRS.

Under the terms of a FFI Agreement, a financial institution would be required to withhold tax with respect to recalcitrant account holders (i.e. account holders that fail to provide the necessary documentation or information requested by the financial institution) and non-participating financial institutions (i.e. financial institutions that are not covered by an IGA or who have not entered into a FFI Agreement). It is unlikely that current Australian law would permit this, especially if the account holder was not in fact a US person. Consequently, it is likely that affected Australian financial institutions would press for Australian Government intervention to allow them to legally perform the FATCA withholding obligations.

In order to perform those withholding obligations, affected Australian financial institutions would also need to develop a FATCA withholding tax capability. The extra cost associated with building the withholding tax capacity and making other necessary changes forms part of the compliance costs attributable to business systems design and development for this Option.

Affected financial institutions seeking to comply with the FATCA requirements would also incur the additional upfront implementation costs and ongoing compliance costs that apply with an IGA (as above).

Costs for Australian industry

Australian industry estimates that the minimum upfront implementation costs for Australian banks, fund managers and life insurance companies seeking to comply with the FATCA requirements in the absence of a Model 1 IGA totals over $477 million. This represents approximately $222 million more than for Option 1.

Ongoing compliance costs are estimated to total approximately $59 million per year. This represents approximately $36 million more per year than for Option 1.

Collectively, the annual yearly costs for this option of both the start-up and recurring costs is $106.59 million per year. This represents approximately $58.32 million more spent per year than for Option 1.

Costs for US citizens

These costs are less than under Option 1 as some Australian financial institutions will not be able to comply with FATCA, meaning that any of their accounts held by US citizens will escape reporting.

Weaknesses of this approach

Like Option 2, this option would not meet the Government's objective of enhancing the integrity of the tax system by improving the existing reciprocal tax information-sharing arrangements from the US to Australia. Under this option, the US is not required to provide equivalent financial account information to Australia. Further, the US is unlikely to receive all its desired information if the FATCA reporting requirements are not met by Australian financial institutions.

Table 5.2 Overview – Relative advantages and disadvantages of options		
	Advantages	**Disadvantages**
Option 1	• Overcomes legal impediments • Most cost-effective option for industry • Industry support • Limited industry interaction with the IRS • Government commitment • Consistent with CRS • Carves out Australian-specific AFIs	
Option 2	• Overcomes legal impediments • Second most cost-effective option for industry (an average yearly extra $8 million)	• Not preferred by industry • No additional commitment to reciprocity of information sharing
Option 3	• No regulation by government	• Doesn't overcome legal risks • Industry exposure to withholding tax • Reduced competitiveness • No enhancement to information exchange • Businesses face negative business model implications

6. Compliance Costs

Methodology

1. Sample

Treasury consulted through peak bodies that represent a significant portion of businesses to be affected by FATCA to estimate the burden of compliance on business.[17] These peak bodies were the:

- Australian Bankers' Association (ABA)
- Customer Owned Banking Association (COBA)
- Financial Services Council (FSC)

FATCA will apply to Australian Financial Institutions that fall within the FATCA definition of 'financial institution'. The definition of financial institution extends to those institutions that fall within the FATCA definitions of Depository Institution, Investment Entity, Custodial Institution or Specified Insurance Company

Banks fall within the definition of Depository Institution for the purposes of the FATCA, and therefore all ABA members are expecting to have FATCA obligations. FSC members that expect to have FATCA obligations include those which fall within the FATCA definitions of Investment Entity, Custodial Institution or Specified Insurance Company. The estimates provided by the FSC represent those members who would be captured under FATCA. .The majority of COBA members expect to be exempt under FATCAs Non Registering Local Bank Exemption and Local Client Base Exemption.

[17] Treasury also contacted the Property Council of Australia on 4 March 2014 in order to get an appreciation of the number of its members that may be captured and exposed to FATCA compliance costs. Unfortunately, it has not been possible to get the data in the time available regarding the number and size of Property Council members that would be impacted, or the Compliance costs that they would be expected to incur. However the Property Council has indicated that pending internal validation, it is comfortable with assuming these costs would be akin to similarly sized businesses who are members of the ABA or FSC.

2. Costs to business

Table 6.1 Compliance Costs – Descriptions	
Start Up Costs	
Item Name	**Item Description**
Professional Legal Services	These services will be engaged in relation to confirming entities' FATCA obligations. Australian financial institutions are required to establish their FATCA obligations under the extensive US FATCA regulations (in excess of 300 pages plus commentary) and/or the terms of an IGA. Option 3 is the most onerous. The cost of ascertaining the legal obligations under either IGA option (i.e., Options 1 and 2) is similar because the entity only has to rely on the IGA and any corresponding domestic legislation for the obligations that the agreement imposes. Option 3 requires the entity to gain an understanding of the FATCA regulations and also their interactions with Australian law. Essentially it requires familiarity with two tax systems and the interactions between the two. The difference in associated costs will be primarily in relation to the varying degree to which Australian financial institutions will be able to rely on domestic law, and to what extent they will need to be familiar, and comply, with US legislation. Other possible legal advice costs include: • For those businesses that operate in other jurisdictions, if Australia is a non-IGA country, regarding their interactions with IGA countries, FATCA compliant countries and non-compliant countries. • Dealing with recalcitrant accounts. • Developing internal legal guidance for the application of FATCA in each business. • Legal advice about the legality and risks of waivers and both anti-discrimination and privacy law constraints • Contingency funds for any legal challenges to actions by customers or other parties.

Business systems design and development	In order to comply with the due diligence and reporting requirements, each business will have to build an information system capacity to retain information for, identify, classify and interrogate customer accounts. Australian financial institutions are required to apply thresholds to identify and classify customer accounts held at 30 June 2014 into various categories depending on the account balance. Accounts held by individuals must be classified as either non-reportable, lower value or higher value accounts. Accounts held by entities must be classified as either non-reportable or reviewable accounts. Lower value, higher value (individuals) and reviewable accounts must be interrogated electronically and, for certain accounts also manually, to identify whether the accountholders are US individuals or US controlled-entities. Details of reportable accounts must be reported annually to the ATO/IRS. Customer interface enhancement includes updating account opening procedures (on-boarding) and developing self-certification procedures for customers that will have to demonstrate that they are not US persons). In addition, existing systems will need to be enhanced to minimise the effect on customers of the FATCA requirements. Customer interface enhancements are expected. The identification, classification and interrogation obligations increase incrementally from Options 1 through to 3. In particular, a system built for Option 3 will need a withholding tax capacity which institutions do not currently have, greater information collecting capacity to fulfil the more onerous information obligations under the FATCA regulations, and the system must be able to produce information to be reported directly to the IRS.
Business Model implications	The FATCA compliant status of an Australian financial institution with operations in a jurisdiction that is FATCA non-compliant (due to local law conflicts) could be jeopardised. Changes to the business model and becoming legally compliant with both FATCA and local laws would require: • divesting or closing operations in such jurisdictions; • reducing exposure to US sourced assets as a result of the 30 per cent withholding tax; • increasing counter-party risk provisioning; • increased identification (of payees and accountholders) obligations; and • removing or changing product offerings. These costs are the direct cost associated with complying with the FATCA regulations directly. Opportunity, reputational and economic costs have not been included.

Development of staff training and education	This is the cost associated with ensuring staff are able to understand the business’ obligations. This is particularly important for front-line staff that will have to explain why the customer may have to include foreign tax residency status in their paperwork.
Registration with IRS	This is the process by which an entity will register with the IRS. Registration would be required for all relevant subsidiaries of Australian parent financial institutions.
Internal compliance assurance	This is the development of internal governance procedures that will minimise Australian financial institutions’ exposure to legal sanctions for non-compliance.
Business operating model changes	Non-IT changes to business models, including: • organisational change management • alignment of Australian subsidiaries that operate in different financial industries • managing business partner relationships (e.g. external vendors) to ensure FATCA compliance
Management of global conglomerates	Many large financial institutions operate globally and undertake activities covering different industry sectors, e.g. insurance, banking and funds management. This line activity relates to central management and support functions provided from financial institutions’ Australian offices.
Conversion costs	These are the costs associated with building a new solution to comply with the FATCA regulations directly. In general, the FFI agreement approach (Option 3) contains more prescriptive obligations. In order to meet the FFI agreement standards, businesses would incur new costs to enable them to comply. Some Model 1 solutions may be able to be reworked, but these sunk costs have not been included in these prospective figures. It is the cost which businesses will incur in either adapting existing solutions or starting new solutions in a variety of areas, such as account opening procedures, infrastructure and documentation.
Other	This includes FATCA project governance and administration costs, under central and decentralised models, including executive involvement costs.
Recurring Costs	
Operation of business systems	This is the operation of the business system as described above. The components of this price will relate to: • Classification of new customer accounts • Consideration and classification of existing accounts as needed • Reviewing and monitoring customer accounts • Record-keeping and retrieval • System maintenance and updates

Compile and report data to ATO/IRS	In order to comply with FATCA, the necessary due diligence will require businesses to provide reports of all identified US account holders either to the ATO (Option 1) or to the IRS (Options 2 and 3).
Deliver staff training and customer education	This includes: • Delivery and update of training models for staff • Information provided to customers about compliance with FATCA/IGA and the impact on their accounts.
Engagement with the ATO/IRS	Receiving advice from the tax administrations and seeking guidance as necessary.
Manage customer consent issues	Where there is no legal requirement for compliance with FATCA, businesses will have to seek consent for the use and release of their data for FATCA purposes. This is due to the interaction with domestic privacy and anti-discrimination legislation, as canvassed above.
Compliance assurance	This is the ongoing process by which internal processes seek to reduce risks to the business. It will also include part of the budget for the withholding tax capability.
Professional legal services	Ongoing advice on the legal obligations for compliance.
Other	Ongoing costs associated with running a decentralised model. It may also include for some members of the same group, system maintenance and manual inputting of data.

Regulatory Burden and Cost Offset (RBCO) Estimate Table

Table 6.2 Option 1				
Average Annual Compliance Costs (from Business as usual)				
Costs ($m)	**Business**	**Community Organisations**	**Individuals**	**Total Cost**
Total by Sector	$48.27 M[18]	$	$	$
Cost offset ($m)	**Business**	**Community Organisations**	**Individuals**	**Total by Source**
Agency	$	$	$	$
Within portfolio	$	$	$	$
Outside portfolio	$	$	$	$
Total by Sector	$	$	$	$
Proposal is cost neutral?	■ yes ☐ no			
Proposal is deregulatory	■ yes ☐ no			
Balance of cost offsets	<$58.32 M >[19] (per year)			

[18] This cost is attributed to the yearly cost as calculated by: (Start-up cost ÷ 10) + yearly ongoing cost

[19] This cost represents the difference between the status quo (take no action) Option 3 and Option 1. The status quo is estimated to cost $106.59 million per year.

Table 6.3 Option 2				
Average Annual Compliance Costs (from Business as usual)				
Costs ($m)	**Business**	**Community Organisations**	**Individuals**	**Total Cost**
Total by Sector	$56.54[20]	$	$	$
Cost offset ($m)	**Business**	**Community Organisations**	**Individuals**	**Total by Source**
Agency	$	$	$	$
Within portfolio	$	$	$	$
Outside portfolio	$	$	$	$
Total by Sector	$	$	$	$
Proposal is cost neutral?	■ yes	☐ no		
Proposal is deregulatory	■ yes	☐ no		
Balance of cost offsets	< $50.05 M>			

[20] This cost is attributed to the yearly cost as calculated by: (Start-up cost ÷ 10) + yearly ongoing cost

Table 6.4 Option 3				
Average Annual Compliance Costs (from Business as usual)				
Costs ($m)	**Business**	**Community Organisations**	**Individuals**	**Total Cost**
Total by Sector	$106.59[21]	$	$	$
Cost offset ($m)	**Business**	**Community Organisations**	**Individuals**	**Total by Source**
Agency	$	$	$	$
Within portfolio	$	$	$	$
Outside portfolio	$	$	$	$
Total by Sector	$	$	$	$
Proposal is cost neutral?	■ yes ☐ no			
Proposal is deregulatory	■ yes ☐ no			
Balance of cost offsets	NIL[22]			

Table 6.5 Compliance Costs Comparison between Options						
	Option 1		**Option 2**		**Option 3**	
	Annual ($M)	**Total (over 10 years) ($M)**	**Annual ($M)**	**Total (over 10 years) ($M)**	**Annual ($M)**	**Total (over 10 years) ($M)**
Start Up	25.54	255	31.90	319.08	47.74	477.47
Ongoing	22.72	227.2	24.63	246.37	58.84	588.45
Total	48.27	482.68	56.54	565.44	106.59	1065.92

[21] This cost is attributed to the yearly cost as calculated by: (Start-up cost ÷ 10) + yearly ongoing cost
[22] This is the status quo.

Comparing the Compliance Cost Burden

The compliance costs as indicated above show that Option 1 is the least expensive option for business. The estimated compliance costs progressively increase through Options 1 to 3. Less government regulation in this context will cause greater compliance burdens – in addition to economic costs that cannot be included in the RIS compliance cost analysis.

Option 1

Option 1 solely has the combined benefits of treaty protection, efficiency through liaising with the ATO and consistency with other international tax information sharing initiatives developed by the OECD and endorsed by the G20.

It is also the least expensive of the options. Based on the estimates provided by industry, the minimum upfront costs total $255 million. As indicated above, these costs are those that are non-going and reflect the significant set up costs associated with building the systems to enable compliance. The ongoing yearly cost is estimated to be $23 million a year.

Initial start-up costs make up almost 53 per cent of the total compliance costs, with the remaining 47 per cent of the total costs over the ten year period being ongoing.

Business system design and development accounts for 79.9 per cent of the start-up costs and 42 per cent of the total costs (over ten years). The next biggest cost is legal advice costs at 12 per cent of the start-up costs and 7 per cent of the total costs (over ten years). The lowest proportion of start-up costs is the registration with the IRS at 0.5 per cent.

Operation of business systems makes up the highest proportion of ongoing costs at 51.5 per cent and 2 per cent of the total costs (over ten years). Preparing and reporting data for compliance made up 19 per cent of the ongoing costs, and makes up almost 1 per cent of the total costs (over ten years).

Option 2

Option 2 shares some of the common benefits with Option 1, which is reflected in the smaller proportion of cost difference between the two options. The average yearly cost difference between Option 1 and 2 is about $8 million.

Based on the estimates provided by industry, the minimum upfront costs total approximately $319 million. As indicated above, these costs are those that are non-going and reflect the significant set up costs associated with building the systems to enable compliance. The ongoing yearly cost is estimated to be $24.6 million a year.

Initial start-up costs make up almost 56 per cent of the total cost of compliance, with the remaining 43 per cent of the total costs over the ten year period being on-going.

Business system design and development make up 73 per cent of the start-up costs and 41.6 per cent of the total costs (over ten years). The next biggest cost is legal advice costs at 10 per cent of the start-up costs and 5.7 per cent of the total costs (over ten years). The lowest proportion of start-up costs is the registration with the IRS at 0.4 per cent.

Operation of business systems makes up the highest proportion of ongoing costs at 47.5 per cent and 2 per cent of the total costs (over ten years). Preparing and reporting data for compliance accounts for 6 per cent of the ongoing costs.

There are similarities in the proportionate spending across the variety of line items between Option 1 and Option 2. The increases in spending between the two are the increase in cost associated with:

- Start-up – Business systems design and development – worth about $31million
- Start-up – internal compliance assurance – worth an estimated $6.3 million – this cost is not associated with the first option
- Start-up – increasing costs in making changes to the business operating model – almost $1 million
- Ongoing – compliance assurance – $6.1 million

Option 3

Option 3 is the most expensive of the three options. Less government regulation in this context will cause business additional compliance costs.

The total start-up cost associated with this option is $477.47 million. The ongoing cost per year is $58.8 million. Each year, the total average ongoing compliance cost burden that will fall on business is $106.59 million.

The biggest start-up costs are:

- Business design and development representing 51.3 per cent – worth $245.24 million
- Legal costs representing 8.5 per cent – worth $40.42 million[23]

---

23 Due to the complexity of Option 3 and industry's expectation that it will not be adopted, little data was available in relation to the true expected legal compliance costs. For instance, there could be significant costs associated with legal advice on the application of FATCA regulations themselves, closure of recalcitrant accounts and the legality and risks of waivers and both anti-discrimination and privacy law constraints. Contingency funds may also be needed for any legal challenges to actions by customers or other parties. In addition there are fundamental differences in the legal advice that would be required between Option 3 and the options which rely on an IGA. Both Option 1 and 2 would result in an international agreement, which would provide the legal authority to address existing domestic law impediments such as anti-discrimination and

- Business model implications representing 19.7 per cent– worth $94 million

The biggest ongoing costs are:

- Managing customer consent representing 28.4 per cent – worth $16.7 million per year
- Compliance assurance representing 27.86 per cent – worth $16.39 million per year
- Operation of business systems representing 23.3 per cent – worth $13.7 million per year

The biggest differences between the compliance costs under this option and signing either of the two IGAs are:

- An additional $8 million on start-up legal advice under Option 3
- An additional $40 million compared to Option 1 and around an additional $10million compared to Option 2 on the building and design of a system to comply with FATCA directly
- An additional $94 million compared to Option 1and an additional $88 million compared to Option 2 on implications to the business model
- Internal compliance assurance
- Changes to the operation of the business model
- Conversion costs – worth about $39 million
- Other associated costs with start-up
- Ongoing managing customer consent
- Ongoing compliance assurance

privacy barriers. An IGA would provide a legal basis upon which an entity could rely in order to comply with the regulations. This should therefore be taken as a conservative estimate.

Furthermore, the compliance costs associated with Option 3 do not account for the significant pressure from business that would arise should there be no intervention.

- This pressure would be applied at state and federal levels to drive for legislative change to enable compliance with FATCA under domestic legislation.
- Without the legal backing of the treaty status document, uncertainty may arise as to whether the Federal Government would have the constitutional authority to effect the change without the cooperation of the States.
- Changing legislation on a State-by-State basis as required would lead to difficulties around consistency.
- Managing the process by which these legal changes could be made is also likely to be costly and time consuming. There could also be significant delays between the commencement of FATCA and when the necessary domestic changes came into effect.

Economic Costs

The costs in the above table do not include the economic, reputational and opportunity costs of not pursuing either Options 1 or 2. Australian business has emphasised, however, that these additional costs would be significant.

Industry has indicated that changing from the original Australian Government indicated position of the Model 1 IGA will impose significant additional compliance costs. The conversion is most pronounced where no government action is taken, where it is estimated that it will cost $39 million to convert businesses to non-IGA solutions. This cost does not factor in the spent costs already sunk, which is estimated to be about $110 million.

Industry has further indicated that such a change from the Australian Government announcements would place business at a significant disadvantage.

The Australian banking industry has built FATCA compliance systems on the basis that an IGA was imminent. If an IGA were not signed, the ABA is concerned that this would result in the entirety of the Australian banking industry being non-FATCA compliant. This, in turn, would result in immediate significant system redesign costs to meet the standards of a FFI agreement as highlighted by the quantitative analysis.

According to the ABA:

> ‘A failure to implement an IGA would mean that Australian banks and other financial institutions will not be participating FFIs since they are unable to exchange information directly with the US Inland Revenue Service under existing Privacy Laws. This would result in a potential *contraction* of the Australian finance industry’s participation in global markets due to ongoing increased transaction costs, perceived increased counter-party risk (of dealing with Australian banks) and the deconstruction of Australian global bank operating business models. More particularly:
>
> – Investments by Australian banks and managed funds in most US equities will become subject to 30 per cent withholding tax on a staggered basis, so too US securities and debt lent to US subsidiaries of Australian companies. This will result in an artificial reweighting of investment and debt portfolios as Australian financial institutions wind down their participation in the US market.
>
> – Australian banks will, over time, be excluded from participating in global derivative and interbank markets if US and global banks put in place policies which prohibit transacting with parties which are not participating FFIs due to the complications of withholding and reporting.
>
> – Australian banks will, over time, withdraw from jurisdictions which have laws that prevent the signing of a FFI Agreement and do not have an IGA in place to avoid “tainting” the global conglomerate (with non-participating FFI status). Cessation of operations in foreign jurisdictions will also negatively impact Australian Banks’ ability to develop and grow their businesses by limiting and reducing their potential offshore income streams.’[24]

Industry has also noted that there would be a reputational cost for Australian financials as a result of being in a non-compliant jurisdiction. Industry contends that access to finance will become difficult for Australian banking institutions without an IGA.

Industry further notes that there would also be opportunity costs associated with pursuing a non-IGA option. This would include the profits associated with alternative projects that would have to be forfeited due to expenditure on FATCA.

[24] ABA advice to Treasury on 7 March 2014

7. Consultation

The Australian Government announced that it would commence discussions on an IGA with the US on 7 November 2012. While the proposed Australia-US IGA like that of most other countries reflects the US Model 1 agreement, the Government has been actively engaged with Australian stakeholders to ensure the overall compliance burden of the US legislation is minimised and the legitimate interests of Australian citizens are protected.

Treasury has conducted extensive consultation throughout the IGA negotiation process including through the invitation of public written submissions, a general information session for industry representatives and targeted stakeholder meetings.

Prior to the previous Government's announcement that Australia would enter into IGA negotiations with the US, written submissions were sought in relation to the advantages and disadvantages of pursuing an IGA. Treasury received feedback from 32 stakeholders: 23 from businesses and their representative bodies, 7 from individuals and 1 each from the Office of the Australian Information Commissioner and the Tax Justice Network.

Overall, Australian industry was supportive of entering into an IGA. Industry broadly agreed that this option reduces the compliance cost for industry and consumers through removing the need for Australian financial institutions to enter into, administer and certify individual agreements with the IRS. Furthermore, industry was of the view that utilising existing reporting channels would minimise information transmission costs and improve efficiency. However, concerns were also raised that there would be significant costs as a result of the need to establish new infrastructure, processes and compliance frameworks. Some industry participants submitted that these costs would be likely to fall disproportionately on smaller institutions such as Australia's mutual banking sector and would reduce their competitiveness against the big four banks.

The Information Commissioner acknowledged that an IGA would generally address legal privacy concerns by making disclosures 'required or authorised by law' for the purposes of the Privacy Act. The Information Commissioner noted that other privacy law obligations would continue to apply if an IGA was concluded, including the obligation to notify individuals about the purpose for which information is collected and the organisations to which the information will be disclosed. The proposed IGA would facilitate Australian financial institutions' compliance with the FATCA requirements because the IGA would require domestic law to be implemented.

Some individuals that generally oppose FATCA expressed the view that individual FFI agreements would distribute the FATCA burden more equitably, with the burden falling exclusively on individuals who wish to deal with financial institutions that access US funding.

US citizens who reside in Australia are generally opposed to the conclusion of an IGA on the grounds that it could expose them to IRS enforcement action. While the IGA would not provide any special concessions for such US citizens, the US offers an *Offshore Voluntary Disclosure Program* (OVDP) for US taxpayers to get their US tax affairs in order. The OVDP would allow US taxpayers with undisclosed foreign accounts and unreported income to seek protection from criminal prosecution. However, US citizens have complained that the OVDP is only attractive where the individual only has a small amount of US tax outstanding.

In addition to financial costs, industry also identified legal impediments to compliance with FATCA in the absence of an IGA.

One stakeholder noted that suitable amending legislation would be required to support Australian financial institutions' reporting obligations under the IGA. Treasury intends to develop relevant amendments to the taxation laws, in consultation with industry, to give effect to Australia's obligations under the IGA.

The Information Commissioner was concerned that the Model IGA did not contain any specific rules regarding the storage, security and retention of personal information, access to information, correction of information, or limits on the use of personal information. In response to this concern, Treasury notes that the proposed IGA would specifically provide that all information exchanged would be subject to the confidentiality and other protections provided for in the tax treaty, including provisions limiting the use of information exchanged. The *Exchange of Information* Article in the Australia-US tax treaty specifically provides that:

> *Any information so exchanged shall be treated as secret and shall not be disclosed to any persons other than those (including a Court or administrative body) concerned with the assessment, collection, administration or enforcement of, or with litigation with respect to, the taxes to which this Convention applies.*

The *Exchange of Information* article in the tax treaty follows internationally accepted principles and imposes a higher standard of tax secrecy than Australia's domestic tax secrecy laws. In so doing, it provides legal protection against the misuse of personal information.

Industry also provided comments in relation to the content of the IGA. In particular, it was noted that definitions of certain terms published in the model agreement are inconsistent with its interpretation and understanding in the Australian financial services industry. The proposed IGA tailors these definitions to the Australian context to the extent possible.

Industry was also keen to ensure that Australian financial entities received equivalent IGA treatment to their counterparts (or competitors) in other IGA jurisdictions. Treasury has worked with industry and US Treasury to include IGA text that achieves equivalent treatment to the extent possible without creating unintended gaps in the FATCA reporting framework. While it was possible to accommodate some of industry's proposals (such as the Memorandum of Understanding clause which clarifies the reporting obligations for securities registered in an Australian securities clearing and settlement facility), US Treasury officials could not accommodate other Australian industry proposals which they considered were inconsistent with the FATCA rules or reporting framework (such as the Australian Property Council's request for FATCA exemptions for Australian property trust structures).

Numerous other written submissions were received as part of Treasury's ongoing consultation with industry on IGA design issues – especially from the ABA and the FSC, and their members. Following the IGA negotiation announcement, consultation has focussed on suitable content for Annex II of the proposed IGA, practical IGA due diligence (Annex I) issues, and IGA implementation issues. Treasury has worked closely on a technical level with peak industry bodies to address these specific concerns. The ATO has also been involved in the implementation aspects of the IGA.

Throughout the consultation process, the proposed IGA has received widespread support from Australian industry. Peak industry bodies and corporates have advised that the conclusion of an IGA would significantly reduce their FATCA-related compliance costs and overcome domestic legal constraints. Not proceeding with the IGA would be contrary to the interests and submissions made by the financial services industry.

The Tax Justice Network is also broadly supportive of an IGA as it is consistent with the global trend towards facilitating the automatic exchange of tax information.

The following bodies have provided input to the IGA consultation process:

- Australian Bankers Association (ABA)
- Australian Finance Conference (AFC)
- Australian Financial Markets Association (AFMA)
- Australian Securitisation Forum (ASF)
- Association of Superannuation Funds of Australia (ASFA)
- Australian Securities Exchange (ASX)
- Australian Custodial Services Association (ACSA)
- Computer Share

- Customer Owned Banking Association (COBA) – formerly Abacus – Australian Mutuals
- Export Finance and Insurance Corporation
- Financial Services Council (FSC)
- Future Fund
- Property Council of Australia (PCA)
- SMSF Professionals' Association
- Tax Institute
- Treasury's Tax Treaties Advisory Panel (consisting of professional body and industry representatives)

Other corporate stakeholders that have been consulted include the major accounting bodies and legal firms and firms that are part of the property management, infrastructure, superannuation, banking and financial services industry. State and Territory governments and their investment entities were also consulted. Treasury has also consulted with the ATO, Australian Prudential Regulation Authority, the Department of Industry and the Department of Foreign Affairs and Trade. Advice was also sought from the Office of International Law (Attorney General's Department), the Australian Government Solicitor and the Office of the Australian Information Commissioner.

Together with the ATO, Treasury expects to conduct further consultation as the IGA is implemented domestically.

8. Conclusion

Treasury's preferred option is to conclude a Model 1 IGA (Option 1).

Option 3 would fail to meet the Government's overriding objectives. It would not:

- Adequately protect industry's international competitiveness because it would put Australian financial institutions at a disadvantage compared to financial institutions from countries that have concluded IGAs with the US;
- Guarantee industry's compliance with FATCA;
- Provide greater FATCA treatment certainty for Australian entities and their financial products; or
- Implement enhanced information-sharing with the US.

Option 2 would adequately protect industry from exposure to the FATCA withholding tax but would commit each Australian financial institution to develop and maintain an ongoing relationship with the IRS, including the provision of sensitive customer information directly to the IRS. It would also fail to meet the Government's overriding objective of obtaining enhanced information from the US on a fully reciprocal basis.

Option 1 meets all of the Government's objectives.

Industry's support for the conclusion of a Model 1 IGA is consistent with the desire to reduce industry's own compliance burden whilst remaining able to operate competitively in a global marketplace. An IGA would also minimise the compliance costs on the broader Australian community.

9. Recommendation

The Treasury recommends the signature of the proposed Model 1 IGA to allow time to implement the IGA before the FATCA rules commence on 1 July 2014 and to meet the first IGA reporting date of 30 September 2015.

10. Implementation and review

The Treasury would develop relevant amendments to the taxation laws, in consultation with industry, to give effect to Australia's obligations under the IGA. Although the final design and form of the amendments still needs to be settled, the legislation is likely to consist of a reporting obligation on relevant Australian financial institutions to provide the necessary information (as specified in the IGA) to the ATO and a supporting administrative framework. Such amendments would address the potential conflicts with privacy law and anti-discrimination law.

It is intended that all relevant enabling legislation to give effect to the IGA be enacted prior to July 2014 (being the date on which the FATCA obligations commence). This would negate the need for transitional rules prior to the first IGA reporting date of 30 September 2015.

In parallel, the ATO will continue to consult with prospective reporting Australian Financial Institutions and the IRS on the development of appropriate systems, methods and guidance for IGA reporting.

ATTACHMENT A

The proposed (Model 1) IGA framework

The proposed IGA would consist of three elements:

1. the main body;
2. Annex I (due diligence obligations for Australian financial institutions); and
3. Annex II (exempt entities and products).

It would also be accompanied by a Memorandum of Understanding dealing with some interpretation issues and confirming that Australian financial institutions will be treated as FATCA compliant from the date of signature of the IGA.

1. Main body

Preamble

The preamble notes Australia and the US's mutual desire to:

- Build on the existing relationship of mutual assistance in tax matters, including the automatic exchange of tax information authorised by the Australia-US tax treaty;
- Improve international tax compliance and pursue reciprocal and equivalent levels of information exchange;
- Address Australian legal impediments and reduce the FATCA compliance burden;
- Work together on achieving common reporting and due diligence standards for financial institutions in the long term; and
- Coordinate FATCA reporting obligations with other US tax reporting obligations of Australian financial institutions.

Definitions

Article 1 defines the key terms used in the IGA (vis-à-vis the FATCA regulations' definitions), e.g. 'Reporting Australian Financial Institution' (Australian financial institutions that must undertake due diligence and report information on US accounts) and 'US Reportable Account' (the types of financial accounts that are required to be reported on). Terms not defined in the IGA would be interpreted in accordance with Australian law.

Obligations to obtain and exchange information on reportable accounts

Article 2 obliges Australia to obtain and exchange information with the US on accounts that have been deemed reportable by the IGA's due diligence rules (Annex I). Article 2 also prescribes the relevant account information to be reported by Australian financial institutions to the ATO:

- Name, address, US tax identification number, account number, name and identifying number of the reporting Australian financial institution, account balance or value of the account as of the end of the relevant year, and in certain cases, the total gross amounts of dividends, interest and income from other assets held in the account, gross proceeds from the sale or redemption of property and gross deposits and withdrawals.

Time and manner of exchange of information

Article 3 governs the timing and manner of the exchange of information. For instance, it allows the amount and character of payments into reportable US accounts to be determined under Australian tax laws, rather than US FATCA regulations or other US tax laws.

Article 3 also phases-in the information that has to be obtained for the 2014 to 2016 calendar years, according to its type. It also provides a general deadline for the provision of information to the IRS — 9 months after the end of the calendar year to which it relates.

FATCA treatment of Australian financial institutions under the IGA

Article 4 operates to treat Australian financial institutions that comply with the IGA's due diligence and information reporting obligations as generally FATCA-compliant by the US and not subject to withholding tax. (However, as explained below, particular Australian financial institutions that have not complied with their obligations may be exposed to withholding tax).

The US FATCA regulations on withholding tax and the closure of 'recalcitrant' accounts will be suspended. Instead, Australian financial institutions will apply IGA due diligence measures to ascertain whether an account is a 'reportable US account' and, if so, report the relevant information to the ATO according to IGA (not US domestic) rules.

Article 4 expressly exempts Australian superannuation funds from FATCA, as well as other financial institutions listed in Annex II.

The IGA will lift the general requirement that all members of a multinational group be FATCA compliant in order for any one member to remain compliant. For instance, the non-compliance of a foreign branch will not taint an Australian financial institution's compliant status (subject to certain conditions).

Further, Article 4 will ensure that Australia will not be obliged to obtain and exchange information prior to the date by which other FFIs are required to report similar information to the IRS under relevant US financial institutions.

Continued collaboration on compliance, enforcement and enhancing transparency

Article 5 sets out how the ATO and IRS will collaborate to enforce financial institutions' compliance with the IGA. In particular, it will allow them to notify each other of any 'significant non-compliance' by a financial institution, in which case domestic law sanctions (including applicable penalties) would apply. While it is envisaged that the existing uniform penalty regime in the *Taxation Administration Act 1953* would apply to non-compliant Australian financial institutions, the precise approach will be determined during the IGA implementation process.

'Significant non-compliance' might include the intentional provision of incorrect information, intentional or negligent omission of information, repeated failure to adhere to the due diligence obligations, or consistent late submission of information.

If the ATO's enforcement actions do not resolve an Australian financial institution's non-compliance within 18 months of notification by the IRS, the IRS will treat the Australian financial institution as non-compliant (as a 'non-participating financial institution'). The general presumption of FATCA-compliance would thus be reversed in respect of that Australian financial institution, thereby exposing it to withholding tax on payments it receives from some foreign financial institutions.

Article 5 also gives financial institutions the flexibility of using third party service providers to fulfil their IGA obligations. The obligations would, however, remain the responsibility of such financial institutions. Industry has welcomed this option.

Article 6 contains a mutual commitment to enhance the effectiveness of information exchange and transparency. For example, the US acknowledges the need for domestic rules to enable it to engage in reciprocal automatic information exchange with Australia.

Article 7 automatically affords Australia (and Australian financial institutions) the benefits of any more favourable terms (on the treatment of Australian financial institutions and their due diligence requirements) that the US provides under an IGA signed with another country.

Article 8 provides for bilateral consultations to help resolve any difficulties that arise with the implementation of the IGA, and for the amendment of the IGA by mutual written consent.

Article 9 clarifies that Annexes I and II form an integral part of the IGA, and Article 10 establishes rules for the entry into force and termination of the IGA.

2. Annex I (due diligence obligations)

Australian financial institutions will be required by Australian law to apply the IGA's due diligence procedures to identify reportable accounts and payments made to certain non-participating financial institutions. These procedures are generally simpler than the equivalent US FATCA regulations provisions and would be adapted to the Australian context in relevant implementing legislation. However, Australian financial institutions may elect to apply the US FATCA regulations if they consider them to be better suited to their circumstances if Australia so permits.

Under the IGA, a financial account will only become reportable (a 'US Reportable Account') when it is so identified through the application of the due diligence requirements in Annex I.

Four separate categories of due diligence requirements are set out for: pre-existing individual accounts; new individual accounts; pre-existing entity accounts; and new entity accounts. A pre-existing account is one maintained as at 30 June 2014.

In acknowledging that Australian financial institutions may have many pre-existing accounts, Annex I will allow Australian financial institutions to review them over extended periods, depending on their value. Reviews would generally consist of searching existing electronic databases, or reviewing information collected for regulatory or customer relationship purposes (including under Anti-Money Laundering procedures), for 'US indicia' — for example, a US place of birth, address, telephone number, or place of incorporation. Where such indicia are detected, or account values exceed certain thresholds, further identification processes may be required to establish the account holder's status.

For new accounts (opened from 1 July 2014) Australian financial institutions must generally obtain customer self-certifications affirming whether or not they are US taxpayers (or, for some entities, whether their owners are US taxpayers). The IGA would allow Australian financial institutions to rely on existing account opening practices, Australian Anti-Money Laundering rules, public information or information their possession, to test whether the self-certifications are reasonable in the circumstances.

Annex I also sets out the procedures for determining whether an account holder is a non-participating financial institution. Australian financial institutions must report the payments made to any account holders that are identified as a non-participating financial institution.

Industry stakeholders have advised they are generally satisfied they can meet these Annex I procedures. Further consultation will be undertaken as necessary with a view to unfolding or clarifying Annex I terms (including in Australia's implementing legislation).

3. *Annex II (exempt entities and products)*

Annex II will be the country-specific part of the IGA, which will exempt certain 'low-risk' entities and products from FATCA's identification, reporting and withholding rules.

Specifically listing certain Australian entities and products will:

- provide greater certainty to Australian stakeholders;
- overcome any ambiguities or gaps arising from the application of the US rules; and
- generally ease the compliance burden on Australian financial institutions.

Annex II was developed in consultation with Australian Government and industry specialists and aims to ensure consistency between stakeholders' needs and FATCA's objective of addressing tax evasion. It will provide relief for Australian entities and products as follows.

ENTITIES

The following entities would be exempt from FATCA.

Australian governmental entities

- Australian federal, state and local governments and their wholly owned agencies and instrumentalities, including:
  - The Clean Energy Finance Corporation, the Export Finance and Insurance Corporation, the Future Fund, the Building Australia Fund, the Education Investment Fund and the Health and Hospitals Fund (or any of their wholly owned subsidiaries); and
  - State government Treasury (or equivalent) corporations
- The Reserve Bank of Australia.

International organisations

International organisations with offices in Australia, including those that are covered by the *International Organisations (Privileges and Immunities) Act 1963*, or that have signed a headquarters agreement for the conferral of privileges and immunities with the Australian Government.

Australian superannuation funds

All Australian superannuation funds, including any plan, scheme, fund, trust or other arrangement operated principally to administer or provide pension, retirement, superannuation or death benefits, including a 'superannuation entity', a 'public sector superannuation scheme', a 'constitutionally protected fund', a 'pooled superannuation trust', or any entity wholly owned by the foregoing.

Small financial institutions

- Financial institutions with a local client base (provided that at least 98 per cent of the financial accounts maintained by that financial institution is held by residents of Australia and New Zealand);
- Local banks (provided that they are an 'authorised deposit-taking institution' as defined in the *Banking Act 1959* and that its total assets do not exceed USD175 million);
- Financial institutions with only low-value accounts (provided that none of the financial accounts it maintains have a balance in excess of USD50 000 and its total assets do not exceed USD50 million);
- Qualified credit card issuers (provided that it is a financial institution solely because it issues credit cards and customer deposits cannot exceed USD50 000)

Deemed compliant investment entities

- Australian trusts to the extent that their trustees are required to report all relevant information;
- Certain Australian financial institutions, controlled foreign corporations and closely held investment vehicles with sponsoring entities that comply with all relevant requirements on their behalf;
- Investment advisors and investment managers;
- Certain regulated collective investment vehicles;

PRODUCTS AND ACCOUNTS

The following products/accounts would be exempt from FATCA.

Certain savings accounts

- Certain retirement and pension accounts that are a 'complying superannuation/FHSA life insurance policy', 'exempt life insurance policy' or 'retirement savings account';
- Certain regulated non-retirement savings accounts;

- Certain tax-favoured products that are ‘employee share schemes’, ‘employee share trust’, ‘first home saver accounts’, ‘funeral policies’ or ‘scholarship plans’.

Certain term life insurance policies

Accounts held by deceased estates

Escrow accounts

Partner jurisdiction accounts

- Accounts of a type excluded under an IGA between the US and a third country.