National Interest Analysis [2014] ATNIA 9

with attachment on consultation

Agreement between the Government of Australia and the Government of the United States of America to Improve International Tax Compliance and to Implement FATCA

(Canberra, 28 April 2014)

[2014] ATNIF 5

Regulation Impact Statement

NATIONAL INTEREST ANALYSIS: CATEGORY 1 TREATY

SUMMARY PAGE

Agreement between the Government of Australia and the Government of the United States of America to Improve International Tax Compliance and to Implement FATCA (Canberra, 28 April 2014) [2014] ATNIF 5

Nature and timing of proposed treaty action

1. The proposed treaty action is to bring into force the *Agreement between the Government of Australia and the Government of the United States of America to Improve International Tax Compliance and to Implement FATCA* (the proposed Agreement), signed on 28 April 2014.

2. The proposed Agreement will enter into force, pursuant to its Article 10, on the date Australia notifies the United States (US) in writing that Australia has completed the necessary internal procedures for entry into force of the proposed Agreement.

3. The Government intends to provide this notification to the US as soon as the Parliament passes the necessary implementing legislation. The Government aims to bring the proposed Agreement into force by 1 July 2014, to coincide with the commencement of the *Foreign Account Tax Compliance Act* (FATCA) in the US.

Overview and national interest summary

4. The proposed Agreement would establish a legal framework to allow Australian financial institutions to comply with FATCA.

5. FATCA is a unilateral anti-tax evasion regime, enacted by the US in March 2010. FATCA is aimed at detecting US taxpayers who use accounts with offshore financial institutions to conceal income and assets from the US Inland Revenue Service (IRS). The relevant provisions are contained in the US Internal Revenue Code 1986 and are supplemented by extensive US FATCA regulations.

6. FATCA requires foreign (that is, non-US) financial institutions to periodically report details of accounts held by US taxpayers or by foreign entities controlled by US taxpayers to the IRS. Non-complying financial institutions face significant penalties, notably a 30 per cent withholding tax on US income.

7. Australian financial institutions have a strong commercial incentive to comply with FATCA, as non-compliance could expose them to significant economic costs, reputational damage, and a loss of international competitiveness. Without the proposed Agreement and its enabling legislation, financial institutions that seek to comply with FATCA could breach Australian anti-discrimination and privacy laws. These laws prohibit discrimination on the basis of nationality and the unauthorised use, collection and disclosure of personal information respectively.

8. The proposed Agreement would also establish a more effective bilateral framework to address international fiscal evasion. It will strengthen existing administrative assistance arrangements between the Australian and US revenue authorities by broadening the scope of taxpayer information that can be exchanged for anti-tax evasion purposes. Accordingly, the proposed Agreement is expected to reinforce Australia's support for international tax transparency and cooperation between revenue authorities to help prevent tax evasion. This is consistent with ongoing international efforts, supported by the G20, to improve tax system integrity.

Reasons for Australia to take the proposed treaty action

9. FATCA will commence on 1 July 2014 regardless of any action taken by Australia.

10. From that date, FATCA will require foreign financial institutions (FFIs) – regardless of their country of location – to periodically report directly to the IRS, certain information about financial accounts held by US taxpayers or by foreign entities controlled by US taxpayers (US Persons).

11. To comply with these reporting requirements, FFIs would have to conclude individual agreements with the IRS which would oblige them to:

a) undertake specified identification and due diligence procedures with respect to their account holders; and
b) report specified information annually to the IRS on their account holders who are US Persons.

12. Compliance with FATCA is not mandatory but non-compliance will expose FFIs to a 30 per cent US withholding tax on income received from sources within the US (US source income). This will require FFIs to withhold and pay to the IRS, 30 per cent of any payments of US source income and gross proceeds from the sale of securities that generate US source 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 taxpayer; or
c) foreign entity account holders that fail to provide sufficient information about the identity of their substantial US holders.

13. The term 'FFI' covers a broad range of financial institutions and, in Australia, would include banks, building societies, credit unions, life insurance companies, private equity funds, managed funds, exchange traded funds and some broker dealers.

14. While FATCA is not extra-territorial, the withholding tax rules make compliance very attractive from the commercial perspective of most affected Australian financial institutions (AFIs). In the absence of the proposed Agreement and its enabling legislation, however, Australia's privacy and anti-discrimination laws would generally preclude AFIs from fully complying with FATCA.

15. The US has entered into intergovernmental agreements (IGAs) for the implementation of FATCA, based on a common model, with a number of jurisdictions. Without the proposed

Agreement, AFIs would be commercially disadvantaged compared with financial institutions from countries that have concluded IGAs with the US.

Overall benefits of the Agreement

16. The proposed Agreement and its 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 AFIs to perform the due diligence and reporting obligations;
- enable information reporting and handling within the Australian legal framework, thus removing the need for AFIs to pursue individual FFI agreements with the IRS;
- provide AFIs with access to less onerous due diligence requirements compared to the FATCA regulations;
- 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;
- ensure that US source income derived by AFIs and other Australian entities (such as government investment funds) will not be subject to the 30 per cent US FATCA withholding tax;
- ensure that AFIs will not be expected to close or withhold tax from non-complying financial accounts (referred to in the Agreement as recalcitrant accounts) or from payments to other non-complying financial institutions;
- ensure that AFIs will automatically receive the benefits of more favourable terms afforded to FFIs under other FATCA IGAs;
- exempt certain categories of AFIs and financial products from the scope of FATCA;
- enhance the integrity of the Australian tax system by creating a framework to broaden the scope of existing information sharing arrangements between the Australian Taxation Office (ATO) and the IRS; and
- reinforce Australia's support for international tax transparency and cooperation between revenue authorities to help prevent tax evasion.

Providing legal certainty to Australian financial institutions

17. The proposed Agreement establishes a legal framework that will allow AFIs to comply with their FATCA obligations without necessarily breaching Australian anti-discrimination and privacy laws. Without the proposed Agreement, AFIs that perform FATCA obligations would breach these laws.

Australian Privacy Laws[1]

18. Without the proposed Agreement and its enabling legislation, the *Privacy Act 1988* (Cth) ('Privacy Act') would constitute a barrier to AFIs' compliance with FATCA.

19. The Privacy Act prohibits the use or disclosure of personal information for a purpose other than that for which it was collected, unless the individual consents to such use or

[1] 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 National Interest Analysis is only concerned with the Privacy Act.

disclosure, or certain conditions apply, for example, where the use or disclosure is required or authorised by law (see Australian Privacy Principle 6).[2] In respect of existing financial accounts, where account holders do not provide consent or respond to requests for consent, the current exceptions in privacy law do not permit compliance with FATCA.

20. The Privacy Act also prohibits AFIs from collecting personal information unless it is reasonably necessary for one or more of the AFI's functions or activities (see Australian Privacy Principle 3.2). In relation to the opening of new financial accounts, there is uncertainty as to whether AFIs would be able to meet these tests for FATCA purposes.

21. In light of the above, the proposed Agreement and its enabling legislation would provide a lawful basis for AFIs to use or disclose personal information for FATCA purposes.

Australian anti-discrimination laws

22. 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*.[3] The fact that FATCA specifically targets US citizens means that it is specifically targeting persons based on their nationality.

23. While it is unlikely that this would be inconsistent with Commonwealth laws governing discrimination on the grounds of race, a distinction based on nationality may be inconsistent with some Australian State and Territory laws.

24. The proposed Agreement would provide legal certainty to AFIs in respect of due diligence and reporting obligations regarding the financial accounts of US Persons.

Enhancing tax system integrity

25. The proposed Agreement will enhance the integrity of the Australian tax system by improving existing reciprocal tax information-sharing arrangements between Australia and the US.

26. 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.

27. Article 25 (Exchange of Information) of the Australia-US tax treaty[4] (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 of the tax treaty that are designed to protect the

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[2] The *Privacy Act 1988* (Cth) was amended by the *Privacy Amendment (Enhancing Privacy Protection) Act 2012* (Cth). 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.

[3] [1975] ATS 40, in force generally 4 January 1969, and for Australia, 30 October 1975.

[4] *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*, [1983] ATS 16 as amended by [2003] ATS 14.

rights of taxpayers.

28. The proposed Agreement, 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 this approach are not possible to quantify at this stage, all improvements in the scope and quality of information available to the ATO can be expected to enhance its administration of Australia's tax laws.

29. 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), which 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 US's FATCA Model 1 IGA.

30. 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.[5]

Obligations

31. The proposed Agreement consists of three elements:

- the main body;
- Annex I (due diligence obligations for AFIs); and
- Annex II (exempt entities and products).

32. The Annexes are an integral part of the proposed Agreement.

33. The proposed Agreement is accompanied by a (non-treaty level) Memorandum of Understanding that would provide interpretive guidance on certain financial institutions and financial accounts and confirm that AFIs will be treated as FATCA compliant by the US from the date of signature of the proposed Agreement.

Main body

34 Article 1 defines the key terms in the proposed Agreement. Many of these terms are consistent with corresponding terms contained in the US FATCA regulations.

35. Article 2 obliges Australia to obtain and exchange information with the US on accounts that have been deemed reportable by the proposed Agreement's due diligence rules (Annex I). Article 2 also prescribes the relevant account information to be reported by AFIs to the ATO. Article 2 imposes a reciprocal obligation on the US to provide certain information on accounts held by Australian taxpayers in US financial institutions.

[5] G20 Communiqué of the Meeting of Finance Ministers and Central Bank Governors, Sydney 22-23 February 2014.

Time and manner of exchange of information

36. 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 (and vice-versa).

Treatment of Australian financial institutions under the proposed Agreement

37. Article 4 operates to treat AFIs that comply with the due diligence and information reporting obligations as generally FATCA-compliant by the US and not subject to withholding tax, provided Australia meets its obligations to obtain and provide information to the US and AFIs meet the reporting and registration requirements described in the Article. However, as explained below, particular AFIs that have not complied with their obligations may be exposed to withholding tax.

38. The US FATCA regulations on withholding tax and the closure of 'recalcitrant' accounts will be suspended. Instead, AFIs will apply the proposed Agreement's 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 the proposed Agreement's (not US domestic) rules.

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

40. 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 regulations.

Continued collaboration on compliance, enforcement and enhancing transparency

41. Article 5 sets out how the ATO and IRS will collaborate to enforce AFIs' compliance with the proposed Agreement. In particular, it will allow them to notify each other of any 'significant non-compliance' by an AFI, in which case domestic legal sanctions (including applicable penalties) would apply.

42. If the ATO's enforcement actions do not resolve an AFI's non-compliance within 18 months of notification by the IRS, the IRS will treat the AFI as non-compliant (as a 'non-participating financial institution'). This could result in the imposition of withholding tax on that AFI's US source income.

43. Article 5 also gives AFIs the flexibility of using third-party service providers to fulfil their obligations under the proposed Agreement. Industry has welcomed this option.

44. 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 equivalent levels of reciprocal automatic information exchange with Australia.

45. Article 7 automatically affords Australia (and AFIs) the benefits of any more favourable

terms (on the treatment of AFIs and their due diligence requirements) that the US provides under an IGA signed with another country.

Annex I (due diligence obligations)

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

47. The due diligence obligations relate to:

- pre-existing individual accounts;
- new individual accounts;
- pre-existing entity accounts; and
- new entity accounts.

48. Industry stakeholders have advised they are generally satisfied that they can meet these Annex I procedures. Further consultation on applying Annex I in practice will be undertaken as necessary.

Annex II (exempt entities and products)

49. Annex II is the country-specific part of the proposed Agreement. It exempts certain 'low-risk' entities and products from FATCA's identification, reporting and withholding rules.

50. 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.

Implementation

51. The implementation of the proposed Agreement will require amendments to Commonwealth taxation laws. Relevant legislation will be introduced into Parliament at the earliest opportunity. These amendments will apply from 1 July 2014, and will require AFIs with reporting obligations to report FATCA-related information to the ATO for onward transmission to the IRS. The amendments will have the effect of ensuring that AFIs, while performing their FATCA obligations, would not breach Australia's anti-discrimination laws and the Privacy Act.

52. Relevant AFIs that do not comply with these obligations would be subject to the existing administrative and civil penalties that apply to entities that do not comply with their tax-related reporting obligations.

53. The implementation of the proposed Agreement will not otherwise affect the existing roles of the Commonwealth, or the States and Territories, in tax matters.

Costs of the Agreement

Administration costs for the Australian Taxation Office

54. The information reported under the proposed Agreement 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.

Business compliance costs

55. Australian industry has estimated that minimum upfront implementation costs for AFIs would be approximately $255 million. Industry also estimates that ongoing implementation costs would be approximately $22.72 million per annum. Further information on business compliance costs can be found in the attached Regulation Impact Statement.

Regulation Impact Statement

56. The Regulation Impact Statement certified by the Office of Best Practice Regulation is attached.

Future treaty action

57. Article 8 provides that the proposed Agreement may be amended by mutual written agreement of both Parties. Unless otherwise agreed upon, any amendments will enter into force when Australia notifies the US that it has completed its necessary internal procedures. Article 10 requires that, prior to 31 December 2016, both Parties consult in good faith to amend the proposed Agreement as necessary to reflect progress on their commitments to enhance the effectiveness of information exchange and transparency.

58. Any amendments would be subject to Australia's domestic treaty-making process, including tabling in Parliament and consideration by the Joint Standing Committee on Treaties.

Withdrawal or denunciation

59. Following its entry into force, either Party may terminate the proposed Agreement by giving written notice of termination to the other Party. The proposed Agreement will then cease to be effective on the first day of the month following the expiration of a period of 12 months after the date on which the notice of termination is given. Termination by Australia would be subject to Australia's domestic treaty-making process.

Contact details

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ATTACHMENT ON CONSULTATION

Agreement between the Government of Australia and the Government of the United States of America to Improve International Tax Compliance and to Implement FATCA (Canberra, 28 April 2014) [2014] ATNIF 5

CONSULTATION

60. The Australian Government announced that it would commence discussions on an IGA with the US on 7 November 2012.

61. 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.

62. Prior to the announcement that Australia would enter into IGA discussions with the US, written submissions were sought on the advantages and disadvantages of pursuing an IGA. Treasury received feedback from 23 businesses and their representative bodies, 7 individuals, the Office of the Australian Information Commissioner and the Tax Justice Network.

63. 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.

64. 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.

65. 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.

66. US citizens who reside in Australia were generally opposed to the conclusion of an IGA on the grounds that it could expose them to IRS enforcement action. While the proposed Agreement does 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.

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

68. 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. Treasury notes that the proposed Agreement would specifically provide that all information exchanged would be subject to the confidentiality rules contained in the Australia-US tax treaty.

69. Industry also provided comments in relation to the content of the proposed Agreement and these were included to the extent possible. While it was possible to accommodate some of industry's proposals, US Treasury officials could not accommodate other Australian industry proposals which they considered were inconsistent with the FATCA rules or reporting framework.

70. Numerous other written submissions were received as part of Treasury's ongoing consultation with industry on IGA design issues – especially from the Australian Bankers' Association and the Financial Services Council, and their members. Consultation focussed on suitable content for Annex II of the proposed Agreement, and practical due diligence (Annex I) 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.

71. 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.

72. The following bodies have provided input to the IGA consultation process: Australian Bankers Association, Australian Finance Conference, Australian Financial Markets Association, Australian Securitisation Forum, Association of Superannuation Funds of Australia, Australian Securities Exchange, Australian Custodial Services Association, Customer Owned Banking Association (COBA) – formerly Abacus – Australian Mutuals, Export Finance and Insurance Corporation, Financial Services Council, Future Fund, Property Council of Australia, SMSF Professionals' Association, Tax Institute, Treasury's Tax Treaties Advisory Panel (consisting of professional body and industry representatives).

73. 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.

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