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FATCA preparations now 'a matter of urgency', says KPMG

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The global investment management industry is largely unprepared for the implementation of new US legislation that will oblige non-US financial services firms to register with the US tax authorities if they have American clients or assets, a report from KPMG warns.

Only one-third, or 32%, of fund managers surveyed expect to be ready in time for the deadline, "and a significant 42% have not yet assessed the time needed to comply", KPMG says, in a summary of its findings, which were unveiled today.

The new law is also going to cause some investors to sell out of their US holdings, the report finds, although exactly how many or on what scale has yet to be seen.

Some 6% of the fund promoters across 12 countries who were interviewed by KPMG's researchers said they would disinvest from both the US equity and fixed income markets as a result of the Foreign Account Tax Compliance Act, while 45% of fixed income funds and 42% of equity funds refused to rule out the possibility of leaving the US market as a result of the legislation.

Only 36% of fixed income fund respondents and 42% of those involved in US equities said they would definitely stay put in the US in spite of the new reporting requirements.

FATCA, which will require details of US clients with assets in excess of $50,000 to be passed to the US Internal Revenue Service, comes into force on 1 Jan 2013. Institutions that do not comply will be subject to a 30% withholding tax on all payments made to them in the US, but many are underprepared, according to KPMG.

"Unless implementation is postponed, we believe that the correct answer to the question of when preparations for FATCA should begin is 'six months ago'", the report warns.

George Bock, global chairman of KPMG's funds tax group, says that unless the implementation date of FATCA is postponed, as many non-US corporations are lobbying Congress to do, "a large part of the industry risks being unprepared".

"While investment managers accept that the cost of compliance will be significant, with more than a third (35%) expecting to spend more than €1m to implement and comply with FATCA, we predict that a significant proportion of the industry have completely underestimated the cost impact, or are assuming that generous carve-outs will be available."

'Not an operational issue'

The report says the Foreign Account Tax Compliance Act is not, contrary to received wisdom, merely an operational issue, but impacts on strategic issues that "only boards and senior executives can address".

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Such concerns extend across products, markets and distribution strategies, the make-up of funds and legal entities and business models themselves, it notes.

Investor information

The report finds that 39% of respondents expect to change their distribution model as a result of FATCA – but the same percentage said they do not currently have access to information regarding the names and addresses of end investors at the transfer agent level.

Just 20% of those interviewed said they were are already able to identify all US source income collected in their funds; the proportion who said they have already integrated the exclusion of US investors into distribution agreements stands at 26%.

On product strategy, 32% expect "some level of change" to the structure of their product range.

While the report notes that the Internal Revenue Service foresees FATCA requirements being eased for funds that minimise sales to US investors, it cautions that attempting to restrict US customer numbers will prove challenging, not least in organising all of a company's distributors to ensure that they all conform with the new requirements.

What is more, excluding American investors could prove tricky, the report points out.

"Significant legal issues may arise in trying to exclude US investors. It has also to be noted that current sales restrictions are based on SEC rules. While there are some commonalities, the category of US taxpayers is far more extensive, which itself makes the design of a new process unavoidable."

While fund managers face significant challenges in their efforts to identify American investors, the task of identifying non-American investors will necessarily be greater: "it appears that the rules currently proposed would require non-US taxpayers in effect to prove a negative in demonstrating their status," KPMG says.

Issues over identifying clients are particularly notable in certain instances, such as those in which fund sales are conducted through intermediaries, according to the report – a concern of particular relevance to the UK market.

To see and download a copy of the KPMG survey, which is entitled *FATCA and the funds industry: Defining the path,* click here.

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