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KPMG Foresees Tax Compliance Problems for Financial Industry

By Accounting Today Staff

New York -- Recent policy changes in areas such as cost basis reporting, the Foreign Account Tax Compliance Act, and the Regulated Investment Company Modernization Act of 2010 are likely to create significant compliance, reporting and monitoring risks and consume resources as companies continue to move toward economic recovery, according to KPMG.

Successful management of these developments will be even more challenging for finance and tax departments as they will simultaneously need to work seamlessly with other areas of their businesses to respond to the tax ramifications arising from the Dodd-Frank Wall Street Reform and Consumer Protection Act.

“U.S. financial institutions will face many new tax challenges in 2011 and beyond as a result of various legislative and regulatory developments over the past several years,” said Scott Marcello, national leader of KPMG LLP’s Financial Services practice. “We believe that maintaining management attention on the tax compliance and operations-related aspects of FATCA, cost basis reporting and the Regulated Investment Company Modernization Act—while also monitoring and responding to the tax ramifications of ongoing regulatory change, such as the Dodd-Frank Act—will be challenging and vital to achieving business growth and success.”

In a recent KPMG survey of mostly Fortune 1000 company executives, more than two-thirds (67 percent) cited tax policy as either “extremely,” “very,” or “somewhat” difficult to address.

“Nearly all business leaders are concerned with the vast majority of public policy changes and re-examining the way they operate, as a result of these changes,” said Marcello.“For financial services companies, tax matters have broad and significant implications and are likely to move among the top rung of leadership priorities.”

U.S. financial institutions and the foreign entities to which they make certain U.S. source payments will face new tax compliance challenges under FATCA. The effective date for this new regime is Jan. 1, 2013.

“It may appear that there is ample time to adequately prepare for the 2013 statutory effective date, but CFOs and tax directors should be aware that most U.S. financial institutions and foreign financial institutions have concluded that implementation will take between 18-24 months,” said Mark Price, KPMG’s Banking and Finance practice national tax leader. “The account identification, withholding, and reporting requirements under this new regime will affect all disciplines and processes—from IT and operations to the tax and regulatory departments. Given that we won’t have definitive rules for some time, affected entities need to secure upper management buy-in as soon as possible to ensure adequate resources are made available for planning purposes."

Equally important, according to KPMG Washington National Tax principal Laurie Hatten-Boyd, this new regime broadens the definition of "foreign financial institution" far beyond a traditional view, to include insurance companies that issue cash value products, hedge funds, private equity funds, and other collective investment vehicles.

"These nontraditional entities face additional burdens in their attempt to be FATCA-compliant," Hatten-Boyd said. "Since they currently do not have the same regulatory requirements to obtain documentation under their local know your customer or anti-money laundering rules, the starting point for these entities is that all accounts are undocumented. They need to start gathering the information and developing the systems they will need to obtain, retain, and report the required information to the authorities when the rules go live."

"Most of the provisions in the Dodd-Frank Act have significant tax implications and it's critical for CFOs, tax directors and other executives to be aware of them," said Marcello.

Viva Hammer, a principal in KPMG's Washington National Tax practice, offered several examples of some of the tax implications resulting from the Dodd-Frank Act. "Clearly, we are going to see a change in the tax treatment of derivatives, but there also will be tax-related issues arising from new bank capital requirements, securitization reform, reorganizations in the structure of financial services groups, and even 'say on pay,'" said Hammer.

The Emergency Economic Stabilization Act of 2008 ushered in a new era of mandatory information reporting to the Internal Revenue Service regarding the sale of securities, their tax basis, and whether the related gain or loss is short- or long-term by mutual fund companies, stock brokers, custodians and transfer agents for most stock purchased in 2011 and all stock purchased in or after 2012.

"Although many broker dealers and mutual fund sponsors currently make cost basis information available to investors on a voluntary basis, mandatory reporting of cost basis reflects a significant departure from current practice," said Deanna Flores, a principal in KPMG's Washington National Tax practice. "Because the effective dates for cost basis reporting apply by type of security, it is crucial that brokers understand how to classify securities in order to determine the appropriate effective date. The first effective date applies to equities acquired on or after January 1, 2011, so CFOs and tax directors should already be taking action."

The Regulated Investment Company Modernization Act of 2010 changed various tax rules applicable to regulated investment companies, which include mutual funds, business development companies, and other comparable investments. Significant changes were made related to the treatment of RIC capital loss carryovers, RIC failures to satisfy the gross income and asset diversification requirements, the tax treatment of periodic RIC distributions, as well as rules governing year-end excise tax.

"This law represents the most comprehensive tax changes for the RIC industry in decades," said Jeffrey Sion, KPMG's Investment Management practice national tax leader. "CFOs and tax directors already should be assessing the direct impact of the RIC Modernization Act on existing accounting and tax systems reporting entity-level and shareholder data, as a significant portion of this legislation will be applicable to events during calendar year 2011."

“A proposal with respect to carried interest was included in President Obama’s 2012 budget proposal, released Feb. 16,” said Glenn Mincey, a principal in KPMG’s Private Equity and M&A Tax practices. “The carried interest proposal appears to focus the legislation in a manner more targeted at investment funds and may continue to have significant tax implications. The alternative investment industry will likely be actively participating in the debate and discussions around this proposal.”