Countdown to FATCA…

The real challenges for senior management start now

By April 25, 2014, financial institutions across the Middle East will need to have entered into an agreement with the U.S. authorities (Internal Revenue Service or IRS) to comply with specific requirements set forth in the FATCA (Foreign Account Tax Compliance Act) regulations so as to avoid being subject to the penal 30 percent withholding on certain U.S.-sourced payments. One of these requirements is that each Foreign Financial Institution (FFI) will need to adopt a FATCA governance program and appoint a Responsible Officer who will take personal responsibility for FATCA compliance on its behalf. Non-compliance with FATCA could leave organizations and senior personnel open to significant financial and personal penalties. Appropriate action should be taken now.

Brief overview of FATCA

The U.S. treasury introduced the FATCA regulations to combat U.S. tax citizens evading taxation by hiding their income and assets in offshore jurisdictions. Under U.S. tax law, U.S. citizens are obligated to declare and pay taxes on all of their worldwide earnings regardless of where these earnings have been derived.

The FATCA regulations do not cover only U.S. citizens but a broader category of individuals including Green Card holders (permanent residents), those born in the United States and those with a significant presence in the United States, collectively referred to as 'U.S. Persons.'

The onus of compliance with FATCA regulations lies with the FFIs, who have until June 30, 2014, to initiate their respective FATCA compliance programs or else suffer tax withholding and severe reputational damage.

> Serious non-compliance could result in legal consequences for the RO, the board, and senior management, and as such it is a matter not to be taken lightly

The FATCA compliance requirements

Every affected financial institution in the Middle East will be required to appoint a Responsible Officer (RO) who will take personal responsibility for ensuring that their respective establishment registers with the IRS via its online FATCA portal and enters into a FATCA agreement (the "FFI Agreement"). This must be done prior to April 25, 2014, to ensure inclusion on the initial list of participating FFIs, which will be published by the IRS on June 2, 2014.

The RO appointed by an FFI must be of a sufficiently senior level (i.e. board level or one tier below) to ensure that the correct level or authority is supporting this program. The RO will sign the FFI agreement, oversee a compliance program and periodically certify compliance to the IRS. Both the FFI agreement and the certifications will be subject to U.S. penalties of perjury.

The 3 main pillars of a FATCA compliance program

Classification Internal business classification will need to be undertaken on group, entity, products, accounts and payments. New and pre-existing U.S. customers will also need to be identified and documented based on a defined set of criteria provided by the regulations.

Reporting There will be two types of reporting, formal and informal. Formal reporting means the FFI will need to report to the IRS on individual compliant U.S. accounts and collectively on non-compliant accounts by deadlines as provided in the FATCA regulations. Informal reporting means the IRS may request documentation from the FFI at any given time and the RO will be obliged to comply with the particular requirements as, and when, requested.

Withholding The FFI will be required to withhold tax at 30 percent on certain U.S.-sourced payments to non-compliant individual and financial/entity accounts. The compliance program must ensure that there are policies, procedures and processes in place that are sufficient to meet the above requirements, and which are capable of providing the necessary assurance to a RO that the FFI is meeting these throughout the certification period.

The senior management of the business

The first step for the board of directors of every financial entity is to consider whether their respective entity is an FFI or not under the FATCA regulations. If it is an FFI, consideration will need to be given to determine if the FFI is in a jurisdiction that has signed an Inter-Governmental Agreement (IGA), which could be a Model 1 or Model 2 IGA. The RO requirement may be removed or reduced under a Model 1 IGA, but nevertheless, the fundamental requirement for having a single senior member taking responsibility for FATCA compliance does not go away. As such, the board of directors will need to review and approve the policies and procedures drafted by the RO to ensure an effective and efficient FATCA compliance program, whether under a local jurisdiction IGA or directly with the IRS.

Responsible officer requirements

Assuming the FFI enters into a direct FATCA agreement with the IRS, there are two main certifications that the former will need to make to the latter:

- The first certification is required no later than 60 days after the final due diligence requirement deadline. This is the certification regarding the diligence requirements of pre-existing accounts.
- The second certification requires the ongoing review and verification from the RO and senior management that the FFI has established and maintains effective internal controls to comply with the FATCA regime.

The requirements of the RO require knowledge, support and changes across the business

Phase 1: Diligence requirements–initial commitment by the FFI

The RO must electronically certify to the IRS–with the full authority of the board of directors behind them–that the two clear requirements have been met, namely:

- The due diligence requirements in terms of existing customers was completed and performed in line with the FFI Agreement. Where required accounts could not meet the required obligations, there was the appropriate treatment of recalcitrant and Non-Participating FFIs (NPFFI); and
- A reasonable inquiry has been made to confirm that the FFI did not have any formal or informal practices in place to assist account holders to avoid FATCA.

Phase 2: Verification requirements–ongoing commitment by the FFI

The compliance program set up by an FFI that includes policies, procedures and processes adequate to meet the IRS FATCA requirements need to be confirmed by the RO collectively on behalf of the board and senior management, under the penalties of perjury, as per the legislation.

The certifications cover requirements and process changes across the business, detailed understanding of business processes and implementation is required.

The certification involves multiple aspects including confirmation that the compliance program is effective and has been reviewed, and that there are no material failures for each applicable certification period. If there are failures in the FFI FATCA regime the RO will be responsible for: declaring material failures, declaring the appropriate actions that will be responsible for remediating these failures and preventing them from reoccurring and also correcting the failures by paying the amount of tax due and amending returns as required.

If the RO is unable to make the certifications as described above, the RO must make a qualified certification and inform the IRS of the required corrective actions.

Serious non-compliance could result in legal consequences for the RO, the board, and senior management, and as such it is a matter not to be taken lightly.

Next steps

On July 1, 2014, the period covering ongoing certification begins. To be able to register, any RO will need to know that the business is taking steps towards compliance now. These would include: setting up a governance structure, implementing best practice policies and procedures and training and maintaining staff awareness.

The million-dollar question across FFIs regionally is how to meet these requirements, which impose a significant burden not only on the RO but any member of management tasked with safeguarding compliance.

The complex regulations will require changes to internal systems, control frameworks and processes and procedures. Putting strong FATCA policies and procedures in place now, with appropriate plan documentation, should provide a RO with sufficient comfort and provide an audit trail for internal reviews.

by **Ali Kazimi**, managing director, international tax services, Deloitte Middle East