THE FATCA REGULATION AND ITS IMPACT ON THE FINANCIAL INSTITUTIONS IN LEBANON

December 2012
AGENDA:

- What is FATCA?
- Definitions
- Due diligence requirements
- Expanded affiliated group provisions
- FFI Agreement
- FATCA Reporting
- FATCA Withholding
- Legal and regulatory issues
- Strategic questions
- FATCA Timeline – Updated
What is FATCA?
The “Foreign Account Tax Compliance Act” which was enacted as part of the Hiring Incentives to Restore Employment (HIRE) Act in 2010 is a U.S. law with international effects.

It is called the “Long Arm” of the US Treasury and was a reaction to the UBS and other Swiss Banks case according to which they were obliged by the US Supreme Court to report US accounts and indemnify the Treasury.

It is the US weapon against Tax Evasion and requires Foreign Financial Institutions to combat it and enforce reporting.
What is a FFI?

- A **Foreign Financial Institution** means any financial institution that is foreign entity. The term financial institution includes any entity that:

  - accepts deposits in the ordinary course of banking or similar business.
  - holds as a substantial portion of its business financial assets for the account of others.
  - is engaged primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interest in such securities, partnership interests, or commodities.
  - is an insurance company and issues a cash value insurance policy or an annuity contract.
What is a NFFE?

- A **Non Financial Foreign Entity** is a foreign entity that is not a financial institution.
- Certain NFFEs are not subject to FATCA reporting or withholding and they include:
  - **Publicly Traded NFFEs and their affiliates** (Stock of a corporation is regularly traded on one or more established securities markets for a calendar year)
  - **Active NFFEs** (<50% of gross income is from passive income or <50% of assets are assets that produce passive income)
  - **Certain Retirement funds** (It is established in a country with which the United States has an income tax treaty in force and is generally exempt from income taxation in that country – if it operates principally to administer or provide pension or retirement benefits – it receives only employer, government, or employee contributions that are limited by reference to earned income)
  - **International organizations** (one that is designated as an international organization by executive order or other facts surrounding any transaction reasonably indicating that the international organization is not receiving the payment as an intermediary on behalf of another person)
  - **Foreign Central Banks**
  - **Foreign Governments**
An Expanded Affiliated Group (EAG) consists of a common parent and its subsidiaries.

It is one or more chains of includible corporations connected through stock ownership with a common parent which is an includible corporation.

2 cumulative conditions:
- The common parent owns directly or indirectly more than 50 per cent of the total voting power or of the total value of the stock of at least one of the includible corporations AND
- More than 50 per cent of the total voting power and of the total value of the stock in each of the includible corporations is owned directly by one or more of the other includible corporations.

Partnerships and other entities: they are treated as members of an expanded affiliated group if the entity is controlled (direct or indirect ownership of more than 50 per cent of the beneficial interest) by members of such group.
A prima facie FFI means any payee if:

- The withholding agent has, as part of its electronically searchable information, a designation for the payee as an intermediary either Qualified Intermediary (QI) or Non Qualified Intermediary (NQI);

- The financial institution has an industry code indicating that the account holder is a financial institution (North American Industry Classification System codes/Standard Industrial Classification Codes)
What is a Grandfathered Obligation?

- It means any obligation outstanding on January 1, 2013. The term obligation means any legal agreement that produces or could produce a passthru payment.

- Any material modification (which is determined to a grandfathered obligation will cause it to lose its grandfathered status.)
A passthru payment is as any withholdable payment and any other payment attributable to a withholdable payment. Essentially, a payment which derives indirectly from a US source.

 Participating FFIs must calculate a passthru payment percentage in order to determine how much of income paid is a passthru payment. This percentage is calculated by reference to the amount of US assets held by the PFFI

 The final regulations are expected to include details about the passthru regime
What is a Withholdable Payment?

- Any payment of U.S. source Fixed, Determinable, Annual or Periodical (FDAP) income; and

- Any gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends that are U.S. source FDAP income
Will the US carry through FATCA?

The US is pressing ahead with implementing FATCA

- FATCA enjoys cross party support in the US. It is very unlikely that a new US President would choose not to implement it.
- Despite objections from governments, financial institutions and representative bodies, the US has been consistent in their response that FATCA is happening.
- The bilateral approach taken by the 5 EU states, Japan and Switzerland shows the determination of the US to proceed.
- The cooperation of EU countries signals that we may be looking at “FATCAs”, i.e. similar reporting regimes being introduced in other jurisdictions or blocs such as the EU.
- Some changes to the regime may be made, e.g. the timing, but no substantial dilution of FATCA is likely to take place.
International Reaction

- Significant lobbying from large global banks and industry groups
- Behind the scenes communication between governments
- Canada the most publically opposed
- US has resisted pressure to significantly change FATCA requirements
- Many countries are now looking to sign IGAs with the US to simplify FATCA for their financial institutions
DUE DILIGENCE REQUIREMENTS
Due Diligence

- Individuals
  - Pre-existing Accounts
  - Entities
- New Accounts*
  - Individuals
  - Entities

*As of January 1st 2014
Pre-existing individual accounts identification

Account Balance

≤$50K*

- Exclude from due diligence unless FFI decides otherwise

$50K* – $1M

- Review electronically searchable information for US indicia
- If US indicia found, obtain further information
- If no US indicia, no further action required

>$1M

- Enhanced review required
- Review of non-electronic information may be required.
  - If US indicia is found in electronic search do not do paper review
  - If no US indicia found in electronic search then review paper files
- Relationship manager enquiry

Aggregation of balances across EAG. If you do not have the tools to aggregate, then not held liable for aggregation.

*$250K de minimis for insurance and annuity contracts
## U.S. Indicia and Cure

<table>
<thead>
<tr>
<th>US indicium</th>
<th>Documentation additional to W-8BEN</th>
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<tbody>
<tr>
<td>US place of birth</td>
<td>• Non-US passport or government issued ID evidencing citizenship in another country</td>
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<tr>
<td></td>
<td>• Evidence of loss of US citizenship</td>
</tr>
<tr>
<td>• US resident or mailing address</td>
<td>Non-US passport or government issued ID evidencing citizenship in another country</td>
</tr>
<tr>
<td>• US telephone number</td>
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<tr>
<td>• Standing instructions to transfer funds to US account</td>
<td>Documentary evidence such as:</td>
</tr>
<tr>
<td>• Power of attorney granted to person with US address</td>
<td>• Tax residence certificate from foreign country and evidence that most recent tax return filed</td>
</tr>
<tr>
<td>• Care-of or hold mail address that is the sole address of account holder</td>
<td>• Valid identification issued by a government body which shows the person’s name and address</td>
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US citizenship and tax residency require filling form W-9
Enhanced review of paper files required only to the extent that the following is not available in the “electronically searchable information”.

| Nationality or residence address | Current residence and mailing addresses | Current telephone numbers | Whether there are standing instructions to transfer funds to another branch or institution | Whether there is current care of or hold mail address, if no other address is found for the account | Whether there’s a power of attorney or signature authority for the account |

Enhanced review not required where W8 BEN on file and there’s evidence showing non US. Still, must do relationship manager inquiry.
Pre-existing entity accounts identification

Account Balance

≤$250K
- Exclude from due diligence unless FFI decides otherwise

>$250K
- Determine the nature of the entity
  - If it is an FFI, determine whether PFFI or NPFFI
  - If it is a passive NFFE, determine substantial US owners, if any, or treat as recalcitrant

Aggregation of balances across EAG. If you do not have the tools to aggregate, then not held liable for aggregation.
Passive NFFE–required due diligence

- Excluded unless FFI decides otherwise.
- Must seek to identify substantial US owners.
- Can generally rely on information collected for AML/KYC for this.
- NFFE must certify that it has no substantial owners or provide information on such owners.
- Failure to provide info results in NFFE being recalcitrant.

**Substantial US Owner:** US person holding more than 10% directly or indirectly.

*Reporting accounts >$1m applies to calendar year 2013 & 2014
For calendar year 2015 onwards, report accounts > $250k*
Entity accounts classification process

1. Specified US Person?
   - No: Obtain documentation → No withholding or reporting
   - Yes:
     - FFI?
       - Yes: FATCA compliant?
         - Yes: Obtain documentation and verify → No withholding but reporting
         - No: Withholding
       - No: Not FATCA compliant → Withholding
     - No: NFFE
       - Yes: Active NFFE?
         - Yes: Obtain documentation → No withholding or reporting
         - No: Passive NFFE
           - Obtain info on substantial US owners
             - Info provided?
               - Yes: No withholding but reporting
               - No: Info not provided
                 - Withholding
New individual accounts

$50K Exclusion

- Option to exclude depository accounts with balance of $50k at the end of calendar year.
- Where balance exceeds $50K, account must be documented.
- Aggregation required if have tools.

Note that you can only aggregate same type of accounts

Documentation supporting US or non US status

- W8BEN/W9 or
- Tax residence certificate from non US tax authority or
- Government issued ID with name and address

Check for US Indicia

- Review all information collected for opening or maintaining the account
Certification Requirements

The Responsible Officer is required to Certify:

<table>
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<tr>
<th>Within 1 year of effective date of FFI Agreement</th>
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<tr>
<td>• PFFI has completed the review of all high-value (&gt; US1m) pre-existing accounts</td>
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<td>• PFFI did not have any formal or informal practices in place from 6 August 2011 to the date of certification to assist account holders in avoidance of FATCA requirements (e.g. instructing account holders to split accounts to avoid classification as a high-value account)</td>
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<th>Within 2 years of effective date of FFI Agreement</th>
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<tr>
<td>• PFFI has completed the identification procedures and documentation requirements for pre-existing accounts or treats relevant accounts as recalcitrant</td>
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- Certifications are given under penalties of perjury
Implications

- All members of an EAG must either be a PFFI or a registered deemed – compliant FFI or a limited FFI

- If one member is a NPFFI, no EAG group member can become FATCA compliant
Deemed Compliant FFIs

- There are 2 types of Deemed Compliant FFI:

1. A **registered deemed-compliant** FFI generally is required to register with the IRS to declare its status as deemed-compliant and to attest to the IRS that it satisfies certain procedural requirements.

2. A **certified deemed-compliant** FFI is not required to register with the IRS, but will certify to the withholding agent that it meets the requirements of its certified deemed-compliant category on a Form W8.
Types of Registered Deemed Compliant FFIs

- **Local FFIs:** FFIs that have no fixed place of business outside its country of organization and 98% of the accounts maintained by the FFI must be held by residents of the FFI’s country of organization.

- **Non-reporting members:** This member should implement policies and procedures to ensure that if it opens or maintains any US accounts or accounts held by nonparticipating FFI or US financial institution, it transfers any such accounts to an affiliate that is a participating FFI or US financial institution.

- **Qualified Investment Vehicles:** The FFI must be regulated in its country of incorporation or organization as an investment fund. Each holder of record of direct debt interests in excess of $50,000 or equity interests in FFI (of its units or global certificates) or any other account holder of a financial account with the FFI must be a participating FFI, registered deemed-compliant FFI, US person or exempt beneficial owner.

- **Restricted Funds:** An FFI that is regulated as an investment fund under the law of its country of organization and for which each distributor of the investment fund’s interests is a participating FFI, a registered deemed-compliant FFI, or a restricted distributor (sales to US persons, passive NFFEs, and nonparticipating FFIs are prohibited).
Types of Certified Deemed Compliant FFIs

- **Non-registering local bank**: The FFI must operate and be licensed solely as a bank in its country of incorporation or organization and engage primarily in the business of making loans and taking deposits from unrelated retail customers.

- **Retirement plans**: It must be organized for the provision of retirement or pension benefits under law of each country in which it is established or which it operates. Contributions must consist only of employer, government, or employee contributions and must be limited by reference to earned income. No single beneficiary may have a right to more than five percent of the FFIs assets.

- **Non-profit organizations**: It is established and maintained in its country of residence exclusively for religious, charitable, scientific, artistic, cultural, or educational purposes and is exempt from income tax in its country of residence.

- **Low-value accounts**: It solely accepts deposits in the ordinary course of a banking or similar business or, as a substantial portion of its business, holds financial assets for the account of others. No financial account maintained by the FFI has a balance or value in excess of $50,000. The FFI has no more than $50 million in assets on its balance sheet.

- **Owner–documented FFI**: It maintains no financial accounts for nonparticipating FFIs, it does not issue debt that constitutes a financial account in excess of 50K USD to any person and it provides a withholding agent with all required documentation regarding its owners to be reported to IRS if US owners exist whether or not it has a substantial US Owner (\(\geq 10\%\)).
In general

- Deemed compliant status reduces the burden of FATCA compliance on qualifying FFIs.
- Less reporting obligations and, generally, no withholding required.
- Does not mean that FFI is exempt from FATCA: significant compliance obligations exist.
- Complex and restricted conditions to qualify.
- Not likely to be of significant benefit to MENA banks.
Transitional conditions for limited branches and affiliates

- Limited branch and FFI affiliate under laws of local country cannot:
  - Report US accounts to the US or close or transfer such accounts to a participating FFI.
  - Withhold on, block or transfer recalcitrant accounts

- Requirements for limited status include:
  - Branch conduct normal FATCA due diligence procedures, retain account holder documentation on relevant accounts and report to the IRS to the extent it is able.
  - Must not open US accounts or accounts for non-participating FFIs.
  - Will identify itself as a non-participating FFI to others.

Laws in certain countries prevent FFI from becoming FATCA compliant. This will disqualify all EAG members. Transitional conditions exist.
What happens in 2016 for EAG with limited FFIs?

- Participating status of EAG could be terminated.
- Will this period be expanded?
- Questions on FFI presence in countries like Syria, Sudan, Iran, Yemen, etc.

Transitional conditions end on the 31st of December 2015
Special registration procedures must be followed for FFIs that are part of an EAG

Each EAG member must designate a Lead FFI to initiate and manage online registration process for the EAG

The final regulations will provide more details concerning the procedures for group registration

Further details on group registration procedures will follow in forthcoming regulations
How does an FFI become FATCA compliant?

It must enter into an FFI Agreement with the US IRS and agree to:

- **Identify US accounts**
  - FFI must carry out a review of all pre-existing accounts to identify US account holders
  - Additional information from account holders may be required for this purpose
  - Account opening procedures must be changed to ensure that new accounts can be classified as US or non-US

- **Report to IRS**
  - FFI must submit a report each year to the IRS
  - The report must include:
    - certain details of US account holders and their accounts
    - certain details on payments to non-FATCA compliant FFIs
    - general information on uncooperative US account holders and possible US account holders

- **Withhold US tax**
  - FFI withhold 30% tax on certain payments made to:
    - uncooperative US account holders and certain possible US account holders
    - other financial institutions that are not FATCA compliant
  - Tax withheld must be paid to the IRS
The regulations state that the FFI agreement will contain the following obligations and provisions:

- Withholding
- Account holders classification
- Annual reporting
- Default provisions (error, non compliance)
- EAG provisions
- Agreement to obtain secrecy waiver or close accounts
- Conducting verification procedures
- Replying to IRS requests
Verification procedures

I. Written policies and procedures
- Due diligence for identifying and documenting account holders
- Withholding requirements
- Periodic reviews of compliance with Policies & Procedures FATCA compliance

II. Certification
- Periodic certification by responsible officer
- May be required to provide factual information
- Periodic reviews of compliance with Policies & Procedures FATCA compliance
- May be required to disclose material failures to comply with Agreement

III. External audit
- Where IRS concerned about compliance based on reporting and certification
- Audit by external auditor
- One or more issues selected by IRS

External audit is exceptional. No periodic or random audits by IRS.
Default under FFI agreement

- FFI Agreement will specify compliances failures and other conditions which result in a default of the agreement.

- Compliance failure will not be a default unless such failure occurs in more than limited circumstances when a PFFI has not substantially complied with its obligations under FFI agreement.
Implications of not becoming FATCA compliant

- **30% withholding tax**
- **From 1 January 2014**: US FDAP income
- **From 1 January 2017**: Gross proceeds of disposal of assets producing US interest and dividends
- **From 1 January 2017**: Passthru payments
Introduction

- Annual information report due by 31 March
  - Automatic 90 day extension on filing of requisite form
  - Additional 90 day extension may be available in hardship cases
- Report in prescribed format and by e-filing
- Each branch of an FFI may elect to file separately
- Reporting either in USD or specified local currency (currency translation at spot rate on 31st of December)

Reporting due date is the 31st of March with an automatic 90-day extension upon written request
What must be reported?

Individual Accounts
- Name, address and TIN of each US account holder.
- Account Number.
- Account balance or value.
- Payments made to account during calendar year.
- Other information as required.

US Owned Entity Accounts
- Name, address and TIN of entity and of each US substantial owner.
- Account number.
- Account balance or value.
- Payments made to account during calendar year.

Recalcitrant
- Total number and value of:
  - Active recalcitrant accounts with US indicia.
  - Active recalcitrant accounts with no US indicia.
  - Dormant recalcitrant accounts.
Withholding

- Required on certain withholdable payments made to recalcitrant account holders and non-participating FFIs
- FFI can minimize withholding burden and impact by closing accounts held by recalcitrant account holders and non-participating FFIs (within 90 days after the date on which the FFI first has knowledge or reason to know of the change in the account holder’s chapter 4 status)
- No information on when withheld tax is due to be paid to the IRS and on manner of payment
Withholdable payments and withholding rate

- Withholdable payments are:
  - US source Fixed, Determinable, Annual or Periodical (FDAP) income (dividends, interests, wages, salaries, premiums, etc.)
  - Gross proceeds from the sale or other disposition of a property within the US.

- Withholding also required on passthru payments (still very debated and unsettled).

- Withholding rate is at 30%.
How it goes:

U.S. Withholdable Payment
U.S. source income + gross proceeds

30% U.S. WHT

UNLESS

Foreign Financial Institution (FFI) enters into an agreement with the IRS to identify its U.S. investors

Non Financial Foreign Entities (NFFE) provides information on substantial U.S. owners (if any)
Withholding scenarios

Scenario 1
FFI has not entered into FATCA Agreement with the IRS

- U.S. Withholding Agent
  - $100
  - $30
  - IRS
  - $70
  - FFI
  - $35
  - US Recalcitrant
  - US Compliant

Result:
- 30% withholding tax imposed on FFI
- Compliance account holder suffers

Scenario 2
FFI compliance with its FATCA Agreement but has Recalcitrant; elects to withhold

- U.S. Withholding Agent
  - $100
  - IRS
  - $100
  - FFI
  - $35
  - US Recalcitrant
  - $50
  - US Compliant

Result:
- No withholding tax imposed on FFI
- FFI applies 30% withholding to $50 payment to Recalcitrant account holder
- Compliant account holder is not harmed

Scenario 3
FFI complies with its FATCA Agreement but has Recalcitrant; elects not to withhold

- U.S. Withholding Agent
  - $100
  - IRS
  - $85
  - FFI
  - $35
  - US Recalcitrant
  - $50
  - US Compliant

Result:
- USWA applies 30% withholding to payment amount allocable to Recalcitrant account holder
- Compliant account holder is not harmed
LEGAL AND REGULATORY ISSUES
Overview

Legal and regulatory issues are:

- Conflict with secrecy law
- Authorized signatory’s power to waive secrecy is debatable
- FATCA may conflict with terms and conditions for pre-existing accounts (should new terms & conditions for account opening/deal contracts be signed?)
- Can an FFI legally withhold foreign taxes
- The obligations of FFIs that are members of the same group can be very different from one another

Will laws and regulations be changed, and if so, will it happen on time?
Intergovernmental agreements

- FFI provides information to its country’s tax authority
- Tax authority passes on this information to the IRS
- Financial institutions within the concerned country are deemed compliant
- Approach taken by 5 EU countries (UK, France, Italy, Germany and Spain) and being considered by others (Switzerland, Japan, Luxembourg, etc.)
STRATEGIC QUESTIONS
Questions to tackle:

- Should we cease offering banking facilities to non-residents? Is such an option legal and feasible?
- Should we terminate accounts held by recalcitrant account holders and non-participating FFIs?
- Should we sell US assets to defer FATCA withholding on payments received until 2017 (date on which withholding on foreign passthru payments is effective)?
- Will any of our overseas branches/affiliates qualify for deemed compliant status?
FATCA TIMELINE
FATCA Timeline – Foreign Financial Institution

A. 8 February 2012
IRS published draft FATCA regulations

B. July 2012
Draft of Model I IGA released

C. August 2012
Drafts IRS forms released

D. 1 January 2013
Grandfather rule: Payments made on certain non-equity obligations (with a defined term) outstanding as of January 1, 2013 are exempt from FATCA withholding

E. Q1 2013
Final FATCA regulations to be released

F. 31 December 2013
Deadline to enter into FFI Agreement with IRS (thereafter be considered NPFFI)

G. 1 January 2014
FFI agreement becomes effective

H. 30 June 2014*
Deadline for FFIs to complete remediation on all prima facie FFIs

I. 31 December 2014
Deadline for FFIs to complete remediation on all high-value accounts

J. 31 March 2015
IRS reporting on ‘US’ accounts and aggregate reporting on recalcitrant accounts for 2013 and 2014

K. 31 December 2015*
Deadline for FFIs to complete due diligence reviews for all remaining accounts

L. 31 March 2016
Annual IRS reporting on ‘US’ accounts and aggregate reporting on recalcitrant accounts

M. 1 January 2017
Withholding begins on non-compliant accounts for gross proceeds payments

N. 31 March 2017
Annual IRS reporting on accounts held by NPFFIs

O. 31 March 2017
Last year of IRS reporting on accounts held by NPFFIs

*Beginning in 2015, FFIs were required to implement rules such as the enhanced due diligence and reporting requirements under FATCA.

Note: The timeline includes important dates and events related to the implementation and enforcement of FATCA, emphasizing the phases of compliance and reporting requirements for foreign financial institutions.
THANK YOU

Malek E. Costa – 2012