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An Update on Foreign Account Tax Compliance Act (FATCA)

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Foreign Account Tax Compliance Act (FATCA), though being a US regulation, has global implications as it effectively covers all US persons. State Bank of Pakistan (SBP), Pakistan Banks Association (PBA), Securities & Exchange Commission of Pakistan (SECP), individual commercial banks, non-bank financial institutions and other stakeholders in their respective capacities are undertaking steps to meet FATCA compliance requirements.

SBP vide a recent BPRD Circular Letter No. 16 dated April 30, 2014, has advised that in view of the unforeseen delay in the Intergovernmental Agreement (IGA) between Pakistan and US governments, banks/ DFIs/ Microfinance banks may, as a precautionary measure, complete the registration process with the Internal Revenue Service (IRS) of the US, latest by May 5, 2014 as a Participating Foreign Financial Institution (PFFI). SBP has also advised that any potential change in status of Pakistani financial institutions as a result of IGA finalisation, will be communicated once materialised.

This is a major development and warrants immediate action on the part of financial institutions regulated by SBP, to complete the registration process within a very stringent timeline. The purpose of this paper is to update the stakeholders on related key FATCA aspects and implications in case of registration with the IRS in the absence of an IGA and the possible scenario of IGA envisaged in the future, and to provide practical guidance on various important areas to be addressed in the FATCA programmes.

Registration and key related requirements in case of registration with the IRS in the absence of an IGA

- May 5, 2014 is the last date for finalising registration by banks/ DFIs/ MFBs as per SBP Circular. Globally, it is the last date if any bank or other institution is desirous of having their names in the first list.
- The second list will be published on <u>July 1, 2014</u> and for this the last date for finalising registration is <u>June 30, 2014</u>.
- If registrations are finalised after the above-mentioned dates, the banks or other institutions may still be included in the June 2 and July 1 lists, however, no assurance from the IRS.
- Thereafter the list will be updated monthly.
- In the case of registration with the IRS in the absence of an IGA, the compliance needs to be ensured on an Expanded Affiliate Group (EAG) level subject to limited Branch and Limited FFI options and associated requirements for branches and subsidiaries in non-IGA territories which are not legally allowed to comply at that stage.
- EAG will be determined at the ultimate parent level on a global basis. This would mean that the EAG structure of the bank or other institution will need to be evaluated at a global level.

- To avoid the consequence of being non-compliant i.e. withholding of US tax effective July 1, 2014, registration of all entities within EAG will have to be finalised by June 3, 2014. There are various options and scenarios for registrations available under the law. In case of any delay there will be impact of withholding till the time registration is finalised.
- In addition to identification and reporting of US persons and financial institutions in accordance with FATCA timelines and performing related client-on boarding and due diligence procedures as per FATCA timelines, all entities in the EAG shall be required to withhold FATCA tax on US source income in terms of their dealing with non-participating FFIs (NPFFIs) or in relation to recalcitrant accounts. This is challenging and will involve required core banking and reporting/ withholding system readiness.
- In the case of registration with the IRS in the absence of an IGA, the banks and other institutions will have to submit first report to IRS as early as March 2015.

Registration and key related requirements in IGA 1 scenario

- In case IGA is in substance agreed/ signed by July 1, FFIs can readily register as Registered Deemed Compliant FFIs and get their GIINs included in the FFI list (as early as possible) but latest by December 31, 2014. Where the registrations by banks, DFIs and MFBs are finalised by May 5, 2014 as per SBP Circular, they may have to subsequently change their registration status, on signing of IGA or in substance IGA agreement, in accordance with SBP directives.
- In substance agreement will actually imply an in-principle agreement between the two governments on the basis of Model 1 IGA and will be in furtherance to the mere intention of entering into an IGA.
- Registered FFIs under Model 1 (FFIs that appear on IRS List) will not be subject to FATCA tax withholding nor will be required to withhold FATCA tax on US source income in terms of their dealing with NPFFIs or in relation to recalcitrant accounts. Rather only reporting of such payments/ obligations will be required.
- In case Pakistan's IGA with US is agreed in substance by June 30, 2014, six months till December 2014 will be available for getting IGA signed and creating the required enabling legal and regulatory environment.
- In case IGA is not agreed in substance by June 30, 2014, withholding of above-mentioned FATA tax will start effective July 1, 2014, in terms of dealing with NPFFIs or in relation to recalcitrant accounts. Similarly, in the eventuality of any Pakistani institution becoming/ remaining NPFFI by June 30, 2014 and hence not holding valid GIIN, it will become subject to FATCA withholding tax effective July 1, 2014.

Based on our current understanding, IGA 2 scenario is not contemplated in Pakistan at this stage and hence details of this scenario have not been provided in this paper.

Future course of action

- In both the above-mentioned scenarios, Pakistani banks or other institutions will need to remain internally prepared for all aspects of FATCA on an expeditious basis.

- The FATCA programme needs to address all related aspects of the operating model including FATCA governance, business processes, data and MIS framework, source and analytical systems etc. for both new and pre-existing accounts and institution of a FATCA reporting regime on an entity-wide basis. These core aspects of FATCA compliance need to be given due attention besides addressing administrative aspects of registrations.

- Many financial institutions have implemented or do have in place structured process improvement and KYC/ AML initiatives. There is a need to ensure linkages between FATCA and all these inter-related efforts to ensure synergies at one end and that FATCA becomes an integral part of the institution's internal operating model for management on an on-going basis.

- In competitive times of today, having a FATCA model that facilitates compliance with minimum possible impact on customer service levels, is key.

Global status of IGA negotiation as of April 21, 2014:

Countries which have signed Model 1 IGA:

- Canada
- Cayman Islands
- Costa Rica
- Denmark
- Finland
- France
- Germany
- Guernsey
- Hungary
- Honduras
- Ireland
- Isle of Man
- Italy
- Jersey
- Luxemburg
- Malta
- Mauritius
- Mexico
- Netherlands
- Norway
- Spain
- United Kingdom

Countries which have agreed in substance to Model 1 IGA:

- Australia
- Bahamas
- Belgium
- Brazil
- British Virgin Island
- Croatia
- Czech Republic
- Estonia
- Gibraltar
- India
- Jamaica
- Kosovo
- Latvia
- Liechtenstein
- Lithuania
- New Zealand
- Poland
- Portugal
- Qatar
- Slovak Republic
- Slovenia
- South Africa
- South Korea
- Romania

Countries which have signed Model 2 IGA:

- Bermuda
- Chile
- Japan
- Switzerland

Countries which have agreed in substance to Model 2 IGA:

- Austria

This update should not be considered as professional opinion/ advice on any matter as this note summarises the key matters and requirements of FATCA for the guidance of the stakeholders in general. This update can also be accessed on our web-site www.pwc.com/pk.

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