



Dr. AbdelGadir Warsama Ghalib
Senior Legal Advisor & Head of
Legal Dept, Bank of Bahrain &
Kuwait – BBK Professor of Law,
American University, Bahrain

The Foreign Account Tax Compliance Act (FATCA) Bahrain case study

The Foreign Account Tax Compliance Act (FATCA) is an American law issued lately with the main purpose of preventing tax evasion by American citizens or companies, due to the fact that the tax evasion has become very noticeable therein and gravely affects the national economy. This new law, the FATCA, provides that all foreign financial institutions (FFI) are required to identify their American customers and to report their financial activities to the Internal Revenue Service (IRS). Non-compliance, will automatically lead to the enforcement of withholding tax penalties on the foreign financial institutions (FFI) and also the relevant customers who are not complying. So, banks as they are part of the (FFI) could face penalties and be subject to certain fines according to FATCA.

The (FFI), for clarity, covers all financial institutions including banks outside America. For the purposes of giving the necessary report, the (FFI) are required to register with the Internal Revenue Service (IRS) as Foreign Financial Institutions (FFI) under FATCA. The final registration of (FFI), for FATCA purposes has been extended many times, however, it has been finally extended up to 5 May 2014.

The Foreign Financial Institutions (FFI), may choose to participate or not participate in FATCA taking in consideration the consequences of their choice. The (FFI) that choose to report and participate, are to be classified as the participating financial institutions (PFFI), on the other hand, the others who choose not to report and participate are classified as non-participating financial institution (NPFFI). However, for the (FFI) who choose to report and participate, there are two option models as initiated by the American authorities. The Inter-governmental Agreement (IGA) model (1) and The Inter-governmental Agreement (IGA) model (2).

Regarding the Inter-governmental Agreement (IGA) model (1), with particular reference to reporting, the (FFI) that are deemed compliant are not subject to the withholding tax requirement and are classified as the participating financial institutions (PFFI) and they are supposed to report to their Central Bank, or such other designated authority, all necessary information about their American customers and their financial details. Regarding the Inter-governmental Agreement (IGA) model (2), all the financial institutions (FFI) that fall within the jurisdiction are also considered as deemed compliant with FATCA, however, they are required to register and to report all information about their American customers to the (IRS) in America directly. Also, at the same time, they have to report to the local authorized agencies.

Of the two models, it is very clear that, the foreign financial institutions (FFI) may either report the information related to their American customers through their governments i.e. Central Banks \ other designated authority, or not through any of their government agencies but directly to the (IRS). The difference between the two models is very clear, as each one goes in a different direction. Even though most countries opted for (IGA) Model (1), however, I believe we need more time to assess which of the two models is the most appropriate direction.

In Bahrain, the Central Bank of Bahrain (CBB), issued certain instructions to all licensees in Bahrain to comply with FATCA rules and, moreover, to register as (FFI) under FATCA before the 5th of May 2014 and to send their Global Intermediary Identification Number (GIIN) to the Central Bank of Bahrain (CBB). It is very clear that, Bahrain has opted to apply the Inter-governmental Agreement (IGA) Model (1), wherein the (PFFI) are required to

give the required information about their American customers to the Central bank of Bahrain (CBB), which will in turn submit to the (IRA) on behalf of the (PFFI) in Bahrain.

This is very crucial step for the (PFFI) in Bahrain and shows that there will be no direct link whatsoever between the (PFFI) in Bahrain and the Internal Revenue Service (IRS) in America. We believe that, this may give some protection to the Participating Financial Institutions in Bahrain due to the fact that they will not be subjected to any direct penalties, or face-to-face interaction with the American Authorities (IRA). As initiated by (CBB) and based on (IGA) Model (1), in case there is any lack of information, or if there is any need for any extra information about any American customer, this will be handled and processed through the Central Bank of Bahrain (CBB) and not the (PFFI), if any need arises ?

In adherence and implementation of the directives issued by the Central Bank of Bahrain (CBB) to all banks \ licensees in Bahrain, we have noticed that almost all banks in Bahrain prepared or started in preparing themselves for FATCA implementation. To achieve this, banks in Bahrain, issued certain instructions and policies to be followed for applying FATCA provisions on all American customers.

Based on such new policies and guidelines in Bahrain, all American customers are obliged to give their written consent to their banks allowing them to pass the required information about their accounts to the Internal Revenue Service (IRS) as provided for in FATCA rules. Based on the customers' written consent the banks are legally authorized (by customers) to give and disclose the banking information, so there will be no breach of the banking confidentiality rules. The express written consent by the customer, inter alia, breaks the confidentiality principle and gives relief to banks when disclosing any information classified as confidential.

Moreover, the customer must clearly undertake to keep the bank fully aware of any details or developments that could happen in the account or in his status at any time. If, for any reason, a customer fails or refuses to give such information or any existing or new details the bank may close the account or take any other necessary action they deem appropriate to protect themselves. Some existing or new accounts are to be classified and reported as "Recalcitrant accounts", wherein the customer fails or refuses to give enough

information. There are special procedures to be followed in case of "Recalcitrant accounts" that require special approval from the CEO of the bank to open a new account or to close or keep the existing account based on certain business justifications to be given to the CEO by the concerned personnel & depts.

We have to bear in mind that not all customers \ accounts are the same, accordingly the banks must be ready for different instances, as some customers \ accounts may not be cooperative nor interested to give any support in this connection. Each of such instances must be properly assessed before taking any action or decision. The action, we believe, must depend on the merits of each case. This situation, in fact, makes good continuous homework for banks.

Another point regarding customers arises, wherein it is not clear if the customer is having a US status. This could happen, because sometimes there is lack or no sufficient adequate information to decide the US status of the customer. This issue is vital because FATCA applies only to US persons.

The indications that a person could be regarded as a US person is called as US Indicia. While assessing, the presence of any of the US Indicia in the profile such process would require further scrutiny to decide his US status. The mere presence of US Indicia does not mean that the person is US person. This means that the "Indicia" are to be analyzed, confirmed and thereafter proper classification should be done and confirmed.

With reference to individuals or corporations, for example, the US Indicia could arise in case the individual or corporation was born or incorporated in USA, is having a US address for communication or of residence, is having a US telephone number, is having a standing instruction to transfer money to an account with a US address, is having a power of attorney or signature authority in favor of a person with US address, is having "in care of" or "hold mail" address as the only address of the customer in the profile... etc. If any of such "Indicia" indications is available, the matter must be carefully assessed so as to determine the US status of the individual or the corporation. This is a lengthy procedure and, also, makes real hectic homework for the banks and it needs time, trained staff, more equipment, budget ... etc.

All such information, is required to reach the US status of the customer. If the US status has been

validly confirmed, the (PFFI) must give the necessary information about each US citizen in their report as required by FATCA rules. As mentioned above, in Bahrain, the report shall be prepared by banks and be given to the (CBB), which in turn will pass over to the (IRS) based on the (IGA) model (1).

It is very important to mention that in addition to reporting, there is a withholding requirement as clearly provided for in FATCA rules. Based on such rules, the income \ payments that qualify for withholding are US Sources Fixed or Determinable Annual or Periodic (FDAP) beginning from 1st of July 2014. Later on from 1st January 2017 it includes gross proceeds from the sale of US securities and interest bearing assets. The amount of withholding is 30% of the qualifying payment of the gross amount.

The withheld amount will be remitted to (IRS) and reported as in the prescribed form(s). A certificate of withholding should be issued to the customer containing the relevant details. The withholding requirements must be monitored by special dept. (mostly operations dept.) in each bank and the day to day supervision under the guidance of the appointed FATCA Officer. The accounts that are eligible for withholding will be separately reviewed for blocking the transactions, if required. The process of withholding and reporting to (CBB) or (IRS) are to be handled by the appointed FATCA Officer, moreover, there must be certain mechanism in the bank to counter-check all payments which are withheld and accounts or transactions which are to be blocked.

However, it is important to mention that, there are some issues particularly related to “Recalcitrant” customers and “Non-Participating FFIs” are to be further investigated before withholding any amount. This is due to the fact that the monitoring of such accounts could face some difficulties, with reference to determining if payments are US sourced and are withhold able. All this, among other things, will be subject to the details included in the (IGA) to be signed between Bahrain and (IRS). Banks, in this connection, are to be guided by the Central Bank of Bahrain (CBB).

Irrespective of some difficulties associated with FATCA application in certain places, the matter now is almost in clear shape. The US authority is determined to pursue the issue vigorously and is very keen to get the best results. They have put the necessary pressure on all countries for the sake of obtaining their support. Without global support the FATCA rules will be of no value.

In Bahrain, implementation of FATCA rules has been already on the move as directed by the (CBB). The clear stand of the (CBB) indicates that Bahrain is determined to be part of the global cooperation needed for the successful outcome anticipated from the application of FATCA rules. Almost, as we see, there is a support from all parts of the globe and hopefully the implementation will pass easily to achieve better end results. Certainly, no doubt, there is a need for some time to clean and update all the records \ accounts and to give the necessary reports, however, the start in confidence is needed to reach the goal.

Needless to say that everywhere, in principle, the tax evasion is not accepted at all, moreover, it is an illegal and immoral act. Based on this understanding, the aggressive stand of US authorities against tax evaders must be strongly supported by everybody and should be taken as a good model for application in all places. There is a need for a firm stand against such unethical bad attitudes.