European Banking Federation

Institute of International Bankers

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April 30, 2012

Re: Comments on Proposed Regulations Under FATCA

Dear Ms. Corwin and Messrs. Danilack and Musher:

The European Banking Federation (the "EBF") and the Institute of International Bankers (the "IIB") appreciate the opportunity to provide comments on the proposed regulations, issued on February 8, 2012, relating to the implementation of Chapter 4 of Subtitle A of the Internal Revenue Code (the "Code"), as enacted by the Foreign Account Tax Compliance Act ("FATCA") provisions of the Hiring Incentives to Restore Employment Act of 2010 (the "Act").

We commend the Treasury and IRS for issuing a thoughtful and detailed set of proposed regulations, and for addressing many of the concerns that we and other interested parties have expressed regarding the implementation of FATCA. We also applaud the Treasury's intention to enter into intergovernmental agreements with other countries to address conflicts between FATCA's requirements and the laws of those countries and to simplify the implementation of FATCA more generally.

Nonetheless, we continue to have serious concerns regarding several significant aspects of the proposed regulations. If left unaddressed, these problems threaten the ability of many foreign financial institutions ("FFIs") to become and remain participating FFIs despite their best intentions to do so. While some of these problems are more of a technical nature, others may require substantial reconsideration and revision to meet the government's laudable goal of reducing unnecessary and excessive costs and burdens on the financial industry while fulfilling the policy objectives of FATCA. Specifically, we remain concerned that the proposed regulations do not fully address the operational and systemic challenges presented by many of the proposed rules or the available alternatives that would be far less burdensome, and we offer many of our detailed comments in the spirit of contributing to a greater awareness of these challenges.

The Appendix contains extensive detailed comments and recommendations. As requested in the Preamble, our comments are in the same order as the proposed regulations and our recommendations are set off and numbered sequentially. We have also referenced our prior comment letters[1] where appropriate.

We focus in this letter on the overriding concerns that emerge from the detailed comments and recommendations in the Appendix.

## 1. Certain Rules Remain Unnecessarily Burdensome and Potentially Unworkable in Significant Respects

Our paramount concern is that notwithstanding the efforts by the Treasury and IRS to achieve (as stated in the Preamble) "an appropriate balance between fulfilling the important policy objectives of chapter 4 and minimizing the burdens imposed on stakeholders," in several key areas the proposed regulations fall short of that objective in ways that are potentially crippling but ultimately curable through reasonable changes. Important aspects that we believe need to and can be better addressed include:

- ***Coordination with AML/KYC Practices and Due Diligence for New Entity Accounts.*** While the proposed regulations seek to better coordinate FATCA with existing AML/KYC practices, it is critical that a higher level of coordination be achieved to eliminate unnecessary burdens and costs. For example, the requirement that virtually all new account documentation be renewed periodically will impose enormous costs on FFIs. Similarly, it is impractical to require FFIs to obtain U.S. tax-centric documentation from nearly all new entity accounts.

- ***The Treatment of Non-Commercial Investment Entities Subjects PFFIs to Unacceptable Operational Risks and Costs Disproportionate to Any U.S. Compliance Benefit.*** We have previously urged the Treasury and IRS to develop a set of rules for non-commercial investment entities (such as family trusts or investment companies) that are based upon the § 1472 regime that applies to passive NFFEs (nonfinancial foreign entities) instead of subjecting these entities to the extremely burdensome alternatives of either full FFI compliance or the owner-documented FFI rules. We believe that the Treasury and IRS must fashion a workable rule that recognizes that the vast majority of non-commercial investment entities serviced by participating FFIs ("PFFIs") have no U.S. owners or nexus. We offer an alternative approach based upon the FATCA statute that sharply reduces the costs and risk to PFFIs while achieving FATCA's compliance objective.

[1] See the joint EBF/IIB Letters of April 23, 2010 (the "April 2010 Submission"), November 12, 2010 (the "November 2010 Submission") and June 13, 2011 (the "June 13, 2011 Submission"). We have also addressed separately several other discrete issues in other letters.

- ***Relief for Low-Risk Entities and Accounts Can Be Expanded without Compromising FATCA's Objectives.*** We welcome the addition of new categories of entities that are treated as deemed-compliant FFIs ("DCFFIs"). However, many of the DCFFI categories contain conditions that will make them unavailable for large numbers of entities that ought to be covered, and other categories of low-risk entities and accounts are still subject to full FFI compliance burdens. Also, the exceptions for holding companies and for NFFE affiliates should be expanded to avoid subjecting financial group holding companies as well as NFFE group holding companies and investment subsidiaries to burdensome and in some cases unadministrable requirements.

- ***Guidance Program Regarding the Application of FATCA to Specific Entities and Accounts.*** The proposed regulations are complex, and the application of critical definitions (such as what is a Category (iii) FFI (investment entity)) to specific situations or the implementation of certain requirements will necessarily be uncertain. It will not be possible for the IRS to anticipate and address every such ambiguity in drafting the final regulations. We believe that it will be important to the successful implementation of FATCA for there to be a mechanism by which interested parties can obtain answers to their questions, and for any general guidance emerging from these questions to be disseminated on a real-time basis (perhaps through Q&A postings on the IRS website, as has been done with respect to Schedule UTP).

## 2. The Proposed Effective Dates for New Account Documentation Procedures Leave Insufficient Time for Implementation

The 2013 effective date for new account documentation is a serious problem that requires immediate attention by Treasury and the IRS. We recognize and appreciate that the Treasury and IRS have made efforts to respond to comments made by EBF/IIB and many others in the financial industry to phase in key FATCA effective dates, such as for distinguishing preexisting accounts from new accounts, withholding on different categories of payments, and reporting. However, as we stated in our prior comments, financial institutions need from 18-24 months from the issuance of final regulations to either upgrade existing IT systems or build new ones, and to put in place other procedures and operating systems, in order to comply with FATCA. It will be difficult, if not impossible, for financial institutions to meet the first effective dates to have new account opening procedures and the related systems in place by January 1, 2013, for USFIs and by July 1, 2013, for FFIs. At a minimum, and assuming the final regulations, model FFI agreements, new certification forms and all related instructions are finalized by September 30, 2012 (and that intergovernmental agreements are uniform with one another and consistent with the regulations), we believe that the effective dates for new account due diligence and documentation to be in place must be extended to January 1, 2014. The effective dates for reporting and withholding similarly should be adjusted for a sensibly sequenced implementation schedule. There should also be a grace period before there is enforcement action against FIs that have been acting in good faith to implement the new rules. We provide further details regarding the effective dates in the Appendix.

### 3. The Limited Transitional Relief for Entities that Cannot Fully Comply with FATCA Due to Foreign Legal Constraints is Inadequate

Another serious problem is the overly limited transitional relief for FFI operations in jurisdictions in which FATCA conflicts with local law requirements. We appreciate the inclusion in the proposed regulations of rules dealing with "limited" branches and affiliates, as well as the joint statement regarding the intergovernmental approach. However, when this limited transitional relief terminates at the end of 2015, FFIs (including large multinational banking groups) that have expended huge amounts of money and effort to comply in good faith with FATCA will become nonparticipating FFIs (and thus subject to FATCA withholding) even if only one or several branches or affiliates continue to be unable to comply due to foreign legal constraints. We believe that Treasury and the IRS should craft a more reasonable and workable solution, up front, so that FFIs can appropriately assess the consequences of entering into FFI agreements. We address this issue further in our detailed comments.

### 4. The "FATCA Partners" Arrangements Should Be as Uniform with One Another and Consistent with the Regulations as Possible

As noted above, we applaud the Treasury's intention to enter into intergovernmental agreements with other countries to address conflicts between FATCA's requirements and the laws of those countries and to simplify the implementation of FATCA more generally, pursuant to arrangements with countries that become "FATCA Partners" with the United States (as defined in the "Joint Statement From the United States, France, Germany, Italy, Spain and the United Kingdom Regarding an Intergovernmental Approach to Improving International Tax Compliance and Implementing FATCA," February 8, 2012). The EBF is preparing a separate letter containing detailed comments regarding FATCA Partners arrangements. At this juncture we wish to emphasize that the arrangements that are entered into between the United States and particular countries should, to the maximum extent possible, be uniform with one another and consistent with the regulations, so that FFIs and their affiliates are not required to apply different rules and systems to implement FATCA in the various countries in which they operate. Moreover, a PFFI should be permitted to continue to comply with FATCA pursuant to the terms of its FFI agreement (which may facilitate worldwide uniformity in its compliance systems) rather than be required to assume the different obligations under FATCA Partners arrangements.

### 5. Foreign Passthru Payments

We support the decision by Treasury and the IRS to generally rethink the approach to foreign passthru payment withholding contained in Notice 2011-34 and particularly to find potential alternative approaches that would apply to FATCA Partners agreements. However, we are concerned that FFIs will be unable to enter into an FFI Agreement with this concept reserved in the proposed regulations since FFIs will have no idea of how much risk they may be taking on by agreeing to this type of withholding without knowing the details. We accordingly ask that this potential problem be taken into account in the FFI agreement itself to avoid problems of FFIs refusing to become PFFIs as we discuss in the Appendix.

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The EBF and IIB appreciate the opportunity to submit these comments and recommendations to Treasury and the IRS. Please do not hesitate to contact us if we can provide further assistance.

Sincerely,

EUROPEAN BANKING FEDERATION

By ______________________________

Guido Ravoet
Secretary General

INSTITUTE OF INTERNATIONAL BANKERS

By ______________________________

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**APPENDIX**

# DETAILED COMMENTS BY EBF / IIB ON THE FATCA PROPOSED REGULATIONS

## I. COMMENTS REQUESTED IN THE PREAMBLE

### A. Responses to Specific Requests

**1. Foreign Passthru Payments.** Please see the extensive comments and suggestions made in the EBF/IIB submission dated June 13, 2011.

In addition, we note that the proposed regulations "reserve" on the rules regarding foreign passthru payments, and we were pleased to see that the effective date for withholding on such payments has been substantially delayed, apparently to allow Treasury and the IRS to work with countries that become "FATCA Partners" with the United States (as defined in the "Joint Statement From the United States, France, Germany, Italy, Spain and the United Kingdom Regarding an Intergovernmental Approach to Improving International Tax Compliance and Implementing FATCA," February 8, 2012) and the financial community to develop workable rules or other alternatives to such withholding. That being said, we are concerned that FFIs in many jurisdictions may find it difficult or impossible to sign an FFI agreement that references an unknown concept that conceivably could expose the FFI to both legal and reputational risk if the FFI is unable to comply.

Recommendation No.1: We strongly recommend that the FFI agreement explicitly recognize this serious problem by specifying that by entering into an FFI agreement, a PFFI is not making any commitment with regard to foreign passthru payment withholding unless and until it agrees to comply with those rules after having an opportunity to review them.

**2. Periodic Reviews and Certifications Under FFI Agreement.** Please see Section VIII.A below.

**3. Alternative First Year Certification Under FFI Agreement.** Please see Section VIII.A below.

**4. Transitional Reporting of "Other Financial Payments."** Please see Section XXI.C below.

**5. Procedural Safeguards for Refunds**. We are very concerned that it will take a considerable amount of time for FFIs and other withholding agents to properly document all accounts and other counterparties, and therefore, at least initially, there will be significant amounts of tax withheld under FATCA in respect of payments to persons that are treated as NPFFIs or recalcitrant account holders but for which proper documentation is eventually obtained. It is critical that an effective and efficient refund mechanism be in place to ensure that refunds are made on a timely basis to avoid potentially significant market disruptions. To be effective, this mechanism will need to address situations involving tiers of FFIs and other entities so that ultimate beneficial owners are not prejudiced as a result of payments passing through a NPFFI or other intermediary entity that is not fully compliant with FATCA. We recognize that any refund mechanism must also contain procedural safeguards to ensure that money is not paid out improperly to persons that are not entitled to receive the refunds. Because of the numerous administrative, procedural and conceptual considerations that are involved, we believe that Treasury and the IRS are in the best position to design a framework and outline the details of such a refund mechanism, and we are prepared to comment once such a framework and outline are proposed.

**6. Standards for QI, WP and WT Verification and Determining Material Failures in Compliance.** For the reasons discussed in Section VIII.A below, we strongly endorse replacing the external audit verification procedures under QI, WP and WT agreements with the internal verification and certification mechanism under FFI agreements.

**7. Additional Categories of Deemed-Compliant FFIs ("DCFFIs").** Please see Section XVI below.

**8. Grandfathering of Certain Equity Interests in Securitization Vehicles.** We strongly support the comments that have been made by others to the effect that grandfathering relief needs to be provided to outstanding securitization vehicles, which are not in a position to obtain information regarding the holders of their equity and debt interests.

## B. Additional Comments

In response to the Preamble's request for any additional comments, we respectfully submit the following.

### 1. The FFI Agreement Should Allow Flexibility, Including Regarding Organizing Compliance and Reporting Along Business and Geographic Lines.

The Preamble requests comments on issues not addressed in the proposed regulations, particularly on how FATCA compliance might work at the expanded affiliated group level. We appreciate this request and note that many large multinational groups of financial institutions ("FIs") are struggling with exactly this issue in their FATCA implementation projects as they try to ensure that they are developing a workable structure to perform FATCA withholding, reporting and verification. We believe an expansion and modification of the "Centralized Compliance Option for FFI Groups" suggested in Notice 2011-34 should be considered as described below.

By way of background, the basic problem facing many large multinational FI groups is that most of their business lines typically will fall into one of the three FI functional activities described in § 1471(d)(5)(A)-(C). However, these business lines may not be contained in a discrete or exclusive legal entity (that is, there may be many different business lines transacting in whole or part through the same legal entity and a business line may have its operations split between any number of legal entities). By contrast, the FATCA proposed regulations – and the statute – are drafted under the assumption that a specific legal entity is engaged in one of the §1471(d)(5)(A)-(C) activities and therefore such legal entity should receive an FFI EIN, do any FATCA withholding, file the appropriate FATCA reporting, and ensure that a "responsible officer" of the entity verify compliance. The operational reality is quite different.

For example, assume that a multinational FI group has a large number of different business lines and that those business lines are divided into four geographic areas (it is common for such areas to include North America, Latin America, Europe/Middle East/Africa (EMEA), Asia/Pacific). One of the business lines is global custody. In each geographic area, any number of legal entities may be associated with the global custody business line – one may house the customer master account platform, a different one may be responsible for personnel, another one maintains the withholding system, etc. Those legal entities may also be used by other business lines for their own transactional purposes (that is, they are not exclusively "global custody" legal entities). The result is a complex and often bewildering attempt to artificially "map" legal entities to FFI categories and figure out a way for the primary FFI business line to "own" the legal entity for FATCA compliance. The challenge becomes even more pronounced as one contemplates the overall structure of a multinational group, which can face internal reorganizations as well as purchases and sales of businesses affecting these entities and the need to properly map them – although the business line itself and its FI functions remain largely static.

We believe that a better approach would be to allow multinational FI groups to identify groups of separate *business line FFIs* under the definitions in §1471(d)(5)(A)-(C). Each business line FFI would then designate a legal entity to serve as its "compliance FFI." That compliance FFI would be responsible for ensuring that the business line: (1) has systems and procedures compliant with FATCA; (2) performs any necessary FATCA withholding and reporting; (3) alerts payors that a part of the business line operation is in a "limited" jurisdiction requiring withholding on payments made to that part of the business line; and (4) designates a responsible officer to verify that the business line is in compliance with FATCA.

We would further ask that this concept provide sufficient flexibility for a group to determine logical groupings of business lines or business groups and geographic areas since there are many different ways that FI groups organize themselves by business and geographic area and might want to "roll up" compliance in different ways to one or more "compliance FFIs." The worldwide parent would be responsible for designating a "lead FFI" to provide a "FATCA Compliance Plan" to the IRS that details the mechanics of such an alternative compliance structure to the IRS so that the IRS can have complete transparency regarding the plan and be assured that all FFIs within the expanded affiliated group are properly accounted for in their entirety.

We believe that this alternative FATCA Compliance Plan model allows groups to avoid the artificial exercise of associating legal entities with particular business lines when operationally such business lines may be transacting in whole or in part through any number of legal entities and the business line itself is the relevant "FFI." Such an approach is often likely to be more consistent with existing internal audit procedures and regulatory oversight, which typically focus on business activities rather than on legal entities per se. Indeed, the internal audit systems of financial institutions as well as their regulators typically focus their compliance efforts and review on an enterprise-wide risk management basis that more naturally falls under business lines. We believe that the IRS will achieve a better compliance result by allowing multinational

FI groups to develop compliance systems focused on actual FFI activity and existing operations and on those internal officials responsible for the compliance of that business.

Recommendation No. 2: Develop a FATCA Compliance Plan model to allow expanded affiliated FI groups to give the IRS an alternative compliance model centered not on legal entities but on actual business operations.

**2. The IRS Should Introduce a Guidance Program Regarding the Application of FATCA to Specific Entities and Accounts**. The proposed regulations are complex, and the application of critical definitions (such as what is a Category (iii) FFI investment entity) to specific situations or the implementation of certain requirements will necessarily be uncertain. It will not be possible for the IRS to anticipate and address every such ambiguity in drafting the final regulations. On the other hand, individual firms and the financial industry in general will need to have such questions answered on a real-time basis in order for FATCA to be implemented successfully.

Recommendation No. 3: The IRS should set up a guidance mechanism through which interested parties can obtain answers to their questions, and for any general guidance emerging from these questions to be disseminated on a real-time basis (perhaps through Q&A postings on the IRS website, as has been done with respect to Schedule UTP, together with any explanations that would be helpful regarding the rationale for any changes that are made in the guidance from time to time). In addition, it would be helpful to many FFIs if the IRS were to produce a "plain language" document like Publication 515 to summarize and explain the FATCA requirements since parsing the regulations is a difficult task for non-attorneys and non-native English speakers.

## II. THE PROPOSED EFFECTIVE DATES FOR "NEW ACCOUNT" DOCUMENTATION PROCEDURES LEAVE INSUFFICIENT TIME FOR IMPLEMENTATION (§ 1.1471-1(b)(48))

The 2013 effective dates for withholding agents to have new account documentation procedures in place (January 1, 2013 in the case of U.S. financial institutions ("USFIs") and July 1, 2013 for participating foreign financial institutions ("PFFIs")) is a serious problem that requires immediate attention by Treasury and the IRS. We recognize and appreciate that the Treasury and IRS have made efforts to respond to comments made by EBF/IIB and many others in the financial industry to phase in key FATCA effective dates, such as for distinguishing preexisting accounts from new accounts, withholding on different categories of payments, and reporting. However, as we stated in our prior comments, financial institutions need from 18-24 months from the issuance of final regulations to either upgrade existing IT systems or build new ones, and to put in place other procedures and operating systems, in order to comply with FATCA. It will be difficult, if not impossible, for financial institutions to meet the first effective dates to have new account opening procedures and the related systems in place by January 1, 2013 for USFIs and by July 1, 2013 for FFIs.

That being said, we believe that many financial institutions will likely try to make as much progress as possible on the basis of the proposed regulations while awaiting the final regulations. For example, many financial institutions will use the time prior to the publication of final regulations to begin developing new account opening procedures and to assess the capabilities of their current IT systems to determine if they can be modified or if they must be replaced. It is important to realize, however, that while financial institutions will be making assumptions in the design of their compliance models based on the proposed regulations, they can only launch a comprehensive IT effort to modify or replace existing systems on the basis of final regulations given the cost and complexity associated with such a project, which will affect a potentially large number of existing systems around the world for multinational FFIs and USFIs. Such an IT project will need to: (1) ensure that account master systems are able to capture all relevant FATCA data for new customers and counterparties; (2) allow for on-going account maintenance and the ability to monitor changes in circumstances that might indicate U.S. status; (3) integrate or coordinate such information with that collected in related systems, such as AML/KYC and other regulatory systems; (4) develop coding to describe the "FATCA type" for each customer/counterparty; (5) ensure that such coding facilitates the appropriate withholding rate, if applicable, for every payment system; (6) generate the appropriate information return reports, including the modified Forms 1042-S and any new IRS reports associated with substantial U.S. owners of NFFEs; and (7) automate the FFI-EIN verification to ensure there is an appropriate match of the FFI-EIN number for each PFFI customer with the IRS' records. Other necessary workstreams will include the wholesale revision of existing account opening and customer on-boarding procedures, expansion and revision of both withholding and reporting capabilities, and the training of staff around the world as to the new requirements.

Accordingly, assuming that the regulations, FFI agreement and all new withholding forms and instructions are issued in final form by September 30, 2012 (and that intergovernmental agreements are uniform with one another and consistent with the regulations), we believe that at a minimum the effective date for new accounts should be January 1, 2014, for both FFIs and USFIs. We recognize that even this date is quite challenging because financial institutions would have only 15 months to make the necessary IT and other operational changes. However, given that we expect the industry to make progress during this year on the basis of the proposed regulations, we believe that the 2014 date is feasible, based on the foregoing assumptions, so long as there is a grace period before there is enforcement against FIs that have been acting in good faith to implement the new rules.

In addition, we ask that the "new account" concept be replaced by a "new relationship" concept. AML/KYC rules require financial institutions to document a new customer. There is no documentation requirement if an existing customer simply opens a new account. Consistent with the Preamble's statement that, "[w]ith respect to new accounts the proposed due diligence rules rely extensively on an FFI's existing customer intake procedures," we ask Treasury and the IRS to conform the definition of a "new account" to the AML/KYC rules so that FATCA does not impose new burdensome documentation requirements on FFIs.

Finally, if the Treasury and IRS agree to move the "new account" effective date from 2013 to 2014, it would be logical to have the related dates similarly adjusted for a sensibly sequenced implementation schedule. That is, reporting would begin for the 2014 year; prima facie FFIs would be identified in 2014; and withholding would begin 2015. We note that although the proposed regulations ostensibly provide a year for documenting prima facie FFIs, in reality they would need to be documented within six months because withholding would commence on January 1, 2014 (§ 1.1471-2(a)(4)(ii)(B)), which is an impractical timeframe for most FIs given the large number of prima facie FFIs that are counterparties.

In this regard, we believe that section 1474(f) provides ample authority to Treasury and the IRS to establish an orderly implementation schedule that FIs reasonably can be expected to meet despite the official 2013 effective date of the statute. However, in the event that Treasury and the IRS remain concerned about their authority to make such effective date changes by regulation, an alternative approach might be to provide a "grace period" through January 1, 2015, during which FIs would make a good faith effort to comply with the rules but would not otherwise be subject to penalty or the assessment of withholding liability.

<u>Recommendation No. 4</u>:

a. At a minimum, and assuming the final regulations, model FFI agreements, new certification forms and all related instructions are finalized by September 30, 2012 (and that intergovernmental agreements are uniform with one another and consistent with the regulations), the definition of "preexisting obligation" in §§ 1.1471-1(b)(48) should be extended to no earlier than January 1, 2014, and the effective dates for new account due diligence and documentation to be in place should be extended to the later of such date or the date a PFFI's FFI agreement becomes effective. There should also be a grace period before there is enforcement action against FIs that have been acting in good faith to implement the new rules.

b. Change the concept of documenting "new accounts" entered into after the effective date with documenting new customer relationships so that this requirement is consistent with AML/KYC practices.

c. Adjust other effective dates for an orderly implementation schedule or provide a grace period through 2015.

## III. EXPAND ELECTION TO BE WITHHELD UPON, INCLUDING TO NQIs THAT ARE PFFIs (§ 1.1471-2(a)(2)(iii))

We are aware that Treasury and the IRS received many comments in response to the FATCA notices expressing concern with the potential operation of the "election to be withheld upon" of FATCA section 1471(b)(3). In response, the proposed regulations limit the ability to make the election to QIs that are PFFIs (and to the foreign branches of USFIs serving as QIs) that do not assume primary withholding responsibility under chapter 3 for that payment. The regulations further limit the scope of the election to U.S. source FDAP payments.

We do not object to the apparent goal of §§ 1.1471-2(a)(2)(iii)(A) & (B) to require consistency between the chapter 3 and 4 obligations of QIs. However, this goal would be more logically attained if the requirement did not apply at an entity level but on a QI account basis so that the chapter 4 requirements would then be consistent with how withholding agents have currently established their systems for chapter 3 withholding. By contrast, applying the rule at the entity level would lead to substantial and unnecessary commercial restructuring with no apparent compliance benefit to the IRS.

In addition, a QI should be able to make an election to be withheld upon with respect to U.S. source gross proceeds and foreign source amounts, provided the implementing withholding agent <u>explicitly</u> agrees to take on this task. We realize that QI agreements ("QIAs") currently are primarily limited to designated accounts receiving U.S. source FDAP payments, but it seems sensible to allow expansion of QIAs to provide flexibility to also cover chapter 4 type payments, provided both parties explicitly agree to such expansion.

Likewise, we believe that the regulations should contain a more general section 1471(b)(3) election that more closely adheres to the concept in the statute and which would be available to NQIs and non-withholding foreign partnerships and trusts that are PFFIs, provided that both parties agree to the terms of the election and to what the election will cover (i.e. U.S. source FDAP and/or US source gross proceeds and/or foreign source amounts). In other words, a PFFI that is a NQI would not have the ability to force another withholding agent to take on this responsibility but such withholding agent could do so if it made commercial sense and it had both the infrastructure and desire to take on the withholding for the other party. We think that this is a desirable feature of the regime since it may allow some PFFIs to avoid building systems to perform gross proceeds withholding.

While section 1471(b)(3) only applies to withholding, we believe that the regulations should also provide that the withholding agent taking on the withholding responsibility under such an election may also take on the associated reporting responsibility, as is currently the case for chapter 3 purposes and with respect to Form 1099 reporting performed by some U.S. withholding agents for their QI customers. We see no potential downside to the IRS and potential cost and burden reductions for effected PFFIs.

Finally, we note that clearing organizations have systems and procedures that are particularly ill-suited to the "election to be withheld upon" given their unique role to provide market efficiencies by netting the transactions of their members. We believe that clearing organizations should be explicitly carved out of eligibility to serve as a withholding agent pursuant to a section 1471(b)(3) made by a downstream FFI. We think that this is particularly appropriate given that the withholding and reporting on netted transactions would provide little of value to the IRS.

<u>Recommendation No. 5</u>:

a. The election by QIs to be withheld upon under §§ 1.1471-2(a)(2)(iii)(A) & (B) should be extended to gross proceeds and foreign source amounts, provided that the withholding agent agrees to assume that responsibility.

b. Similarly, the election to be withheld upon under §§ 1.1471-2(a)(2)(iii)(A) & (B) should also be available to PFFIs and non-withholding foreign partnerships and trusts that are NQIs and should apply to U.S. source FDAP and gross proceeds as well as foreign source amounts, provided that the withholding agent agrees to assume that responsibility.

c. The regulations should provide that where a withholding agent takes on withholding responsibility under §§ 1.1471-2(a)(2)(iii)(A) & (B), it may also agree to take on the associated reporting responsibility.

d. Clearing organizations should be explicitly excluded from the election to be withheld upon so that they are not placed in the position of having to develop potentially expensive systems to accommodate requests of FFIs to be "withheld upon" particularly given that any such systems would produce highly distorted withholding and reporting results for the IRS.

## IV. REVISE TREATMENT OF DVP/COD TRANSACTIONS (§ 1471-2(a)(2)(v))

§ 1.1471-2(a)(2)(v) provides that with respect to a "delivery versus payment" (DVP) or "cash on delivery" (COD) or similar transaction, each broker that pays gross proceeds is a withholding agent with respect to the payment. By contrast, for purposes of chapter 61, only the broker that receives the gross proceeds from a sale against delivery of the securities sold (as opposed to the executing broker) is subject to reporting and withholding requirements (§ 1.6045-1(c)(3)(iv)).

There are millions of DVP/COD transactions every day, covering the broad gamut of trading in stocks and securities. These transactions include exchange-traded stocks and bonds as well as over-the-counter (OTC) trades. In the vast majority of these transactions, the executing and receiving brokers face a clearing house. Many other transactions, however, consist of direct broker-to-broker trades.

At present, executing brokers do not have systems in place to track each transaction for information reporting and withholding purposes. Moreover, these trades are effected through numerous different trading platforms, and most FIs have multiple such trading platforms, each with its own software. Given the enormous volume of DVP/COD trading activity, the multiplicity of trading platforms and the numerous receiving brokers with which each executing broker transacts, it is a significant operational challenge to build from scratch systems that would enable executing brokers to comply with the requirements of the proposed regulations, one that cannot be accomplished within the time frame of the proposed regulations.

A significant factor in the operational challenge presented by the proposed regulations arises from the interface between the DVP/COD rules and the definition of payee in § 1.1471-3(a). The payee definition requires a withholding agent to look through a PFFI counterparty that it may treat as an agent or intermediary, and to treat the principal as the payee, in the case of a payment of U.S. source FDAP income, unless the PFFI counterparty is a QI that has assumed primary withholding responsibility. Payments of gross proceeds often include, or are accompanied by, amounts that are treated as dividend or interest income. Thus, the proposed regulations could be read to require executing brokers to determine not only whether each of their counterparties is a USFI or a PFFI, but also to build a system that would enable it to gather information regarding the persons for whom each PFFI counterparty that is not a QI that has accepted primary withholding responsibility is acting, which could require it to look through multiple tiers of PFFIs for thousands or even millions of individual trades.[2] Such a requirement is untenable in practice. Moreover, as discussed in Section VII.B below, we believe that it is not mandated or desirable from the perspective of the conceptual framework of FATCA implementation. Rather, we believe that for purposes of chapter 4, a withholding agent should always be entitled to treat an FFI counterparty or other account holder as the payee and should never be required to look through such FFI. If that person is a PFFI it will be required to perform due diligence on its account holders; if that person is a NPFFI, the withholding agent would withhold under FATCA.

Recommendation No. 6:

[2] Indeed, because § 1.1471-3(a) defines "payee" differently for FDAP income and gross proceeds, the identity of the payee could be different for different portions of the same payment.

a. Treasury and the IRS should work with the industry to develop an appropriate and workable framework for implementing FATCA in the context of DVP/COD transactions, and should provide a reasonable timeframe that would enable FIs to build the necessary systems once the details are fixed.

b. We believe that an appropriate and workable framework would provide that (i) where a trade is effected through a clearinghouse, the executing broker treats the clearinghouse as its payee, and the clearinghouse treats the receiving broker as its payee, and (ii) where the trade does not involve a clearinghouse, the executing broker treats the receiving broker as its payee. In addition, § 1.1471-3(a) should be revised as set forth in Section VII.B below to ensure that in no circumstances would the executing broker need to look through the receiving broker or the clearinghouse (or that the clearinghouse would be required to look through the receiving broker).

## V. CLARIFY DEFINITION OF PRIMA FACIE FFI (§ 1471-2(a)(4)(ii)(B))

The definition of "prima facie FFI" is confusingly structured and worded and as a result it is unclear as to the respective obligations of FFIs and USFIs to identify such entities. We believe that the better reading of the provision is that for offshore accounts, paragraph (B)(1) only requires an FFI to determine if its electronically searchable systems indicate that a payee is a QI or NQI and to treat such entities as prima facie FFIs. Paragraph (B)(2), by contrast, only applies to onshore U.S. accounts and requires an additional search for specific NAIC codes that also indicate financial institution status. The confusion arises because paragraph (B)(3) references neither paragraph (B)(1) nor (B)(2). We believe that the better reading is that it simply adds additional SIC codes to the NAIC codes mentioned in (B)(2) and accordingly only applies to the onshore search. The concern is that it could also be interpreted as an additional requirement for offshore accounts.

Recommendation No. 7: We believe that this ambiguity in the regulation should be resolved by only having a paragraph (B)(1) and (B)(2), with the current paragraph (B)(3) incorporated as the second part of the (B)(2) onshore search requirement.

## VI. EXTEND GRANDFATHERING FOR FOREIGN PASSTHRU PAYMENTS (§ 1.1471-2(b))

§ 1.1471-2(b) generally provides that payments made with respect to "obligations" outstanding on January 1, 2013, are not treated as "passthru payments" and thus generally are not subject to withholding under FATCA. The proposed regulations delay this grandfather date from March 19, 2012, to January 1, 2013, in order to provide financial institutions with sufficient time to modify their systems and documentation to take into account FATCA's requirements – *i.e.*, to ensure that FATCA withholding does not apply to obligations that were documented prior to FATCA's requirements becoming known and FIs having had the opportunity to properly reflect those requirements in the relevant documentation.

The deferral of the grandfather date is a welcome change, and generally will help to facilitate financial institutions' ability to revise the documentation for obligations that produce withholdable payments prior to FATCA's substantive obligations becoming effective. However, a problem remains with respect to the application of the grandfather rule to foreign passthru payments, including especially swaps and other derivatives that are governed by ISDA (or other) master agreements, as well as payments on securities that are posted as collateral pursuant to a Credit Support Annex ("CSA") to such master agreements. While it is true that neither ISDA master agreements nor the CSAs of such agreements have fixed terms, the specific trades executed pursuant to ISDA agreements do have fixed terms that would qualify for grandfathering treatment.

The process of revising documentation to reflect the requirements of the foreign passthru payment regime is expected to be highly complex and will require substantial time to implement after the relevant rules are issued in final form. Depending on the ultimate breadth of the foreign passthru payment rules, many FIs will find themselves in the position of having to renegotiate thousands of individual agreements. For example, notional principal contracts typically are entered into pursuant to a short-form confirmation that specifies the economic terms of the specific transaction but that incorporates by reference, and is governed by, a lengthy master agreement that contains the other terms and conditions of derivatives transactions to be entered into between the parties. While these master agreements generally adopt a basic form (such as one of the forms issued by ISDA), they are individually negotiated arrangements, and each of them will need to be reviewed and renegotiated to properly allocate the risks and compliance obligations imposed by the foreign passthru payment rule. That process cannot commence in any meaningful manner until FIs have had an opportunity to analyze the requirements of final regulations relating to the foreign passthru payment rule.

In this regard, the standard ISDA master agreements generally place the burden of withholding tax on the party making the payment (so that it would be required to gross up a payment for any withholding tax), whereas FIs generally will wish to shift the burden of any FATCA withholding to a payee that is a NPFFI or recalcitrant holder (so that the payor can make the payment net of the FATCA withholding tax).

Although the parameters of the foreign passthru payment rule are not yet known, even a simplified version of the approach described in Notice 2011-34, which requires withholding with respect to amounts that otherwise are treated as non-U.S. source income, would require that FIs build new systems and fundamentally reconsider the documentation used for the obligations that they issue. The delay of the effective date of withholding with respect to such payments until 2017 (or later) may provide sufficient time for these systems to be built. However, the delay in the effective date for these rules does not address the documentation concerns described above because, under the proposed regulations, once withholding begins, it would apply to any obligation issued after 2012. For example, a 5-year currency swap transaction entered into in 2013 may be subject to the passthrough payment rules if they become effective in 2017. This will put FIs in the untenable position of entering into an enormous number of transactions between now and the effective date that ultimately will be affected by the foreign passthru payment withholding requirements without having the opportunity to analyze the impact of such requirements and implement the changes to documentation that will be required to properly address these requirements and to properly allocate the withholding risk.

<u>Recommendation No. 8</u>: Section 1.1471-2(b) should be revised to provide an extended grandfather period for obligations with respect to which foreign passthru payment withholding may be required as well as to payments on securities that are posted as collateral pursuant to the

related CSAs.  In order to provide FIs with sufficient time to implement the required procedures and renegotiate the relevant documentation, we recommend that such withholding not apply with respect to any obligation entered into prior to the later of (x) the date on which foreign passthru payment withholding commences and (y) one year following the issuance of final regulations relating to foreign passthru payment withholding.

## VII. WITHHOLDING AGENT IDENTIFICATION OF PAYEES (§ 1.1471-3)

### A. Introduction

While EBF and IIB member institutions have USFI subsidiaries and branches that will be subject to the rules of §§ 1.1471-2 and -3, which are applicable to withholding agents generally, the principal focus of this submission is on the application of the proposed regulations to FFI agreements.  Accordingly, in addition to the comments set forth in this Section, please refer to our comments in Sections IX.A.1 and B below regarding § 1.1471-4(c), in which we discuss aspects of the application of § 1.1471-3 to PFFIs by reason of the incorporation by reference of those rules under § 1.1471-4(c).

### B. Definition of Payee (§ 1.1471-3(a))

The Preamble explains that, "These rules generally follow the rules under § 1.1441-1(b)(2) for determining the payee of a payment subject to withholding or reporting for chapter 3 purposes, but are modified in several ways . . . ."  Thus, while in general "a payee is the person to whom a payment is made, regardless of whether such person is the beneficial owner of the amount," there are several significant exceptions.  For example, a payment to a foreign person that the WHA may treat as an agent or intermediary is not the payee if it is, inter alia, "[i]n the case of a payment of U.S. source FDAP income, a participating FFI acting as an intermediary, other than a QI that has assumed primary withholding responsibility."  § 1.1471-3(a)(3)(i)(A)(2).  Also, a foreign flow-through entity is not a payee unless it is, inter alia, "[a]n FFI, other than a participating FFI receiving a payment of U.S. source FDAP."  § 1.1471-3(a)(3)(ii)(A)(1).  In these cases, the principal (in the case of an agent or intermediary) or owner of the flow-through entity would be treated as the payee.  § 1.1471-3(a)(3)(i)(B), (ii)(B).  As set forth in the remainder of § 1.1471-3, a withholding agent must obtain a certification or other documentation from each "payee" regarding its chapter 4 status.

We understand that the foregoing exceptions are intended to incorporate in chapter 4 the circumstances in which an FI must in any event look through a payee for purposes of chapter 3 to obtain information regarding the beneficial owner of U.S. source FDAP income, and thus to conform the chapter 4 rules with the chapter 3 rules.

While we strongly advocate a close coordination between chapters 3 and 4, we respectfully submit that it is unnecessary and confusing to look through PFFIs in determining who is the payee for purposes of chapter 4.  If the required documentation under chapter 3 is not provided, withholding tax will be imposed under that provision; it is not necessary also to impose withholding under chapter 4, as a result of the entity look-through provisions of § 1.1471-3(a)(3), for the failure to provide documentation that is not required under an FFI agreement.

More fundamentally and problematic in practice, it appears that the proposed regulations do not precisely correlate the chapter 3 and chapter 4 rules, and if not corrected will result in the imposition of potentially enormous and unnecessary compliance burdens on withholding agents, who would be required to build new systems to look through each PFFI counterparty that is an agent or intermediary (and any indirect such PFFI in the chain of ownership) that is not a QI that has accepted withholding responsibility. One such very troublesome set of circumstances is discussed in Section IV above in connection with DVP/COD transactions, but there may well be others.

Finally, when applied to U.S. source FDAP payments made to an intermediary or flow-through entity that is a PFFI but that is not treated as the "payee" under § 1.1471-3(a)(3), these requirements appear to undermine the integrity of the PFFI concept, since § 1471 envisions that a PFFI or other withholding agent would satisfy its obligations under chapter 4 by determining that it is making a payment to an FFI that is a PFFI, without suggesting anywhere that the withholding agent would need to look through the PFFI under any circumstances. In this regard, it is worth remembering that one of the reasons for the QI system was that financial institutions and funds were reluctant to provide information regarding their customers and investors to their competitors, as was required under the prior system. We do not believe that FATCA contemplates a return to the pre-QI system.

<u>Recommendation No. 9</u>:

1. Delete § 1.1471-3(a)(3)(i)(<u>2</u>) and § 1.1471-3(a)(3)(ii) (since revising § 1.1471-3(a)(3)(ii)(A)(<u>1</u>) to apply to any FFI would effectively mean that for chapter 4 purposes all flow-through entities are treated as the payee, which seems to be the correct result).

2. With respect to § 1.1471-3(a)(3)(iii), see Section VII.C below.

### C. <u>The Treatment of U.S. Branches of Foreign Banks Should be Better Conformed to Chapter 3 (§ 1.1471-3(a)(3)(vi))</u>

The proposed regulations generally follow our previously made recommendation that a U.S. branch of a foreign bank be treated in a similar manner to the treatment accorded under § 1.1441-1(b)(2)(iv). Thus, where a U.S. branch and a withholding agent have agreed to treat the U.S. branch as a U.S. person under that chapter 3 rule, a payment to the U.S. branch will be treated as a payment to a U.S. person for chapter 4 purposes as well. However, the proposed regulations do not explicitly adopt the important rule in § 1.1441-1(b)(2)(iv)(B) that even where the U.S. branch and the withholding agent do not agree to treat the U.S. branch as a U.S. person, a payment to the U.S. branch will be treated as a payment of ECI unless the withholding agent can reliably associate the payment with a withholding certificate or other appropriate documentation.

As a result of the foregoing rules, under § 1.1441-1(b)(2)(iv), all payments to a U.S. branch are exempt from chapter 3 withholding unless the U.S. branch affirmatively provides the withholding agent with a withholding certificate or other documentation that indicates that it is acting as an intermediary for persons that are subject to withholding. Thus, § 1.1441-1(b)(2)(iv) achieves the salutary result of allowing U.S. FIs and U.S. branches of foreign banks to deal with one another on an equal footing, in respect of the tens of millions of transactions that are effected each year without requiring that each payment be associated with a withholding certificate or other appropriate documentation.

If the ECI rule is not incorporated in § 1.1471-3(a)(3)(vi), in general a U.S. branch would be required to enter into an agreement to be treated as a U.S. person with each withholding agent in order to avoid withholding under chapter 4. In addition, as a result of the proposed inapplicability of the eyeball test under the § 6049 (and related) regulations for purposes of chapter 4 (see § 1.1471-3(f)((3)(ii), discussed in Section VII.G.1 below), the U.S. branch would be required to provide the withholding agent with a withholding certificate or other documentation with respect to each payment, regardless of whether the U.S. branch entered into an agreement to be treated as a U.S. person.

These departures from the existing reporting and withholding framework would require significant operational changes in the way U.S. branches of foreign banks and USFIs deal with each other. As noted, these changes will affect tens of millions of transactions each year. Many of these transactions are one-off capital markets transactions rather than payments relating to previously identified accounts, and thus it would be very difficult, impractical and costly for U.S. branches and USFIs to build and operate systems that enable them to transfer information regarding the chapter 4 status of the payee with respect to each payment.[3]

We also are concerned that the proposed regulations would place U.S. branches of foreign banks at a competitive disadvantage to USFIs, and that USFIs and other U.S. withholding agents will prefer to transact with other USFIs rather than with U.S. branches of foreign banks in order to minimize their FATCA burdens. We urge Treasury and the IRS not to adopt rules that would discriminate against U.S. branches of foreign banks, which are an important and integral part of the U.S. banking and capital markets.

Recommendation No. 10:

a. § 1.1471-3(a)(3)(vi) should explicitly adopt the ECI rule of § 1.1441-1(b)(2)(iv)(B).

b. The second sentence of § 1.1471-3(a)(3)(iii), which allows a withholding agent that makes a withholdable payment to a USFI that is acting as an agent or intermediary to treat the USFI as the payee if the withholding agent has no reason to know that the USFI will not comply with its obligation to withhold under §§ 1471 and 1472, should be expanded to include payments to U.S. branches of foreign banks.

### D. Documentary Evidence Should Generally Be Valid Unless and Until There Is a Change in Circumstances (§ 1.1471-3(c)(6)(C))

§1.1471-3(c)(6)(C)would require PFFIs to re-document virtually all their accounts every three years or, if later, the expiration date of the documentary evidence (e.g., passport or driver's license) that is provided. This requirement is inconsistent with AML practices around the world and represents a departure from the existing chapter 3 regulations (QIs, for example, have no

[3] The complexities and costs would be increased significantly if our recommendations regarding DVP/COD transactions (see Section IV above), the definition of "payee" under § 1.1471-3(a) (see Section VII.B above) and the presumptions under § 1.1471-3(f) (see Section VII.G below) are not adopted.

such requirement with respect to the documentary evidence upon which they rely). The cost of implementing such re-documentation would be staggering since existing systems would need to be substantially modified or replaced to allow for such dates to be tracked automatically. Moreover, we respectfully submit that it is not necessary for the regulations to impose such a burdensome requirement to ensure compliance with FATCA's objectives. The number of individuals who change their citizenship or the country of their permanent residence is very small, and such changes usually are accompanied by other changes in circumstances (such as informing the particular FFI of a change in address), which would warrant re-documentation of individual accounts as well as entity accounts controlled by those individuals, as appropriate, under § 1.1471-4(c)(2)(iii).

Accordingly, we recommend that Treasury and the IRS adopt an approach consistent with their commitment to harmonize the AML/KYC standards as much as possible with the FATCA requirements to reduce unnecessary burdens and costs while still achieving an acceptable compliance result.

Recommendation No.11: § 1.1471-3(c)(6)(C) should be revised to provide that documentation regarding a person's chapter 4 status remains effective unless and until (i) the documentation is updated under applicable AML/KYC requirements, (ii) there is a change of circumstances presenting indicia of U.S. status, or (iii) the withholding agent knows or has reason to know that it is no longer accurate in respect of such person's chapter 4 status.

### E. The Rules Permitting Reliance on Documentation Provided By Other Withholding Agents Should Be Expanded (§§ 1.1471-3(c)(6)(iv) and (vi))

§ 1.1471-3(c)(6)(vi) states that " the exceptions set forth in §1441-1(e)(4)(ix)(A) through (C) that permit withholding agents to rely on the documentation held through coordinated account systems, families of mutual funds, and through certain U.S. brokers, apply for purposes of documenting accounts under Chapter 4." We appreciate that the intent of this rule is to provide flexibility to PFFIs to rationalize the FATCA due diligence and documentation requirements such that one PFFI can rely on the efforts of either another PFFI or on a centralized group documentation concept.

However, we respectfully submit that, since they were implemented in 2001, these § 1441 rules have proven to be overly narrow and restrictive in many situations, and now would be a good time to rethink these rules, particularly where a group of PFFIs is involved. Accordingly, we believe that all three rules should be expanded to allow for more rational and cost effective due diligence and documentation procedures.

First, we ask that § 1441-1(e)(4)(ix)(A) be expanded to clarify that all members of an expanded affiliated group may rely on the due diligence and documentation performed by a related affiliate even if the information is not included in a "coordinated account information" system. All that should be necessary is for the primary PFFI/DCFFI to provide the relevant identification details to the other affiliate so that such other affiliate can populate its systems with the relevant information for its FATCA compliance. Under the current § 1441 rule, there have been many inappropriate situations where one withholding agent in such a group has been effectively penalized for trying to rely on the Form W-8BEN supplied to it by a related entity. It is difficult to see how tax administration is served by such a restrictive approach.

Second, we ask that § 1441-1(e)(4)(ix)(B) be expanded beyond "families of mutual funds" to other fund family types, such as related groups of private equity funds, hedge funds, etc. There is no apparent reason why this helpful rule should be so limited since there is no apparent difference in the compliance result of a family of non-mutual funds relying on centralized documentation as opposed to each having its own documentation.

Third, we ask that the "introducing broker" rule in § 1441-1(e)(4)(ix)(C) be expanded to allow any PFFI (that is, not just introducing brokers) to rely on a certification from another related or unrelated PFFI (or USFI) that the first PFFI has performed any necessary FATCA due diligence and has established that the customer either does not hold a "U.S. account" or provides any relevant U.S. tax identification details to the second PFFI. We believe that this is an appropriate expansion of this rule given that both parties are subject to the same rules and procedures under the regulations and their respective FFI agreements with the IRS.

Fourth, we ask that the Treasury and IRS allow withholding agents to use less burdensome electronic methods to establish the participating status of an FFI. Specifically, we ask that withholding agents be allowed to require FFI customers/counterparties to complete acceptable dematerialized withholding certificates and provide FFI EINs through website links.

Fifth, we ask that Treasury and the IRS collect as part of the FFI application process any standard international identifier that applies to the entity making the application. Many FFIs are so identified by ISIN codes if they are funds and BIC codes if they are banks. A withholding agent may well have these codes in their existing account data for pre-existing relationships and can easily collect them as part of the new account on-boarding process. If the IRS were to publish for an FFI both its FFI EIN and its identifier codes, withholding agents could then easily and more accurately establish that they are dealing with a PFFI without having to collect withholding certificates. This would particularly assist FFIs in their efforts to identify prima facie FFIs but would also allow for a less burdensome and more accurate process for new accounts as well.

Sixth, we ask that the regulations allow one withholding agent to rely on copies or photocopies of relevant tax documentation supplied by another withholding agent to establish FATCA status. We read § 1.1471-3(c)(6)(iv) to only apply to copies and faxes supplied by the customer to the withholding agent and not from one withholding agent to another. We note that such practices have long been accepted in the QI context (for example see section 5(ii) and (iii) of the U.K. QI country attachment).

Seventh, we find particularly troublesome the requirement that copies of documentary evidence must be "certified" or "notarized." We believe that such a restriction is inconsistent with the reality of how customers routinely provide information to financial institutions. For example, it is hardly rare for a customer to provide a financial institution with a copy of a passport or other document to establish identity. Such copies are relied upon unless the financial institution has reason to question the validity of the document. We believe that the same standard should apply in the FATCA context.

Finally, we think it is critical that provisions be made to permit an FI that acquires accounts from another FI (for example, through the acquisition of the assets of one or more branches) to rely on the documentation obtained by the transferor FI, rather than being required to treat the acquired accounts as new accounts that must be documented afresh.

Recommendation No. 12:

a. The regulations should be expanded as described above to (A) clarify that all members of an expanded affiliated group may rely on the due diligence and documentation performed by an affiliate even if the information is not included in a "coordinated account information" system; (B) permit investment funds under common management, such as families of private equity funds or hedge funds, to rely on centralized documentation; and (C) expand the introducing broker rule to permit reliance on certification from other PFFIs or USFIs as described above.

b. § 1.1471-3(c)(6)(iv) should be revised to allow the use of dematerialized withholding certificates provided through web based applications.

c. The IRS should develop a more streamlined and electronic matching program for withholding agents to more easily establish the PFFI/DCFFI status of a customer/counterparty by integrating ISIN, BIC and any other international identifier with the applicable FFI's EIN on the published IRS list of FFI EINs. Conforming changes should be made to § 1.1471-3(d)(3) & (5) to permit a withholding agent to determine an FFI's status as a PFFI or DCFFI on the basis of such matching program in lieu of obtaining a withholding certificate.

d. § 1.1471-3(c)(6)(iv) should be clarified that it is permissible for withholding agents to rely on copies and faxes of tax documentation provided to them by another PFFI. That same regulation should remove the requirement that copies must be certified or notarized to bring the rule into line with standard industry practice.

e. The regulations should be expanded as described above to permit an FI transferee of acquired accounts to rely on the documentation obtained by the transferor FI and to not be required to treat the acquired accounts as new accounts that must be documented afresh.

### F. Documentation Required to Establish a Payee's Chapter 4 Status (§ 1.1471-3(d))

**1. In general.** Please see Section IX.B.2 below for our comments regarding the application of the § 1.1471-3(d) documentation requirements in the context of FFI agreements.

**2. Identification of PFFIs and DCFFIs (§1.1471-3(d)(3) & (5)).** Please see Section VII.E above for our recommendation that withholding agents be permitted to determine an FFI's status as a PFFI or DCFFI on the basis of an electronic matching program in lieu of obtaining a withholding certificate.

**3. Identification of Owner-Documented FFIs (§ 1.1471-3(d)(7).** Please see Section XVII below for our recommendation that the owner-documented FFI provisions be limited to commercial investment vehicles and that non-commercial investment vehicles be subject instead to § 1472.

Even if the scope of the owner-documented FFI rules is narrowed as recommended below, these rules appear to be more burdensome than is necessary to accomplish their objective and are likely to be unavailable to many of the FFIs for which they are intended. For example, the restriction on the entity issuing debt to any person in excess of $50,000 will exclude many entities since it is not uncommon for even unsophisticated investment vehicles to borrow money for investments, including through such devices as securities loans and repos. Similarly, limiting the annual audit letter method to only those accounting firms with a U.S. office is overly restrictive and is likely to lead to unacceptably high costs for many entities considering this approach.[4] We believe that local accounting and law firms should be allowed to follow a defined set of requirements published by the IRS to provide the appropriate certification.

In addition, an entity should be allowed to notify the withholding agent that it desires to be an owner-documented FFI through the account opening process, and not necessarily by the withholding agent being required to collect a "withholding certificate" since the vast majority of these entities likely will have no U.S. owners or any U.S. investment and nexus. Similarly, where the initial due diligence and documentation procedures indicate that there are no U.S. beneficial owners, the withholding agent should not be required to collect annual withholding statements or renew underlying beneficial owner documentation until the withholding agent is aware of a change in circumstances that an underlying beneficial owner has U.S. status. Please see our related comments in Section IX.B.2 on the need to avoid U.S. tax-specific documentation requirements for the identification of entities in the account opening process.

We agree with the approach in § 1.1471-3(d)(7)(i)(B) that the owner-documented FFI relationship is strictly contractual between the parties and that a withholding agent is not required to take on the documentation and processing burdens associated with the owner-documented FFI exception.

<u>Recommendation No. 13</u>:

a. § 1.1471-3(d)(7) should be revised to permit an owner-documented FFI to provide documentation supporting the chapter 4 status of a holder of more than $50,000 of its debt.

b. Treasury and the IRS should review the other requirements of § 1.1471-3(d)(7) to determine which of them is truly necessary and which can be relaxed as we have suggested above. In particular, we ask that the regulations allow the use of any unrelated and independent accounting firm regardless of whether it has a U.S. office to provide an auditor's letter in place of an FFI owner reporting statement and documentation.

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[4] If this requirement is retained, it should permit foreign accounting firms that have U.S. affiliates also to qualify.

### G. Presumptions Regarding Payee's Status in the Absence of Documentation (§ 1.1471-3(f))

**1. The "Eyeball Test" Presumptions Regarding Payments to Certain Exempt Recipients Should Be Retained (§ 1.1471-3(f)(3)(ii)).** While not clear whether intended, the proposed regulations apparently do not permit use of the "eyeball test" of the § 6049 (and related) regulations with respect to payments to exempt recipients that are corporations, foreign governments, international organizations, foreign central banks of issue, securities or commodities dealers, financial institutions (such as banks), nominees or custodians, brokers and swap dealers. Under the proposed regulations, unless a withholding agent can associate each payment made to one of the foregoing exempt recipients with a withholding certificate or other appropriate documentation, it must treat the payment as made to a foreign person. Under the presumption rule applicable to inadequately documented foreign persons, the withholding agent is generally required to treat such foreign person as a NPFFI (see § 1.1471-3(f)(5), discussed below).[5]

The proposed requirement that U.S. financial institutions, brokers, dealers and custodians must provide a withholding certificate or other appropriate documentation that is effective for each payment received would require significant operational changes in the way USFIs deal with each other, similar to the concerns expressed in Section VII.B above regarding the proposed treatment of U.S. branches of foreign banks. These changes will affect millions of transactions every day. Many of these transactions are separate and discrete capital markets or over-the-counter (OTC) transactions rather than payments relating to previously identified accounts, and it would be difficult, impractical and costly for USFIs to build and operate systems that enable them to transfer information regarding the chapter 4 status of the payee with respect to each payment.

Recommendation No. 14: We believe that application of the "eyeball test" to date has allowed withholding agents to meet their compliance burdens in a cost effective manner. We see no reason why its use should not be retained for the FATCA purposes of presuming an entity is "U.S." This is particularly the case for exempt recipients described in § 1.6049-4(c)(1)(ii)(I),(M), (O), (P) and (Q). This could be done by providing that for purposes of chapter 4 these enumerated types of exempt recipients are treated, in the case of a U.S. person or a U.S. branch of a foreign bank or insurance company, as exempt recipients, and in the case of a non-U.S. person, as a foreign person.

**2. Presumption of Status as an Intermediary Generally Should Not Apply to PFFIs or DCFFIs (§ 1.1471-3(f)(5)).** This provision is ambiguous and potentially far-

[5] This provision would significantly limit the scope of the favorable rule in the second sentence of § 1.1471-3(a)(3)(iii), which allows a withholding agent that makes a withholdable payment to a USFI that is acting as an agent or intermediary to treat the USFI as the payee if the withholding agent has no reason to know that the USFI will not comply with its obligation to withhold under §§ 1471 and 1472. It would appear that the withholding agent could not rely on that provision unless it receives a withholding certificate or other appropriate documentation from the payee since otherwise it must treat the payee as a foreign intermediary that is a NPFFI under § 1.1471-3(f)(3)(ii). We question whether this literal reading of the rules was intended.

reaching. Under this rule, in the absence of adequate documentation, a withholding agent must treat the payment as made to an intermediary that is a NPFFI if the withholding agent:

> "has documentary evidence or other documentation that indicates, or the facts and circumstances of the transaction, including the name of the person who receives the payment or the presence of sub-account numbers, indicate that the person who receives the payment is a bank, broker, custodian, intermediary, or other agent and the withholding agent has no knowledge that the person receives the payment for its own account."

A fair reading of this provision is that a withholding agent must treat every payee that it knows is a bank, broker or custodian as an intermediary (regardless of whether there are sub-account numbers) unless the withholding agent knows that the person receives the payment for its own account. As a general proposition, it may well be appropriate to require a U.S. withholding agent – which in any event must obtain a certification regarding the status of each payee – to affirmatively determine whether the payee is acting as an intermediary. However, when applied to a payment that is made by a withholding agent to a PFFI or DCFFI, this provision appears to conflict with the requirements of § 1.1471-4 regarding a PFFI's obligations under its FFI agreement. As discussed in Section IX.B.1 below, we believe that Treasury and the IRS intended that, under its FFI agreement and § 1.1471-4, a PFFI will never be required to provide documentation regarding its account holders (or, in the case of a PFFI that is acting as an agent or intermediary, its principal) to a withholding agent (except to the extent already required under chapter 3 in respect of U.S. source FDAP, or if the PFFI is a QI that makes a § 1471(b)(3) election or is an owner-documented FFI).

Recommendation No. 15: The regulation should clarify that the intermediary presumption is not applicable to payments made to a PFFI or a DCFFI.

**3. Presumption Regarding Entity Type.** The proposed regulations do not appear to contain a presumption regarding the status of an entity as a corporation or flow-through entity.

Recommendation No. 16: For reasons similar to those discussed in Sections VII.B and VII.G.2 above, every PFFI or DCFFI should be treated as other than a flow-through entity (or as an agent or intermediary) for purposes of chapter 4.

## VIII. GENERAL REQUIREMENTS FOR FFI AGREEMENTS (§§ 1.1471-4(a))

### A. Verification Procedures (§§ 1.1471-4(a)(6) &-4(c)(10))

The proposed regulations provide that a "responsible officer" of a PFFI will be required to periodically certify to the IRS that the PFFI has complied with its obligations under its FFI agreement, and may be required to provide further factual information and disclose material failures with respect to compliance with the agreement. These periodic certifications generally will satisfy the PFFI's obligation to verify compliance with its FFI agreement; external audits will be required only in unusual circumstances.

We commend the Treasury and IRS for their decision to waive the requirement of routine formal audits in favor of a somewhat less burdensome process, but we still have concerns regarding the responsible officer certification process. We understand that the draft model FFI agreement to be released in the near future will provide details regarding the procedures relating to responsible officer certifications. It is critical that those procedures provide clear guidance setting forth workable rules that detail what constitutes an acceptable "internal review." It is equally important that the regulations and/or the FFI Agreement provide flexibility to expanded affiliated FFI groups to adopt reasonable "reporting up" structures and procedures and allow responsible officers to rely on them to comply since expanded FFI groups can differ significantly in how they structure their worldwide business operations (see Section I.B.1 above). We encourage the IRS to consider the comments raised by the IIB in its June 16, 2010 comment letter regarding certain FATCA issues in developing these procedures (as summarized below).

Section 1.1471-4(c)(10) requires that a responsible officer certify, to the best of his knowledge after conducting a reasonable inquiry, that the PFFI did not have any formal or informal practices or procedures in place at any time after August 6, 2011 to assist account holders in the avoidance of FATCA. In the Preamble, Treasury and the IRS requested comments regarding the procedures that should be required of PFFIs that are unable to provide this certification. We believe that responsible officers that are unable to provide the required certification should be required to provide a statement explaining the reasons that the responsible officer cannot so certify, and describing the procedures that the PFFI has adopted. The circumstances under which a responsible officer is unable to provide the requisite certification, and the appropriate remedial actions to be taken, are likely to vary widely among FFIs. Thus, in drafting the model FFI agreement, the IRS should not attempt to impose one single remedy to address the situation, but rather should use the details set forth in the responsible officer's certification to determine the appropriate remedial steps to be taken in the particular case. The instructions for the model FFI agreement also generally should provide that failure to be able to provide this certification ordinarily will not cause an FFI to be ineligible to be a PFFI, as long as it follows whatever remedial procedures the IRS specifies in the particular case.

<u>Recommendation No. 17</u>:

a. The procedures for responsible officer certifications in the model FFI agreement should explicitly provide expanded affiliated groups the flexibility to put in place reasonable "reporting up" structures and procedures and allow responsible officers to rely on them to comply. We ask that the model agreement also provide clear guidance regarding the substance of the review and reporting provisions that FFIs must adopt. Specifically, as discussed in the IIB's June 16, 2010 comment letter, the procedures that need to be performed in connection with a certification should not include any statistical testing or other examination of the results under these procedures and standards but, instead, only that the appropriate procedures and standards are in place and that to the best knowledge of the certifying person those procedures and standards are being followed.

b. In cases in which a responsible officer cannot certify that a PFFI did not have any formal or informal practices or procedures in place at any time after August 6, 2011 to assist account holders in the avoidance of FATCA, the responsible officer should be required to provide a statement explaining the reasons that the responsible officer cannot so certify, and describing the procedures that the PFFI has adopted. The IRS should determine the appropriate remedial actions to be taken based on the particular facts and circumstances.

### B. <u>Clarify that One Non-Compliant Member of an Expanded Affiliated Group Does Not Lead to Default of Entire Group (§1.1471-4(a)(7))</u>

The proposed regulations refer to the FFI agreement to specify the conditions under which an FFI will be considered to be in default. We ask that the FFI agreement also address the related question of when an entire expanded affiliated group will be considered in default. There is widespread uneasiness on this issue given the size of many expanded affiliated groups and fact that such definition can include all manner of entities, such as securitization vehicles, partnerships and trusts, not normally considered part of the "group." One concern is that the failure to detect a lack of compliance in one FFI in the group might lead to immediate default of the group's PFFI status. Another concern is the amount of time that it can take to "remediate" problems, as seen in ample detail since 2001 in the Chapter 3 context.

<u>Recommendation No. 18</u>: The rules should provide discretion to the IRS to agree to a remediation plan whereby one or more noncompliant PFFIs are allowed to address their shortcomings over a reasonable amount of time without endangering the PFFI status of the rest of the group.

## IX. <u>DUE DILIGENCE FOR THE IDENTIFICATION OF ACCOUNT HOLDERS UNDER THE FFI AGREEMENT (§ 1.1471-4(c))</u>

### A. <u>In General</u>

We commend the Treasury and IRS for modifying the guidance in the Notices regarding the due diligence procedures that PFFIs will be required to undertake to identify their U.S. accounts in a number of important respects to take account of concerns expressed by the financial industry regarding the administrative burdens on FFIs. The Preamble states that:

- "the proposed regulations rely primarily on electronic reviews of preexisting accounts" and "extended reliance on information gathered in the context of the due diligence required to comply with the anti-money laundering/"know your customer" (AML/KYC) rules";

- "With respect to new accounts, the proposed due diligence rules rely extensively on an FFI's existing customer intake procedures. Accordingly, the proposed regulations generally do not require an FFI to make significant modifications to the information collected on customer intake, other than with respect to account holders identified as FFIs, as passive investment entities, or as having U.S. indicia."

We welcome these general statements of intent, and agree that the closer the FATCA due diligence and documentation rules correspond with existing AML/KYC obligations and commercial practices, the less burden will be placed on FFIs to comply, with no apparent detriment to the compliance goals of FATCA. However, the proposed regulations unfortunately do depart, often substantially, from prevailing AML/KYC standards and commercial practices, particularly for entity accounts. The result, if left unchanged in final regulations, will be for FATCA due diligence and documentation requirements to largely supplant local AML/KYC standards and become a de facto international standard, at considerable cost and complexity to the FFIs seeking to comply. We question whether this was the intent of Treasury and the IRS, and our comments below are intended to help restore the laudable balance expressed in the Preamble. We organize our comments in three areas – general comments, those relating to entity accounts and those relating to individual accounts.

**1. <u>The Manner in which the § 1.1471-3 Standards Are Incorporated by Reference Should Be Clarified (§§ 1.1471-4(c)(2)(i), -4(c)(2)(ii) and -4(c)(3)(i))</u>.** These key provisions require a PFFI, in general, to apply "the principles" of §§ 1.1471-3(b), (c) , (d) and (f) (relating, respectively, to the determination of a payee's status, associating a payment with a withholding certificate or appropriate documentation, describing the documentation requirements, and containing presumptions in the absence of adequate documentation), as well as the standard of knowledge in § 1.1471-3(e), as though the PFFI were a withholding agent making a withholdable payment and the account holder were the payee. In certain respects, however, this formulation is too ambiguous, and in some circumstances (noted below) it leads to burdensome and, we believe, unintended requirements being imposed on PFFIs.

<u>Recommendation No. 19</u>: §§ 1.1471-4(c)(2)(i) and (3)(i) should set forth the rules applicable to PFFIs in a clear and intelligible manner, taking account of differences between PFFIs and other withholding agents. Our substantive recommendations regarding how the "the principles" of §§ 1.1471-3(b), (c), (d) and (f) should be modified as applied to PFFIs are set forth in the context of our comments regarding entities, in Sections VII.D -VII.G above and Section IX.B below.

**2. <u>Change in Circumstances (§ 1.1471-4(c)(2)(iii))</u>.**

The application of the aggregation rules for purposes of this provision should be clarified as set forth in our recommendation.

<u>Recommendation No. 20</u>: This provision should be revised to clarify that the clause "applying the aggregation rules" means that the computerized system linking of accounts and the relationship manager aggregation rules are applied not only for purposes of determining the aggregate balance or value of accounts but also for purposes of determining whether a new account is associated with a preexisting account. Thus, in the example given in the proposed regulation, if a holder of a preexisting account provides a U.S. address in connection with the opening of another account, that should not be treated as a change in circumstance with respect to the preexisting account if the FFI's computerized system does not link those accounts or a relationship manager does not know or have reason to know that the accounts are directly or indirectly owned, controlled or established (other than in a fiduciary capacity) by the same person.

**3. <u>Record Retention Should be Conformed to AML/KYC Practices (§ 1.1471-4(c)(2)(iv))</u>.** The record retention requirement in § 1.1471-4(c)(2)(iv) is inconsistent with the AML and other record retention requirements in many jurisdictions, and it would be burdensome and costly for FFIs to revise their practices in this regard. For example, we understand that retaining copies of certain forms of documentation may raise privacy law concerns in various countries.

Recommendation No. 21: We strongly recommend that the regulation be conformed to local AML/KYC practices since that will substantially reduce burdens on FFIs and better allow for integrated and efficient processes. Given the considerable disruption to current processes if Treasury and IRS expand the record retention requirements beyond current AML/KYC practices, FFIs will need (1) an extended phase-in period to implement the new requirements; and (2) a grandfathering exemption for records regarding accounts in existence prior to the full effective date of this expansion.

**4. Validity Period for Documentary Evidence (§ 1.1471-3(c)(5)(C)).** See VII.D above for our concerns about the significant burdens that this rule would impose on PFFIs and our recommendations in that regard.

### B. Identification Procedure and Documentation for Entity Accounts (§ 1.1471-4(c)(3))

**1. Identification of the "Account Holder" (§ 1.1471-4(c)(1): Non-Applicability of the Payee Identification Rules of § 1.1471-3(a).** As a preliminary matter, we note that the § 1.1471-4(c) provisions incorporate by reference only the rules of §§ 1.1471-3(b) - (f), and thus do not by their terms incorporate the payee identification rules of § 1.1471-3(a). Indeed, § 1.1471-4(c)(1) refers to the requirement to determine the chapter 4 status of an "account holder," which is defined in § 1.1471-1(b)(2) as "the person who holds an account under section 1.1471-5(a)(3)." Significantly, and unlike the payee identification rules of § 1.1471-3(a), § 1.1471-5(a)(3) provides that, with very limited exceptions, "An entity is treated as holding an account regardless of whether the entity is a flow-through entity."

Accordingly, we believe that Treasury and the IRS intended that the broad entity look-through provisions under the payee identification rules of § 1.1471-3(a) are to have no applicability to PFFIs and their account holders, except to the extent already required under chapter 3 in respect of U.S. source FDAP.[6] (See also Section VII.B above, where we recommend that these limited entity look-through provisions be removed from § 1.1471-3(a)).

Recommendation No. 22: To eliminate any confusion, the regulations should explicitly state that, except as noted above, the payee identification rules of § 1.1471-3(a) have no applicability to PFFIs and their account holders.

**2. Application of the Principles of § 1.1471-3(d) Documentation Requirements to Establish a Payee's Chapter 4 Status (§ 1.1471-4(c)(3)(i)).** This provision incorporates by reference the detailed documentation requirements of § 1.1471-3(d), which specifies what documentation is required for each type of entity.

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[6] See § 1.1471-3(a)(3)(i)(A)(2) (in the case of U.S. source FDAP income paid to a PFFI acting as an intermediary, other than a QI that has assumed primary withholding responsibility) and § 1.1471-3(a)(3)(ii)(A)(1) (a flow-through entity that is an FFI receiving a payment of U.S. source FDAP income).

**a. Preexisting Offshore Obligations.** For many types of entities, PFFIs can avail themselves of special, more favorable documentation rules for preexisting offshore obligations. In general, the rules for preexisting offshore obligations permit a PFFI to rely on documentation that it would typically receive as part of its AML/KYC process and/or on other information that is otherwise typically available to it, and thus a PFFI generally would not need to obtain U.S. tax-specific information from its account holders with respect to preexisting entity accounts. The most significant departure from the AML/KYC rules relates to the documentation of PFFI and DCFFI status, for which we set forth our recommendations in Section VII.E above. Otherwise, in general, the § 1.1471-3(d) documentation requirements for preexisting offshore obligations should be workable for PFFIs, although we set forth below several recommendations for improving these provisions.

**b. New Offshore Obligations.** For many types of entities, new offshore obligations will also be eligible for more favorable documentation rules than those that apply to onshore obligations (which typically require the collection of U.S. tax forms), but in most cases a PFFI will need to obtain a statement under penalty of perjury or other U.S. tax-specific documentation to establish a new offshore entity account holder's chapter 4 status when opening the account.

The requirements for new offshore obligations are problematic for PFFIs because they require a PFFI to obtain a statement under penalty of perjury or other U.S. tax-specific documentation from virtually every new entity account. As we expressed in the past,[7] we believe that it is not commercially viable to impose U.S. tax-centric requirements in the due diligence that PFFIs will need to conduct in connection with opening new accounts since the overwhelming majority of an FFI's customers or counterparties are non-U.S. entities owned by non-U.S. persons. Retaining the approach in the proposed regulations would be the equivalent of a U.S. entity trying to open a U.S. bank account and being asked to supply Russian tax documentation or certifications relating to a Russian tax law even though the U.S. entity has no Russian owners and no Russian nexus.

Furthermore, we question whether the additional information that the proposed regulations require for new offshore obligations, compared to what is required for preexisting offshore obligations, is necessary in order ensure compliance with FATCA. Examples of requirements that appear particularly superfluous but burdensome include (i) the letter from counsel required to identify a non-profit organization, (ii) the written statement under penalty of perjury required from retirement funds, and (iii) the written statement under penalty of perjury required from publicly traded NFFEs and their affiliates.

Recommendation No. 23: For entity accounts, we urge Treasury and the IRS to apply to new offshore obligations the same due diligence standards as would apply to preexisting offshore obligations (taking account our recommendations relating thereto) because that approach better

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7 *See* the EBF-IIB FATCA Submission dated April 23, 2010 at pp. 13-14 (commenting, "We strongly believe that the regulations should not require FFIs to collect any specific U.S. tax document or even U.S. specific certification for non-U.S. bank and security accounts. Such a requirement would be akin to a U.S. bank trying to comply with a Chinese requirement to identify Chinese tax residents by asking its new U.S. customers to sign a Chinese tax document or answer Chinese tax residency oriented questions during the account opening process for a U.S. bank or security account. Such an approach is commercially not viable.").

meets the stated goal of Treasury and the IRS to harmonize the FATCA requirements as closely as possible to prevailing AML/KYC and current FFI business practices and would have no apparent deleterious effect on achieving the compliance objectives of FATCA.

**c. <u>Reliance on Industry Codes</u>.** The proposed regulations permit or require U.S. withholding agents to rely on the standard industry codes (SICs) of the North American Industry Classification System or other standard industry codes (as defined in § 1.1471-1(b)(56)) to determine whether the business activity of an entity would characterize it as a "prima facie" FFI. See § 1.1471-2(a)(4)(ii)(B)(2) and (3) (as drafted, it appears that paragraph (2) is explicitly limited to USFIs while (3) is not, but IRS officials have suggested publicly their intent to limit paragraph (3) to USFIs as well). By contrast, § 1.1471-3(d)(11)(iv)(A) permits reliance on SIC codes by FFIs to establish active NFFE status for preexisting offshore obligations but apparently not for USFIs engaged in the same effort onshore. We question the administrative rationale for both rules. We believe that it makes far greater sense for both USFIs and FFIs to be able to use internal, local or standard industry codes in such determinations where applicable in the regulations and would further request expanding the use of such codes for generally determining the nature of entity account holders. For example, in connection with new offshore obligations of NFFEs, a PFFI should be able to rely on a SIC that corresponds with an active business type. Finally, we interpret § 1.1471-1(b)(56) as not limiting the definition of a SIC to the NAIC or other generally available standardized code system but also as encompassing internal codes used by an FI; this should be confirmed more clearly since such codes achieve the same end – automation of compliance processes to the greatest extent possible consistent with sound commercial practices.

<u>Recommendation No. 24</u>: § 1.1471-3(d) and other provisions in the regulations should create a level playing field for USFIs and FFIs and allow each to rely on industry codes where helpful to comply with a particular FATCA obligation such as identifying a prima facie FFI or an active NFFE. Furthermore, the regulations should confirm that all FIs can use any standardized commercial classification coding system analogous to SIC codes, including internal classification systems and locally developed codes, to determine the nature of the business activities of an account holder or payee where relevant for FATCA due diligence purposes.

**3. <u>Application of the Principles of § 1.1471-3(f) Presumption Rules to Establish a Payee's Chapter 4 Status (§ 1.1471-4(c)(3)(i))</u>.** This provision directs a PFFI to apply the "principles" of the § 1.1471-3(f) presumption rules (as applicable to entities) as though the PFFI were a withholding agent making a withholdable payment and the account holder were the payee.

Please see Section VII.G above for our recommendations regarding necessary clarifications to the presumption rules of § 1.1471-3(f), which are also relevant for purposes of determining how the principles of those provisions should be applied to PFFIs.

## C. <u>Identification Procedure and Documentation for Individual Accounts (§ 1.1471-4(c)(4), (7), (8))</u>

We believe that the due diligence rules for individuals in the proposed regulations – compared to those for entities – generally better reach the stated goal of attempting to harmonize the FATCA due diligence and documentation requirements with prevailing commercial practices and AML/KYC standards. However, we believe that two key U.S. indicia should be reconsidered.

First, we believe that including U.S. telephone numbers as an indicia of U.S. status adds unnecessary complexity and costs, is inconsistent with prevailing AML/KYC obligations, which have no analogous requirement, and should be eliminated. The "001" international telephone prefix does not apply only to U.S. phone numbers but those in Canada and the Caribbean as well. Accordingly, it is not a simple matter to comply with the requirement to track such numbers, but requires all area codes in the three geographic areas to be monitored, tracked and updated. As you are aware, this is hardly a static set of codes but has proliferated substantially with the advent of mobile and smart phones.

Likewise, possession of a "U.S." number is not necessarily indicative of U.S. status given the evolution in telecommunications and the growth of the mobile and smart phone markets. It is not uncommon for residents of other countries to have a U.S. phone number for any number of reasons given the wide array of service providers and competing phone and data plans. Requiring financial institutions to have to figure this out for every customer and counterparty is an unnecessary burden when the other U.S. indicia more directly indicate a U.S. nexus.

Second, we understand why the proposed regulations include a "U.S. place of birth" as a U.S. indicia, but we believe that it should be eliminated given that it is neither the commercial practice for FFIs to collect such information nor is it relevant for AML/KYC purposes. Furthermore, we believe that the population of "accidental" U.S. citizens who happened to be born in the United States but have not considered themselves Americans may be significantly larger than expected by Treasury and the IRS. We question the value of creating a potential administrative headache for FFIs, the IRS and affected individuals who will be forced to deal with this population of individuals that likely have technical U.S. tax filing obligations but often have no effective tax liability given their residence in other high tax jurisdictions. We believe that all of the above problems can be easily avoided by focusing on the citizenship country of a customer rather than his or her place of birth.

<u>Recommendation No. 25</u>: We recommend that the U.S. indicia list be modified to remove both U.S. telephone number and place of birth as relevant criteria.

### D. <u>Aggregation of Banking and Cash Value Insurance or Annuity Accounts (§§ 1. 1474-4(c)(4)(iii)(B) -4(c)(4(iv)(B))</u>

<u>Recommendation No. 25</u>: The regulations should clarify which aggregation threshold applies when an existing system applies to both banking and insurance businesses. Some financial groups have both banks and insurance businesses, and the insurance customer may have a related bank account, for example, to hold earnings on annuity products. In such instances, it is unclear whether the $50,000 or $250,000 threshold applies. We recommend that if such accounts are so linked, the higher threshold should apply since the bank account typically is an accommodation account for the insurance customer.

## X. SOME FLEXIBILITY SHOULD BE INTRODUCED INTO THE APPLICATION OF THE EXPANDED AFFILIATED GROUP CONCEPT (§1.1471-4(e)

Under § 1.1471-4(e)(1), in general each FFI that is a member of an expanded affiliated group must obtain the status of either a PFFI or a registered DCFFI as a condition for any other member of the expanded affiliated group to obtain such status. It is also contemplated that rules will be issued to facilitate a centralized application and administration process for FFI agreements by a lead member of an expanded affiliated group on behalf of all of its members.

The term "expanded affiliated group" is defined under § 1471(e)(2) and § 1.1471-5(i)(2) to include any affiliated group of corporations in which the parent owns more than 50% of the value and voting power of the stock of each member, as well as any partnership or other entity if more than 50% of the value of the beneficial interests in such entity is owned by other entities that are members of the expanded affiliated group.

The "all or none" rule of § 1.1471-4(e)(1) is predicated on the belief that the parent of an expanded affiliated group is in a position to control and to obtain the necessary information regarding each member. This, however, is not necessarily the case, in particular with respect to partnerships and other non-corporate entities, which may be treated as members of an expanded affiliated group if other members own more than 50% of the value of the beneficial interests in such entity even though they may not control the entity. Moreover, in the case of groups of investment funds (such as a family of private equity funds in which the manager controls many entities that may have different beneficial owners) as well as securitization vehicles, it would be desirable to permit the manager to handle the FFI agreements relating to most or all of the entities that it controls (or manages) on a combined basis even though no single person owns more than 50% of the value of the beneficial interests of the various partnerships. The FFI agreements for various joint venture or joint investment vehicles (including investment entities formed as part of "club" or co-investment deals) may, depending on business and other considerations, most suitably be handled by one or another of the members or managers or on a separate entity basis.

Recommendation No. 27: The "all or none" rule of § 1.1471-4(e)(1) as well as the FFI agreement application and administration rules should provide flexibility, on an entity-by-entity basis, for an FFI that is a partnership or other entity (including a corporation) that is controlled (or managed) by a person that does not own more than 50% of its beneficial interests to be either (i) combined with an expanded affiliated group that includes other entities controlled (or managed) by that person, (ii) combined with an expanded affiliated group that includes other entities owned by a person that owns more than 50% of the beneficial interests in such FFI or (iii) treated separately for purposes of entering into an FFI agreement.

## XI. THE LIMITED BRANCH AND AFFILIATE RULES ARE LAUDABLE BUT REQUIRE MODIFICATION (§ 1.1471-4(e)(2) and -4(e)(3))

The limited branch and affiliate rules are intended to address the problem facing many FFIs that are unable to comply fully with FATCA because of a conflicting local law requirement or prohibition. Such conflicts may, for example, prohibit reporting information directly to a foreign tax authority such as the IRS, withholding tax on behalf of a foreign sovereign, or blocking account activity of non-cooperative customers. The regulations address this problem by allowing an FFI expanded affiliated group to be treated as "participating" if it designates those branches and affiliates that are in "limited" jurisdictions, provided they take as many steps as legally possible to comply with the regulations without violating local law. This "limited" status only applies through the end of 2015. At that point an expanded affiliated group with one or more branches or affiliates in jurisdictions prohibiting some aspect of FATCA compliance apparently will be considered "non-participating" and the entire group will be subject to FATCA withholding, regardless of the efforts made by the group to otherwise comply with the regulations. In addition, even during the interim period ending on December 31, 2015, limited branches and affiliates will be treated as the equivalent of NPFFIs and subject to FATCA withholding on payments made to them.

The administrative purpose for limiting relief under this rule to an interim period ending on December 31, 2015 appears to be to encourage as many jurisdictions as possible by that date to become FATCA Partners and/or to modify or remove the local law impediments that prevent FFIs in that jurisdiction from complying with FATCA. However, we believe that the political reality is that even if they have the best intentions, many jurisdictions will not be able to move fast enough to become FATCA Partners or to change their laws. It is also quite unclear if an FFI will be able to restructure its operations in such a way as to avoid whatever issue exists in a particular jurisdiction. That means that many PFFI groups that have made significant investments to comply with FATCA will nonetheless be deemed non-participating and subject to group-wide FATCA withholding as of 2016.

We believe that the "limited" concept makes sense but that there is a better and more equitable way to structure the relief so that it both keeps pressure on other jurisdictions to find ways to allow local FFIs to comply with FATCA and does not unduly punish PFFI groups that are in the process of spending tens of millions of dollars to comply with the FATCA regime.

<u>Recommendation No. 28</u>:

a. <u>Allow a Grace Period for Limited Branches and Affiliates of Expanded Affiliated Groups of PFFIs</u>: We do not believe that it is advantageous to either FFIs or to the IRS to subject limited affiliates and branches of PFFI expanded affiliated groups to immediate withholding beginning in 2014 on U.S. source FDAP and certain gross proceeds beginning in 2015 (assuming our recommendation in Section II above for a delay in the general commencement of withholding is not adopted). There is a great likelihood that the political processes in other countries will take more than that amount of time to agree and implement the enabling legislation to become FATCA Partners or to modify laws to allow local FFIs to comply with FATCA. Assuming that many countries do lag behind the timetable of the proposed regulations, starting in 2014 there will be a potentially serious and disruptive level of FATCA withholding that may unnecessarily disrupt capital flows into the United States and punish the PFFI expanded affiliated groups that are spending significant amounts of money to comply as fully as possible.

We urge Treasury and the IRS to consider a more moderate approach to allow the PFFI groups and other governments to effect an orderly transition into FATCA by allowing a grace period from withholding for PFFI branches and affiliates until 2016, at which point FATCA withholding would apply to such limited branches and affiliates within a PFFI group. That timing would allow all parties sufficient time to plan for the transition into the full FATCA regime with the least possible amount of disruption to capital markets and PFFI commercial operations.

Also, if this grace period concept were adopted by Treasury and the IRS, then provision should also be made for an "orphan" FFI that is not part of an expanded affiliated group but operates in a "limited" jurisdiction. Such an orphan FFI should not be penalized until the end of the grace period simply because it has no affiliates that can become a PFFI, provided such an orphan FFI has entered into an FFI agreement and demonstrated its willingness to comply to the extent it can do so.

b. Allow PFFI Status After 2016 Even If Group Contains Limited Banks or Affiliates: We are very concerned that the limited FFI and branch concept sunsets in 2016. Such an approach leaves expanded affiliated PFFI groups in the untenable position of being treated as NPFFIs after having invested significantly in efforts to comply with FATCA. We likewise fail to see how this draconian approach is consistent with FATCA's stated policy goals to maximize reporting on U.S. persons while minimizing FATCA withholding events, because an expanded affiliated group treated as non-participating will be subject to full FATCA withholding despite its efforts to comply and by definition will supply no information on U.S. accounts to the IRS. We instead suggest that the limited FFI and branch status should be retained as a permanent feature of FATCA, and in conjunction with our first recommendation above, should result in FATCA withholding against such limited entities only after 2015.

In addition, we strongly believe that it would be appropriate to provide that an entity complying as fully as possible with FATCA in a "limited" jurisdiction that has entered into good faith negotiations with Treasury to become a FATCA Partner should not be subject to withholding after 2015. We believe that such an approach would serve the self-interest of the United States of encouraging other jurisdictions to enter into such arrangements in a timely manner.

c. Definition of "Limited": We are largely in agreement with the criteria that would make a branch or affiliate "limited" (e.g., an FFI in a jurisdiction that prohibits reporting information, closing or transferring accounts, etc.). See §§ 1.1471-4(e)(2)(iii) and -4(e)(3)(ii). However, there are some jurisdictions that require financial institutions to open accounts pursuant to various "access to financial services" regimes to ensure that citizens are able to secure basic financial services to be able to participate in day to day economic activities. Institutions in such jurisdictions may not be able to deny opening an account to a prospective "recalcitrant" customer who refuses to supply any required FATCA information. We recommend that a "limited" jurisdiction be expanded to include prohibitions on refusing to open an account for a customer.

## XII. THE DEFINITION OF "FINANCIAL ACCOUNT" AS APPLIED TO FINANCING ACTIVITIES OF BANKS, INCLUDING WIDELY TRADED BANK DEPOSITS, SHOULD BE CLARIFIED (§ 1.1471-5(b))

§ 1.1471-5(b)(1)(iii) provides broad relief for financing activities conducted by banks (and other FFIs other than Category (iii) FFIs) by providing that non-regularly traded equity or debt instruments in such an FFI generally will be treated as "financial accounts" *only if* the value of the debt or equity interest is determined, directly or indirectly, primarily by reference to assets that give rise to withholdable payments. Thus, the proposed regulations appear to recognize that foreign banks' ordinary course financing activities do not raise significant FATCA compliance concerns. As written, however, the proposed regulations exclude from this favorable treatment an important category of bank financing.

Many banks issue transferable certificates of deposit that are tradable in the capital markets. These instruments generally function identically to other tradable securities – they may be widely held and traded in a regulated or over-the-counter market and they may not be registered directly with the issuer – and thus it may be difficult for the issuer to obtain the required holder documentation. The principal substantive difference between these transferable certificates of deposit and conventional securities is that the former are entitled to deposit protection under local bank regulation. Because these instruments are regulated as deposits, however, it appears that they would separately be treated as "financial accounts" pursuant to §§ 1.1471-5(b)(1)(i) and -5(b)(3)(i), and thus would not be covered by the more flexible rules provided for other debt instruments issued by the bank. This result is inconsistent with the flexibility contemplated by § 1.1471-5(b)(1)(iii).

In addition, the formulation of the relief described above for financing activities conducted by banks (and other FFIs other than Category (iii) FFIs) is potentially susceptible to being misconstrued and should be clarified. For example, we believe that the exclusion of equity or debt instruments "if the value of the debt or equity interest is determined, directly or indirectly, primarily by reference to assets that give rise to withholdable payments" is not intended to exclude U.S. dollar-denominated debt instruments issued by a bank that holds U.S. Treasury securities or other securities issued by U.S. issuers. We also believe that this exclusion would not cover structured note programs in which, at the time of issuance, less than 50% of the value of the instrument is determined, directly or indirectly, by reference to underlying assets that give rise withholdable payments (for example, because the holder was assured of receiving a substantial portion of its principal and/or its contingent return is capped). On the other hand, we believe that this exclusion would cover the issuance of a debt or equity instrument whose principal amount and returns thereon were fixed primarily by reference to specified U.S. stocks or securities (although we note that such instruments are not typically issued by FFIs that are not Category (iii) FFIs). Thus we believe that the intention of this exclusion is to operate as an anti-abuse rule in situations in which a bank acts as a conduit for investment in specified assets and similar situations, rather than to apply to structured note or other existing financing activities of banks, at least until further guidance is provided regarding passthru payments.

<u>Recommendation No. 29</u>:

a. The definition of "depository account" in § 1.1471-5(b)(3)(i) should be revised to exclude certificates of deposit and other similar instruments that are issued in the form of negotiable instruments that are traded on a regulated market or an over-the-counter market. Thus, such instruments would be treated as "financial accounts" only to the extent they are debt instruments that are described in § 1.1471-5(b)(1)(iii).

b. The scope of the exclusion § 1.1471-5(b)(1)(iii) for non-regularly traded debt or equity instruments of FFIs (other than Category (iii) FFIs) unless the value of the debt or equity interest is determined, directly or indirectly, primarily by reference to assets that give rise to withholdable payments, should be clarified to confirm our understanding as described above.

## XIII. ESCROW ACCOUNTS SHOULD BE EXCLUDED FROM THE DEFINITION OF FINANCIAL ACCOUNTS (§ 1471-5(b)(2)

Many fiduciaries, such as attorneys or public notaries, establish accounts to hold money in escrow for parties engaged in many different kinds of transactions, such as property closings or share acquisitions. Escrowed amounts typically are not held for long periods of time, and the beneficial owners of the money deposited in such accounts can change on a constant basis. We believe that requiring the entitled persons/beneficial owners using these accounts to be identified for FATCA purposes is neither necessary nor ultimately helpful to the IRS. In addition, we believe that escrow accounts present little to no risk of U.S. tax evasion potential since they are by nature transitory in nature (as opposed to serving an investment purpose), designed solely to facilitate commercial transactions, and held by fiduciaries. We accordingly ask that escrow accounts set up to facilitate commercial transactions should be excluded from the definition of financial accounts in § 1471-5(b).

Recommendation No. 30: Exclude escrow accounts maintained by fiduciaries to facilitate commercial transactions from the definition of financial account given that they present little to no risk of U.S. tax evasion since by their nature they are not for investment purposes but purely to facilitate commercial transactions.

## XIV. THE EXCLUSION OF CERTAIN RETIREMENT, PENSION AND SAVINGS ACCOUNTS FROM THE DEFINITION OF FINANCIAL ACCOUNT SHOULD BE EXPANDED ((§ 1471-5(b)(2))

The proposed regulations contain exclusions from the definition of "financial account" for certain accounts that are subject to regulations as a personal retirement account or are registered and regulated as an account for the provision of retirement or pension benefits provided certain criteria are met, including an annual contribution limit of $50,000. Treas. Reg. § 1.1471-5(b)(2)(i)(A) and (B). Non-retirement savings accounts are also excluded if certain criteria are met, including an annual contribution limit of $50,000.

We welcome the intent of these provisions to simplify compliance by carving out accounts that present little or no risk of U.S. tax evasion potential because they are highly regulated by a local government and their tax favored status necessarily is accompanied by many restrictions on their use that would render them of little value as a vehicle for tax evasion.

However, we also believe that these definitions can and should be expanded in several regards. First, many countries rely on the insurance industry to offer retirement, pension and saving accounts, all of which are highly regulated, tax favored and bound by different restrictions on their use. There is no apparent difference between such insurance products and those offered by governments, employers or pensions. We accordingly ask that the regulations specifically allow such insurance products to be covered.

Second, the regulations do not appear to recognize that the funds for legitimate tax-favored and restricted products can come directly from a self-employed individual as well as from an employer or employee. We believe that the regulations should clarify this important point and provide for this source of funds provided it has been contributed to a qualifying account.

Third, the $50,000 contribution limit should be removed or at least substantially increased since there are any number of legitimate reasons that an employer, pension, government or individual might exceed such limit. For example, an employer may have to contribute more than $50,000 in order to top up a worker hired close to retirement age or to ensure that a plan remains qualifying under local law. As another example, in many countries a lump sum will be paid for a contract to provide a retirement annuity that will exceed the limit. We believe that the $50,000 limit is best removed and reliance should be placed on the fact that the account is highly regulated by the local government, tax favored and bound by restrictions on its use.

<u>Recommendation No. 31</u>: We ask that the final regulations exempt from the definition of "financial account" any government-regulated and tax-favored account, including those offered by insurance companies, and that individual beneficiaries be allowed to qualify as the "source of funds" for a qualifying account. Furthermore, we ask that the $50,000 annual contribution limit be eliminated or at least substantially increased.

## XV. THE SCOPE OF WHAT IS A CATEGORY (iii) FFI SHOULD BE NARROWED AND ADDITIONAL CARVE-OUTS SHOULD BE ADDED (§ 1. 1471-5(e)(1)(iii) & (f))

### A. Overview

The statute defines a Category (iii) FFI (an investment entity) as an entity that "is *engaged in the business* of investing, reinvesting, or trading in" securities, partnership interests, commodities or any interest therein" (§ 1471(d)(5)(C) (italics added)). Notice 2010-60 indicated that the concept of "business" as used in (§ 1471(d)(5)(C) "is different in scope and content from the concept of a 'trade or business' as used in other sections of the Code," and thus may extend to isolated transactions "depending on such factors as the magnitude and importance of the transaction in comparison to the entity's other activities." The Notice indicated that the determination must be made on the basis of all relevant facts and circumstances, but that the regulations would provide further guidance on this question.

The only relevant provision of the proposed regulation, § 1.1471-4(e)(4), does not provide further guidance regarding the application of a qualitative, facts-and-circumstances inquiry, and simply states that, "[a]n entity is primarily engaged in the business of investing, reinvesting, or trading if the entity's gross income attributable to such activities equals or exceeds 50 percent of the entity's gross income" during a prescribed period.

<u>Recommendation No. 32</u>: Treasury and the IRS should provide clearer guidance on this critical question. Also, this question is closely related to the interface between Category (iii) FFIs and § 1472, as to which we provide recommendations in Section XVII below. In any event, if as it appears from the proposed regulations, the intention is to interpret the scope of Category (iii) FFIs very broadly, except as set forth in precisely defined exceptions, it is critically important for Treasury and the IRS to ensure that the exceptions that are contained in the regulations effectively cover those cases that need to be excluded in order for the rules to be administrable.

As set forth in our specific recommendations below, we believe that there are very serious gaps in the exceptions, which need to be corrected.

### B. Nonfinancial Holding Companies and their Investment Subsidiaries (§ 1.1471-5(e)(5)(i))

The proposed regulations helpfully provide that holding companies for nonfinancial groups generally are not treated as FFIs and are treated as excepted NFFEs. However, we are concerned that the exception as drafted is so narrow that it will have very little practical utility. The exception in §1.1471-5(e)(5)(i) applies only if *none* of the holding company's subsidiaries is a financial institution. However, a large number of corporate groups include at least one entity that would likely be treated as a financial institution under the broad definition in the proposed regulations, such as a subsidiary that manages the group's investments or a company that finances customer purchases of products sold by the group (and/or by third parties).[8]

The existence of an investment or customer finance subsidiary within a corporate group – or indeed (as discussed below), the existence of a subsidiary that conducts an active financial business – should not affect the basic notion that a holding company for an active business group typically should not properly be viewed as engaged "in the *business of* investing, reinvesting, or trading in securities" for purposes of FATCA because as a practical matter U.S. persons cannot directly or indirectly utilize an investment in the holding company to avoid U.S. tax by investing in financial assets separate from active nonfinancial businesses.

As noted above, many affiliated groups that conduct non-financial businesses include one or more subsidiaries that hold and manage investments for the group or that provide customer financing. Absent an exemption, those subsidiaries generally would be Category (iii) FFIs, although typically the only "financial accounts" in such an entity would be those held by its affiliates or straight debt issued by those subsidiaries to finance their activities. As noted above, if those affiliates are active NFFEs, we believe that there is little risk that U.S. persons would be able to use the investment subsidiary to make indirect investments in U.S. assets or otherwise avoid U.S. tax. In that respect, such a subsidiary should be viewed as analogous to a hedging or financing center of a non-financial group, which is exempt from being treated as an FFI, and is treated as an excepted NFFE, pursuant to §1.1471-5(e)(5)(iv).

Similarly, the rules relating to NFFEs that are publicly traded corporations and their affiliates (§§ 1.1471-3(d)(11)(1) & (2), 1.1472-1(c)(1)(i) & (ii)) would not be available to an investment or customer finance subsidiary of a publicly traded NFFE group or to the publicly traded corporate parent of the group if it had any such subsidiaries.

The treatment as an FFI of such an investment or customer finance subsidiary or a holding company of a nonfinancial group that contains such an investment or customer finance subsidiary would impose on the nonfinancial group and its investment and customer finance

[8] The exception for hedging/financing centers of nonfinancial groups in § 1.1471-5(e)(5)(iv) may cover a customer finance company, on the grounds that it provides financing "for" members of its expanded affiliated group, although technically the financing is provided to/for the expanded affiliated group's customers, but in any event the exception would not apply if, as is not uncommon, the finance company also provides financing to third parties.

subsidiaries the substantial burdens of entering into and complying with a FFI agreement without serving a significant tax compliance purpose. Moreover, these burdens could be avoided by a well-advised group that is willing and able to restructure those subsidiaries and to file elections for such subsidiaries to be treated as disregarded entities for U.S. federal income tax purposes. We do not believe it sensible to require nonfinancial groups to engage in such restructurings and check-the-box elections to avoid being treated as FFIs.

Recommendation No. 33:

a. § 1.1471-5(e)(5)(i) should be revised to remove the requirement that no subsidiary of a holding company be a financial institution.

b. § 1.1471-5(e)(5) should be expanded to include an exception for an investment or customer finance subsidiary of a nonfinancial group provided that (i) the entity is not described in § 1.1471(e)(1)(i), (ii) or (iv), (ii) equity interests in the entity (other than nonparticipating preferred stock) are entirely owned by one or more members of its expanded affiliated group that are not financial institutions, (iii) the entity does not issue any financial accounts (other than debt whose value is not determined, directly or indirectly, primarily by reference to assets that give rise to withholdable payments) to non-members of its expanded affiliated group and (iv) the expanded affiliated group of which it is a member is primarily engaged in a business other than that of a financial institution (which should be satisfied if more than 50% of the aggregate amount of gross income of the members of the expanded affiliated group, excluding amounts from other members, is not passive income as defined in § 1.1472-1(c)(1)(v)).

c. Conforming changes should be made to §§ 1.1471-3(d)(11)(1) & (2), 1.1472-1(c)(1)(i) & (ii). In addition, § 1.1472-1(c)(1)(ii) should be revised so that it applies to any "entity" that is a member of the same expanded affiliated group as a publicly traded corporation, and not limited to a corporate member.

### C. Financial Group Holding Companies and Certain Finance Subsidiaries Need Relief from FATCA (§ 1.1471-5(e)(5)(i))

The proposed regulations do not contain any exception from FFI status for holding companies of active financial groups. Consequently, if the Category (iii) FFI definition is interpreted broadly to cover any holding company (by virtue of the fact that it holds the stock of subsidiaries), a bank holding company or other financial group holding company would be a Category (iii) FFI. While its publicly traded equity and debt would be excluded under the exception for interests that are regularly traded on an established securities market, many bank holding companies issue substantial amounts of debt – such as medium term notes (MTNs) – that are not regularly traded on an established securities market. Much of this debt is in bearer form, and in any event, it would not be practical for the bank to apply FATCA due diligence, reporting or withholding to such debt. Moreover, such debt is invariably held by any non-financial institution through a financial account at a financial institution, so FATCA due diligence, reporting and withholding would be satisfied at that downstream level.

Similarly, a bank holding company or bank may use a separate entity (such as an SPV or a finance subsidiary) to issue MTNs or other debt to raise funds for use by the group. These entities also do not benefit from an exemption from FFI status under the proposed regulations.

If the MTN or other debt were issued by the group's bank subsidiary, it would be excluded from the definition of financial account under § 1.1471-5(b)(1)(iii). The holding company or finance entity affiliate should eligible for a similar exemption.

More generally, the proposed regulations' exemption for nonfinancial holding companies appears to acknowledge that the mere ownership of the stock of one or more subsidiaries should not be treated as equivalent to the type of investment activities conducted by Category (iii) FFIs. We respectfully submit that the activities of a bank holding company or other holding company of an expanded affiliated group that is conducting an active financial business are indistinguishable from those conducted by nonfinancial holding companies. Thus, the reasoning that supports an exemption for nonfinancial holding companies should apply equally to *any* holding company, provided it does not otherwise conduct activities that would cause it to be treated as a "financial institution." (To the extent any activities described in § 1.1471-5(e)(1) are conducted within the holding company's expanded affiliated group, the relevant members of the group will be treated as FFIs and will be required to comply with FATCA.)

<u>Recommendation No. 34</u>:

a. § 1.1471-5(e)(5)(i) should be expanded to apply to a holding company of an "active financial business group." For this purpose, an active financial business group should be defined as an expanded affiliated group in which more than 50% of the financial assets of the group, determined by disregarding any interests in members of the group, are held by any entity that is a Category (i), (ii) or (iv) FFI or that is primarily engaged in an active non-financial business.

b. §1.1471-5(b)(1)(iii) should be revised to provide, in addition, that a debt or equity interest issued by the holding company or any member of an active financial business group will be treated as a financial account only if the value of the debt or equity interest is determined, directly or indirectly, primarily by reference to assets that give rise to withholdable payments, provided that this additional rule will not apply to a debt or equity interest issued to a person other than a member of the expanded affiliated group by a member (other than the holding company) that is a Category (iii) FFI (determined by treating that member as owning a proportionate share of the assets, and conducting the businesses, of any other member in which such member holds a debt or equity interest).

## XVI. <u>THE CATEGORIES OF DCFFIs SHOULD BE EXPANDED (§ 1.1471-5(f))</u>

### A. <u>Introduction</u>

We appreciate that Treasury and the IRS both (i) introduced new categories of DCFFIs and (ii) liberalized the criteria for specific categories of DCFFIs that had been discussed in the FATCA Notices. We particularly support the concept underpinning DCFFI status to reduce the FATCA compliance burden on those entities that can reasonably be identified as presenting a "low risk" of fostering activity that is contrary to the compliance goals of FATCA. However, we believe that the qualifying criteria for some DCFFI categories in some instances eschew a direct approach in favor of a more circuitous one or contain requirements that appear superfluous. As a result, many entities that legitimately present a low FATCA risk will be forced into full PFFI status, and many others will be forced to take on far more burden, cost and risk than necessary to carry out FATCA's policy goals. We discuss each DCFFI category in more detail below.

### B. <u>Liberalize the Criteria for "Local FFIs" and for "Nonregistering Local Banks" (§§ 1.1471-5(f)(1)(i)(A) & -5(f)(2)((i))</u>

The proposed regulations specify that a "local FFI" constitutes a registered DCFFI and modify criteria that were originally contained in Notice 2011-34 to treat certain "local banks" as DCFFIs. The proposed regulations also provide an exception, as a certified DCFFI, for a "nonregistering local bank." We welcome these changes since they allow more entities to take advantage of this status. However, we think that the criteria for these exceptions can be further liberalized while still attaining the compliance goals of the IRS.

Treasury and IRS officials have stated that the objective of identifying "local" FFIs is to provide less sophisticated FFIs a less burdensome regime than having to enter into an FFI agreement. We respectfully submit that the simplest and most administrable way to achieve this goal is by focusing on the prohibition against such FFIs holding accounts for NPFFIs and U.S. persons (unless the U.S. person is resident in the FFI's home country, consistent with the approach in the proposed regulations). We believe that institutions able to meet such restrictions are likely to be less sophisticated, and they definitely will meet the statutory objective of identifying low risk entities that should not be subject to the full FATCA regime. We also note that this approach is more consistent with § 1471(b)(2)(A)(i) and (ii) of the FATCA statute than many of the criteria set forth in the proposed regulations.

Accordingly, we would recommend revising the "local FFI" criteria by including only the core requirements that are consistent with § 1471(b)(2)(A)(i) and (ii). Our suggested approach would require qualifying FFIs to have all of their operations: (1) licensed as currently described in § 1.1471-5(f)(1)(i)(A)(1); (2) prohibited from soliciting or holding U.S. accounts (except for U.S. persons resident in the particular country) or NPFFI accounts; (3) subject to local tax law reporting or withholding for local accounts; (4) adopt appropriate procedures to comply with the exception; and (5) perform any necessary due diligence to identify preexisting U.S. and NPFFI accounts. Similar changes should be made to the requirements for nonregistering local banks.

We explain our rationale on different aspects of the current rule in the following recommendations.

<u>Recommendation No. 35</u>:

a. <u>Eliminate Same Country Requirement</u>: We understand that Treasury and the IRS included the criteria in §§ 1.1471-5(f)(1)(i)(A)(2) and (8) (i.e., no fixed place of business or affiliate outside the local country) to help identify true "local" entities. However, whether such entities are "local" does not appear to be the relevant criterion to identify a low risk entity for FATCA – rather the identification, elimination and on-going prohibition against NPFFI and most U.S. accounts should be the core requirement. Moreover, there are many small, local banks that for one reason or another have one or two offices or branches in other countries. We accordingly recommend eliminating paragraphs (2) and (8) of the current rule and instead requiring all parts of an FFI group to meet the qualifying criteria that we describe above. Similar changes should be made to the criteria for nonregistering local banks contained in paragraphs (B) and (F) of § 1.1471-5(f)(2)(i).

b. Replace Solicitation Rule With More Targeted Approach: Paragraph (3) of the current rule prohibits soliciting new customers outside the local country. For this purpose, a website is not considered to be solicitation of account holders outside the FFI's country of organization so long as inter alia the website does not advertise the availability of U.S. dollar denominated deposit accounts or other U.S. dollar denominated investments. Instead of this restrictive requirement, we recommend a more targeted rule that simply prohibits the direct solicitation of U.S. and NPFFI accounts. Even assuming that Treasury and the IRS do not adopt our third recommendation below to eliminate the 98% local customer rule, we think that our suggested targeted approach helps avoid many gray areas that render the current "no solicitation outside the local country" rule highly difficult to administer. We further point out that eliminating the current solicitation rule is consistent with the logic that led the Treasury and the IRS to clarify that operating a website does not constitute "soliciting" outside the local country. For example, why should a television, print or radio advertisement that is viewed or heard outside the "local" country, violate the prohibition not to solicit account holders outside the local country any more than operating a website? Do such traditional advertisements have to be worded to state that non-residents are discouraged from becoming customers to guard against being considered non-compliant if such advertisements are viewed or heard outside the local country? Revising the "no solicitation outside the local country" rule as recommended would avoid these kinds of thorny issues. Moreover, given the U.S. dollar's position as the principal international reserve currency and is the official currency of at least eleven countries other than the United States, we think it unrealistic to prohibit a website from advertising the availability of U.S. dollar denominated deposit accounts or other U.S. dollar denominated investments, since many non-U.S. persons will have commercial reasons to hold U.S. dollar denominated financial instruments, and even local institutions can be expected to offer such services to their customers. Similar changes should be made to the criteria for nonregistering local banks contained in paragraph (C) of § 1.1471-5(f)(2)(i).

c. Eliminate or Reduce the 98% Resident Rule: Paragraph (5) requires a "local FFI" to have at least 98% of its accounts held by local residents. We believe that there is a strong case in favor of eliminating this threshold since there is no apparent reason why the Treasury/IRS should object to an FFI having greater numbers of non-residents as customers assuming that the FFI does not allow non-resident U.S. persons or NPFFIs as accountholders.[9] As with our comments above, we believe that this deemed compliant category should be less focused on the "local" nature of the FFI and more on the actual constituency of the customer base since that approach is far more consistent with § 1471(b)(2)(A)(i) and (ii).

[9] If the proposed regulations are not revised as discussed in Section XVII below to exclude non-commercial investment vehicles from the scope of Category (iii) FFIs, the exceptions for "local FFIs" and nonregistering local banks are unlikely to be available since it is not feasible to expect these entities to close accounts of all non-commercial investment vehicles that are NPFFIs.

In the alternative, if Treasury and the IRS want to retain the "local" flavor of this category, we believe that the 98% requirement should reflect more realistic commercial realities and be reduced to 90% but applied to each part of the FFI group (e.g., 90% of the customers of an FFI branch or an FFI affiliate).

d. Adopt Broader Definition of Europe: We appreciate that the Treasury and the IRS agreed to treat the European Union as one country. However, if Treasury and the IRS decide not to adopt our third recommendation to eliminate the 98% local resident rule and either retain that threshold or a lower one, we would respectfully ask that the regulation be more inclusive and define "Europe" as effectively one country consisting of the members of the European Union and the European Free Trade Association since both facilitate capital flows and investments among the member countries.

### C. Liberalize the Criteria for FFIs with Only Low-Value Accounts (§ 1.1471-5(f)(2)(iv))

Under the proposed regulations, a Category (i) or (ii) FFI can qualify as a certified DCFFI if (i) neither the FFI nor any other member of its expanded affiliated group maintains *any* financial accounts that have a balance or value in excess of $50,000 (applying the aggregation rules of § 1.1471-5(a)(4)(i)) and (ii) the FFI (or, any expanded affiliated group of which it is a member) has no more than $50 million in assets.

These limitations – in particular, the limitation on the total assets of the FFI or its expanded affiliated group – are too restrictive to provide significant practical utility. The $50 million limitation is so low that it is likely to apply to only a very few local banks, and we believe that this limit can be increased substantially without significantly increasing the risk of tax evasion. The restriction on the overall size of the accounts that the FFI can maintain makes it highly unlikely that such a bank would attract U.S. customers that are seeking to evade tax, even if the overall balance sheet of the FFI were permitted to be somewhat larger. Similarly, we believe it unlikely that U.S. persons seeking to evade tax would risk investing material amounts of money in banks that do not have substantial assets (or, by implication, capital). Thus, we believe that the limitation on the total assets of the FFI or its expanded affiliated group should be increased significantly – for example to $500 million (which would still be a small bank by most standards).

We also believe that the requirement that neither the FFI nor any other member of its expanded affiliated group maintain *any* account with a balance or value in excess of $50,000 is too restrictive. Although the $50,000 threshold in general may help to reduce the risk that the FFI could be used to facilitate tax evasion, the inflexibility of the rule could further limit its utility for small FFIs. (For example, an FFI could lose its deemed-compliant status simply because the assets in a single customer account appreciate in value to greater than $50,000.) Thus, we recommend that the rule be modified to permit a de minimis amount of accounts to exceed the $50,000 threshold, so long as appropriate safeguards are in place to ensure that any such accounts are not U.S. accounts or held by NPFFIs. For example, the rule could be revised to require that (i) no more than 10 percent of the assets held in financial accounts at the FFI are held in accounts for which the balance or value is greater than $50,000 (but in any event not in excess of, say, $500,000), and (ii) with respect to any accounts having a balance or value in excess of

$50,000, the FFI maintains procedures to ensure that such accounts are not U.S. accounts or held by NPFFIs.

Recommendation No. 36:

a. § 1.1471-5(f)(2)(iv)(C) should be revised to increase the limit on the FFI's (or its expanded affiliated group's) assets to $500 million.

b. § 1.1471-5(f)(2)(iv)(B) should be revised to permit the FFI to maintain financial accounts with a balance or value in excess of $50,000 (but in any event not in excess of, say, $500,000) if (i) no more than 10 percent of the assets held in financial accounts at the FFI are held in accounts for which the balance or value is greater than $50,000 and (ii) with respect to any accounts having a balance or value in excess of $50,000, the FFI maintains procedures to ensure that such accounts are not U.S. accounts or held by NPFFIs.

## XVII. THE SCOPE OF WHAT IS A CATEGORY (iii) FFI SHOULD BE NARROWED BY REMOVING NON-COMMERCIAL INVESTMENT ENTITIES (§ 1. 1471-5(e)(1)(iii) & -5(e)(4))

There is an urgent and critical need for Treasury and the IRS to reconsider their interpretation of the interplay between §§ 1471(d)(5)(C) and 1472(d) since it leads to the unadministrable result of categorizing all non-U.S. investment entities, no matter how small, as "financial institutions." We strongly believe that a failure by Treasury and IRS to address this issue will severely impair the ability of FIs to comply with the regime and impose costs and burdens on such FIs grossly disproportionate to any compliance benefit. We believe that these adverse effects can and must be avoided.

§ 1472(d) states that "for purposes of [§ 1472], the term "non-financial foreign entity" ("NFFE") means any foreign entity which is not a financial institution (as defined in section 1471(d)(5)." § 1471(d)(5) defines three categories of "financial institution." The first two categories are entities that engage in banking type activities (§ 1471(d)(5)(A)) and those that serve as custodians or other financial intermediaries, such as brokers (§ 1471(d)(5)(B)). We believe that it is obvious that such entities should be treated as "financial institutions" and not NFFEs since their functions necessarily are commercial and available to the public. It is logical to assume that such entities would have the capability to enter into an FFI Agreement (provided they are not carved out as "low risk").

§ 1471(d)(5)(C) presents a very different issue. That provision states that a financial institution includes an entity that "***is engaged (or holding itself out as being engaged) primarily in the business*** of investing, reinvesting or trading in securities (as defined in 457(c)(2) without regard to the last sentence thereof), partnership interests, commodities (as defined in section 475(e)(2)), or any interest (including a futures or forward contract or option) in such securities, partnership interests, or commodities." (Emphasis added)

Treasury and the IRS have interpreted the above provision to mean that all passive investment vehicles, no matter how small, must be carved out of NFFE treatment and instead treated as Category (iii) FFIs (see § 1.1471-5(e)(1)(iii) & -5(e)(4)). This leads to what we view as an administratively unworkable result of treating any non-commercial investment vehicle, such as a family or individual trust or a passive investment vehicle or even a small special purpose vehicle ("SPV"), in the same way as a large and sophisticated hedge fund or other "commercial" investment vehicle and expecting such a non-commercial investment vehicle to be able to enter into an FFI agreement with the IRS and otherwise comply with the new requirements under FATCA, even though the vast majority of these entities will be non-U.S. entities with no U.S. owners and no U.S. investments.  The only alternative provided by the proposed regulations is the "owner-documented FFI" provision which, as explained below, is not practical for many such non-commercial investment entities.

We respectfully question whether § 1471(d)(5)(C) was intended to cover most non-commercial investment vehicles in view of the long-standing historical understanding that "investing" in stocks and securities does not constitute a trade or business (see, e.g., *Higgins v. Commissioner*, 312 U.S. 212 (1941)).  In any event, given that § 1471(d)(5) itself and § 1474(f) grant Treasury and the IRS the regulatory authority to depart from the precise statutory definition of an FI, we urge Treasury and the IRS to adopt an approach that avoids the disproportionate costs and risks of treating all non-commercial investment entities as FFIs.  Specifically, we believe that Category (iii) FFIs should be limited to commercial investment vehicles, and that this limitation in its scope can be delineated based on the concept of "holding oneself out" as engaged in the business of investing.  This concept, which is already set forth in the parenthetical clause in § 1471(d)(5)(C), is one that FIs can easily incorporate into account opening procedures to distinguish between commercial and private entities.  For this purpose, an investment entity should be treated as holding itself out as engaged in the business of investing if it is organized and managed by an investment advisor or fund manager.

Moreover, by treating non-commercial investment entities as NFFEs, § 1472 would become a fully functioning statutory provision rather than the peripheral one that is envisioned in the proposed regulations, limited essentially to real estate investment vehicles and other "passive NFFEs."   More to the point, § 1472 would operate as intended to provide an administrable way for the enormous number of non-commercial investment entities around the world to certify to withholding agents as to whether they have any U.S. owners, which certification can be checked against AML/KYC standards and other account records.

The certification approach of § 1472 is vastly superior to the potentially significant administrative complexities of the "owner-documented FFI" provision contained §§ 1.1471-3(d)(7) and -5(f)(3) if it is applied to the vast numbers of non-commercial investment entities around the world.  We cannot stress strongly enough that the "owner-documented FFI" concept fails the administrative goals that Treasury and the IRS have announced that they intend to follow in fashioning FATCA guidance.

First, the cost, burden and complexity of the proposal are staggering.  It would require FIs to receive a U.S. tax form stating that the entity is an "owner-documented FFI," collect, validate, maintain and renew all underlying ownership documentation, and collect and process an annual withholding statement and certificate.  In the alternative, affected FFIs would have to annually provide a letter from an accounting firm – with an office in the U.S. – that it has no U.S. owners. What is important to remember is that the objective of this enormous effort, which would require an army of staff around the world to administer, would be to find the small percentage of non-

U.S. investment entities with a U.S. owner while the vast majority of these investment entities would have no U.S. owners, investments or nexus.

Second, the proposal bears no resemblance to any AML/KYC standards but is a dramatic departure from them. By contrast, collecting a certification of ownership and checking any representations made as to the owners of such entities, which would apply under a §1472 approach, would be quite consistent with many AML/KYC regimes.

Third, the proposal is not simply inconsistent with current commercial practice, but constitutes an overbearing and unnecessary burden on both the customer entities and the FIs servicing them. It requires FIs to take a number of steps with this customer population that would create commercial havoc; to name just a few – collecting U.S. tax forms, requiring new annual documentation from them for a U.S. tax purpose, and requiring them possibly to take on the cost of having a large accounting firm certify that they have no U.S. owners. We stress again that all of these new requirements and obligations would apply to a population of entities that overwhelmingly will have no U.S. ownership or nexus at all.

Fourth, while treating non-commercial FFIs as NFFEs would (absent further action by Treasury and the IRS) result in increasing the ownership threshold of "substantial U.S. owners" from 0% to 10%, we do not believe that such increase would impair the compliance goal of FATCA to identify U.S. persons attempting to evade tax offshore, nor would such compliance goal be impaired if, ideally, the threshold were increased to the percentage of ownership that applies for local AML/KYC procedures for identifying the owners of passive investment vehicles. In the vast majority of situations, U.S. persons engaged in attempted tax evasion require – and establish – substantial ownership and control of their offshore entities to effectuate the evasion. We believe it is this rationale that led Congress in the first place to insert a more-than-10% ownership threshold into § 1472. If there is a concern regarding families manipulating ownership interests to evade the more than 10% substantial U.S. owner threshold, a family attribution rule could be added. However, it is unlikely that a non-commercial investment entity would be made up of a substantial number of unrelated parties all banding together to evade U.S. tax, and that if such were the case, an FFI in which that entity held an account would not have reason to know of such evasion plans.

<u>Recommendation No. 37</u>: We urge Treasury and the IRS to adopt the interpretation of § 1471(d)(5)(C) offered above and allow non-commercial investment entities to be treated as NFFEs. Additionally, withholding agents should be specifically allowed to use industry codes where possible to identify a commercial from a non-commercial investment entity. We further ask that such entities be allowed to provide the certifications provided for in § 1472, which could be built into commercially viable and non-U.S. specific account opening procedures. Information collected during this account opening process would be checked against AML/KYC information and other account records for consistency and validity. We believe that the "owner-documented FFI" concept can be retained provided the non-commercial investment entities are no longer defined as "FFIs." That concept would then operate as it should to allow withholding agents and commercial investment entities to assess whether it is a sensible alternative to the customer being required to enter into its own FFI agreement.

## XVIII. THE DEFINITION OF ACTIVE NFFE SHOULD BE REFINED (§ 1.1472-1(c)(1)(v))

We believe that the approach to determining whether an FI is dealing with an "active NFFE" as defined in § 1.1472-1(c)(1)(v) should be fundamentally rethought. The definition introduces an unnecessary degree of complexity and uncertainty to what should be a relatively straightforward determination. The proposed regulation approach appears to be modeled on the passive foreign investment company ("PFIC") rules and introduces many of the same administrative complexities that have long plagued those rules. For example, both withholding agents and NFFEs must determine from year to year whether an NFFE is "active" or "passive" based on a valuation of its assets, which may not be at all evident particularly for smaller entities that may end up with more cash or investments in some years compared to non-liquid "operating" assets (including intangibles that are difficult to value and may not be reflected on the entity's financial statement). In addition, withholding agents must attempt to learn far more about their entity customers than has ever been contemplated for any commercial or AML/KYC purpose in order to determine whether more than 50% of assets are passive or not. As we stated above, Treasury and the IRS should attempt as much as possible to meet their stated goal of harmonizing FATCA requirements with prevailing commercial and AML/KYC practices to reduce unnecessary burdens and costs.

We ask that the regulations adopt a more pragmatic and less U.S.-tax technical approach to this issue by allowing NFFEs and withholding agents to rely on existing commercial practices and AML/KYC rules to make this determination. For example, the regulations should allow the use of standard industry codes of all types to identify both preexisting and new accounts as "active" businesses that satisfy the exception and otherwise rely on their normal commercial practices in making this determination. Such codes could be collected and verified in the account opening process and would establish the treatment of the entity unless there is a true change in circumstances that would suggest that the NFFE was no longer an "active" business. As another example, some AML/KYC regimes require FIs to distinguish passive investment vehicles in order to subject them to higher level scrutiny, and FIs operating in such jurisdictions should be able to rely on that determination.

At a minimum and if the Treasury and IRS retain the existing approach, the definition of "passive" is far too broad and will inadvertently include too many active businesses. We offer in our recommendations below some suggestions on how to address this problem.

Recommendation No. 38:

a. Replace the highly U.S.-tax technical rule with a more pragmatic one based on prevailing commercial and AML/KYC practices to identify "active" NFFEs, including the use of standard internal or industry codes.

b. If the definition of "passive" is retained:

i. For purposes of § 1.1472-1(c)(1)(v), passive income should not include dividend or interest income from any member of the expanded affiliated group or gains from the sale of interest in any member of the expanded affiliated group. In addition, for clarity's sake, § 1.1472-

1(c)(1)(v) should include a statement similar to that which is in the nonfinancial holding company rule of § 1.1471-5(e)(5)(i) to the effect that, "An entity is not described in this [paragraph] if the entity functions (or holds itself out) as an investment fund, such as a private equity fund, venture capital fund, leveraged buyout fund or any investment vehicle whose purpose is to acquire or fund companies and then hold interests in those companies as capital assets for investment purposes."

ii. Paragraph (C) should be revised to include rents and royalties derived in the active conduct of a trade or business conducted by employees of the NFFE or of any member of its expanded affiliated group (since employees are often concentrated in a single company within the group).

iii. Paragraphs (H), (I) and (J) should have broad business hedging exceptions.

## XIX. <u>THE TREATMENT OF GROSS PROCEEDS FROM SECURITIES GENERATING ECI SHOULD BE REFINED (§ 1.1473-1(a)(4)(ii))</u>

The proposed regulations appropriately treat any item of income that is ECI as excluded from the definition of a "withholdable payment" (§ 1.1473-1(a)(4)(ii)). In many cases, however, under §§ 864 and 865, gross proceeds from the sale or exchange of stocks and securities are treated as foreign source income and not ECI even though the dividend and interest income on such securities would be ECI. It would be very expensive for FFIs and other withholding agents to have to set up systems to separately categorize such stocks and securities so as to treat dividends and interest as withholdable payments but gross proceeds as not being withholdable payments. Also, such a distinction does not seem to make sense for FATCA compliance purposes, as evidenced by the fact that the characterization of gross proceeds from property under FATCA generally depends on the FATCA characterization of the dividends or interest payments that such property can produce.

<u>Recommendation No. 39</u>: The regulation should be revised to provide that gross proceeds from stocks and securities will not be a withholdable payment if the dividends or interest that such stocks and securities may produce would be ECI.

## XX. <u>THE RESPECTIVE RESPONSIBILITIES OF AGENTS AND THEIR PRINCIPALS NEEDS TO BE CLARIFIED (§ 1.1474-1(a))</u>

§ 1.1474-1(a)(3) provides that PFFIs can use agents to fulfill their obligations under FATCA but that such PFFIs retain responsibility for FATCA compliance. However, the proposed regulations do not clearly delineate the responsibilities of agents and do not state that such agents "step in the shoes" of their PFFI or DCFFI principal and do not have FATCA responsibilities that are independent of, or broader than, those of their principal.

The regulations should be revised to clarify that (U.S. or foreign) entities acting *solely* as agents for payors do not have responsibilities for FATCA compliance independent from or greater than those of their PFFI (or DCFFI) principal. Without this rule, agents would be put in the untenable position of being required to conduct due diligence and to obtain documentation without having the practical ability to do so under the arrangements with their PFFI principal. Conversely, PFFIs or DCFFIs that use an agent could be required to perform due diligence and obtain documentation to enable their agents to comply with their chapter 4 obligations notwithstanding that FATCA has exempted such PFFIs or DCFFIs from those requirements.

Recommendation No. 40:

§ 1.1474-1(a)(3) should be revised to provide that a person acting *solely as agent for a payor* does not have independent FATCA obligations when acting in its capacity as an agent, and that its obligations are no greater than those of its principal. The regulation should also be clarified to apply to sub-agents.

## XXI. REPORTING (§ 1.1474-1(d))

### A. Reporting by USFIs and U.S. Branches of Accounts Held By U.S. Owned Foreign Entities

The regulations are straightforward regarding the information that a PFFI must report with respect to U.S.-owned foreign entities, and they clarify that a form will be issued to facilitate such reporting. See § 1.1471-4(d)(3)(iii) & (v). However, the regulations are unclear as to what U.S. withholding agents must do to report such U.S.-owned foreign entities, whether such withholding agents are USFIs or the U.S. branches of PFFIs. Is the intent of §1.1472-1(e) to require the same form referenced in § 1.1471-4(d)(3)(v)? If so, this would constitute a new and substantial reporting requirement (particularly if our suggested treatment of non-commercial investment entities as NFFEs is adopted) and should be clearly specified. By contrast, do they collect the underlying information on any U.S. owners and report the information on a Form 1099? We believe that § 1.1474-1(i) is unclear in that regard and question why Form 1099 reporting would not be used for owner-documented FFIs since they supply withholding agents with both allocation information and information identifying any underlying U.S. persons. It is unclear why the IRS would require a new reporting system in this situation.

Recommendation No. 41: The regulations should clarify this important point so that it is clear what affected U.S. withholding agents must do to comply with their FATCA reporting obligations for U.S.-owned foreign entities. We believe that USFIs and the U.S. branches of PFFIs should not be required to file the form referenced in § 1.1471-4(d)(3)(v) since such information is available to the IRS in the course of any audit. Instead, Form 1042 reporting should continue to apply, with perhaps a revision being made to § 1.1474-1(d)(3) to specify that such reporting has been made to a U.S.-owned foreign entity. For owner-documented FFIs, we ask that Treasury and the IRS determine whether existing Form 1099 reporting can accommodate FATCA-related reporting.

### B. Clarification Of the Scope of Form 1042-S Reporting (§ 1.1474-1(d)(2)(i))

The proposed regulations state that the following amounts are subject to Form 1042-S reporting: "(A) U.S. source FDAP income (regardless of whether subject to withholding under chapter 4 and including a passthru payment that is U.S. source FDAP income) paid on or after January 1, 2014; (B) Gross proceeds subject to withholding under chapter 4; and (C) Foreign passthru payments subject to withholding under Chapter 4." We believe that the intent of the above language is to require Form 1042-S reporting only if the withholding agent has actually withheld under FATCA on a payment, with the exception of U.S. source FDAP income, which would always be subject to reporting. If this is the case, we urge that the language be clarified since for U.S. tax purposes the fact that a payment is "subject to withholding" simply means that it can be withheld upon, not that it actually has been withheld upon (see for example the analogous concept of "subject to tax" in the § 894 context to distinguish flow-through entities from opaque entities). This clarification is critical since the scope of the reporting obligation would be exponentially greater (and very troublesome) if all FATCA-relevant payments must be reported as opposed to those that have been withheld upon.

<u>Recommendation No. 42</u>: Clarify the language in the regulation that Form 1042-S reporting is required on gross proceeds and foreign passthru payments only to the extent that an amount has <u>actually</u> been subject to FATCA withholding not that it simply could be subject to withhholding.

### C. <u>Remove Transitional Reporting Rule for Foreign Source FDAP Paid to NPFFIs ((§ 1.1474-1(d)(2)(ii)(A))</u>

The proposed regulations contain a transitional reporting rule that requires withholding agents to report certain payments made to NPFFIs during 2015 and 2016 if they constitute "a payment of FDAP income as defined in § 1.1473-1(a)(2)(i)(A) that would be a withholdable payment if paid by a U.S. person." We understand that the intent of this provision is to allow the IRS to collect information prior to any implementation of the foreign passthru payment rules sometime after 2016 on foreign source income payments paid to NPFFIs. We strongly object to this requirement as exceedingly burdensome on PFFIs since such entities generally do not have the systems in place to do this sort of reporting and would have to go to considerable expense and effort either to modify existing systems or create new systems to comply with this transitional requirement. Furthermore, we question whether this information is necessary for the IRS since it will also be receiving other data from PFFIs on the aggregate number of such NPFFIs.

<u>Recommendation No. 43</u>: We respectfully ask Treasury and the IRS to remove this rule on the basis that it imposes financial and logistical burdens on PFFIs that are highly disproportionate to any compliance benefit that might be derived by the IRS.

### D. <u>Harmonize Reporting Deadlines ((§§ 1.1474-1(d)(1), 1.1474-4(d)(3)(vi) &</u> -4(d)(6)(v))

The proposed regulations require that (1) reporting with respect to substantial U.S. owners of NFFEs, and (2) filing of information returns with respect to payments (i.e., Form 1042-S) be done by March 15 (§ 1.1474-1(d)(1)). They also require that (1) the general reporting with respect to U.S. accounts and (2) reporting with respect to recalcitrant account holders to be done by March 31 (§§ 1.1474-4(d)(3)(vi) & -4(d)(6)(v)).

<u>Recommendation No. 44</u>: The reporting deadlines for all of these obligations should be March 15, consistent with the existing filing dates for Forms 1042-S.