

[TEXT OF THE FATCA COMMENT LETTER SUBMITTED BY
ABU DHABI INVESTMENT COUNCIL]

18 January 2012

Ms. Manal S. Corwin
Deputy Assistant Secretary
Office of Tax Policy
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington DC, 20220

Dear Ms. Corwin,

This letter concerns the application of the Foreign Account Tax Compliance Act (commonly referred to as “FATCA”) to sovereign wealth funds that qualify as a “foreign government” under *section 892 of the U.S. Internal Revenue Code* of 1986, as amended (the “Code”) and certain wholly-owned subsidiaries of such funds that do not themselves qualify as a “foreign government” under *section 892*.

For the reasons summarized below, we recommend that the U.S. Department of the Treasury and Internal Revenue Service (the “IRS”) issue guidance providing that (a) an investment fund or other entity that qualifies as a “foreign government” under *section 892* (other than a fund or entity that is a “controlled commercial entity”) will be so classified under *sections 1471(f)(1)* and *1472(c)(1)(D)*. We also suggest the manner in which certain entities that are wholly-owned, directly or indirectly, by a sovereign wealth fund should be treated under FATCA.

Overview of FATCA Requirements

FATCA (*sections 1471-1474*) was enacted in 2010 and is intended to curb evasion of U.S. tax laws by U.S. persons. To the extent relevant here, FATCA imposes withholding requirements on certain payments to “foreign financial institutions” (*section 1471*) and “non-financial foreign entities” (*section 1472*). The provisions of FATCA are generally effective with respect to payments made on or after January 1, 2013.

For purposes of the withholding requirement imposed by *section 1471(a)* with respect to certain payments to a foreign financial institution (an “FFI”), the term FFI is defined in *section 1471(d)(4)* and *(5)(C)* to include any foreign entity that, subject to such regulatory exceptions as may be provided by the Secretary of the Treasury (the “Secretary”), is engaged primarily in investing in or trading enumerated categories of assets. Under *section 1471(b)*, an FFI must register with and enter into an agreement with the IRS in order to avoid withholding on certain U.S. source payments. *Sections 1471(f)(1)* and *(4)* provide that the withholding requirements applicable to payments to FFIs are not applicable to any payment to the extent that the beneficial owner is either a “foreign government” or a member of a class of persons identified by the Secretary as “posing a low risk of tax evasion”.

For purposes of the withholding requirement imposed by *section 1472(a)* with respect to certain payments to a non-financial foreign entity (an “NFFE”), the term NFFE is defined in *section 1472(d)* to include any foreign entity which is not a financial institution. *Section 1472(b)* provides in relevant part that withholding is not required with respect to a payment if the beneficial owner of the payment certifies to the withholding agent that the beneficial owner does not have any substantial U.S. owners. *Sections 1472(c)(1)(D)* and (G) provide that, except as otherwise determined by the Secretary, the withholding requirements applicable to payments to NFFEs are not applicable to any payment that is beneficially owned by any “foreign government” or any “class of persons identified by the Secretary”. *Section 1472(c)(2)* provides the NFFE withholding requirements do not apply to any class of payments identified by the Secretary as “posing a low risk of tax evasion”.

Classification of Sovereign Wealth Funds Under *Section 892*

Section 892 provides an exemption from U.S. federal income tax for certain categories of U.S. source income when that income is received by a foreign government. n1 The exemption does not apply, however, to income received from the conduct of a commercial activity; income received by or from a controlled commercial entity; or to gain from the sale or other disposition of an interest in a controlled commercial entity. For this purpose, the term “controlled commercial entity” is defined to include [definition to come].

The term “foreign government” is defined in the regulations under *section 892* as including both the “integral parts” and “controlled entities” of a foreign sovereign. n2 In the absence of contrary published guidance, many sovereign wealth funds have structured their investments and other activities on the assumption that the IRS would regard them as controlled entities rather than integral parts of the relevant non-U.S. sovereign. n3

The principal difference between the two classifications is that controlled entities, but not integral parts, are subject to a requirement that they not engage in any commercial activity, however small, anywhere in the world. n4 If a controlled entity engages in a commercial activity, it would be classified as a controlled commercial entity and, as such, would not be eligible for the *section 892* exemption. In contrast, if an integral part engages in a commercial activity, the income from that activity is not eligible for the *section 892* exemption, but the exemption remains available for the integral part’s non-commercial income from U.S. sources.

While sovereign wealth funds invest directly in a broad range of assets, they frequently form subsidiary corporations to make certain investments. These subsidiaries, which are wholly-owned, directly or indirectly, by the sovereign wealth fund, do not meet the requirements for a “controlled entity” (and are thus not classified as a “foreign government” under *section 892*) if they are organized in a country other than that of the relevant foreign sovereign. To the extent such a subsidiary makes investments in the United States, it would be subject to U.S. federal income tax in the same manner as any other non-U.S. investor. Such subsidiaries are used for a variety of reasons and the *section 892* regulations provide that any commercial activities of such a subsidiary are not attributed its shareholders for purposes of applying the commercial activity limitation imposed with respect to commercial entities. n5 The equity

interests held by a sovereign wealth fund that is classified as a controlled would of course vest in the relevant foreign sovereign upon dissolution of the fund.

Treatment of Sovereign Wealth Funds under FATCA

By definition, neither a sovereign wealth fund that is classified as a “foreign government” under *section 892* nor a wholly-owned investing subsidiary of such a fund has any U.S. owners and thus these types of entities do not raise any of the policy concerns that prompted Congress to enact FATCA as a tool to combat tax evasion by U.S. persons. Accordingly, and there would be no reason to apply FATCA to these entities. Nevertheless, third party fund sponsors and other entities seeking investments by a sovereign wealth fund appear to have concluded that a sovereign wealth fund and/or its investing subsidiaries may technically fall within the definitions of either an FFI or an NFFE. Such a result would expose sovereign wealth funds and their wholly-owned subsidiaries to substantial information reporting burdens and, in some cases, a requirement that they register with the Internal Revenue Service.

We recommend that guidance be issued promptly resolve the current uncertainty and that such guidance provide substantially as follows:

1. An entity that qualifies as a “foreign government” under *section 892* and is not classified as a “controlled commercial entity” as that term is defined in the *section 892* regulations (a “qualified *section 892* entity”) will be classified as a “foreign government” for all purposes under FATCA. Such entities (a) will not be subject to the requirement that an FFI register with an enter into an agreement with the IRS under *section 1471* and (b) payments to such entities will not be subject to withholding under either *section 1471* or *1472*.
2. Third parties may rely, without further inquiry, upon a written certification by a qualified *section 892* entity that it is properly classified as a “foreign government” under FATCA. A certification will be conclusively deemed to be adequate if the submitter has designated itself as a “foreign government” on a Form W-8EXP and provides a copy of such form to the relevant third parties.
3. An entity that is wholly-owned, directly or indirectly, by a qualified *section 892* entity and is classified as an FFI or an NFFE (a “qualified controlled entity”), will (a) if an FFI, be exempt from the requirements of *section 1471* pursuant to *section 1471(f)(4)* as

a member of class that presents a low risk of tax evasion and (b) if an NFFE, payments to such an entity will not be subject to withholding under section 1472 if the entity or its beneficial owner certifies in accordance with *section 1472(b)* that it is a qualified controlled entity and thus has no substantial U.S. owners.

4. Third parties may rely, without further inquiry, upon a written certification by a qualified controlled entity (or the qualified *section 892* entity that is its beneficial owner) that it is properly classified as “qualified controlled entity” under FATCA (i.e., it certifies that, pursuant to *section 1472(b)(1)(A)*, that all of the beneficial interests in the controlled entity are owned by a single qualified *section 892* entity and that it therefore does not have any substantial United States owners).

We stand ready to respond to any questions you may have and would welcome the opportunity to discuss the views expressed in this letter with representatives of the U.S. Treasury and IRS.

Sincerely,

Najwa Attiga
General Counsel
Abu Dhabi Investment Council
Abu Dhabi, United Arab Emirates

FOOTNOTES:

n1

The *section 892* exemption does not apply to income from any commercial activity (as defined in the *section 892* regulations) or to income received by or from a controlled commercial entity.

n2

Temp. Treas. Reg. section 1.892-2T(a).

n3

The term “controlled entity” is defined to include “. . . an entity that is separate in form from a foreign sovereign or otherwise constitutes a separate juridical entity if it satisfies the following requirements: (i) it is wholly owned a controlled by a foreign sovereign directly or indirectly through one or more controlled entities; (ii) it is organized under the laws of the foreign sovereign by which owned; (iii) its net earnings are credited to its own account or to other accounts of the foreign sovereign, with no portion of its income inuring to the benefit of any private person; and (iv) its assets vest in the foreign sovereign upon dissolution. *Temp. Treas. Reg. section 1.892-2T(a)(3)*.

n4

Recently issued proposed regulations would create a limited exception for certain “inadvertent” violations of the commercial activity limitation.

n5

Temp. Treas. Reg. section 1.892-5T(d)(2).