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Re: Comments on Notice 2010-60 Providing Preliminary Guidance on FATCA

Dear Ms. Corwin and Messrs. Shay, Musher and Danilack:

The European Banking Federation (the “EBF”) and the Institute of International Bankers (the “IIB”) are submitting this joint comment letter in response to IRS Notice 2010-60 (the “Notice”) regarding the implementation of information reporting and withholding under Chapter 4 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”). As you are aware, we previously submitted extensive comments and recommendations regarding FATCA implementation issues in our joint submission dated April 23, 2010 (the “April Submission”) and in the IIB’s follow-up letter dated June 16, 2010 (the “June Letter”).

We note that the Notice in some instances does not address issues upon which we commented or takes an approach different from that which we advocated. We ask that our comments on the Notice presented in this letter be read in conjunction with our earlier letters, which continue to represent our views as to reasonably appropriate and administrable steps for Treasury and IRS to take to implement FATCA.

We also would welcome the opportunity to meet with you to discuss the comments in this letter, and will follow up with you in this regard.

1. *General Comments on the Notice.*

The EBF and IIB appreciate and support the compliance goal of FATCA to provide tools to the IRS to combat offshore tax evasion by U.S. individuals and U.S.-owned entities. However, an overarching concern expressed in our prior comment letters is the need for Treasury and the IRS to exercise the substantial discretion given them by the statute to strike a pragmatic and reasonable balance between FATCA's legitimate compliance objective and administrability in order to limit the costs, commercial challenges, and the legal, operational and regulatory risks to non-U.S. financial institutions.<sup>1</sup> Whether and to what extent Treasury and the IRS ultimately realize that goal will turn on how numerous individual questions, relating to the myriad topics touched upon in the Notice and in our prior submissions, are addressed.

We appreciate that Treasury and the IRS have publicly stated that the Notice is only the first set of FATCA guidance and is intended to provide an early view of their thinking to those financial institutions affected by the legislation. We accordingly reserve our judgment as to whether the ultimate FATCA regime will strike the appropriate balance between administrability and compliance objectives. However, the sheer number of new issues and questions raised by the Notice – as well as those that are not addressed in the Notice – and the approaches adverted to thus far in the Notice, have raised significant concerns in the non-U.S. banking community as to the ultimate direction of the pending guidance and whether many financial institutions will be able to comply with the rules even though they are willing to do so.

Withholding tax and reporting rules affecting tens of millions of accounts can operate effectively only if the legal rules set forth in FATCA can be reduced to a largely automated back office function that is staffed by reasonably trained personnel who are not U.S. legal experts. The Notice, by contrast, presents in broad outlines a highly manual, customer-intensive effort with numerous different FATCA categorizations that depend upon a detailed understanding of U.S. tax technical rules and associated extensive documentation requirements. We do not believe that such a system can successfully be implemented without substantial potential tax exposure and reputational risk to the financial institution attempting to do so.

In our prior submissions, we emphasized the importance of maximizing the risk-based concepts in FATCA to pare down the overall administrative effort to those situations presenting the greatest compliance risks to the United States. We continue to urge the Treasury and IRS to take this approach rather than the one apparently incorporated in the Notice, which seems to aim more for coverage of as many entities as possible regardless of the potential risk of material U.S. tax evasion. We also believe that there should be extensive, largely automatic carve-outs from FATCA for low risk payments, institutions and entities.

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<sup>1</sup> The EBF and IIB have not commissioned legal opinions analyzing the potential legal conflicts between various FATCA requirements and different non-U.S. legal regimes, including those of the E.U. However, we understand that recent comments submitted to Treasury raise a number of issues in this regard that ought to be fully vetted and considered.

Likewise, we have recommended that Treasury and the IRS adopt a pragmatic and proportional approach to the challenges presented by non-U.S. institutions attempting to identify a very small number of U.S. direct and indirect customers in an overwhelmingly *non-U.S.* customer base invested in *non-U.S.* deposit accounts and securities, a “needle-in-a-haystack” phenomenon of epic proportions. We are concerned that the Notice falls short in this regard in many key respects, particularly with regard to the Notice’s highly complex and impractical customer identification and documentation requirements as well as the treatment as “recalcitrant” of account holders with no apparent U.S. nexus or indicia of U.S. status who do not provide information to a withholding agent that is not required under their local law.

For example, whereas Japanese banks have an aggregate of 790 million customer accounts, U.S. citizens resident in Japan represent only 0.04% of the population and only 2.4% of foreign national residents.<sup>2</sup> Japanese banks are not generally perceived as having a cognizable number of customer accounts held directly or indirectly by specified U.S. persons seeking to avoid U.S. taxes. And while the proportion of U.S. to non-U.S. accounts at banks and securities firms based in various other countries is perhaps not as infinitesimal as Japan, the amounts generally are *de minimis*. Yet many Japanese and other foreign financial institutions cannot meet the Notice’s conditions for exemption from the two-year and five-year rules of Section III.B.2.a of the Notice) because they have not collected documentation establishing the nationality of each customer and reflected such information in an electronically searchable database. Thus, under the Notice, these institutions would need to engage in a highly manual, customer-intensive effort to properly identify and document the non-U.S. status of huge numbers of accounts.

Our members are still attempting to quantify the potential cost of implementing the Notice’s customer identification and documentation requirements, but preliminary indications are that the costs will be staggering for many financial institutions and for the industry as a whole. For example, several large institutions have estimated on a conservative basis that they will incur an incremental cost, on average, of \$10 to properly identify and document (under the two-year or five-year rule in Section III.B.2.a of the Notice) each existing account for which they do not have documentation establishing non-U.S. status.<sup>3</sup> For several of these institutions, the number of such accounts may be 30 – 50 million, and many more institutions have ten million or more existing accounts that would need to be re-documented. Thus, the incremental cost for an institution with 25 million accounts to bring its existing accounts into compliance under the Notice would be at least \$250 million, and the overall cost to the industry to comply with the Notice’s identification and documentation requirements for existing accounts will run at least several billion dollars.

We recognize that FATCA is enacted legislation in the United States that Treasury and the IRS are obliged to implement. However, now that Treasury and the IRS have spent many months confronting the enormous challenges in devising a set of rules to implement FATCA, we hope they have a greater appreciation for the inherent risks, costs, legal

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<sup>2</sup> See Japanese Bankers Association comment letter on Notice 2010-60 dated November 1, 2010.

<sup>3</sup> We believe that the \$10 per account figure may be quite understated in light of prevailing labor rates for staff and management, postage costs, and third party consultant fees (as a simple example of such costs, the cost of a registered letter in France is \$6 and it can take several mailings to solicit the necessary documentation, as seen in the QI effort).

complications (including conflicts with foreign laws) and complexity of building extensive systems and procedures worldwide to satisfy the compliance concerns of just one taxing authority. These problems will be compounded as other countries enact their own legislation to achieve the same compliance result.

We present more specific views below on the Notice. We have arranged the comments in largely the same order as the sections of the Notice rather than in order of importance.

## *2. Timing of the Guidance and the FATCA Effective Date.*

The Notice indicates that Treasury and the IRS “intend to issue guidance in advance of the effective date of chapter 4 to ensure that affected persons have time to implement the systems and processes to comply fully with the new withholding, documentation, and reporting obligations imposed by chapter 4.” We appreciate this sensitivity to the need to build systems in sufficient time to implement the new rules, but we are very concerned that already there is insufficient time to do so before the 2013 effective date.

It is certainly true that some financial institutions have begun to take the limited information known about FATCA, including that contained in the Notice, to review their worldwide operations and customer bases to assess the potential impact of FATCA, including the daunting anticipated costs of building compliant systems. However, as we cautioned Congress, Treasury and the IRS in the past, neither foreign financial institutions (“FFIs”) nor domestic financial institutions will be able to comprehensively modify their systems and processes to implement FATCA, train their employees or commence (electronic or manual) searches of their customer accounts until final regulations are issued.

This delay in effort by financial institutions is not attributable to a lack of commitment to comply with FATCA but from simple commercial realities. A financial institution cannot afford to launch major compliance efforts on the basis of compliance criteria that are themselves explicitly subject to comment and revision by Treasury and the IRS. For example, the Notice’s most comprehensive provisions involve identification of U.S. accounts, but FFIs will need final U.S. indicia criteria before they can construct and run electronic searches of their client account profile systems in light of the substantial costs related to such efforts.

It is our collective experience that worldwide IT systems cannot be either built or modified until financial institutions have a firm understanding of what information must be captured, what items must be withheld and what items must be reported. As previously discussed, the most optimistic estimated timeframe for a successful IT-build is 18 – 24 months or longer from the time final regulations are issued. The reason for this time lag in building IT systems is that financial institutions must first assess whether they will build the system internally or buy a third party system and then obtain approval of senior management of that basic decision, educate their IT personnel about the tax technical rules, and test the system itself to ensure that it is compliant.

In addition to modifying IT systems, additional time will be needed to develop and implement other processes, train staff, etc., only some of which can be done in parallel with the IT build-out. Thus, a minimum estimated time frame for many institutions simply to set up a FATCA compliance system is 24 months or longer from the time final regulations are issued. As indicated elsewhere in this letter, depending on the nature of the requirements that are ultimately adopted with respect to the identification and documentation of existing accounts, the process of reviewing existing accounts may take several years if it is feasible at all. Given these timing realities, Treasury and the IRS might consider, from the outset and in consultation with the financial industry, a staggered effective date for the nature and level of compliance with different aspects of FATCA, and embed that concept in the guidance that is issued so that financial institutions can most efficiently prioritize their implementation efforts to coincide with such a staggered effective date. Depending upon the timing of final regulations that the financial industry can effectively implement, we note that it may be necessary to request a wholesale extension of the effective date of FATCA to avoid large numbers of FFIs and U.S. financial institutions being considered non-compliant despite their best efforts to comply.

### 3. Grandfathered Obligations (Notice, Section I).

The Notice indicates that the term “obligation” for purposes of section 501(d)(2) of the Act – which grandfathers payments made under, and gross proceeds from the disposition of, any obligation outstanding on March 18, 2012 – “means any legal agreement that produces or could produce withholdable payments,” but “does not include any instrument treated as equity for U.S. tax purposes, or any legal agreement that lacks a definitive expiration or term.”

We have the following comments:

a. Treasury and the IRS should clarify that a conventional revolving credit agreement, under which a borrower may make multiple drawdowns, repayments and subsequent drawdowns, is a legal agreement that, if entered into on or before March 18, 2012, will be grandfathered. Such agreements are often syndicated to many lenders and may have terms of five years or longer. Thus, revolving credit agreements that are already outstanding or that will come into force between now and March 18, 2012 will allow drawdowns after December 31, 2012. The same considerations that make it impractical for term loans that are outstanding on March 18, 2012 to comply with FATCA apply to these revolving credit loans as well.

b. The guidance should clarify that an instrument that is denominated as debt (for example in the instrument, prospectus or issuing memorandum) and that has a fixed maturity will not be considered to be “treated as equity for U.S. tax purposes.” Withholding agents and investors should be able to rely on the stated terms of an instrument and the prospectus without worrying that FATCA may apply if the instrument is recharacterized as equity (for example, under a thin capitalization analysis).

c. Treasury and the IRS should consider allowing withholding agents the option as to whether they wish to grandfather any obligations, and if they opt not to, then they should be explicitly relieved of any liability for any resulting withholding to the beneficial owner of the payment on payments associated with these (otherwise grandfathered) obligations. We suggest this alternative because withholding agents, and particularly non-U.S. financial

institutions, will often find it very difficult to make correct determinations as to what an obligation is under U.S. tax law and whether it has been “substantially modified,” and we do not believe it appropriate for them to have to assume the risk of making a wrong classification. In addition, it may be easier and less complicated for an FFI or a U.S. financial institution to avoid having to code its product master (also known as “security master” in some institutions) systems to distinguish between grandfathered and non-grandfathered obligations, particularly in light of the “substantial modification” provisions that may cause a grandfathered instrument to lose such status post-March 18, 2012. We recognize that third party data providers may be able to adequately track both initial grandfathering status and “substantial modification” information to supply to withholding agents so that they can code their product master systems. However, even if this turns out to be the case, withholding agents should not be forced either to assume this expense or the risk from any faulty information being provided to them. In that regard, it would be helpful if the guidance either put the onus on the debt issuers to notify the market that a substantial modification has occurred or for withholding agents to be explicitly allowed to rely on third party data providers to inform them of such modifications. On the other hand, it is likely that clearinghouses and most other withholding agents whose customers are qualified FFIs will endeavor to treat those obligations that qualify for grandfathering as not subject to withholding in order to prevent the market disruption that might arise if large numbers of financial institutions impose withholding on such grandfathered obligations.

4. *Definition of Financial Institution Under Section 1471(d)(5)(C) (Notice Section II.A.3).*

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The Notice states that the concept of an institution being in the “business of investing, reinvesting, or trading” is not the same as that used for other U.S. tax law purposes, which typically turns on the existence of substantial business operations, but may instead extend to “isolated transactions” which would depend upon all the facts and circumstances that would need to be considered pursuant to regulatory guidelines.

We recommend that this concept be reconsidered because it would impose an unnecessary layer of complexity to the already daunting task of identifying section 1471(d)(5)(C) entities. It would appear that an entity could drift into and out of FFI status from year to year depending upon these “isolated” transactions, which adds unwarranted uncertainty for both FFIs and the affected entities as to their respective obligations under Chapter 4. In any event, the burden of making this determination clearly should not be imposed on the withholding agent, who will invariably lack both the necessary factual information regarding its customers and a sufficient number of personnel available and capable of making this sophisticated U.S. tax judgment. Instead, if this concept is retained, a withholding agent should be entitled to rely on a certification provided by the customer entity as to whether it is an FFI (and whether it meets any exceptions), without performing any independent due diligence, until the customer entity notifies the withholding agent that its status as an FFI has changed.

We have another, more fundamental concern with an expansive interpretation of what constitutes being “engaged primarily in the business” of investing under section 1471(b)(5)(C). The effect of this expansive interpretation when combined with the Notice’s excluding active NFFEs from FATCA reporting (which we strongly support) will produce the odd result of there being few, if any, NFFEs subject to withholding under section 1472. We

question whether this is a desirable result or consistent with the statutory scheme. We also believe that the term “engaged primarily in business” should not be interpreted to extend to smaller entities that serve largely as “incorporated pocketbooks” or purely personal investment vehicles as opposed to commercial ones, although this concern may well be ameliorated by the Notice’s exception for “small” FFIs to the extent that concept is modified as we recommend (see Paragraph 5.C below). Additional suggestions regarding the scope of NFFE are discussed in paragraph 5.H below.

5. Exclusion of Entities from FFI Status (Notice Section II.B).

A. Overall Approach.

We continue to believe that large swathes of the FFI population should be explicitly carved out of FATCA under easily applied and administrable rules because such entities present little risk of U.S. tax evasion. The Notice provides few such carve-outs and those that are provided are of limited utility or administratively challenging in their own right, as we discuss in greater detail below. We made many suggestions for carve-outs in our prior submissions and ask Treasury and IRS to consider them as they prepare subsequent guidance.

In particular, we believe that there are many bases to carve out various kinds of funds and collective investment vehicles as discussed extensively in our prior submission to you. While we are encouraged by your request for comments on whether local requirements to exclude U.S. investors may constitute grounds for a fund to be carved out of FATCA, we do not believe that these can, or should, be the sole criteria. Some countries lack such prohibitions but have funds that we do not believe are likely vehicles for U.S. tax evaders because, for example, they are widely held and publicly offered to the public and have substantial numbers of owners.

We also wish to emphasize the broader theme of our April Submission that, in our view, it is essential that the guidance adopt a pragmatic, risk-based approach to assessing which categories of entities present a low risk of tax avoidance by U.S. persons and therefore should be exempted from the onerous requirements of FATCA. The Notice has taken some steps in that direction, and we encourage Treasury and the IRS to expand the categories of entities that are excluded from FATCA, including the categories discussed in our April Submission.

B. Excluded Non-Financial Type FFIs (Notice II.B.1).

The Notice provides that the following entities should not be treated as FFIs provided that they are not financial entities: (1) certain holding companies; (2) start-up companies; (3) liquidating companies; and (4) hedging/finance centers. For start-up companies, the start-up designation is only good for a 24-month period.

The Notice requests comments, *inter alia*, as to “what mechanisms withholding agents could use to properly identify such entities (including self-certification, as appropriate).” Consistent with our general comment in Paragraph 1 above regarding the need to have FATCA operate as a largely automated back office function and our recommendation in Paragraph 4 above, we believe it imperative that withholding agents be permitted to rely on a certification from the entity that it falls within one of these exceptions, without any due diligence obligation

imposed on the withholding agent. However, we describe below in the section on documentation our concerns with certification requirements.

C. *Excepted “Small” FFIs (Notice II.B.3).*

We have heard conflicting statements from IRS and Treasury officials as to the intent of this provision to treat certain “small” FFIs as excepted if the withholding agent secures adequate information and documentation establishing whether the FFI has any U.S. owners/investors. On the one hand, some government officials have stated on privately funded webcasts that they intend to define “small” by the number of investors in the entity or perhaps by some other criteria such as the amount of assets held by the entity or the payments received by the entity. More recently, at two public conferences in New York, we understand that IRS and Treasury officials have stated that their intent is not to define what “small” means at all but to allow the withholding agent to make an independent judgment in relation to which of its FFI customers it would be willing to perform the added documentation and due diligence required by this section of the Notice in order for that FFI customer to be treated as excepted (the “voluntary due diligence” approach).

We believe that the “voluntary due diligence” concept may prove largely unworkable for most withholding agents because of the potentially large population at issue. First, it shifts to the “large” participating FFIs the costs of collecting documentation, performing due diligence with respect to the documentation, reporting any relevant information, and accepting the compliance and operational risks if there are any mistakes made with the foregoing actions for large numbers of “small” FFIs. A “large” participating FFI could avoid these potentially significant costs by simply having these small entities enter into their own FFI agreements with the IRS regardless of whether this is a sensible administrative result. Granted, some participating FFIs may be willing to charge for this service and some “small” FFIs may be willing to sustain such new costs imposed on them, but that is hardly a foregone conclusion for either the “large” or “small” FFI, and becomes exceedingly unlikely for the vast majority of “small” FFIs that are not even invested in any U.S. securities and have no nexus with the U.S. market.

Second, the “voluntary due diligence” concept assumes that it is desirable for a “large” participating FFI to build into its withholding tax processes a relatively intense and manual interaction with its FFI customer base to determine which ones it will treat as “small” and which ones it will not. As we have stated above, withholding tax systems ideally should work as automatically as possible.

In light of the foregoing, and consistent with our general comments in Paragraph 1 as well as our recommendations in Paragraphs 4 and 5.B above, we recommend that the burden of determining whether an FFI can and does qualify as a “small” FFI be shifted from the withholding agent to the “small” FFI. Thus, a withholding agent should be permitted to rely on documentation provided by a customer that, on its face, complies with the conditions imposed on a “small” FFI (including information regarding any U.S. owners/investors in the “small” FFI), without performing any independent due diligence.

We also recommend that Treasury and the IRS clarify the requirements and conditions that would need to be satisfied by a “small” FFI, including in particular the relationship between these rules and the rules applicable to NFFEs. We believe that “small” FFIs should be subject to requirements and conditions that are no more onerous than those imposed on NFFEs, including that they be required to identify only each “substantial U.S. owner” (i.e., a more than 10% owner or, as we discuss in our April Submission, a more than 25% owner so as to correspond to the majority of AML/KYC regimes in other countries).

Furthermore, we recommend that efforts be made to find a reasonable way to reduce the overall population of FFIs to a manageable level on the basis that certain entities do not present a risk of material U.S. tax evasion. One option might be to exclude altogether any FFI with less than a specified threshold in assets held by the “large” participating FFI. By analogy to the statutory exclusion for deposit accounts, a \$50,000 threshold might be considered, but this seems too low for investment accounts. Instead, we recommend a threshold of at least \$250,000 or preferably a higher amount (e.g., many of our members believe a \$1 million threshold is more consistent with identifying accounts likely to present a material risk of U.S. tax evasion). For ease of administration, this higher threshold should be based (at the option of the participating FFI) on either the aggregate amount of investments in the account made by or on behalf of the “small” FFI or the balance of the account on, say, December 31, 2010 (thereby obviating the need to deal with fluctuations in market value and foreign currency conversions).

*D. Exclusion for Non-U.S. Retirement Plans (Notice II.C).*

Our April Submission provided comments on this exclusion and we refer you to our comments. We believe that the criteria listed in the Notice as to which non-U.S. retirement plans should be treated as excluded are unnecessarily narrow. For example, we estimate that 80% of European retirement plans would fail to satisfy the criteria that the plan not allow U.S. participants who work outside the jurisdiction where the plan was established. A relatively easy way to liberalize the criteria with no apparent increase in compliance risk would be to eliminate clause (iii) requiring that the U.S. employee must work in the same country as where the plan was established, along with a clarification that the plan need only constitute a retirement plan under local law and not under U.S. law (which has been a contentious issue in the treaty context for many years). In the alternative or in addition, Treasury and IRS might specify that the following plans are exempt: (1) pension plans determined to be good treaty residents by the competent authorities of the United States and the other country; (2) state sponsored/sanctioned pension plans and schemes; and (3) non-U.S. pension plans that meet criteria similar to those used in other parts of the Code in their particular jurisdiction. (We defer to Treasury and the IRS to coordinate with their colleagues specializing in benefit plans as to the appropriate definition to be used.)

*E. FFIs with No U.S. Accounts.*

While not mentioned in the Notice, we believe that guidance in the very near term is particularly needed on how an FFI can prove that it has no U.S. accounts and the associated due diligence and audit/verification requirements associated with this concept (this concept also has great relevance for a participating FFI to determine if certain of its worldwide affiliates and entities meet this exception). We are aware that many entities are considering eliminating their

U.S. accounts (and some have already done so) in order to eliminate the substantial costs and burdens associated with the FATCA regime. We understand that some IRS officials have expressed the hope that the “voluntary due diligence” concept will be sufficient to prevent FFIs from eliminating their U.S. accounts, but we think that is quite unlikely and does not comport with widespread activity already underway by potential FFIs to determine if it is preferable simply to eliminate their U.S. accounts. Accordingly, the FFI community should understand exactly what is expected for them to comply with this requirement.

6. *U.S. Branches of FFIs (Notice, Section II.D.1).*

The Notice states that (i) “Treasury and the IRS do not intend to exempt an FFI from the requirement to enter into an FFI Agreement, even if the FFI receives withholdable payments solely through its U.S. branch,” (ii) Treasury and the IRS are considering permitting a U.S. branch of an FFI that receives a withholdable payment as an intermediary to document its account holders for chapter 4 withholding purposes under the requirements to be imposed on U.S. financial institutions, and (iii) the regulations will not incorporate the type of special presumption included for chapter 3 withholding purposes in Treasury regulation section 1.1441-4(a)(2)(ii), which treats a payment to a U.S. branch of a foreign bank or insurance company as “effectively connected income” (“ECI”).

If we understand the framework envisioned in the Notice, a U.S. branch of an internationally headquartered bank would need to establish to the satisfaction of each counterparty on each transaction that it enters into that it has in force a valid FFI Agreement (we assume that the branch does not itself have to enter into its own FFI Agreement but may be included in its parent’s FFI Agreement but this should be clarified). Moreover, the proposed framework would subject transactions involving such U.S. branches to two divergent sets of rules – for chapter 3 purposes, these U.S. branches would effectively be treated by their counterparties in the same manner as U.S. financial institutions, whereas for chapter 4 purposes they would be treated as FFIs.

U.S. branches of internationally headquartered banks are active participants in the broad spectrum of capital markets, interbank and wholesale financial activity, and enter into a large volume of transactions on a daily basis, many of which are short-term (such as overnight repos of Treasury securities, bankers acceptances, etc.). We have serious concerns that the approach outlined in the Notice will lead to undue confusion, administrative burdens and operational complexities for both U.S. branches and their counterparties that will unnecessarily impede these transactions.

We are sympathetic, and do not object, to the desire of Treasury and the IRS to require an FFI to enter into an FFI Agreement even if the FFI receives withholdable payments solely through its U.S. branch. However, we strongly recommend that this goal be implemented by treating the U.S. branch as a separate U.S. withholding agent – and as a distinct and separate person from its head office or other non-U.S. branches – with respect to all payments made by the U.S. branch to or for the account of the FFI, rather than treating the U.S. branch itself as a foreign person. Moreover, the presumption in Treasury regulation section 1.1441-4(a)(2)(ii) should apply equally for Chapter 4 as it does for Chapter 3 purposes. Thus, the FATCA rules should apply to the actual and deemed payments made between the U.S. branch and its head

office (or other branches), not to payments made by third parties to the U.S. branch. Similarly, the U.S. branch should be subject to the same FATCA rules as U.S. institutions with respect to payments that it makes to third parties, as is the case for Chapter 3 purposes.

Our proposed modification of the Notice would result in U.S. branches being treated in the same manner as other U.S. financial institutions in terms of their dealings with the markets, but would nonetheless ensure full compliance with FATCA, especially given the high degree of regulatory scrutiny of such branches.

*7. Collection of Information and Identification of Persons by Financial Institutions (Notice, Section III).*

*A. Introduction.*

We appreciate the difficult choices faced by Treasury and the IRS regarding the need to obtain documentation relevant to identifying U.S. accounts and the practicalities, burdens, and costs to participating FFIs to obtain that documentation. The EBF and IIB included proposals in our April Submission that were aimed at achieving a suitable balance. We continue to believe those suggestions are preferable to the Notice's proposals. We urge Treasury and the IRS to reconsider our prior proposals before issuing further guidance. This section of our comments provides specific comments and proposals on the documentation and due diligence requirements proposed in the Notice and reiterates, in summary fashion, some of the comments made in our April Submission.

We believe that the Notice's procedures fail to achieve the proper balance between FATCA's compliance objectives and the ability of FFIs to obtain documentation while encouraging FFIs to become participating FFIs. As adverted to in Paragraph 1 above, we are particularly concerned that the Notice's proposed procedures do not appreciate the basic obstacle facing the non-U.S. financial community from FATCA: namely, that non-U.S. FFIs must attempt to identify a small minority of U.S. accounts in a predominantly non-U.S. customer base with customers who typically have no U.S. tax nexus. The proposed procedures also do not recognize that local laws governing non-U.S. FFIs provide no rules requiring "uncooperative" customers, whether U.S. or non-U.S., to comply with U.S. tax requirements. Customers with no U.S. tax nexus and with no U.S. indicia may well see no reason to cooperate with a U.S. law requirement, which, for them, is irrelevant and which many will regard as an unwarranted and objectionable infringement to their financial privacy. Our April Submission addressed this problem by distinguishing between customers holding U.S. securities, where there realistically could be a withholding event to use as a lever to get cooperation, from customers who hold no U.S. securities.

*B. The Computation of the \$50,000 Depository Account Exception Provides Little Relief; Consideration Should be Given to Exclusion of Non-Interest Bearing Deposit Accounts.*

Under Part III.B.2.a.1, and III.B.2.b.1, a participating FFI may treat a depository account held by an individual as other than a U.S. account if the average month-end balances (or if the average of the balances or values are determined less than monthly, the average of the

balances or values as determined for purposes of reporting to the account holder during the year) of all depository accounts at the participating FFI are less than \$50,000, or the equivalent in foreign currency, in the calendar year preceding the entry into force of the FFI Agreement. We do not believe that the Notice provides workable rules for the exception and, therefore, provides little relief contrary to the intent of the statute. We see two basic problems with the Notice's approach that Treasury and the IRS should address.

The first problem relates to the averaging concept to determine the \$50,000 threshold. Most FFIs will not have automated systems that will enable them to make the necessary balance, value and currency conversion determinations for each month-end or other reporting period. The exception will, therefore, have to be determined manually. By contrast, simply measuring the account balance at year-end very likely can be done automatically since the required search only has to capture one item at a single point in time. While we understand that the averaging concept may be in response to the government's fears of abuse, we believe that fear is far outweighed by the additional costs and burdens to the participating FFIs. Accordingly, we request that the year-end approach be adopted.

We appreciate that Treasury and the IRS chose not to use their authority to apply the \$50,000 determination by treating all members of a participating FFI's expanded affiliated group as a single financial institution. There is, however, a difficulty that should not be overlooked. The Notice requires that the \$50,000 threshold be determined by taking into account all the deposit accounts on an entity-level basis. Requiring an entity level determination is not feasible if a single financial institution has a number of business lines, offices or branches, each with its own unique account system. Very few banks use a universal account system that links different accounts of a single customer to a distinct identifying number. Therefore, such financial institutions cannot know if accounts held in different systems relate to the same account holder. Matching accounts across business lines, offices or branches by using the name of an account holder is not viable because information in a financial institution's systems is retrieved by account number, not account name. Thus, name matching would have to be done manually, which is not possible at a bank with hundreds of thousands or millions of accounts. Further, for some accounts a slightly different name designation will be used by the same account holder (e.g., John Doe and John X. Doe). In these cases, the determination of whether two account holders are the same person would have to use additional criteria, for example, address matches. Additionally, even where an institution uses the same account system in multiple jurisdictions, it may be precluded by legal restrictions from sharing account information between jurisdictions. Accordingly, we believe that the \$50,000 determination should be required only with respect to the system servicing the particular account, rather than for the entire entity (and, where precluded by legal restrictions, limited to particular jurisdictions as to which sharing of information is permitted).

As an additional recommendation, we ask that FFIs be permitted to exclude all non-interest bearing bank accounts (typically demand deposit accounts) from the definition of a financial account within the meaning of Code section 1471(d)(2). Such accounts do not afford holders the possibility of avoiding taxation of income because they do not earn any income, and thus exempting such accounts from FATCA would not undercut the policies of FATCA. Moreover, excluding such non-interest bearing accounts would simplify FATCA compliance for many institutions since they have many such accounts and those accounts are readily identifiable.

*C. Limitation of the Electronically Searchable Information Rule for Preexisting Accounts of Individuals and Entities.*

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Under sections III.B.2.a., Step 5 and III.B.3.a., last paragraph, a participating FFI may rely on documentation “received” after an electronic search of account information if the participating FFI does not know, or have reason to know, that the documentation is unreliable or incorrect. We believe that the guidance should clarify that the electronic search relates to systems supporting the withholding agent’s current client database (e.g., account masterfiles). In addition, we suggest clarification that the “know, or have reason to know,” standard applies without regard to information that the participating FFI might have in its files (other than electronically searchable information). Any other result would eliminate the intended benefit of the rule to reduce the burden and cost of compliance by relieving FFIs of the burden of having to manually search its files for documentation that is not electronically searchable.

In addition, we understand that Treasury and IRS officials have stated publicly that they do not expect withholding agents to build or purchase search engines for existing systems that lack or have limited electronic search capability. We welcome that clarification and ask that future guidance include this important detail. It would also be helpful if future guidance also clarifies that electronically maintained information, e.g., pdf files, does not have to be searched unless such information is searchable by existing search engines. This point requires clarification because many financial institutions are raising the issue as a potential concern.

Finally, we interpret the Notice to state that if documentation found through an electronically searchable database establishes that an account is not a U.S. account (e.g., a passport that does not show the United States as the place of birth or other equivalent documentation) then the two- and five-year transition rules do not apply to the account. As discussed in paragraph 6.F, below, we believe the two and five year transition rules should be eliminated, but if they are retained, we think that Treasury and the IRS should specifically state that this is the case. In addition, we believe that future guidance should also specify that if a system has an indicator that a KYC type document had been collected, then the FFI may rely on that system indicator even if it does not actually have a copy of the KYC document that was examined. In some jurisdictions, it is not required (or even permitted) to retain a copy of the documentation provided the account records show that an appropriate KYC document (e.g., a passport) had been examined to establish the identity of the account holder.

*D. Elimination of the Requirement to use Form W-8BEN for Individuals.*

Parts III.B.2.a., Step 4, and III.B.2.b., Step 5, require that an individual holder of a preexisting or new account must rebut the presumption of U.S. status by providing a Form W-8BEN *and* documentary evidence establishing non-U.S. status if the indicia of potential U.S. status is a U.S. address or U.S. place of birth. An individual holder of a preexisting or new account can rebut the presumption of U.S. status by providing a Form W-8BEN *or* documentary evidence if the indicia of potential status is an in-care of, hold mail, or P.O. Box address that is the sole address on file; there is a power of attorney or signatory authority granted to a person with a U.S. address; or there are standing instructions to transfer funds to an account maintained in the U.S. or directions received from the U.S. address.

First, we recognize that a Form W-8BEN is a justifiable documentation method under chapter 3 to establish the foreign status of an account holder because the account holder is investing in U.S. securities and must prove any reduction in the standard 30% withholding tax on U.S. source payments. The participating FFI documentation rules, however, apply whether or not the account holder invests in U.S. securities. Non-U.S. individuals will be reluctant or refuse to provide a U.S. tax form when they invest only in non-U.S. investments and accounts because they simply will see no reason to supply a U.S. tax form for non-U.S. economic activity. We believe that an FFI should be free to solicit relevant information in a commercially viable way from such customers, whether through other forms of documentation or certifications that may not even necessarily reference U.S. status. We additionally see no reason why certifications should require a penalty of perjury statement (as has become routine for “affidavits of unchanged status” documents in the chapter 3 context), since the IRS would lack jurisdiction to prosecute a non-U.S. person in a foreign country unless they happened to journey into the United States.

We also believe that a participating FFI should be able to rebut the presumption of U.S. status by providing know-your-customer documentation that is acceptable under the QI Agreement documentation attachment, and that this standard should apply whether or not the participating FFI is a QI. In addition, some QI Agreement documentation attachments have accepted documentation or other information that would not satisfy current know-your-customer rules to prove non-U.S. status for accounts established before the applicable know-your-customer rules were in place (e.g., the acceptance of a Canadian Social Insurance Number in the documentation attachment to the Canadian QI Agreement). There is no reason that such documentation or other information standards should not apply to preexisting accounts.

*E. The Time Periods for Requesting and Obtaining Documentation for Preexisting Accounts are Unwieldy and Too Short.*

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Parts III.B.2.a., Step 5 (applicable to individuals), and III.B.3.a, Steps 2 and 3 (applicable to entities) establish time periods for collecting documentation for preexisting accounts if there are indicia of potential U.S. status (or FFI status) in electronically searchable information. If indicia of U.S. status exist, a participating FFI must request within one year of the effective date of its FFI Agreement that the individual or entity provide documentation sufficient to establish the account holder’s U.S. or non-U.S. status. An account holder must provide documentation establishing status within one year of the date of the FFI’s request. In the case of entity accounts, the time frames are similar, although they require an entity account holder that is tentatively classified as an FFI to provide an FFI EIN and certification of participating FFI status within 9 months of the effective date of the participating FFI’s FFI Agreement.

These rules are too complicated: they require financial institutions to separately track different time periods for different accounts and for different categories of requests and responses, and it will be unwieldy to do so. Also, the time periods proposed for requesting and obtaining documentation are, as a practical matter, too short for the reasons set forth in paragraphs (i) and (ii) below. We recommend that instead of imposing separate time periods for requesting and providing documentation, with disparate start dates, the guidance should provide a general period of several years from specific dates (e.g., the effective date of an FFI Agreement as to a particular category of accounts) and to specific dates (preferably a clear year-end date)

within which the entire process of requesting and receiving the documentation for those accounts must be completed. For the reasons discussed in Paragraph 1 above, those dates (and the scope of the requirements) should be fixed in a manner that takes into consideration the practical compliance realities faced by FFIs.

(i) *One-Year Time Period for Participating FFIs to Request Documentation.*

A participating FFI is not required to request documentation for preexisting accounts if it already has documentation that establishes U.S. status. Even if documentation establishing U.S. status already exists (e.g., a Form W-9 or other documentation acceptable under chapter 3), in most cases it will not be included in electronically searchable systems. If the documentation is not kept in an electronically searchable information system, the entire process will be manual. Even if a participating FFI keeps documentation establishing an account holder's status in an electronically searchable system, it is very unlikely that such systems are searchable in a way that would distinguish U.S. status from non-U.S. status, particularly where the customer is not invested in U.S. securities. Also, an electronic search could take a considerable amount of time, particularly for participating FFIs with hundreds of thousands or millions of accounts. In any event, since the system could not automatically identify U.S. from non-U.S. status, the process of verifying whether the documentation retrieved establishes U.S. status would still have to be done manually. If the Treasury and IRS were to expand the documentation requirement to the expanded affiliate group of a participating FFI under section 1471(e), meeting the requirements would increase the burden and costs exponentially.

(ii) *Obtaining Documentation within One Year of the Request.*

Receiving documentation within one year of a participating FFI's request is also unworkable. If a participating FFI requests documentation for accounts with indicia of U.S. status at the time the indicia are found, the one-year time period for receiving documentation will be staggered. It will be difficult, if not impossible, to track whether the participating FFI received the documentation within one year of the date of the request. The only way such a determination could be made would be to build an electronic tracking system, adding costs and burdens for a system that will be only temporarily useful.

Re-soliciting documentation from all account holders within one year of the effective date of an FFI Agreement is not a viable solution to the problem. In many cases the account holder may not provide the information timely. For example, a U.S. individual who has already provided a Form W-9 that the participating FFI did not maintain in an electronically searchable system, may ignore a request for documentation because a Form W-9 does not expire. Further, whether an individual is a U.S. person or a non-U.S. person, if the individual has no assets that produce passthru payments, being classified as a recalcitrant account holder has no effect because 30 percent withholding would not apply. Thus, there is no incentive for such a person to comply with documentation requests.

Even where documentation is provided within one year from a request of a participating FFI, the FFI would have to examine the documentation to determine if it is valid under the "know, or has reason to know" standard, and, if the documentation is not valid under

that standard it must make a second request. Documentation received in response to a second request will often go beyond the Notice's one year period for obtaining documentation.

The difficulties in obtaining appropriate documentation should not be underestimated. Qualified Intermediaries have often spent more than a year getting appropriate documentation even where the account holder was subject to withholding as a consequence.

(iii) Definitional Issues.

Future guidance must also define what documentation, other than a Form W-9, is sufficient to determine whether the U.S. indicia documentation rules apply, and, if those rules do apply, what documentation is sufficient to establish U.S. or non-U.S. status.

(iv) Scope of the Due Diligence Requirement.

Documentation received after a participating FFIs request can be relied upon unless the participating FFI "knows, or has reason to know," that the information in such documentation is unreliable or incorrect. We believe that to make this rule workable, the "know, or reason to know," standard should be limited only to examining the documentation provided to determine if it is sufficient to establish U.S. or non-U.S. status. Examination of other documentation, whether or not electronically available, should not be required unless the information in the newly provided documentation is unreliable or incorrect on its face.

(v) If Rules are Retained, Limit their Application.

If the one-year time periods described in the Notice are retained, they should be retained only if the indicia of U.S. status are highly probative of potential U.S. status; for example, U.S. place of birth, U.S. address, or standing instructions to transfer funds to an account maintained in the United States. Refer to Paragraph G. of these comments for a discussion of the indicia of potential U.S. status rules.

F. The Two and Five Year Rules for Existing Documentation Should be Eliminated.

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Under Part III.B.2.a., for all preexisting individual accounts that are treated as non-U.S. accounts with balances exceeding \$1,000,000 during the year preceding the first year of an FFI Agreement, the FFI must apply the procedures applicable to new individual accounts within two years of the effective date of the FFI's FFI Agreement unless the participating FFI has collected, reviewed, and maintained documentation sufficient to establish the U.S. or non-U.S. status of such accounts. A similar rule applies within five years of the date of the FFI's FFI Agreement for all accounts without respect to the \$1,000,000 threshold (except for those deposit accounts below the \$50,000 threshold). Neither rule applies, however, if (i) the participating FFI has collected, reviewed, and maintained documentation sufficient to establish the U.S. or non-U.S. status of the account, *and* (ii) such U.S or non-U.S. status is reflected in electronically searchable information. Future guidance will also prescribe circumstances under which the procedures will be reapplied for accounts that are treated as other than U.S. accounts and that exceed the \$50,000 threshold rule.

A full evaluation of the practicality of the two and five year rules will depend on guidance that Treasury and the IRS provide as to the scope of the exception, and we request that such guidance be provided as quickly as possible. For example:

- i What is the standard for determining whether “the participating FFI has collected, reviewed, and maintained documentation sufficient to establish the U.S. or non-U.S. status of the account”? What sort of documentation is acceptable and sufficient? Is there a difference between “documentation” in the two-year rule and “documentary evidence” in the five-year rule? Would the requirement that documentation be “maintained” be satisfied where the FFI makes a notation as to what it has reviewed (e.g., a passport) and the relevant data (e.g., date, identification number, nationality), but has not retained a copy of the documentation?
- ii Under what circumstances will such U.S. or non-U.S. status be “reflected” in electronically searchable information? Is a nationality or residence field adequate? Is such U.S or non-U.S. status reflected in electronically searchable information notwithstanding that an image of the documentation is not electronically saved?
- iii Under what circumstances and to what extent will an FFI that satisfies the conditions of the Notice regarding electronically searchable information for existing accounts fall within the exception?

In any event, as noted in Paragraph 1 above, we believe that the two- and five - year transition rules may make FATCA unadministrable for many FFIs with large individual customer bases. We understand that many institutions do not have electronic databases that record the nationality or permanent residence of individual account holders. In addition, while financial institutions in many (but not all) countries generally obtain documentation concerning the nationality of individual account holders, they may not have such documentation for accounts that were opened before the effective date of the relevant AML/KYC rules. As a result, we are concerned that the cost of complying with the two- and five-year transition rules will be prohibitive, as described in Paragraph 1 above.

Accordingly, we urge Treasury and the IRS to adopt the suggestion in our April Submission that an FFI would only be required to add a customer presumed non-U.S. under the electronic search to its FFI annual report if it somehow acquired actual knowledge of the customer’s U.S. status (e.g., through that customer providing new documentation to the bank in the normal course of business; sending a change of address showing a new U.S. address, etc.).

*G. Indicia Used to Determine Potential U.S. Status for Existing and New Accounts.*

Parts III.B.2.a., Step 3, and III.B.2.b., Step 4, contain indicia that are used to determine potential U.S. status. Some of these are not sufficiently indicative of U.S. status, are ill defined, or can be replaced with more relevant indicators.

(i) *U.S. Permanent Residence or Correspondence Address.*

A U.S. address associated with an individual account holder (whether a permanent residence address or a correspondence address) and a U.S. place of birth are indicia of potential U.S. status for preexisting and new accounts. To rebut the presumption of U.S. status both a Form W-8 and documentary evidence are required. We believe, for the reasons stated in our April Submission and paragraph 6.D. above, that the collection of U.S. tax forms should not be mandatory. Instead we propose that participating FFIs should be able to rely on know-your-customer rule documentation provided under the QI Agreement documentation attachment applicable to the participating FFI or a certification of non-U.S. taxpayer status from the account holder.

(ii) *In-Care-Of, Hold Mail, and P.O. Box Addresses.*

We have assumed that the Notice intends that an in-care-of address, hold mail address, or P.O. address that is the sole address on file with respect to the account holder is an indication of potential U.S. status *only* where that address is in the United States, and we request that this be clarified in the guidance.

If this is not the case, this indicator is vastly overbroad, particularly in the context of FATCA where holding U.S. assets is not a prerequisite to requiring documentation. The great majority of account holders in participating FFIs will be non-U.S. persons who will use such addresses for reasons unrelated to U.S. tax evasion. For example, an Argentinean account holder with no U.S. indicia may hold Asian assets only through a Singapore affiliate of a British bank and give a hold mail instruction because of personal safety concerns or other reasons. Why should such a case give rise to indicia of U.S. status? Likewise, some countries in the Middle East only use P.O. Box addresses, and if Middle Eastern account holders are solely invested in non-U.S. securities there does not appear to be a valid basis to conclude that the account has “U.S. indicia.”

(iii) *Standing Instructions to Transfer Funds to an Account Maintained in the U.S. or Directions Received from a U.S. Address.*

*Standing Instructions:* We would appreciate confirmation as to how the Treasury and IRS define the term “standing instructions.” We assume that the Government is using the term in the same way that the industry would use it to mean only permanent instructions provided to the financial institution by the customer to send money to the customer in the United States on a regular basis. We note that this is how the concept is used in Treas. Reg. §1.6049-5(e)(5) (Example 6), which addresses a similar issue for when interest paid outside the United States is subject to Form 1099 reporting obligations by a non-U.S. payor (“[US customer] has instructed [Foreign Bank] to wire the interest at 90 day intervals to [U.S. customer’s] account with [Domestic Bank] within the United States.”). However, as we have stated elsewhere, having exact definitions, including for the concept of “standing instructions,” are needed in order to reduce the overall FATCA rules to manageable and compliant systems and procedures.

*Directions from a U.S. Address:* If the rule is meant to apply only to instructions physically received from a U.S. address, it would seem to literally apply only to instructions

received by post. In the modern financial system, this rarely happens. Instructions are transmitted by telephone, fax, by e-mail, or entering information directly into the FFI's website. Furthermore, very few if any FFIs keep or track envelopes containing written instructions. If the U.S. address rule were applied under the literal interpretation, the process would necessarily be a manual one.

If the intent of the rule was that any instructions, no matter how transmitted, result in potential U.S. status, it would be simply unadministrable. In nearly every case, it would not be possible to verify the source of the instruction. Faxes may be an exception, because the transmission would contain an area code with the telephone number of the fax machine, but this raises the same problems that exist with mail sent from U.S. addresses.

We also note that that the rule would be overbroad if it applied to a single communication from within the United States. Recognizing this, Treas. Reg. § 1.6049-5(e)(2) treats a payment of interest as made inside the United States and potentially subject to Form 1099-INT “. . . if the customer has transmitted instructions to an agent, branch, or office of the institution from inside the United States by mail, telephone, electronic transmission or otherwise concerning the deposit or account (*unless the transmission from the United States has taken place in isolated and infrequent circumstances*)." Both financial institutions and the IRS have long criticized the above rule as unadministrable and we believe FATCA should not be compounding the problem. We believe that this concept of "directions from a U.S. address" should be eliminated.

H. *Documentation for Entity Accounts, the Definition of Excepted NFFEs and the Remaining Scope of the NFFE Concept.*

The observations made above regarding identification and documentation for individual accounts apply as well to entity accounts. Thus, as noted in Paragraph 7.E above, the time periods for requesting and obtaining documentation for preexisting accounts are unwieldy and too short.

Moreover, as noted in our April Submission, preexisting entity accounts present substantially greater compliance challenges than individual accounts because of the need to determine not only whether the entity is a U.S. person or not, but also whether the entity is a (participating, deemed-compliant, non-participating, etc.) FFI or NFFE, and whether the entity has a "substantial U.S. owner."

The Notice significantly ameliorates these compliance challenges by treating any entity that is engaged in an active trade or business (other than a financial institution ("FI") business) as an excepted NFFE, and any account of such an entity maintained at a participating FFI as not constituting a U.S. account. The EBF and IIB applaud this sensible rule. While the Notice does not explicitly say so, we understand this approach to implicitly relieve any such NFFE from being required to determine whether it has any "substantial U.S. owners" and, if so, to identify such persons.

The participating FFI can make the determination that an NFFE is engaged in an active trade or business based on "appropriate evidence," including statements of business

activities, receivables or payables related to business activities or other business records. Treasury and the IRS are also considering information obtained from third party credit databases – a concept which we support. Additionally, an entity can provide documentation establishing that it is an excepted NFFE; it should be clarified that this documentation can be a simple certification.

Further guidance should be provided as to the level of active, non-FI business activity that must be conducted by an entity that also has investment or other FI activity in order to qualify as an excepted NFFE. In addition, the Notice apparently contemplates that entities that are not FFIs but do not establish that they are engaged in an active non-FI business would be non-excepted NFFEs, and would have to provide information regarding its direct and indirect U.S. owners. In view of the Notice’s expansive interpretation of what constitutes being “engaged primarily in the business” of investing under section 1471(b)(5)(C), we find it surprising that entities that are not FFIs would not qualify for the active business exception from NFFE status, and accordingly we suggest that the scope of this class of entities be clarified. In other words, under the Notice’s expansive interpretation any entity that is not an FFI necessarily ought to be considered to be engaged in a sufficient amount of non-FI business to qualify as an excepted NFFE.

As discussed in our April Submission, we believe that the NFFE concept can and should play an important role, and should cover smaller investment entities that cannot qualify under the Notice’s exclusion for “small” FFIs (which we referred to in our April Submission as “small foreign investment entities” or “SFIEs”) as well as certain FFIs, such as QIs eligible for a QI external audit waiver and institutions currently operating as NQIs.

The guidance should clarify that an NFFE must identify only a “substantial U.S. owner,” as provided in the statute (i.e., a more than 10% owner or, as we discuss in our April Submission, a more than 25% owner so as to correspond to the majority of AML/KYC regimes in other countries). We are concerned that the Notice (see, e.g., Section III.B.3.a.4)c) could be read as expanding the reporting to every specified U.S. person that is a direct or indirect owner of an NFFE which leads to administrative burdens sharply disproportionate to the risks of material U.S. tax evasion.

Finally, as previously noted in the April Submission and the Notice, it will be important for guidance to develop presumptions regarding entity classification categories to ease the burden of compliance; similarly it will be important for guidance to relieve FFIs and other withholding agents from liability for good faith errors in classifying entities. In addition, we believe that withholding agents should have the option to collect certifications from entity account holders upon which they may rely as to all relevant aspects of that entity’s FATCA status.

I. *New Individual and Entity Account Relationships of Preexisting Account Holders.*

The Notice provides that for purposes of the information and identification rules, a new individual account includes a new account relationship established by an individual holding a preexisting individual financial account with the FFI, so that, for example, if an

individual who has a preexisting depository account at the FFI opens a custodial account after the effective date of the participating FFI's FFI Agreement, that account would be subject to the post-effective date procedures for new accounts (Notice, Section III.B.2.b). A similar rule applies to new entity accounts, although it lacks the specificity of the individual account rule (Notice, Section III.B.3.b).

Guidance should confirm that the opening of, say, a new depository account by an existing depository account holder is not treated as the opening of a new account relationship, and that this distinction applies for entity accounts as well.

In addition, we recommend that consideration be given to conforming the definition of what is a new account to the regulatory rules and banking practices to which the particular FFI is subject. Thus, a new account relationship should be deemed to arise for purposes of FATCA only where the applicable KYC/AML or other local rules require the account holder to provide identifying information. Where such information is not otherwise required, the imposition of this requirement under FATCA would require burdensome and costly changes to procedures and systems.

To illustrate, U.S. as well as non-U.S. banks often permit existing account holders to sign up on line for additional services involving the opening of different types of accounts, without having to undergo new account opening procedures. For example, if "U.S. Customer" opened a checking account with "U.S. Bank", that bank would collect and validate a Form W-9 from the customer and examine/collect a government-issued identification document (typically a driver's license). U.S. Bank would not have the obligation to require U.S. Customer to provide such documentation to open (perhaps through an on-line banking relationship) a money market account, a certificate of deposit, a savings account, etc. Requiring non-U.S. banks to re-document such new "accounts" is burdensome, impractical and of no apparent compliance value. Under our recommendation, the opening of such an account would not be treated as the opening of a new account for FATCA purposes.

#### J. Consistency of Terminology, Presumptions and Other Rules.

The Notice inconsistently uses such terms as "documentation", "documentary evidence" and other key terms. We think future guidance should both clarify the terminology used in the Notice and consistently define and then employ the new terminology. We highly recommend that to the extent possible, Chapter 4 terminology should be the same as existing Chapter 3 terminology. This is particularly true of the terms "documentation," "documentary evidence," and certification. Those terms are not only used inconsistently with their chapter 3 meanings but are also not consistently used within the Notice itself. Other terms need to be carefully evaluated for whether a definition is necessary or not. For example, for determining the \$50,000 threshold, would margin accounts, collateral accounts, and commitments by the participating FFI be considered "deposits"? Treasury and the IRS must take into account that such terms are not necessarily understood by those who do not speak English or for whom English is a second language, and are not U.S. tax practitioners.

For many participating FFIs, Chapter 4 compliance work will be done by the same personnel who handle chapter 3 reporting. Use of consistent terminology, presumptions and other rules for Chapter 3 and 4, to the extent appropriate, would ease compliance burdens.

8. Reporting on U.S. Accounts (Notice, Section IV).

Section IV of the Notice describes the preliminary views of Treasury and the IRS regarding the manner and type of information reporting that FFIs must provide to the IRS annually with respect to their U.S. accounts under the FFI Agreement.

The Submission describes our concerns and recommendations regarding these topics, which we will be pleased to supplement once Treasury and the IRS release proposed guidance on these topics. At this juncture, however, we wish to underscore the broad theme articulated in the Submission and reiterated in paragraph 2, above, that it is critical that Treasury and the IRS vigorously pursue approaches to these topics that minimize the administrative burdens on FFIs.

In this regard, we support the proposal to eliminate duplicative reporting by “providing that in the case of a participating FFI that maintains an account of another participating FFI, only the participating FFI that has the more direct relationship with the investor or customer will be required to report the information required under section 1471(c)” (Notice, Section IV.E). We recommend that this rule be applied broadly and liberally.

We also strongly believe that only static data (i.e., account balance at year end) should be required to be captured for the FFI annual report and not data on annual flows into and out of the account (i.e., gross receipts and withdrawals). The Treasury and IRS should not underestimate the complications and costs associated with capturing and archiving such data, as well as reporting it, given the likely enormous amount of such data. While we understand that marginal increase in compliance benefit to the IRS from receiving such data, we believe that the static data, particularly account balances, will provide the IRS with more than adequate compliance information.

9. Request for Specific Comments (Notice, Section V).

Please refer to the Submission and the June Letter for our comments regarding most of the topics on which Section V of the Notice requests specific comments. Many key areas have not been addressed (e.g., audit/verification procedures; application of rules to affiliated groups; election to be withheld upon; QI/FFI overlap; refunds; and many others). We provide the following specific additional comments:

a. Passthru Payments. The Notice requests comments regarding what we consider to be the critical issue of the treatment of passthru payments (Notice, Section V.B). We remain very concerned about the concept of a “passthru payment” leading to a U.S. withholding event on non-U.S. source income because the non-U.S. source amount is considered “attributable to” a withholdable amount by the United States. Requiring U.S. taxes to be withheld on non-U.S. source amounts raises troubling jurisdictional, legal and practical operational questions, and we believe that such withholding should be limited to the most abusive situations.

As noted in our April Submission, in our view, the regulations should provide that a payment should be considered attributable to a withholdable payment and thus a passthru payment only where there is a traceable link between the account holder and the withholdable payment and the withholdable payment is highly correlated to the non-U.S. source amount received by the account holder. Further, the traceable link/“highly correlated” concept must be weighed against the operational and systems capabilities to determine when such a link is present and by the market disruption that would occur if the traceable link is too broad or attenuated (for example where the investment is through tiers of entities). We believe that a traceable link should only be deemed relevant in the case of an investment entity or investment account in which the account holders are looking to an identifiable portfolio of securities (which might be actively managed in the discretion of the manager) that includes predominantly U.S. securities as the source of their returns. We strongly believe that the passthru payment concept should not apply as a matter of course to investment accounts where U.S. securities and the corresponding U.S. withholdable amounts are less directly related to the non-U.S. source payment received by the investor. For example, if an investment account or fund were “traceable” to an investor but held only 1% U.S. securities and 99% non-U.S. securities, we believe that it would be both burdensome and impractical to require systems and procedures to impose a corresponding 1% U.S. withholding on the non-U.S. source amounts paid to the investor. We recommend that Treasury and the IRS adopt a standard that would apply the passthru payment concept only in truly abusive situations and not as a standard operational rule.

It would be particularly inappropriate and burdensome for payments that a bank or other financial institution makes from general funds (a “general funds payment”) – such as deposit interest or interest on general debt securities issued by the institution – to be treated as passthru payments. If all or some proportionate share of such payments were treated as passthru payments, it would be extremely difficult for many financial institutions to become participating FFIs and to maintain their U.S. investment activities because they would consider the 30 percent withholding tax to be an unavoidable cost of doing business that, in many cases, would render such activities uneconomic. The numerous interpretive and administrative complexities in determining the amounts subject to withholding, and the operational challenges of implementing such withholding, may also discourage financial institutions from participating in the new system.

Moreover, if the passthru payment concept is to be applied to securitization vehicles (such as CLOs, CBOs, etc.) and similar structured finance entities, in which cash flow from U.S. securities may be used to make payments to senior creditors while more junior interest holders must report (phantom) taxable income, special care will need be taken in crafting clear and precise rules that ensure that the risk of withholding for noncompliance with the FATCA rules is borne only by the recalcitrant holder or non-complying lower-tier FFI and not by other holders of debt or equity interests in the entity or by the entity itself, since any shifting of such risk could adversely affect the commercial viability of such vehicles.

Finally, we are concerned about the suggestion that the passthru payment concept may provide FFIs with a way to force “recalcitrant” account holders to comply with FATCA’s reporting requirements. As we have noted elsewhere in this submission, there are any number of situations that have nothing to do with U.S. tax evasion that might lead a non-U.S. customer with

no U.S. indicia and with no U.S. investments or accounts to not cooperate with an FFI seeking information from that customer not required by the FFI's home jurisdiction. It would be particularly inappropriate to require any sort of withholding on non-U.S. source amounts paid to these customers. We discuss below further concerns with the concept of "recalcitrant" account holders.

b. *Sanctions for Recalcitrant Account Holders.* On the question of possible sanctions with respect to recalcitrant account holders (Notice, Section V.D), we understand the concern that withholding should not become a permanent substitute for collecting and reporting information with respect to U.S. accounts. However, we think that terminating FFI Agreements due to the number of recalcitrant account holders remaining after a reasonable period of time is a draconian response, which would be appropriate (if at all) only in those rare situations in which (i) there are probative indicia that the recalcitrant account holders are in fact specified U.S. persons (or entities controlled by them) and not merely foreign persons who for one reason or another do not respond to inquiries, (ii) those recalcitrant account holders represent a high percentage (e.g., more than 50 percent) of the weighted average volume of accounts at the FFI receiving withholdable payments, and (iii) the FFI is not diligently and actively pursuing all reasonable remedies available to it under its local laws with respect to those recalcitrant account holders.

We stress that a vast number of "recalcitrant" account holders will not be "recalcitrant" because they are U.S. taxpayer trying to hide from the IRS, but because they are non-U.S. investors (with no U.S. indicia) invested in non-U.S. accounts with no nexus with the United States and with no local law obligation to cooperate with a withholding agent seeking the relevant information.

#### 10. *Interaction of Cost Basis Regulations and FFI Regime.*

We are pleased that the final cost basis regulations did not adopt a proposed change that would have included QIs in the definition of a "broker" required to perform cost basis reporting for transactions effected outside the United States. However, we would like to raise three points for your consideration.

First, the preamble to the final regulations states that Treasury and IRS will clarify the interaction of the cost basis requirements and the FFI rules. We welcome this statement. We believe that it remains unclear whether an FFI, including a QI, must provide a U.S. withholding agent with Forms W-9 for Form 1099 reporting if the FFI instead provides information about the U.S. customer on the FFI's annual report. The two requirements appear to be redundant.

Second, we also assume that any clarification of the interaction between the cost basis rules and the FFI rules will also address whether an FFI assuming Form 1099 reporting under section 1471(c)(2) must also take on cost basis reporting. It would be helpful to know if Treasury and the IRS instead intend to adopt some of the suggestions that have been made by other organizations to allow non-U.S. institutions a scaled-back Form 1099 reporting alternative that would eliminate such requirements as cost basis reporting.


Third, we are concerned that while QIs are not subject to the Form 1099 cost basis reporting requirements (except where a sale of securities that produces, or could produce U.S. source income is effected inside the United States), they nonetheless remain obligated to provide transfer statements to other financial institutions upon the transfer of U.S. and non-U.S. securities for their U.S. customers. The failure of the cost basis regulations to except transfers of U.S. and non-U.S. securities is contrary to the objective stated in the preamble to exclude securities from the transfer statement requirement if cost basis reporting is not required. Further, the transfer statement requirement causes us great concern because cost basis information on such securities has not been, nor is it likely to be, collected or maintained since there are no non-U.S. tax reasons to do so in the home countries of the affected institutions and section 6045 reporting will almost never be required because sales of securities are rarely, if ever, effected inside the U.S. and, in any event, it is not possible to anticipate whether a sale will be effected inside the U.S. We accordingly believe that the requirement to provide transfer statements should be eliminated. The requirement is exceptionally disproportionate to any U.S. compliance goal.

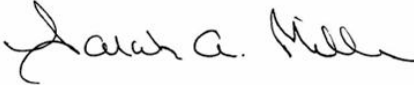
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The EBF and IIB appreciate the opportunity to submit these comments and recommendations to Treasury and the IRS. We look forward to discussing these comments with you, but please do not hesitate to contact us with any questions you may have.

EUROPEAN BANKING FEDERATION

INSTITUTE OF INTERNATIONAL BANKERS

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