

[TEXT OF THE FATCA COMMENT LETTER SUBMITTED BY  
THE ASSOCIATION OF GLOBAL CUSTODIANS]

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**Re: Comments on Foreign Account Tax Compliance Act (FATCA) Provisions of the Hiring Incentives to Restore Employment (HIRE) Act**

Dear Ms. Corwin and Messrs. Caballero, Danilack, Mundaca, Musher, Shay, and Shulman:

I am pleased to provide the attached comments prepared by a working group of the Association of Global Custodians (“AGC”) on certain of the Foreign Account Tax Compliance Act (FATCA) provisions of the Hiring Incentives to Restore Employment Act (the “HIRE Act”). As you may know, the AGC is an informal group of ten global banking institutions with affiliates and branches in numerous countries that provide global custody services and related securities asset-servicing functions to cross-border institutional investors around the globe. AGC members are listed on the letterhead above.

We appreciate the openness of the IRS and Treasury to feedback from industry participants on the FATCA provisions and your active solicitation of input on these important issues. As discussed in further detail in the attached comments, the AGC respectfully requests that the IRS and Treasury clarify that financial intermediaries which are not a counterparty to a derivatives transaction should not be considered the withholding agent for purposes of new *Internal Revenue Code Section 871(l)*. Published guidance is urgently needed on this issue as the effective date of the withholding provisions on “specified notional principal contracts” (“SNPCs”) is September 14, 2010. If you have questions concerning the following comments or would like additional information, please contact the undersigned or Lisa Chavez, Northern Trust. Members would also be pleased to arrange a conference call if that would be helpful to you.

Sincerely yours,

Carol A. Dunahoo  
Baker & McKenzie LLP  
Counsel to the AGC

## COMMENTS:

### **Request for clarification of applicability of derivatives provisions to intermediaries**

Notice 2010-60, which was just released on August 27, 2010, provides preliminary guidance on a number of priority issues involving the implementation of the new FATCA withholding provisions, and solicits comments on a number of issues. The AGC intends to submit comments in response to *Notice 2010-60* prior to the November 1, 2010 deadline. However, at this time, AGC members believe it important to draw your attention to an issue that relates to provisions effective September 14, 2010 that was not addressed to *Notice 2010-60*. Members believe this issue uniquely affects global custodian banks; requires urgent priority guidance; and has not been previously addressed in other comment letters that have been submitted.

The HIRE Act provisions which provide that a payment made pursuant to a “specified notional principal contract” that is directly or indirectly contingent upon or determined by reference to the payment of a dividend from U.S. sources will be treated as a U.S. source dividend, are effective beginning September 14, 2010, and will create a withholding tax obligation on payments previously excluded from withholding as non-U.S. source. As such, the AGC believes that there is a particularly urgent need for guidance regarding who is responsible for tax withholding under these new provisions, which are set forth in new *Section 871(l) of the Code*.

The term “specified notional principal contract (“SPNC”) is defined in *Section 871(l)(3)(A)* as any notional principal contract (“NPC”) where (1) the party to the contract entitled to receive a payment contingent upon or determined by reference to the payment of a dividend from U.S. sources (the long party) transfers the underlying security to another party (the short party), which in turn will transfer the underlying security back to a long party entitled to the dividend equivalent payment; (2) the underlying security is not publicly traded; (3) the underlying security is posted as collateral by a short party with the long party in connection with a contract; or (4) the contract is identified as a specified notional principal contract in regulations to be issued.

*Section 871(l)(7)* specifically provides that each person that is a party to a contract that provides for a dividend equivalent payment shall be treated as having control of such payment for purposes of Chapter 3 and Chapter 4. Existing regulations under Chapter 3 provide that a “withholding agent” is responsible for withholding, and that a “withholding agent” generally means any person that has the control, receipt, custody, disposal, or payment of an item of income subject to withholding. n1 Guidance is urgently needed to address the interaction of new *Section 871(l)(7)* with the existing definition of “withholding agent.

A custodian may be considered a “withholding agent with respect to a dividend equivalent payment under Chapter 3 as a person that has receipt and/or custody of such payment. However, a custodian will not be a party to the contract for a SNPC, and as stated below, will not have sufficient information to determine whether a payment is made pursuant to a SPNC or to determine the amount of withholding. Language in the Joint Committee on Taxation’s Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3310, the “Hiring Incentives to Restore Employment

Act,” Under Consideration by the Senate (JCX-4-10) (February 23, 2010), (the “Joint Committee Technical Explanation”), indicates an intent to place the withholding responsibility on only the parties to the transaction, rather than on the custodians or other intermediaries, because only the counterparties have “control of the payment for this purpose. n2 Accordingly, guidance is urgently needed to confirm that a custodian or other intermediary or agent that has receipt and/or custody of a payment made pursuant to a SNPC will not be a “withholding agent” under Chapter 3 or Chapter 4 where such custodian is not a party to the contract.

Placing the withholding obligation for dividend equivalent payments made pursuant to a SNPC with the parties to the contract as set forth in *Section 871(l)(7)* is also consistent with the practicalities of these transactions. Custodians and other financial intermediaries or agents are not likely to have sufficient information about the terms of the underlying contract to know whether a notional principal contract meets any of the first three criteria of *Section 871(l)(3)(A)* noted above. Rather, this information would be specifically within the knowledge of the counterparties to the swap transaction. In addition, intermediaries typically see only the net payment made on a notional principal contract transaction, not the gross amount (on which withholding would be required pursuant to *Section 871(l)(5)*). As such, AGC recommends that the Treasury and the IRS issue guidance clarifying that custodians and other intermediaries that are not parties to the contract are not considered “withholding agents” for purposes of Chapter 3 or Chapter 4 with respect to dividend equivalent payments made pursuant to SNPCs.

## Conclusion

The AGC greatly appreciates the opportunity to provide the comments set forth above on the FAT-CA provisions, and members hope they are of assistance as you formulate guidance and regulations to implement the new rules.

## FOOTNOTES:

n1

*Treas. Reg. Section 1.1441-7(a)(1).*

n2

The Joint Committee Technical Explanation states: “For purposes of chapter 3 . . . and chapter 4 . . ., each person that is a party to a contract or other arrangement that provides for the payment of a dividend equivalent is treated as having control of the payment. Accordingly, Treasury may provide guidance requiring either party to withhold tax on dividend equivalents.”