

[TEXT OF THE FATCA COMMENT LETTER SUBMITTED BY
AUSTRALIAN BANKERS' ASSOCIATION]

7 June 2011

Hon. Douglas H. Shulman
Commissioner
Internal Revenue Service
CC:PA:LPD:PR (NOT-121556-10),
Room 5203,
PO Box 7604, Ben Franklin Station,
Washington, DC 20044

Dear Mr Shulman,

Notice 2011-34

The Australian Bankers' Association ("ABA") n1 appreciates the opportunity provided by *Notice 2011-34* (the "Notice") to provide further comments on the implementation of the Foreign Account Tax Compliance provisions of the HIRE Act ("FATCA").

The ABA previously filed comments with the Department of the Treasury and the Internal Revenue Service (IRS) on 1 November, 2010 and 26 February, 2011 ("ABA's Prior FATCA Comments"). For your convenience, copies of those comments are attached. n2

In this letter we want to take the opportunity to emphasise three issues that we see as critical to any scheme for implementing FATCA effectively, efficiently and fairly.

First, existing mechanisms for tax information exchange should be used ~ augmented where necessary ~ to the greatest extent possible to minimise redundant reporting. **Second**, as applied to banks and other foreign financial institutions that are engaged in active financial services businesses, the percentage of assets method for calculating passthru payment withholding, newly announced in *Notice 2011-34*, should be abandoned because, among other things, it reaches broad classes of payments unrelated to purposes for which FATCA was enacted. **Third**, the implementation of FATCA needs to be accomplished in phases because the delay in promulgating regulations and issuing guidance makes it highly unlikely that any institution will be able to do anything more than enter an agreement with the IRS by 1 January, 2013. Actually, meeting any obligations under such an agreement will take considerably longer.

On the third point, it is important to note that international payments messaging systems (e.g. SWIFT) used by financial institutions worldwide will need to be updated to allow participating Foreign Financial Institutions (**FFIs**) to identify sufficient details on U.S. sourced payments and that changes to these systems generally require very long lead times.

The following pages expand on the above key points in more detail. Specific comments responding to each section of the Notice are included in Appendix 1: Section-by-Section Detailed Comments.

1. Building on Existing Tax Information Reporting

As set out in detail in the ABA's Prior FATCA Comments, we firmly believe that the Secretary can, and should, exercise his discretion under *Section 1471(b)(2)(B)* to exempt banking operations in jurisdictions like Australia and New Zealand from FATCA because they are highly tax compliant and tax transparent, making them inhospitable to tax evasion. Nevertheless, we have come to recognise that Treasury and IRS are unlikely to do so. During his recent visit to Sydney, Deputy Secretary Neal Wolin emphasised this point.

The Deputy Secretary has confirmed however, the views expressed in Secretary Geithner's January letter to Australia's Ambassador to the United States. The Secretary noted the importance of building upon existing arrangements for information exchange, such as those contained in the U.S.-Australian income tax treaty, as a means for reducing FATCA's compliance burdens. We are concerned that, although the ABA and other banking associations urged this approach in earlier comments and at meetings, *Notice 2011-34* makes no mention of utilising existing exchange mechanisms. We hope that this is simply because of a choice not to address this issue in this Notice, as opposed to a rejection of the concept, and that further guidance or the proposed regulations will include this approach.

Specifically, we urge the adoption of what we described in a prior comment as "an alternative form of agreement." We envisage that such an agreement would incorporate existing, and perhaps enhanced, mechanisms for information exchange at the government-to-government level. This could be in accordance with a Double Tax Agreement in place with the United States, or via a separate Taxation Information Exchange Agreement ("TIEA"), addressing the specific information requirements in line with the aims of FATCA. Thus, an institution's obligations under its FATCA agreement with the IRS would be calibrated by the extent to which the relevant governments have agreed to share information in the global fight against tax evasion.

As we have explained previously, much of the tax information reporting required by FATCA is already reported to the IRS by Australian and New Zealand institutions through the Australian Tax Office ("ATO") and the New Zealand Inland Revenue Department ("NZIRD"). We understand that the IRS has expressed the view that there may be additional data elements that may need to be reported, for example TINs, but we believe that can readily be discussed and agreed within existing channels, avoiding the need to create new redundant and expensive reporting mechanisms.

Moreover, we believe such an approach would have immense benefits to the IRS and National Tax Authorities. Strengthened agreements for tax information exchange will enable the IRS to share the burden of information collection with its counterparty governments. Enforcement arising from failure to provide the required information will also be easier to accomplish in the home jurisdiction of the recalcitrant entity.

We envisage a tripartite arrangement where the IRS first sets out precisely what information is needed to satisfy FATCA. It then negotiates with willing governments mechanisms for the exchange of that information. FFIs that are subject to such enhanced mechanisms will enter into FATCA agreements with the IRS that acknowledge the existence of such mechanisms and reduce the institution's compliance burden accordingly. The institutions then would work with their National Tax Authorities to provide the data required by the strengthened inter-governmental agreement.

From our preliminary discussions with the ATO and NZIRD, we believe that they are willing to consider such strengthened agreements. We urge the U.S. Treasury and the IRS to take advantage of this opportunity. With sufficient willingness between government negotiators to be open to new areas for cooperation, such strengthened agreements can address and satisfy FATCA's reporting requirements, including a mechanism for identifying U.S. accounts.

The ATO, NZIRD and IRS already share a considerable amount of information automatically and we understand they have agreed in principle to provide whatever information is needed by their counterparts for tax administration purposes within the confines of domestic law. We believe that an enhanced agreement could provide not only for the reporting of information with respect to the accounts of persons clearly identified as U.S. taxpayers, but could also be crafted to allow for the collection and exchange of information concerning accounts of persons with certain indicia that they may be U.S. taxpayers who may be hiding their tax status. For example, existing provisions in the Australian tax framework gives the ATO the right to serve a notice to collect further information about named individuals or entities.

Using enhanced tax information exchange the governmental parties to such agreements can assist each other in identifying possible tax evaders for further investigation. By referencing such enhanced tax information exchange regimes in an FFI's agreement with IRS, the IRS can be assured that the FFI will cooperate with its own National Tax Authority and receive the benefit of the considerably more robust powers of the tax authority to require "recalcitrant" account holders to provide information to resolve their U.S. tax status. Simply put, building on the existing tax exchange mechanisms that already exist with jurisdictions like Australia and New Zealand, will be much more likely to produce the FATCA information than anything a participating FFI could do.

2. Passthru Payments

Section II of the Notice prescribes a seemingly straightforward mechanical approach (a "percentage of assets" test) that is intended to enable a participating FFI to satisfy its obligations under *Section 1471(b)(1)(D)* to withhold U.S. tax on so-called "passthru payments" made to recalcitrant account holders and non-participating FFIs ("NPFIs").

For the reasons summarised below, the ABA recommends that this method be abandoned in its entirety and not be included in the forthcoming proposed regulations.

As discussed below, the ABA believes that the percentage of assets method represents a questionable interpretation of the underlying provisions of FATCA defining a passthru payment; will be extraor-

dinarily difficult for many participating FFIs to administer; will raise serious questions under applicable home country laws as to the authority of a participating FFI to withhold payments that have no connection to the U.S.; and appears to be inconsistent with the overall economic policies of the United States to encourage inbound investment.

The ABA and its member banks are committed to working with Treasury and the IRS to develop a suitable solution for achieving the statutory objectives of FATCA in respect of passthru payments.

2.1 Questionable Statutory Interpretation

Section 1471(d)(7) defines the term passthru payment as any withholdable payment (as defined in *Section 1473(1)*) and any “other payment”, but only to the extent that such “other payment” is “attributable to” a withholdable payment. Under the percentage of assets test as set forth in the Notice, these “other payments” need not have any demonstrable connection to a withholdable payment, such as would exist under a tracing or similar approach. Instead, a percentage of payments made by a participating FFI to a recalcitrant or non-participating FFI would be deemed to be “attributable to” a withholdable payment based on the percentage of the participating FFI’s U.S. assets to its total assets.

The ABA acknowledges that the purpose of the passthru rules is to prevent non-participating FFIs from using participating FFIs to gain exposure to the U.S. capital market and to provide participating FFIs with “leverage” in dealing with recalcitrant account holders. Nevertheless, the expansive approach taken in *Notice 2011-34* to classifying a payment as an “other payment” that is subject to passthru withholding will inevitably mean that banks will be required to withhold and remit U.S. tax on a broad range of payments. This would occur even though such payments are not remotely related to any U.S. sourced income, or to the anti-tax evasion goals that prompted Congress to enact FATCA.

It appears that under the Notice, non-U.S. sourced payments made by participating FFIs to recalcitrants and non-participating FFIs in the ordinary course of business will be swept in the “other payment” basket ~ and thus subject to passthru withholding ~ by reason of the percentage of assets test. Indeed, nothing in the Notice suggests that the phrase “payments made by an FFI” (to quote the Notice) will exclude payments that are clearly not connected with the United States or the purposes for which the U.S. Congress enacted FATCA.

Moreover, it would appear that a broad range of other ordinary course of business payments by such banks will technically fall within the definition of “other payments” that are subject to Passthru Payment Percentage and withholding. These include, but are not limited to, salaries and wages payments to employees; pension payments to the elderly and disabled; rental payments; customer initiated payments; payments under a swap contract or other derivative irrespective of the nature of the underlying reference asset or instrument; drawdown of loans and transfers between accounts.

As discussed more fully in Section II of Appendix 1, many of these types of payments are purely local in nature, have no link to the receipt by the payor bank of a U.S. source payment, and thus seem clearly to fit within the class of payments that, as described in *Section 1472(c)(2)*, are part of a “class of payments” that pose “a low risk of tax evasion”. Whatever test is ultimately prescribed for identifying “other

payments” subject to passthru withholding, it should exclude purely local payments (payments emanating from a jurisdiction outside the U.S.).

There is a potentially substantial risk that an individual account holder may be subject to passthru withholding improperly if there is a non-participating FFI in the chain of FFIs through which funds are transferred as a matter of course every business day. For example, in a typical chain of payments transaction, a participating FFI will be required to withhold in order to treat a payment made to a non-participating FFI as an “other payment” that is subject to passthru withholding, even if the payment is ultimately credited to the account of an individual depositor in a participating FFI and that depositor is not a recalcitrant account holder.

As the foregoing examples illustrate, the passthru withholding scheme envisaged by the Notice will reach a broad class of payments that have no link to receipt of U.S. source funds by the payor bank and present no risk of U.S. tax evasion. For that reason, the percentage of assets test, as it would be applied under the Notice, represents a questionable interpretation of the statute. The ABA does not consider that it is satisfactory simply to say that such a blanket application of the passthru withholding regime will give participating banks and FFIs “leverage” over recalcitrant account holders, many of whom will not be U.S. persons and who will have that classification solely by reason of a failure to respond to a bank inquiry about U.S. status that they reasonably believe has nothing to do with them (as for example, they have never left Australia or made investments in the U.S.).

In connection with the foregoing, the manner in which other features of the proposed percentage of assets test would be applied under the Notice underscores the fact that the test will produce results that are not reasonably related to the statutory objectives of FATCA.

The ABA acknowledges that money is fungible, but as the examples above illustrate, the *Section 1471(d)(7)* requirement that a payment be “attributable” to a withholdable payment would in many cases be effectively “repealed” by the adoption of a mechanical percentage of assets test.

The statute should be interpreted to require that, in order for a payment to be classified as an “other payment” that is subject to passthru withholding, there must be some identifiable link between that payment and the receipt of funds by the payor participating bank or other FFI from U.S. sources. The percentage of assets test, as described in the Notice, falls far short of that standard.

2.2 Severe Issues of Administration

Contrary to the implicit premise of *Notice 2011-34* that a percentage of assets test could be more easily administered by participating FFIs than a direct tracing test of the type envisaged by some commentators on *Notice 2010-60*, the percentage of assets test will be extraordinarily difficult to administer.

If applied as broadly as contemplated by *Notice 2011-34*, no bank or depository institution of any size will be able to develop and implement the necessary passthru payment withholding regime by the 1 January, 2013.

The issue is not merely one of timing or of cost, however disproportionate those costs may be to the anti-tax evasion benefits that would be gained. As discussed more fully in Appendix 1, the issues of administration presented by a broadly applicable percentage of assets test are extraordinary.

For participating FFIs to be able to apply withholding to a “withholdable payment” made to a recalcitrant or non-participating FFI, changes will be required to the international payment gateways, e.g. SWIFT. Specifically, nearly all payments received by banks in Australia from sources outside Australia are processed through SWIFT. The SWIFT system is another example of an existing, widely used and proven mechanism that can be utilised in implementing FATCA.

Financial institutions across the world rely on the SWIFT system and the inclusion of the additional and necessary information to identify payments would require:

- (1) Changes at the payment source (i.e. U.S. financial institutions will be required to record additional information on any SWIFT messages used for international payments);
- (2) Changes to the format of SWIFT messages and the SWIFT gateway itself to capture the additional required data; and
- (3) Changes in systems at the receiver end to record source, payment type and the history of withholding associated with the payment.

Without these changes, the ability to withhold on withholdable payments could not be implemented because it would be impossible to identify sufficient details about payments from U.S. sources.

Moreover, changes to the SWIFT system are currently only made annually and in our experience have an 18 month lead time.

2.3 Issues under Australian and New Zealand Law

Under the passthru payment regime as described in the Notice, a participating FFI may be required to withhold on payments (including payments made in the ordinary course of business for goods or services) made to persons that have no connection with the United States and who may be subject to tax on the gross amount of those payments in other jurisdictions. Insofar as the ABA can determine, the laws of Australia and New Zealand contain no provisions that would provide banks and other depository institutions located in Australia and New Zealand with the explicit legal authority to withhold on such payments. This will create legal uncertainty that these and other countries may be unable or unwilling to resolve by legislation or similar action, particularly in the case of the many classes payments where, under the Notice, an FFI will have no ability to demonstrate that the payment is linked to (i.e., “attributable” to) a withholdable payment.

This may expose banks and other FFIs to third party claims and liabilities under their home country laws, leaving the FFI open to claims of illegal misappropriation of funds pursuant to the withholding.

2.4 Deterrent to Inbound Investment

Like virtually every country, the United States encourages inbound investment. In the ABA's view, the percentage of assets test, if applied to banks and other FFIs that offer multiple financial products and are otherwise engaged in an active financial services business, will in fact provide the opposite incentive. To the extent the class of payments treated as "other payments" subject to passthru withholding is too broad, or such a bank or other FFI is unable to determine its passthru percentage with certainty, it will have a strong incentive to limit its investments in U.S. assets in order to avoid, or at least minimise, the risk of noncompliance and its exposure to home country claims.

3. Phased-In Implementation of FATCA Requirements

Finally, the ABA urges the adoption of a phased-in approach for the implementation of FATCA's compliance requirements. In commenting previously, the ABA has documented the enormous costs of compliance, both in terms of actual expenses and in changes to bank operations that will be necessary in order to comply with FATCA. Additionally, we have identified obstacles under Australian law to the implementation of FATCA. Both industry and Government in Australia recognise that this is a very substantial and complicated undertaking.

Even at this stage, more than a year after enactment, there remain many substantive issues and questions, ranging from the very high level ~ like the appropriate structure for the provision of information, or the manner in which any withholding obligations will be implemented ~ to a myriad of technical details.

If the effective date of FATCA cannot be postponed, we suggest that the requirements of FATCA can be met by having FFIs enter into agreement with the IRS on or before 1 January, 2013, while providing within those agreements a reasonable phase-in period, recognising the complexity of the tasks involved and beginning no earlier than at least 18 months and preferably 24 months after the completion of the rulemaking proceedings and publication of any related guidance.

We propose that Agreements provide for phasing in the requirements. For example new customer on-boarding processes could commence 24 months from the date of the final Regulation, with automated searching on pre-existing customer segments commencing concurrently with the on-boarding. Completion of remediation activities would occur within the timeframes allowed under *Notice 2011-34*.

Allowing for a phased approach will permit large banking organisations with complex information technology systems the necessary time to design and implement the systems required to meet the extensive new FATCA requirements.

4. Conclusion

The ABA submits these comments on the Notice with the intention of providing Treasury and the IRS with constructive recommendations on the proposed FATCA regime. Our comments emphasise the three issues that we see as critical to any scheme for implementing FATCA effectively, efficiently and fairly:

(1) The ABA maintains its fundamental position that, in keeping with the Secretary's January 2011 letter, the ABA's proposal of 26 February, 2011, and the meeting with the Deputy Secretary recently held in Sydney with executives of ABA member banks, existing mechanisms for tax information exchange must be used to the greatest extent possible to minimise redundant reporting. ABA strongly believes that building on such existing mechanisms will produce FATCA information in the most cost-effective and efficient manner.

(2) With regard to passthru payments, the ABA recommends that the percentage of assets test, as described in the Notice, be abandoned for banks engaged in an active financial services business. The test set forth in the Notice will capture such a large class of payments that it represents a questionable interpretation of the statute; presents severe issues of administration; may expose banks and other FFIs to third party claims and liabilities under their home country laws; and could provide an incentive for these institutions to reduce their investments in the United States.

(3) The ABA urges the adoption of a phased-in implementation of the FATCA provisions.

Again, thank you for your consideration of our views. We would like to discuss with you the key points of this letter. We understand that efforts are being made to schedule a meeting in late June with the Department, the IRS and a delegation from the ABA, including representatives of member banks. We look forward to that meeting. In the interim, if we can help you in any way or answer any questions you may have, please do not hesitate to contact me or our counsel at Patton Boggs.

Yours sincerely

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FOOTNOTES:

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The ABA represents the Australian banking industry. It works with its members to provide analysis, advice and advocacy and contributes to the development of public policy on banking and other financial services. The ABA also works to ensure the banking system can continue to deliver the benefits of competition to Australian banking customers. In communicating the industry's views, the ABA works with National, State and Territory Governments, regulators, international organisations, other industry associations, the public, community groups and the media. The ABA has 23 members, including the four major Australian commercial banks, regional banks and international banks holding an Australian banking licence. The vast majority of the banks in New Zealand are owned by ABA member banks.

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See letter from the ABA to the Hon. Douglas H. Shulman, dated November 1, 2010; *see also* letter from the ABA to Michael H. Plowgian and Mae J. Lew, dated 26 February, 2011.

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Except where otherwise indicated, all references in this letter to “sections” are to sections of the Internal Revenue Code of 1986, as amended (the “Code”).