

[TEXT OF THE FATCA COMMENT LETTER SUBMITTED BY  
EUROPEAN FUND AND ASSET MANAGEMENT ASSOCIATION]

November 12, 2010

[Ref. 10-1226]

For the attention of:

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**Comments of the European Fund and Asset Management Association  
in Response to IRS Notice**

e 2010-60

The European Fund and Asset Management Association (“EFAMA”) is pleased to submit the following comments regarding guidance to be issued by the Department of the Treasury (“Treasury”) and the Internal Revenue Service (“IRS”) in respect to the implementation of the Foreign Account Tax Compliance subtitle of the Hiring Incentives to Restore Employment Act of 2010 (referred to herein as “FATCA”). Our comments are both in furtherance of our continuing dialogue with the government regarding the impact of FATCA on Undertakings for the Collective Investment of Transferable Securities (“UCITS”) and comparable funds, and their managers and distributors and in specific response to the request for comments in *Notice 2010-60* (“the Notice”). In the context of the Notice,

we note that much of the detailed information provided with our letter of July 7, 2010 has already been responsive to the Notice's request for comments. We have attached our letter of July 7, 2010 to this submission for ease of reference as Appendix III.

This submission also introduces some proposals (described in detail in Appendix I) for funds that do not benefit from other exceptions or deemed compliance with FATCA and which intend to prohibit U.S. investors from investing in the funds. While we are confident that these proposals are workable for most funds represented by EFAMA, further discussion will be required with the IRS and Treasury on the detailed implementation, including how to adapt the proposal with respect to those countries where the sales distribution models do not easily fit with this suggested approach. We do not put this forward as a universal, 'one-size-fits-all' solution; as we explain, national facts vary, so what is required is a flexible range of *creative responses* to the challenge of making FATCA practical for a great range of fund industry participants to comply with. The EFAMA proposals in this submission should be read in parallel with our original submissions regarding exceptions for low-risk funds, publicly-traded funds, widely-held funds, and funds that prohibit U.S. investors. We anticipate that comments from national associations may address obstacles based on local law or practice, and that these proposals should be workable for the U.S. tax authorities and will assist in establishing a viable and effective set of implementation guidelines for FATCA.

As part of these proposals, EFAMA also suggests that a similar regime (referred to in the attached Appendix I as the "Simplified Compliance Distributor" regime) should be introduced for distributors that prohibit U.S. investors to create a more efficient process to encourage participation.

EFAMA welcomes the opportunity to meet with you to discuss these proposals in greater depth, and to explain our concerns and the reasons why we believe these proposals should be acceptable for the IRS and Treasury.

## **1. Introductory Comments**

### **1.1. Industry Considerations**

In the course of analyzing the impact of FATCA on the funds industry in Europe and developing pragmatic proposals for implementing FATCA in a workable way, it has been very apparent to us that the variation in depositary and distribution arrangements for funds between different countries markedly affects the way FATCA impacts funds.

Clearly, it is not practical to have a different, discrete FATCA regime for each major investor market around the world. We believe, however, that it will be necessary and appropriate to have a 'toolkit' of options that industry participants can apply to their own local circumstances. This approach will best serve the joint goal of the industry and the government of maximizing the reach of the effectiveness of FATCA while minimizing the number of 'full scope' Participating FFIs ("PFFIs").

As a general comment, it should be noted that technical discussions in the context of FATCA will also need to take into account the varied legal constitutions of European fund vehicles.

Moreover, other industry associations have raised concerns in the context of the EU Directive on data privacy. We have not sought to assess legal obstacles for the implementation of FATCA but have rather focussed on how we can try to make it work as an industry. Having said that, any such concerns would very likely be equally valid for the European fund industry and we would be ready to further assess this as needed.

## 1.2. Guiding Principles

In our prior submissions, we have set forth in detail our basic proposals for the most effective application of FATCA to the European funds industry. Our goal in these proposals is to establish a framework for the application of FATCA to the European funds industry, and fund managers and distributors, that conforms with and enhances the fundamental goals of FATCA as we understand them from our perspective as participants in the legislative process and through both formal and informal dialogue with representatives of the IRS and Treasury. That is, we seek to assist in the establishment and implementation of a guidance architecture that enhances the ability of the IRS to detect U.S. tax evaders by encouraging Foreign Financial Institutions (“FFIs”) and Non-Financial Foreign Entities (“NFFEs”) to agree to undertake appropriate due diligence, reporting, and disclosure responsibilities.

Achieving the most effective regulatory framework for both the government and the public requires taking into account the following fundamentals:

- **Limiting the Scope of FATCA** ~ In enacting FATCA, Congress gave the IRS and Treasury broad regulatory authority. It is evident that the intent of this broad regulatory authority was to contract, not expand, the scope of the statute. The universe of foreign entities potentially subject to FATCA is immense. Without regulatory limits on that scope, FATCA would be harmfully disruptive to the global marketplace and to foreign investment in the United States. Targeting those entities that present a real and substantial risk of U.S. tax evasion will alleviate this potential harm, make FATCA manageable for the IRS, and act to encourage those entities that government needs to be compliant to “opt in.”
- **Eliminating Low Risk Entities** ~ Consistent with the above theme, *Section 1471(f)* effectively eliminates from the application of FATCA specified entities that present a low risk of being used as vehicles for U.S. tax evaders and authorizes the IRS and Treasury to expand the list of low risk entities that should be exempted from FATCA.

- **Minimizing Disruptions to the Marketplace** ~ From our participation in the legislative process and discussions with policy-makers in both Congress and the Executive Branch, we believe it is clear that one of the primary motivations behind the expansive regulatory authority provided to the IRS and Treasury was a recognition that if the statutory rules were not circumscribed by regulations, the potential disruption to ordinary financial transactions and the resulting harm to the global economy would be extensive. In the context of the European funds industry, it is essential that the regulators understand how the funds industry operates and develop rules that are compatible with the structure of the industry rather than creating friction between the regulatory rules and industry norms. In its discussions with and submissions to, the IRS and Treasury, EFAMA has attempted to provide that guidance and remains committed to continuing to work with you toward that end.
- **Recognizing and Addressing Potential Obstacles to Success** ~ The extra-territorial reach of FATCA is unprecedented and one of its more controversial aspects. It places burdens on foreign entities that in some cases are in conflict with local laws and practices. A number of commentators have provided examples of cases where the regulatory rules could create conflicts with local law. EFAMA has encouraged national associations of fund managers to provide further input to the IRS and Treasury on the potential impact of FATCA from their unique national perspective. If the FATCA regulations are to be effective they must recognize these obstacles and allow alternatives in certain cases in order to facilitate foreign entities opting in to the FATCA regime.
- **Focusing the Burden of Compliance on Those Closest to the Beneficial Owner** ~ We believe it is already accepted by the government that the regulatory rules should put the burden of compliance on those closest to the beneficial owner. Often FFI, including funds, are well removed from the beneficial owner of the interests in the FFI, European funds typically are

marketed and owned through a chain of intermediaries. Shifting the burden of FATCA compliance to the intermediaries closest to the beneficial owner removes what otherwise would be an impossible burden on the FFI and conforms to a clearly stated policy of avoiding duplicative reporting.

EFAMA has formulated its proposals with the above principles in mind. In furtherance of those goals, we believe the following standards will best achieve the result desired by both the government and the public:

- **Balance** ~ From a tax enforcement viewpoints, it is tempting to write the rules to be as extensive as possible. An overreaching set of rules, however, would be self-defeating as it would discourage FFIs from opting into the system and may even make the rules impossible or impractical to implement. Furthermore, the rules must take into account their impact beyond the pure tax perspective and must recognize the vast reach of FATCA and its impact on the public. As noted above, we believe this need for balance has been recognized from the creation of the statutory rules and is recognized in the Notice. It is also reflected in past policy, such as the *Section 1441/1442* regulations and the foreign targeting standards in the portfolio interest rules.
- **Practicality** ~ Consistent with the standard of balance theme, the rules must be practical. An example of this is the scope of the definition of a pension plan. The Notice provides an illustration of a possible definition of a pension plan which is exceedingly narrow and would leave a multitude of employee benefit plans outside the low risk category. This is in conflict with the underlying premise of the low risk category ~ to remove from the FATCA architecture as many entities as possible where they are not likely vehicles for use by U.S. tax evaders. We would surmise that the drafters of the Notice were being cautious over concern that a broad definition of covered pension plans would open the door to U.S. tax evaders, but the potential for employee benefit plans that meet national norms to be such vehicles seems minimal. We submit that in order to make FATCA an effective

regime, it is necessary to be more expansive in defining the term “pension plan,” recognizing that if abuse of a more generic rule surfaces, that can be remedied in subsequent regulations, EFAMA’s attached July 7, 2010 submission provides an extensive list of appropriate candidates for inclusion in the low risk category.

- **Flexibility** ~ EFAMA has submitted proposals and includes additional proposals in this submission that should be effective for most of its membership but, as will be evident from submissions from national associations, this is not a world in which “one size fits all.” Any rules adopted in the regulations should recognize that there may be limitations on the effectiveness of the rule given the characteristics of each jurisdiction in which an FFI operates. Thus, the rules should build in sufficient flexibility to allow alternative approaches where the adopted rule is not practical to apply.

As a final introductory comment that builds on the above three standards of balance, practicality and flexibility, we encourage you to recognize that many funds operate in jurisdictions where there are built-in safeguards to lessen the need for additional burdens on these funds. These safeguards fit into two broad and often overlapping categories: (i) jurisdictions where funds, and their managers and distributors, operate in a highly regulated environment that creates a compliance-oriented culture; and (ii) jurisdictions that have in place effective agreements with the United States for the exchange of tax information. A number of our proposals take into account these safeguards where they lead to an approach that lessens the burdens on the FFI while not meaningfully compromising the ability of the IRS to detect U.S. tax evaders.

## **2. Overview of the EFAMA Proposals**

The EFAMA proposals (as augmented by this submission) address the following categories of funds and categories of distributors and fund managers.

### **2.1. The categories of funds are:**

- **Low Risk Funds** ~ These are funds that restrict their investors to categories that fit within the definition of low risk entities that are excepted from the application of FATCA pursuant to statute or are appropriate candidates for the exception under the regulatory authority granted to the IRS and Treasury.

Our proposed scope of low risk investors is described in the attached July 7, 2010 submission.

- **Publicly-Traded Funds** ~ *Section 1471(d)(2)(C)*  
lays the foundation for the exclusion of these funds as it removes from the definition of a “financial account” equity interests in an FFI that are regularly traded on an established securities market. This is representative of a theme throughout FATCA to remove publicly-traded securities and publicly-traded entities from its scope (*see, e.g., Section 1472(c)(1)(A)*).

As stated in our submission of July 7, 2010, EFAMA proposes that publicly-traded collective investment vehicles (“funds”) be deemed to be compliant with the requirements imposed on FFIs under Chapter 4 of the Code. EFAMA proposes to treat all publicly-traded funds, both closed-end and open-ended, similarly. EFAMA proposes open-ended funds (funds the interests in which are issued and redeemed by the fund) be treated as publicly-traded provided that the interests are regularly issued and redeemed. There is precedent for treating an open-ended fund the interests in which are regularly issued and redeemed the same as a fund traded on an exchange. For example, *Treas. Reg. section 1.1296-2(d)(1)* provides the conditions under which stock in an open-ended passive foreign investment company (“PFIC”) is considered marketable stock for purposes of a mark-to-market election applicable to PFICs.

Many publicly-traded funds are already effectively exempt from FATCA reporting rules under *Section 1471(d)(2)*, which, as noted above, excludes from the definition of a “financial account” equity in an FFI that is regularly traded on an established securities market, such as an Exchange Traded Fund. Further, the legislative history grants the Secretary authority to expand that exclusion. While such publicly-traded funds are within the definition of an FFI, they are not required to apply the reporting rules of Chapter 4 in order not to be subject to U.S. withholding tax under Chapter 4. There is no practical or policy reason for creating a market bias in favor of funds

whose interests are traded on an exchange over funds whose interests are traded to the general public either through an interdealer quotation system or through the process of regular issuance and redemption by the fund.

- **Widely-Held Funds** ~ The foundation for excluding widely-held funds from FFI treatment is addressed in some depth in EFAMA's attached July 7, 2010 submission. The rationale for excluding widely-held funds is in many ways analogous to the reasoning for excluding publicly-traded funds. In Europe alone, there are tens of thousands of widely-held funds. This is the long-standing established practice for marketing funds to the public. Publicly-traded funds are a more recent phenomenon of limited use that achieves this same end. The tax law should not interfere with common industry practice by placing widely-held funds in a more burdensome category than publicly-traded funds. A large portion of the ownership of widely-held funds is through chains of intermediaries, including distributors, where the fund administrators have limited or no access to knowledge of the ultimate beneficial owners, who may change daily, and the fund's investments turn over on a daily basis. For all of these funds to be fully integrated into the Chapter 4 compliance procedures would be a monumental task and one that would discourage participation and encourage disinvestment in U.S. securities. We do not believe that Congress had widely-held funds in mind when it extended the definition of an FFI to investment entities. Illustrative of this intent is the statement in the legislative history that it was expected that certain widely-held funds would be excluded.

An investment in a widely-held fund is not the equivalent of an individual maintaining an account with a traditional financial institution where the individual controls the use of his/her funds, nor can an investment in a widely-held fund serve as a personal pocket book for the individual. An investment in certain closely-held investment vehicles, where the investor may own a sufficient interest to control its activities

and where the investments of the fund may be concentrated in a limited number of enterprises, may be an appropriate target for coverage, and we suspect that this is what Congress had in mind. However, an investment in, for example, a highly regulated fund (such as a UCITS fund, in the European context) and which, by definition, must hold a diversified portfolio of investments and is widely-held, does not fit this model. Moreover, other (non-UCITS) European funds regulated for sale in their domestic markets and intended for sale to individuals are also subject to stringent diversification rules. Added to this is the fact that a large bulk of investments in widely-held funds is held through a chain of distributors and those distributors will be FFIs. The proper focus of FATCA is on the institutions closest to the beneficial owners who have the knowledge of who their investors are.

The potential disruption to the marketplace and the impracticality of applying many of the compliance rules to widely-held funds establishes a solid foundation for their exclusion from Chapter 4. An exclusion for widely-held funds, with the safeguards discussed in our July 7, 2010 submission and the additional proposals set out in this letter, is fully consistent with the guiding principles discussed in the introductory section of this submission.

- **Funds That Prohibit U.S. Investors** ~ As discussed in prior submissions, a large number of funds already prohibit U.S. investors for U.S. securities law reasons. This common industry practice creates a platform for the creation of a category of funds that should be viewed as either excepted from the application of FATCA or deemed compliant with the regime because, like Low Risk Funds, funds that prohibit U.S. investors pose a low risk of being a vehicle for use by U.S. tax evaders. In Appendix I, we provide suggestions for criteria that would provide greater assurance that these funds are in compliance with the proposed regulatory criteria. We also propose that funds qualifying under this category not be treated as in violation of the restriction on U.S. investors based on a non-U.S.

investor becoming a U.S. person subsequent to initial investment in a fund (a simple example is an individual resident in an EU state becoming resident in the United States). This is a practical rule addressing a fact pattern that does not violate the low-risk spirit behind the exclusion. We understand it is consistent with the U.S. Securities and Exchange Commission (“SEC”) policy as well n2 .

An exception from the prohibition on U.S. investors should apply where the investor is the fund manager and its investment is disclosed to the IRS. It is not uncommon when a new fund is created for the fund manager to invest the initial seed money for the fund. It is also not uncommon that the fund manager is a U.S. company or an affiliate or has a substantial U.S. owner. Allowing this common practice without violation of the “no U.S. investors” restriction is a practical approach to accommodate a standard industry practice. It would not detract from the treatment of the fund as a Low Risk Fund due to the general prohibition on U.S. investors.

We describe this proposal in further detail in Appendix I and for illustration purposes attach PowerPoint overview slides in Appendix III

- **Markets Where the Issuance of Fund Units and Distribution Payments Are Made Only by PFFIs** ~ In certain European countries, such as Germany, fund units are issued as dematerialized shares held by a Central Securities Depositor (“CSD”) in a collective safe custody account. The dematerialized shares are then held in safe custody with custodian banks (which will be FFIs).

Investors in the fund only have a “virtual” right of co-ownership in the fund which must be held by the investor with a custodian bank. The custodian bank is the institution with specific information about the particular investor; the investment fund does not possess the information to identify the investor. The custodian bank, however, is required under “know your customer” (“KYC”) rules and anti-money laundering (“AML”) regulations to properly identify

the client and to keep respective records.

Where the custodian banks in a particular market have all their holdings via a PFFI (the CSD), the compliance with FATCA in that market is achieved as (1) all fund units are in safe custody with custodian banks (FFIs), (2) the fund's depositary, CSD and custodian banks are FFIs, and (3) normally custodian banks as PFFIs will report U.S.-persons.

As the fund units are normally held through PFFIs, in this case the IRS will, irrespective of whether the fund is a PFFI, be able to obtain, where necessary, reporting from the other PFFIs in the distribution chain directly or indirectly. Therefore, the treatment of mutual funds that operate as described should be accepted as deemed compliant to eliminate duplicative reporting. Requiring funds administered in this manner to be PFFIs in order to be compliant would be redundant and counterproductive.

Therefore, for such cases in the described markets where all holdings are effectively through PFFIs, the FATCA objectives are met, as there normally will be full reporting on underlying investors. It is not necessary to require fund managers in such countries to register as PFFIs, and allowing them not to do so would further the practical goal of limiting the sheer number of PFFIs.

- **All Other Funds** ~ At this stage, we have not identified any other generic category of funds that is appropriate for either exemption from FFI status or deemed compliant treatment. However, as more and more persons become aware of FATCA and its impact, we may discover other fact patterns that justify exemption or deemed compliant treatment.

## 2.2. The following categories of distributors

We endorse the theme expressed by some government representatives that the proper focus for funds is the intermediary closest to the beneficial owner. Immediately below we discuss three categories of intermediaries that should be acceptable categories of direct account holders. A PFFI should be considered to have performed adequate due diligence on an account if it can establish that the account is

held by or through a Qualified FFI, a Simplified Compliance Distributor or a Contracting Distributor.

- **Qualified FFIs (QFFIs)** ~ This category includes PFFIs, excluded or exempted FFIs, and deemed compliant FFIs.
- **Simplified Compliance Distributors (SCDs)** ~ A major concern for EFAMA's membership is the fact that many funds are held through a large number of distributors, numbering in the thousands, and it is highly likely that many of these distributors will not become QFFIs. Many distributors have little or no connection to the United States, either in terms of investments or investors. It would be highly disruptive to the marketing of fund interests if these non-QFFIs caused a fund to be viewed as non-compliant. We therefore welcome the suggestion that certain small FFIs should be allowed to enter the simpler regime available to NFFEs, but would suggest adapting this concept such that the entry qualification for this light touch regime is not primarily size (which brings with it difficulties of definition) but instead is based on a willingness to prohibit U.S. clients. Such SCDs would evidence this by providing an affidavit to the IRS which in turn would issue an identification number on which third parties could rely. We believe this simple concept will be easier to implement and enforce, and is closely analogous to our proposal for funds that prohibit U.S. investors. While we do not support limiting this category to small FFIs, the utility of the SCD category would be enhanced by including a *de minimis* concept, similar to the legislative exception to the definition of a "United States Account" in *Section 1471(d)(1)(B)(ii)*. Accordingly, we recommend that an SCD would be allowed to have *de minimis* US accounts.
- **Contracting Distributors** ~ A key benefit to both the industry and the IRS of having a regime for funds that prohibit U.S. investors is that any distributors willing to distribute *only* such funds need not enter the FATCA regime at all [*i.e.*, such Contracting Distributors would not need to make any agreement

with or provide an affidavit to the IRS but would give the fund a contractual warranty to distribute only funds that prohibit U.S. investors). However, such distributors would be required by contract to prohibit U.S. investors from the fund. We refer to such distributors as ‘Contracting Distributors’.

### **3. Responses to Specific Requests for Comments in *Notice 2010-60***

**3.1.** Many of the requests for comments in Notice 2010-60 are addressed above or in prior submissions by EFAMA, notably the attached July 7, 2010 submission. We offer the following additional comments based on the requests in the Notice.

**3.2.** Passthru Payments ~ Another high priority for our membership is the resolution of the problem of applying a 30 percent U.S. withholding tax on “passthru payments.” The Notice requests proposals for applying 30 percent withholding to passthru payments without increasing the burden on FFIs. As discussed in our prior submissions, there is no practical and targeted approach to the application of withholding on a passthru payment in the context of a European investment fund given a chain of distributors, the frequent turnover of investments, the broad scope of the term “passthru payment,” and the fact that, by election, any FFI can transfer its obligation to withhold on such payments up through tiers of FFIs until the obligation rests on the fund or fund manager. Thus, the IRS and Treasury should consider the following: defining a passthru payment narrowly and limiting the election that a PFFI has to be withheld upon in lieu of withholding on a passthru payment. At a minimum, any election by a distributor for the fund or fund manager to withhold on payments to a distributor should require the consent of the fund/fund manager. Adopting this approach is consistent with the position taken by the Notice, which is that, as to PFFIs, duplicative reporting will be prevented by requiring only the PFFI that is closest in the chain to the beneficial owner to report the identity and account details of the investor. Similarly, only the PFFI that is closest in the chain to the beneficial

owner should have to impose a 30 percent withholding tax on a passthru payment because that PFFI has the best ability to impose such withholding in a manner that will affect the recalcitrant investor. If, after these limitations, there remains the possibility of the fund or fund manager having a passthru payment withholding obligation, we propose that, in lieu of withholding, the fund disclose the recalcitrant account or noncompliant FFI to the IRS. This is a practical resolution of what would otherwise be a highly burdensome and potentially unadministrable procedure.

**3.3. Consideration of Local Law Regulation and Jurisdictions with Effective Exchange of Information Procedures in Place with the United States** ~ Among the comments requested by the Notice is one that EFAMA considers to be crucial to limiting the FATCA compliance burden while fostering tax compliance. Specifically, the Notice requests comments on how local law reporting requirements, in combination with exchange of information under tax agreements with the United States, can be utilized to reduce duplicative reporting. This approach is promising because it leverages established methods of cross-border cooperation. Therefore, this approach potentially increases the importance of those government-to-government measures, which are essential to the improvement of tax compliance in a global economy. This approach is only one of many that the IRS and Treasury could adopt to reduce the potential for duplicative reporting burden.

**3.4. Withholding on Gross Proceeds** ~ While withholding on U.S. source dividends and interests is an extension of the existing Chapter 3 withholding regime, withholding on gross proceeds is a new phenomenon that, to our knowledge, has no precedent. The closest analogy is *Section 1445* withholding in connection with a foreign person's disposition of a U.S. real property interest, which is a very focused and limited withholding regime. The idea that any time any person acquires a U.S. security anywhere in the world (including in the United States), the purchaser will have the

responsibility of determining whether Chapter 4 withholding applies to the payment, is overwhelming. Funds will be particularly impacted given the frequency of their trades. We suggest that this withholding requirement be carefully circumscribed. A start in this direction would be an eyeball test that relieves the purchaser of the withholding requirement if the seller meets certain criteria, such as being a regulated fund, with safeguards to protect against abusive cases. We would be happy to further explore this with you.

#### **4. The Need for Prompt Guidance to the Funds Industry/Continuing the Dialogue**

EFAMA has strived to work with the government as it undertakes the challenge of developing guidance to maximize the effectiveness of FATCA through practical and effective rules, providing extensive information on our industry, the potential impacts of FATCA on our industry and a way forward to address our concerns. As in the case of other financial institutions, the funds industry will need to adapt its procedures and practices to accommodate the regulatory rules that will apply to our industry. Because it will take the European funds industry significant time and effort to institute procedures that adequately address FATCA requirements before 2013, knowing in which direction the government is heading is becoming increasingly urgent. We remain committed to working with you to achieve that end and propose that the next logical step is another meeting between the FATCA guidance team and representatives of EFAMA where we can have a very constructive and thorough exchange to move toward resolution of the issues.

We will look forward to meeting with your team and to making further progress on these key issues of mutual concern.

Sincerely,

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## FOOTNOTES:

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In our preliminary discussions with the government on this subject, there was concern raised about whether money-market funds are an exception. While we do not believe this factor alone should be controlling, if that continues to be a concern, we would be willing to discuss the position of money-market funds further.

n2

We understand that the SEC issues No-Action Letters that provide that, if someone invests while not a U.S. person and then moves to the United States, as long as they make no further investment, this is acceptable.