

[TEXT OF THE FATCA COMMENT LETTER SUBMITTED BY
FLORIDA BAR TAX SECTION]

June 7, 2011

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

RE: Comments to *Notice 2011-34*

Dear Sir or Madam:

I am pleased to submit The Florida Bar Tax Section's comments on *Notice 2011-34*. We commend the Treasury and the Internal Revenue Service for their attention to the complicated issues posed by *Notice 2011-34*.

Principal responsibility for these comments was exercised by Erika Litvak, Daniel Martinez, and Margarita Muina. The comments were reviewed by James Barrett.

Although the members of The Florida Bar Tax Section who participated in preparing these comments may have clients who would be affected by *Notice 2011-34*, no such member has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these comments.

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The Florida Bar Tax Section is comprised of approximately 2,000 members. These materials were prepared by the Comment Projects Subcommittee of the Tax Section.

As always, we will be pleased to provide additional commentary as requested. If you have any questions regarding our comments, please do not hesitate to contact us.

Sincerely,

Guy E. Whitesman, Chair

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The Tax Section has the following comments and recommendations regarding *IRS Notice 2011-34* (New Information Reporting Rules for Foreign Financial Institution, Entities):

I. Comments to “Section II ~ Passthru Payments” of *Notice 2011-34*

A. We recommend that the Service promulgate regulations regarding the definition of “passthru payment” that take into account the diversity of capital structures and business models of participating FFIs and give participating FFIs a choice of methods in calculating the passthru payment amount.

A “passthru payment” is defined under *Section 1471(d)(7)* as any withholdable payment or other payment to the extent attributable to a withholdable payment.

Treasury and the IRS intend to issue regulations providing that a payment made by an FFI (the payor FFI) will be a passthru payment to the extent of: (i) the amount of the payment that is a withholdable payment; plus (ii) the amount of the payment that is not a withholdable payment multiplied by (A) in the case of a custodial payment, the passthru payment percentage of the entity that issued the interest or instrument, or (B) in the case of any other payment, the passthru payment percentage of the payor FFI.

Custodial payments are broadly defined to include any case where an FFI is acting as a custodian, a broker, a nominee or otherwise as an agent. In general, the passthru payment percentage equals its US assets divided by its total assets on four quarterly testing dates.

We believe that the proposed definition of “passthru payment” does not effectively accomplish the purposes of the passthru payment provision of Chapter 4 because the ratio of US assets to all assets of an FFI (or

other issuers) may not bear a relationship to the amount of a payment that is a withholdable payment. Also, the proposed test may impose very significant additional administrative, accounting and compliance burdens that will discourage FFIs from entering into agreements with the Service.

Applying the proposed asset test to all FFIs will create hardships and inequitable results for many FFIs. Some FFIs may have assets that are illiquid and difficult to value on a quarterly basis. Not every FFI produces quarterly reports to its investors. Additionally, the current accounting and reporting systems of many FFIs do not distinguish between U.S. assets (as defined in the proposed regulations) and non-U.S. assets. For many FFIs, calculating a passthru payment percentage may prove very challenging and expensive.

We recommend, therefore, a more flexible approach to calculating the passthru payment amount. For example, FFIs could use a default method of evaluating all of the facts and circumstances to determine payments that are attributable to a withholdable payment. As an alternative to the “facts and circumstances” approach, FFIs that desire more certainty could choose between several safe harbor methods, such as the proposed “asset ratio” or an additional “income ratio” based on the ratio of U.S.-sourced income to world-wide income. With regard to the asset based approach, it may be helpful to allow smaller entities to value their US and foreign assets based upon the cost of such items so that a book value approach could be utilized. n1 Also, it also may be helpful to exclude smaller FFI’s (e.g. FFI’s with an aggregate value of less than \$ 1 million).

B. We recommend that the Service modify the definition of the “passthru payment” so that the U.S. assets that are used in the calculation of passthru payment percentage are deemed not to give rise to withholdable payments for purposes of calculating the amount of the passthru payment.

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The problem with this formula is that it is possible to include both the income produced by, and the value of, certain U.S. assets. Clause (i) includes in passthru payments the amount of the payment that is a withholdable payment. Clause (ii) adds to passthru payments a portion of non-withholdable payments to the extent of the ratio between U.S. assets and non-U.S. assets. Thus, if a particular asset generates withholdable payments by the FFI and is also a U.S. asset, such asset will be taken into account twice – first, its income will be added to the passthru payment and then its value will be used to add an additional amount to the passthru payment. This may cause an FFI with 50% U.S. assets and income, and 50% non-U.S. assets and income to have 75% of its payments treated as passthru payments.

We recommend that the Service modify the definition of “passthru payment” so that the same assets cannot at the same time be giving rise to withholdable payment and be included in the calculation of the passthru payment percentage applicable to payments that are not withholdable payments.

C. “Passthru Payment”

IRC Sec. 1471(d)(7) defines “Passthru Payment” as any withholdable payment or other payment to the extent attributable to a withholdable payment”. n2

Notice 2011-34 stated it was inconsistent with the purposes of Chapter 4 to limit the term to withholdable payments “directly traceable to withholdable payments” as was urged by the commentary to Notice 2010-60. n3

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The reasons alleged in the Notice are twofold:

1. one or more “blocker” entities could be used to channel the payment away from the entity owning the US asset and this entity would have no incentive to enter into an FFI agreement since itself would not be required to withhold the 30%; and
2. “diversity of capital structures and payment arrangements of an FFL.” n4

Instead, the offered solution calls for an FFI to comply with Chapter 4 by: (a) publishing on the last day of each quarter (either redemption or business day based in turn on the entity’s fiscal year) the value of its total US assets over total assets from which the 30% “withholdable” amount can be calculated; (b) apply for deemed compliant status; and (c) obtain an EIN. For purposes of the US asset to total asset ratio, a US asset is defined circularly as “any asset to the extent they could give rise to a passthru payments. n5 For this purpose, equity or debt of US companies are always considered to be US assets while equity or debt of a non financial foreign entity will never be a US assets). The Notice indicates that this choice was adopted in light of commentary received in response to *Notice 2010-60* and provides for a first year transition method. Further it excepts some publicly traded funds and “low risk” obligations.

The indirect tracing mandated by Chapter 3’s Qualified Intermediary agreements described in the Code section 1441 regulations permit qualified intermediary to represent that it can reasonably associate the payment with the documentation (Form W-8BEN) it retains at hand for the provider of the income. We understand that this approach was not utilized in *Notice 2011-34* because of the concern that non participating FFI’s might invest in US assets through participating FFI’s and, as a result, circumvent the policy goals of FATCA. n6

1. As with any method which calls for valuing assets in a Balance Sheet and outside a Balance Sheet, more guidance should be offered on the following:

- If functional foreign currency conventions will apply to translate foreign currency into US dollars.
- Which valuation methods should be adopted for volatile or hard to value assets, specifically, puts, calls, options and notional principal contracts or assets for which no ready market can be found.
- If mark to market asset valuations will be required for dealers over historical cost as provided in Section 1256.
- Whether safe harbors can be enacted to account for applications of different accounting methods specially while International Accounting Standards and GAAP are yet to be reconciled.

2. Look-Through Treatment for “Blockers”/Limit Definition of FFI.

Blocker entities and financial products are used for multiple purposes. For example, *Notice 2009-7* held a domestic partnership organized by two CFC partners to route income from yet a third CFC away from the US shareholder to be a “Transaction of Interest” absent facts that would allow it to abuse Subpart F reporting requirement. In this case, IRS Forms 5471 and 5472 could be amended to require reporting of these ‘enlarged’ transactions analogous to the transaction of interest that is described in *Notice 2009-7*.

In private equity, the US Treasury seems to have at least tacitly sanctioned the use of “blocker” entities or tiered structures to shield foreign investors in private equity funds from having to report on the fund’s generated US source effectively connected income while the fund itself would not be bogged down with withholding obligations that may mar both volatility and marketability.

Conversely, domestic entities such as charities, REITS,

RICS, and others subject to disqualification if they were to exceed certain technically defined income tests, often use “blockers” to change the character of income to the parent entity. In fact, the perceived “blocker” problem is tied into the concept of the FFI ‘as a separate entity with no “look through” the chain.

Further, the authors would adopt the ABA’s Tax Section commentary of August 10, 2010 calling for exemption for low risk vehicles unsuitable for wealth accumulation such as certain kinds of insurance contracts, high contingency or high risk vehicles, such as funds trading in private contracts such as swaps, or other notional principal contracts. It may be possible to deem these entities and vehicles ‘per se’ compliant with Chapter 4, subject to obtaining EIN numbers and periodically certifying their continuing activity in the low risk wealth accumulation area. The ABA Tax Section Commentary calls for carve outs for:

holding companies, research and development subsidiaries, and financing subsidiaries within an affiliated group of non-financial operating companies. And other entities that we believe pose a low risk of U.S. tax evasion, such as certain insurance companies, collective investment funds primarily targeted to foreign investors and U.S. tax-exempt entities, and certain investment vehicles established for certain exempt entities. n7
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The authors also adopt the ABA’s Tax Section request to clarify the meaning and scope of the term “established securities market” as used in *Sec. 401* of the HIRE Act considering that *Sec. 1471(d)(2)* excludes “debt and equity interests regularly traded on an established securities market” but the term “established securities market” is not defined as to trading volume or regulatory oversight. In comparison, we note that *Treas. Reg. Sec. 1.871-1(m)* defines an established securities market to include: (i) a national securities exchange which is registered under *section 6* of the Securities Exchange Act of 1934 (*15 USC 78f*); (ii) a foreign national securities exchange which is officially recognized, sanctioned or supervised by governmental authority; and (iii)

any over-the-counter market.

D. Passthru Payments and Withholding Agents, Including Passthru Entities.

As noted in *Notice 2011-34*, “blocker” treatment can be achieved by tiered entities or by diverse capital structures. It is possible or likely that “blockers” may “trap” US source income that is a withholdable payment just like they are potentially used to prevent a subpart F inclusion in *Notice 2009-7*. However, the foregoing concern is perhaps best addressed on a case by case via transaction of interest determinations or by having one of the tiered layers responsible for withholding for the others, similar to Chapter 3’s Qualified Intermediary programs.

Chapter 3’s Qualified Intermediary agreement may in some ways be analogous to Chapter 4’s IRC Sec. 1471(b) Agreement and the Participating FFI seek to “look through” the non-participating FFI to determine the ultimate beneficiary just like the QI represents to the IRS it holds reliable documentation (IRS Form W-8BEN or W-8IMY) it can associate with the payment through to the non QI entity.

In cases of Chapter 3 withholding, the lower tier partnership need not always obtain the consent of the upper tier before it can “look through” to the “ultimate beneficiary” and may just assume the upper tier is a domestic entity. Chapter 4 could use a similar approach where the lower tier pass through entity can “look through” to the upper tier, with or without obtaining the consent of the upper tier given its responsibility for the requisite 30% withholding. Another issue is the fact that not all payments would be uniform so the participating FFI may be left trying to “split” the payment and withhold or not withhold on only a portion of the payment.

E. Taxability of Bank Interest, Possible Portfolio Interest, and Income Exempt by Treaty Obligations.

IRC Sec. 1473(1)(C) includes interest income paid

by commercial branches of domestic financial institutions which is exempt from income tax by IRC Sec. 861(a)(1), and because there is no threshold for US ownership of entities engaged in investment banking, it is very likely that bank interest, short term original issues discount, portfolio interest, and short term gain on sales of Intangibles will be subject to 30% withholding tax even if it is ultimately held by non US persons. Also, the 30% Chapter 4 withholding tax does not account for basis offsets.

The same items of income and other items are often exempt from US income taxation by US income tax treaties. The authors recognize that Chapter 4's purpose is broader than income recognition and its taxability to the economic owner, but it seems this basic conflict between Chapter 4 requirements and the exemptions under the Code or treaties has not been effectively addressed.

In cases where the ultimate beneficiary can claim a refund, there will be months lost of time value of money or opportunity cost.

Where no refund is possible, as in a case when there is no direct means of tracing the ownership, the economic loss will be borne by the owner of the income who may not be necessarily a natural or juridical US person.

Also, Chapter 4 seemingly defines US persons without regard to the impact of U.S. income tax treaties. n8

We request that the FATCA regulations should make clear that they do not apply to persons who are not U.S. income tax residents after application of the applicable U.S. income tax treaties.

II. Comments Regarding the Application of Chapter 4 of Subtitle A of the Internal Revenue Code (the "Code") to Trusts.

A. We appreciate that the Treasury Department (the "Treasury") and the Internal Revenue Service (the "IRS") have issued *Notice 2011-34* supplementing *Notice 2010-60*, *2010-37 I.R.B. 329*, 08/27/2010 ("Notice

2010-60”), which provides further guidance and requests comments on certain priority issues under Chapter 4 of Subtitle A of the Code (“Notice 2011-34”). Unfortunately, unlike *Notice 2010-60* (in particular, Section II.B.3 of such Notice), *Notice 2011-34* does not contain any further clarification in connection with the application of Chapter 4 to foreign trusts and whether foreign trusts will be deemed-compliant FFIs or NFFEs. Further clarifications are critical given the reasons set forth below.

B. We reiterate the totality of the comments submitted by the Section on November 1, 2010 regarding certain “small FFIs” and, in particular, trusts, given that all the issues raised in such letter remain relevant and unaffected by the issuance of *Notice 2011-34*.

C. Furthermore, the Section agrees with the comments submitted by the American Bar Association on February 14, 2011 that relate to trusts and are incorporate those comments in their entirety into this letter.

D. In addition to the comments set forth above, we have the following additional comments:

1. Deemed Compliant FFIs vs. NFFE.

Section II.B.3 of *Notice 2010-60* provides that the Treasury and the IRS intend to issue guidance under which certain foreign entities (such as a small family trust) that are FFIs pursuant to *section 1471(d)(5)(C)*, but not under *sections 1471(d)(5)(A)* or (B), will nevertheless be considered deemed-compliant FFIs if the withholding agent: (i) specifically identifies each individual, specified U.S. person, or excepted NFFE that has an interest in such entity, either directly or through ownership in one or more other entities; (ii) obtains from each such person the documentation that the withholding agent would be required to obtain from such person under the guidance described in Section III of *Notice 2010-60* if such person were a new account holder or direct payee of the withholding agent; and (iii) reports to the IRS, in such manner as will be provided in future guidance, any specified United States person identified

as a direct or indirect interest holder in the entity (Documented FFIs).

Section III of *Notice 2011-34* describes certain other categories of FFIs that will be deemed compliant pursuant to *section 1471(b)(2)*. Section III does not specifically mention anything regarding trusts. Section III provides that, unless otherwise provided, a deemed-compliant FFI will be required to: (i) apply for deemed-compliant status with the IRS; (ii) obtain an FFI identification number (FFI-EIN) from the IRS identifying it as a deemed-compliant FFI; and (iii) certify every three years to the IRS that it meets the requirements of such treatment.

Both Notices cover certain entities that fall within the definition of an FFI, but are intended to be treated as “deemed-compliant FFIs.” However, each Notice provides for a different mechanism for entities to obtain the status of deemed-compliant FFI.

The process described in Section III of *Notice 2011-34* appears to be in line with *section 1471(b)(2)*, which provides that an FFI may be treated by the Secretary as deemed compliant if the FFI complies with such procedures as the Secretary may prescribe to ensure that such institution does not maintain United States accounts. *Section 1471(b)(2)* requires an affirmative process by the FFI in order to be deemed compliant and Section III of *Notice 2011-34* provides for affirmative procedures that the FFI would need to follow and comply with in order to be considered a deemed-compliant FFI.

On the contrary, section II.B.3 of *Notice 2010-60* provides a procedure for an entity to be deemed compliant that resembles the procedure that withholding agents making payments to an NFFE need to follow under *section 1472(b)* to waive the withholding. In particular, *section 1472(b)* when it refers to the requirements for waiver of withholding in the case of withholdable payments to NFFE requires the withholding agent to obtain a certification from the beneficial owner or payee of the withholdable payment that such beneficial owner does not have any United States substantial owner; or, in the event the beneficial owner has any substantial U.S. owner, obtain certain

information from such substantial U.S. owner that the withholding agent will need to provide to the IRS.

The burden, in the case of a withholdable payment made to an NFFE, is on the withholding agent to obtain the certification; whereas, in the case of withholdable payments made to an FFI, the burden is on the FFI to comply with a particular procedure to waive or eliminate the withholding. It seems then that *Notice 2010-60*, even though it refers to deemed-compliant FFIs, provides for a procedure that would be applicable if dealing with payments to an NFFE and not to FFIs. We believe that there should be a consistent procedure in place for FFIs to be “deemed-compliant FFIs,” which may include obtaining a special FFI-EIN. The fact that the procedure which the Treasury and the IRS laid out in *Notice 2010-60* resembles the process that would be applicable to withholdable payments to NFFEs as opposed to deemed-compliant FFIs seems to suggest that the Treasury and the IRS realize that requiring a small trust to get an FFI-EIN or to comply with certain procedures may be too cumbersome for the trust, as well as difficult to administer, so the burden of obtaining the information is imposed on the withholding agent instead. This is an additional reason why small trusts should be treated as NFFEs and not as deemed-compliant FFIs. Even the process laid out in the Notice seems to acknowledge the necessity to rely on procedures that are applicable to an NFFE as opposed to an FFI.

2. Interaction of Simplified Procedures under Notice 2010-60 and Payments by Third Parties to the Trustee of the Trust.

As noted above, *Notice 2010-60* provides for a simplified procedure to be followed by a withholding agent when making a payment to certain small FFIs (such as small family trusts). Such a procedure would require the withholding agent to obtain certain information pertaining to individuals or entities holding direct or indirect ownership in the trust.

In the particular case of trusts, the trustees of a trust hold title to the trust assets. The trust does

not directly take title to the trust assets. Therefore, payments made to or for the benefit of the trust are generally made to the trustees of the trust. In the case of foreign trusts, the trustee is generally a trust company licensed to act as trustee in the jurisdiction of choice. Such a trust company seems to generally be considered an FFI pursuant to *section 1471(d)(5)(B)*. Given that payment will be directed to the trustee in its capacity as trustee of the trust as opposed to the trust directly, it is unclear how the proposed simplified procedure will interplay with the payment to the trustee. Will the withholding agent have to look at whether the trustee has an FFI agreement in place and also comply with the simplified procedure of *Notice 2010-60*? If the answer is yes, it seems that the withholding agent would need to first confirm that the trustee is a participating FFI because, in the event that the trustee is not a participating FFI, most probably the withholding agent will want to withhold anyway in order to avoid penalties for failure to withhold, which would make the simplified procedure of *Notice 2010-60* irrelevant in the case of a small family trust that has a trustee which is a non-participating FFI. We urge the Treasury and the IRS to implement simplified procedures that take into account the role of the trustee in the context of foreign trusts.

FOOTNOTES:

n1

See *Treas. Reg. 1.897-2(b)(2)* for a similar approach in the FIRPTA withholding area.

n2

1471(d)(7) The term “passthru payment” means any withholdable payment or other payment to the extent attributable to a withholdable payment.

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Notice 2011-34, Section II states in relevant part “in response, Treasury and the IRS have received several comments proposing that a payment attributable to a withholdable payment should include only payments that are either withholdable payments or directly traceable to

withholdable payments. These approaches would not, however, be consistent with the purposes underlying the passthru payment concept.”

n4

Id., Section II (“Moreover, given the diversity of capital structures and payment arrangements of FFIs, a rule that defined passthru payments based on whether a payment was “directly traceable” to a withholdable payment would be difficult for FFIs to apply and the IRS to administer. Accordingly, Treasury and the IRS have not adopted the limited definition of a passthru payment proposed in such comments.”)

n5

Notice 2011-34 at section II.B.4.

n6

See TM’s Daily Report, 97 DTR G-7 May 05/10/2011 Freda, Diane “Financial Institutions Passthru Payment Guidance in FATCA Aimed at Urging FFI’s to Enter Agreements.

n7

See ABA Section of Taxation Comments on Foreign Account Compliance Offset Provisions of the HIRE Act, issued on August 16, 2010 to IRS Commissioner Shulman.

n8

See Code *section 1471(d)(1)*.