

[TEXT OF THE FATCA COMMENT LETTER SUBMITTED BY
INVESTMENT MANAGEMENT ASSOCIATION]

12 November 2010

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Email: Comments@irsounsel.treas.gov

Dear Mssrs. Danilack, Musher and Shay and Ms. Corwin,

The Foreign Account Tax Compliance Provisions within the Hiring Incentives to Restore Employment Act (HIRE Act): *IRS Notice 2010-60*.

This submission is restricted to the issues raised by the Foreign Account Tax Compliance Provisions (which in this letter we will refer to as “FATCA”) in *IRS Notice 2010-60* (“the Notice”) in the context of investment made through the medium of UK authorised funds.

The IMA represents the investment management industry operating in the UK. Our Members include independent investment managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of around US\$ 5.5 trillion of assets, which are invested on behalf of clients globally.

These include authorised investment funds (i.e. regulated mutual funds), institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, our Members represent 99% of funds under management in UK-authorised investment funds, most of which are Undertakings for Collective Investments in Transferable Securities (UCITS).

The IMA is also a member association of the European Fund and Asset Management Association (EFAMA) and has participated in the production of the EFAMA papers on FATCA submitted to you on 20 November 2009, 30 November 2009, 29 April 2010 and 7 July 2010. We have also been heavily involved in the EFAMA submission of 12 November (ie today) and fully support the proposals it contains, which are designed to facilitate the effective operation of FATCA while reducing the potentially very onerous compliance costs. This response does not in the main, therefore, focus on the technical aspects of FATCA, with which the EFAMA response of today deals, but instead addresses the specific practical issues which arise out of the distribution models that apply in the UK. These models give rise to particular difficulties in the context of FATCA. Indeed, the UK distribution landscape potentially makes it impossible for any fund or manager to comply with FATCA, at any cost, which would severely impact the attractiveness of US investment.

This submission also explains why the UK should be regarded as a particularly low risk jurisdiction from the FATCA perspective.

Our response does not specifically address the request for comments in the Notice as these are covered in the EFAMA responses of today and of 7 July 2010, which we fully support.

Authorised Funds (i.e. regulated mutual funds)

In the UK, there are three different categories of funds authorised by the UK Financial Services Authority: UCITS, Non-UCITS Retail Schemes (NURS) and Qualified Investor Schemes (QIS).

UCITS are funds that comply with the EU UCITS Directive, which allows such funds to be marketed in other EU Member States. Such funds have prescriptive rules regarding the range of investments that can be held, individual exposure limits, borrowing limits and so on.

Both NURS and QIS are UK funds that do not comply with the UCITS Directive, so cannot be marketed across the EU. They can be sold to certain categories of UK residents. NURS are retail funds that can invest in a slightly wider range of investments than UCITS (eg. real estate). QIS are funds that are available only to experienced investors who meet certain qualifying conditions. QIS have less prescriptive rules regarding investment and are therefore considered suitable only for experienced investors.

For the reasons mentioned by EFAMA in its previous submissions to you, and which we do not propose to repeat here, IMA believes that UK-authorised funds should be treated as low risk for FATCA purposes.

Distribution of Authorised Funds in the UK

At point 4 second bullet of its 30 November 2009 submission, EFAMA correctly states that the UK retail market is heavily intermediated; only a small, and decreasing, percentage of investments in authorised funds are made by individual investors approaching the authorised fund manager (AFM) directly. Many investors will look to advisers for help in making investment and savings decisions. Therefore, a significant proportion of investment in funds is through the nominee accounts of independent financial advisers, stockbrokers, wealth managers, and others who typically act in an agency capacity (i.e. they are the legal, registered holders of the shares/units, but not the beneficial owners).

AFMs also receive business from execution-only brokers, which has traditionally been a small part of the UK funds distribution model. However, this business area has also grown dramatically in recent years, with the advent of “platforms” (see below), which are used by all types of intermediaries (including traditional execution-only brokers) and, in some cases, direct investors. According to IMA statistics, the intermediated share of fund distribution in the retail section of the UK market has increased from 49% to 85% in the last ten years, and this continues to grow.

Institutional investors

A significant proportion of investors in authorised funds are institutional investors, such as occupational pension schemes, charities, life companies, banks and other investment vehicles, including other authorised funds. The value of their investments is large. These institutions are the legal and beneficial owners of those investments; i.e. strictly, they are the end-investors.

Platforms

Platform propositions have evolved considerably over the last ten years and are responsible for an increasing market share of fund distribution. There is no single, generally agreed definition of a platform; more commonly, the label “platform” is used to describe a range of types of non-advised, agency businesses. They are particularly attractive to wealth managers, stock brokers and independent financial advisers as they offer a “one-stop” source of funds supplemented by back-office, accounting, and reporting services.

Therefore, UK-authorized funds may be owned:

- Directly, by an individual, and in this case, the fund register will show the details of the beneficial owner.
- Directly, by an institutional investor such as a life assurance company. In this case, the fund register will show the details of the beneficial owner, that is, the institutional investor.
- Indirectly, where the individual accesses the fund

directly through a platform rather than through an adviser (typically such a sale is effected through an automatic sales process, such as through the internet).

In this case, there will be one tier of nominee; the fund register will record the platform as the legal owner and it will be the platform that will hold details of the individual investor who is the beneficial owner.

- Indirectly, where the individual accesses the fund through an independent financial adviser, stock broker, or wealth manager. In this case, there will generally be two tiers of nominee because the adviser will acquire the investment through the platform as nominee for various end investors. The platform will aggregate all holdings from various nominees and acquires the investment as nominee, so the fund register will record the platform as the legal owner of the units.
- Indirectly, where the institutional investor acquires the fund through a platform. Again, the fund register will show the platform as the legal owner.

The result is that fund registers now largely comprise nominee account names rather than the names of the underlying investors. Moreover, those nominee names are often themselves an aggregation of nominee holdings (i.e. platforms aggregate the individual aggregate business flows of advisers).

There are no specific UK regulatory requirement is that oblige platforms (of any type) to provide distribution data, even in aggregated form, let alone to divulge the names of the beneficial owners.

Anti Money Laundering and Know Your Customer requirements are carried out at the point in the distribution chain closest to the individual investor. Therefore, the requirements imposed on a foreign financial institution (FFI) need to be imposed at the point of the distribution chain closest to the investor. Whilst we understand that this is the expectation behind the practical operation of FATCA, there are tens of thousands of intermediaries in the UK and in order to comply with FATCA, in its current form, each of these would need to become participating foreign financial institutions (PFFIs). Because these PFFIs transact via platforms in many cases, the platforms would also need to become PFFIs.

Moreover, a very large majority of the financial advisers who may be impacted by FATCA are most unlikely to have any US citizens as clients. They will typically be highly localised businesses, many very small, serving local clients and located throughout the UK. Also, the investment held directly or indirectly by their clients in the US will be small to zero. If they do not become PFFIs - and most will not understand why they should need to do so, given their activities - they will currently be regarded

as “recalcitrant accountholders” under the terms of the FATCA legislation. The end result is that AFMs and intermediaries that need to be full PFFIs are likely to demand that any FFI with whom they do business is a PFII. Thus, the IRS may be faced with applications from a very large number of businesses with no US clients, and often no investment in US assets, simply so they can stay in business. Furthermore, there may be local legal concerns that US tax legislation could cause local distributors, who do not invest in US assets and do not deal with US clients, to be forced out of their legitimate business unless they sign up with the IRS as PFFIs.

In the absence of some relaxation in the current FATCA rules by way of secondary legislation and guidance, the compliance implications of this on both the UK funds industry and the IRS will be very severe, given the sheer number of entities concerned ~ tens of thousands in the UK alone.

Definition of a Foreign Financial Institution: Platforms and Financial Advisers

A platform or financial adviser is not self-evidently a FFI, but IMA assumes that platforms (and many financial advisers) will in fact be FFIs given the very wide definition of the term within the *Section 1471(d)(5)* as an entity which “holds financial assets for the account of others as a substantial portion of its business”. Whilst we understand that this definition is primarily seeking to describe conventional custodial business, it does seem to encompass nominee type business. Clarity on this point is crucial, as the difficulties in applying FATCA in the UK context would become even more intractable if the AFM were to be regarded as the last FFI in the chain.

Funds not Constituted as Bodies Corporate

The categories of investment funds that may fall within the definition of FFI is very wide and includes not only funds constituted as corporate vehicles but also those established under various local domestic provisions which may allow for contractual funds, unit trusts or other entities. It is not, however, clear how the IRS will view such funds and, in particular, the extent, if at all, that the IRS will consider such funds to have a distinct legal status or corporate identity.

Although most funds currently constituted as unit trusts in the UK are FSA authorised (i.e. regulated) unit trusts, other unit trusts are typically utilised as part of pension fund pooling structures vehicles. The US has long recognised the status of Authorised Unit Trusts (AUTs) and the amending protocol of the treaty, signed on 19 July 2002, recognised Unauthorised Unit Trusts used as pension fund pooling vehicles, for the purposes of the UK/US Double Taxation Agreement (DTA). Moreover, the OECD paper *The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles* (the OECD paper) urges that those countries that do not already recognise widely-held collective vehicles as distinct legal vehicles for the purposes of DTAs should do so. This approach, of course, is now codified in the OECD Commentary on the Model Treaty. Confirmation that UK unit trusts, both authorised and unauthorised, will be treated as distinct FIIs for the purposes of the FATCA legislation is requested.

Contractual funds are a type of ownership structure for funds, common in certain European countries, such as the Luxembourg Fonds Commun de Placement (FCP). The IMA has an interest in the

treatment of contractual funds under FATCA, since the UK Government is currently consulting on the introduction of such a vehicle in the UK. Contractual funds are widely regarded as having no independent existence and to be “tax transparent”. Any UK fund of this type that is introduced will not exist for UK tax purposes. The OECD paper suggests that a transparent fund should not qualify for the benefits of a DTA in its own right because it would not be treated as “resident of a Contracting State”, since it is not liable to tax therein. Such vehicles are common in the product ranges of many asset managers and may be established as regulated (e.g. UCITS) or unregulated vehicles.

Any guidance in respect of investment funds should provide that all unit trusts, whether authorised or not, and contractual vehicles such as FCPs, will be recognised for the purpose of the FATCA provisions as separate FIIs, which will put them in a comparable position to similar vehicles established in corporate form. The mechanism to achieve this will differ depending on the nature of the form under which the fund is constituted. In the case of a trust, it will be the trustees acting in that capacity, and in the case of an FCP, the management company acting in that capacity. It is important that the definition should be “relational” so that it is clear that each trustee and management company should be treated as if it were a separate FII in respect of each fund relationship and that these activities should not be grouped with other activities carried out on behalf of other funds or with activities sub-delegated to a member of an affiliated group of which the trustee or management company may be part.

Foreign Retirement Plans

We think that it will be unlikely that many foreign retirement plans would fall within the criteria specified at pages 15 and 16 of the Notice for them to be considered “low risk”. In the UK, many retirement plans are constituted as hypothecated funds within insurance companies and we do not propose in this response to comment on those. We therefore confine ourselves to other employee sponsored plans, which will typically be constituted under a trust deed. The major concern relates to criterion (iii). It will frequently be the case that, in the event that an employee is a US taxpayer, the trust deed will allow for other beneficiaries who may well be US taxpayers. For example, it will be common for there to be a spouse’s/partner’s pension, in the event of the death of the employee post retirement, and various death in service benefits might be paid out to individuals. Such payments would be made at the discretion of the trustees, but taking into account the previously expressed wishes of the employee. Typically, but not invariably, such payments would be made to the late employee’s spouse or partner, and any children of their relationship. Such schemes will not count as low risk under the criteria in the Notice, yet it is hard to see why a retirement plan which meets criteria (i) and (ii), and allows a US person who is an employee working in the country in which the scheme is established, should not be regarded as low risk, even with a wider definition of beneficiary along the lines suggested in this letter. At the very least, IMA requests that the terms of condition (iii) be expanded to include beneficiaries who are the partner/spouse or children of the employee, together with any other beneficiaries following death in service and paid by the trustees of the scheme in accordance with the express wish of the employee.

Why UK Authorised Funds Should be Regarded as Deemed Compliant: Anti-Money Laundering (AML) Rules and Exchange of Information under the UK/US Double Taxation Agreement

EFAMA has already made, in its various submissions, a strong case as to why widely-held EU regulated funds should be regarded as deemed compliant from the FATCA perspective. As stated above, IMA does not propose to rehearse those arguments in this submission. We would, however, suggest that a wealthy and financially sophisticated US taxpayer who is engaged in tax evasion is most unlikely to choose the UK as an appropriate jurisdiction in which to invest the funds he has accumulated, let alone choose to use UK-authorized funds as the appropriate vehicle.

Tax evasion is a crime in the UK, as is the case, of course, in most countries. The UK was, however, a pioneer in introducing “all crimes” anti-money laundering (AML) legislation so that tax evasion, both as a standalone crime (that is where the source of the funds was otherwise legitimate) and as an adjunct to other crimes, is a crime covered by the UK’s AML rules. The UK’s AML regime was extended to cover all criminal property by the Proceeds of Crime Act 2002, where “criminal property” is defined essentially as the proceeds of any conduct that constitutes a criminal offence in the UK or would be an offence if it had been committed in the UK. So, the handling in the UK of proceeds from tax evasion would be an offence under the UK AML regime, even if the predicate offence occurred outside the UK and, moreover, even if tax evasion was not an offence in that other location.

Although many countries are increasingly taking the same approach, including EC member countries following the introduction of Directive 2005/60/EC (known as the Third Anti Money Laundering Directive), the UK has an eight-year history of applying all crimes AML rules, with the result that the necessary systems, procedures, training and employee awareness have long been embedded in the UK system. The UK has a reputation of having implemented its AML rules with a high degree of rigour, as evidenced by complaints from business that the associated costs have given the UK a competitive disadvantage compared to other jurisdictions.

UK AML law requires those working in the “regulated sector” (which includes all banks, insurance companies, brokers, financial advisers and fund managers) to report AML issues to the Serious Organised Crime Agency (SOCA). A requirement to report is triggered where one has suspicions or reasonable grounds, as well as hard evidence. Officers of HM Revenue & Customs (HMRC) have access to a restricted version of the SOCA database, which holds details of Suspicious Activity Reports (SARS) made to SOCA. There is also a team of HMRC officers seconded to SOCA, which has direct access to the full database.

SARs intelligence may be sent to the US from the UK via the Egmont group of financial intelligence units. Also, the UK/US Double Taxation Agreement has an information exchange article (Article 27) which provides that both countries will share information regarding evasion.

Conclusion

It is imperative, if the UK authorised funds industry is to be in a position to comply with FATCA, that significant changes are made to its practical implementation. Given the UK distribution models, and the very large number of intermediaries, it is by no means clear how FATCA could be implemented absent such changes. IMA believes that the latest EFAMA proposals represent a sensible and

practical way forward, and looks forward to engaging with the US Treasury and the IRS, in its twin capacity as an EFAMA member and as the representative of the UK funds industry.

Yours sincerely

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