

[TEXT OF THE FATCA COMMENT LETTER SUBMITTED BY  
MEXICAN BANKING ASSOCIATION AND  
MEXICAN SECURITIES INDUSTRY ASSOCIATION]

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Manal Corwin  
International Tax Counsel  
United States Department of the Treasury  
1500 Pennsylvania Ave, NW  
Washington, DC 20220

Michael Danilack  
Deputy Commissioner (Int'l) LB&I  
Internal Revenue Service  
1111 Constitution Avenue, NW  
Washington, DC 20224

Steven A. Musher  
Associate Chief Counsel (Int'l)  
Internal Revenue Service  
1111 Constitution Avenue, NW  
Washington, DC 20222

**Re: Comments on the Foreign Account Tax Compliance Act, regulations to be issued thereunder,  
and *Notice 2010-60***

Dear Ms. Corwin and Messrs. Danilack and Musher:

The Mexican Banking Association (*Asociacion de Bancos de Mexico* or the “ABM”) and the Mexican Securities Industry Association (*Asociacion Mexicana de Intermediarios Bursatiles* or the “AMIB”), welcome the opportunity to provide the United States Treasury Department (“Treasury”) and the Internal Revenue Service (the “IRS”) with a set of initial comments regarding the Foreign Account Tax Compliance Act (“FATCA”), the provisions of which were enacted into law on March 18, 2010 as part of the Hiring Incentives to Restore Employment Act (the “HIRE Act”).

The ABM is the only banking association in Mexico, and is comprised of 41 commercial banks. It contains among its members the largest commercial banks in Mexico. The ABM includes among its primary goals the development and improvement of inter-bank payment systems and other aspects of banking infrastructure. Accordingly, issues related to the implementation of FATCA are within its core mandate. The ABM also represents the interests of the Mexican banking community in various issues before the Mexican government, as well as in various issues relating to the interaction between banks and non-bank participants in the Mexican credit and financial markets. In addition, because our member firms include so-called “universal banks,” which provide a variety of financial services

(e.g., brokerage services and insurance) alongside traditional banking services, our member firms' interest in FATCA extend beyond FATCA's application solely to traditional commercial banking activity.

The AMIB is the only securities industry association in Mexico and is comprised of 34 brokerage firms and 32 mutual fund managers. The AMIB represents the interests of the securities industry before the Mexican government and vis-a-vis other participants in the Mexican securities markets. As part of its core mandate, the AMIB is concerned with developing the Mexican securities markets, including market infrastructure and payment protocols, and is therefore interested in helping Treasury and the IRS develop rules under FATCA that are consistent with the development of efficient and liquid securities markets in Mexico.

As an initial matter, the ABM and the AMIB both fully support FATCA's overarching goals of preventing tax evasion and promoting financial transparency. Our member firms are committed to working with Treasury and the IRS to help develop rules under FATCA that further these goals in a manner that is effective and practical. It is also necessary, of course, that we be able to implement FATCA in a manner that is consistent with our obligations under the Mexican financial laws. In that regard, the comments and suggestions below reflect specific problems ~ including certain potential conflicts between FATCA and Mexican law ~ that our member firms anticipate as they consider how best to implement FATCA and as they consider the various potential obstacles to becoming "participating FFIs" within the meaning of *Notice 2010-60* (the "Notice"). n1

Please note that these comments are not exhaustive, and that we or certain of our member firms may provide further commentary. Furthermore, we recognize that the task of writing rules to implement FATCA is complicated and likely to involve several iterations of proposed rules, reactions, and revisions. We therefore hope that these remarks will be the beginning of an ongoing and useful dialogue between us and the IRS and Treasury. Our goal is to achieve a set of rules that will allow our member firms to supply the IRS with the information it needs to prevent tax evasion but that also will take account of the legal and commercial realities that our member firms will face implementing FATCA.

## DISCUSSION

### I. Mexican Law and Enforcement Against Recalcitrant Account Holders

Our member firms are concerned that Mexican banking and securities market laws may prevent Mexican "Foreign Financial Institutions" ("FFIs") n2 from being able to enforce the provisions of FATCA against recalcitrant account holders in the manner required by FATCA. FATCA requires that the participating FFI treat as a "recalcitrant account holder" any account holder that refuses to provide the waiver required by *section 1471(b)(1)(F)*. n3 The FFI then must withhold 30 percent of any "passthru payment" made to a recalcitrant account holder and eventually close the account. As discussed immediately below, these provisions raise several issues under Mexican law. Mexican law clearly prohibits financial institutions from withholding funds from client accounts without the relevant client's consent, and it is not always possible for a financial institution to close a client's account at will. Furthermore, there is doubt under Mexican law as to whether an account holder may waive

his or her protections under the Mexican bank and securities market secrecy rules without the consent of the Mexican fiscal authorities (*Secretaria de Hacienda y Credito Publico* or “Hacienda”). We understand that Hacienda is currently considering the question, but currently we have no meaningful visibility as to what Hacienda’s final view on the question will be. Each of these points is discussed in more detail in the sections immediately below.

### **A. Withholding Not Permitted Under Mexican Law**

Although *section 1471(b)(1)(D)(ii)* requires a participating FFI to withhold 30 percent of all “passthru payments” made by it to a recalcitrant account holder, it is a criminal offense under Mexican law for a Mexican “credit institution” (which term includes commercial banks) or for a Mexican brokerage firm to withhold amounts from a customer’s account without the customer’s consent.

The prohibition against such withholding in the case of commercial banks is contained in Article 113b of the Mexican Law of Credit Institutions (*Ley de Instituciones de Credito*), which provides in relevant part that “whoever uses, obtains, transfers, or in any form disposes of the funds or assets of the clients of credit institutions” shall be subject to criminal penalties. n4 A violation of this provision, when committed by an employee or officer of the institution at which the account is held, carries with it criminal sanctions of three to fifteen years imprisonment and a fine of roughly US\$ 2,500 to US\$ 250,000, n5 as well as civil penalties and administrative actions. n6 The prohibition in the case of brokerage firms is imposed by Article 196 of the Mexican Law of Stock Markets (*Ley del Mercado de Valores*), and a violation of that prohibition is punishable by criminal sanctions of five to fifteen years imprisonment n7 and a fine of roughly US\$ 5,000 to US\$ 50,000. We think it is clear that withholding as required by *section 1471(b)(1)(D)* would constitute an impermissible “disposition” of client funds within the meaning of these provisions.

### **B. Not Always Permissible to Close an Account**

Given the prohibitions discussed above against withholding funds from a customer account, the most likely remedy for a Mexican financial institution with a recalcitrant account holder would be simply to close the relevant account in accordance with *section 1471(b)(1)(F)(ii)* and thereby obviate the need for withholding. The legality and effectiveness of that remedy, however, depends upon the type of account in question.

Although we believe, for example, that a commercial bank would be able in most cases under Mexican law to close at will a recalcitrant account holder’s “on demand” accounts ~ for example, checking and savings accounts ~ there are numerous types of accounts that cannot be closed legally without the account holder’s consent before the end of a specified term. In addition, to the degree that a financial account represents equity in an FFI (e.g., an interest in the investment fund), the FFI cannot legally force the account holder to relinquish its equity rights. Finally, certain securities (shares of investment funds primarily) may be held only by a particularly designed broker-dealer as custodian for a customer. Such “exclusive-rights” custodians are not able to close accounts without customer consent, because closing the account would require forcing the customer to sell the relevant security, which we

believe would constitute an illegal “disposition” of property under the laws discussed above in Section I.A.

Of course, an FFI faced with the inability to close a recalcitrant account holder’s account may have other means of encouraging compliance with FATCA. One possibility would be to allow a holder’s existing account to remain open but to refuse to accept further deposits to the account or otherwise expand the FFI’s relationship with the account holder. A securities broker could refuse to purchase additional securities for a recalcitrant account holder. n8

As you know, Section V.D of the Notice requests comments on whether and in what circumstances Treasury and the IRS should terminate an FFI Agreement due to the number of recalcitrant account holders remaining at an institution after a reasonable period of time. We request that any such rule take into account the local legal constraints to which an FFI may be subject and consider the FFI’s attempts to pursue the goals of FATCA within the context of those constraints. An FFI that engages in a good faith effort to obtain information from recalcitrant account holders in a manner that is consistent with the requirements of local law (*e.g.*, by pursuing the measures described above) should not be penalized for an inability to enforce all of the provisions of FATCA against its account holders.

### **C. Waiver of Financial Secrecy Laws**

There is a question under Mexican law as to whether a Mexican FFI’s clients have the ability to authorize the FFI to provide information to the IRS, as required by FATCA, and we understand that this question is currently under review by Hacienda. The issue is the subject of some controversy in part because of Article 117 of the Mexican Law of Credit Institutions, which provides in relevant part that:

“The information and documentation provided for the transactions and services governed by [Mexican Banking Law], is confidential, and credit institutions, in protection of the right of privacy of their clients and users established herein, shall not provide information regarding the deposits, transactions, [and] services . . . , to anyone other than to [the account holder or his or her legal representatives].”

Article 117 enumerates several limited exceptions to this prohibition. It allows provision of the information to a judicial authority when requested by such authority in connection with a legal proceeding to which the account holder is a party, or, upon request, to certain Mexican governmental authorities including the Attorney General, certain banking authorities, the Mexican Treasury, or representatives of the Mexican fiscal authorities, the *Secretaria de Hacienda y Credito Publico* (“Hacienda”).

Article 192 of the Mexican Law of Stock Markets similarly provides that:

“Brokerage firms may not disclose information about the transactions they execute, or the services they provide, except to the account holder and its agents, principals, fiduciaries, or legal representatives, or except when requested to do so by a judicial authority in connection with a proceeding in which the account holder is a part of, or by fiscal authorities or by an agent of the [Mexican Banking Commission], for fiscal purposes.”

Finally, Article 55 of the Mutual Funds Law (*Ley de Sociedades de Inversion*) provides that:

“Mutual funds and other entities that provide different services referred to in this Law, shall not disclose information concerning their operations or the services they execute, except to the holder or beneficiary of the representative capital shares of the mutual fund, or [the holder or beneficiary’s] legal representatives, unless the request comes from a judicial authority under a proceeding in which the holder is a party or defendant, or to federal tax authorities through the [Mexican Banking Commission], for tax purposes. . . .”

Because these provisions of law provide specific exceptions to the general duty of confidentiality, there is a concern that the lists of specific exceptions are intended to be exclusive. Neither of these provisions provides any explicit authorization for a bank or broker to provide an account holder’s information to third parties upon waiver of secrecy by the account holder. Hacienda has not yet provided us with its position on this question, and therefore we do not yet know whether obtaining waivers will be a viable strategy for implementing FATCA in Mexico.

## **II. Issues Related to Cross-Border Payments Between Mexico and the United States**

### **A. Most Cross-Border Payments are Not Related to Financial Assets and Pose Little Risk of Tax Evasion**

By its terms, FATCA appears to be targeted primarily at U.S. persons that hold significant financial assets offshore, and for that reason draws a distinction between financial and non-financial foreign entities. The Notice takes this distinction even further by proposing that a “non-financial foreign entity” (“NFFE”) can be largely exempted from the requirements of FATCA if it is engaged in an active trade or business other than a financial business. We believe that it is equally important to draw a distinction between the different types of transactions that may give rise to cross-border payments between the United States and Mexico. While we recognize, for example, that an investment in a U.S. financial asset by a U.S. person through an off-shore account could be an indication of potential tax

avoidance, the vast majority of cross-border payments between the United States and Mexico are not in respect of financial assets, but instead arise out of commercial activity in the non-financial sector. If ordinary course payments from the United States to Mexican businesses were to become disrupted as a result of FATCA, we believe that neither the policy goals of FATCA nor the overall economic interests of the United States or Mexico would be served.

By way of background, Mexico's physical contiguity to the United States, as well as the existence of the North America Free Trade Agreement ("NAFTA"), have both led to a degree of economic integration between the southern United States and the northern Mexican states, such as Tamaulipas, Nuevo Leon, Coahuila, Baja California Norte, Chihuahua, and Sonora. It is estimated that more than 350,000,000 border crossings occur per year between Mexico and the United States' land border, making it the most trafficked international border in the world. n9

Trade with the United States accounted for 80.5 percent of all of Mexico's exports in 2009. n10 In addition, imports from the United States accounted for 48 percent of all imports to Mexico in 2009. n11 The United States is thus by far Mexico's largest trading partner, and cross-border cash flows related to commerce between the two nations averages approximately US\$ 1 billion per day. n12 By contrast, we doubt that cash flows representing returns on financial instruments between the two nations approaches anything close to that amount.

For the reasons discussed above, we fully support the suggestion contained in Section V.G of the Notice that "certain classes of payments, such as arm's-length payments made for goods or services in the ordinary course of [a] withholding agent's trade or business" be exempt from certification and withholding requirements. We have further considered the question of how an FFI should determine whether a payment is in fact an "arm's-length payment for goods or services," since currently FFIs are usually not informed as to the purpose behind a transfer of funds they are asked to effect. For example, if a clothing retailer in Texas writes a check to an unrelated Mexican supplier, there is no particular reason why the banks processing the payment of the check would know whether the check is for inventory, for services, or for some other purpose. Of course, the bank's inability to know the precise nature of such payments will also prevent it in many cases from knowing whether payments are U.S.-source or otherwise fall within the definition of "withholdable payment" contained in *section 1473(1)*.

On balance, we believe that a reliable and administrable rule would be one under which any payment made between two unrelated parties that is not known to be in respect of a financial instrument is presumed to be an arm's-length payment for goods or services. Because U.S. financial instruments are already subject to the current information reporting regime to determine when dividends and interest are paid to non-U.S. persons, we believe that it might be easier for banks and other paying agents to identify payments in respect of such instruments specifically as withholdable payments subject to FATCA. n13 We also believe that it is appropriate for Treasury and the IRS to focus on cash flows in respect of financial assets, since we believe that financial assets are by far the most likely means by which U.S. persons would hold wealth off-shore in order to evade taxes. However, in the case of payments not in respect of financial assets that are made between two parties related to each other or "owned or controlled directly or indirectly by the same interests" within the meaning of *section 482*, it

might be appropriate for the IRS to consider whether those payments are at arm's-length and to subject such payments to increased scrutiny to see if there is a possibility of tax evasion.

### **B. Remittances from Mexicans Living Abroad**

The ABM and AMIB request clarification that so-called “remittance payments” from Mexicans living in the United States do not constitute “withholdable payments” under FATCA. These payments, usually made in the form of wire transfers and money orders, generally represent amounts earned by Mexican citizens working in the United States, and these amounts are remitted typically for the purpose of supporting the relevant worker’s family. We believe that remittance payments present virtually no risk for tax evasion, since the recipients of such payments tend to be Mexican individuals of limited financial resources who are unlikely to be United States citizens and/or own any significant amount of wealth that they are hiding from U.S. authorities. It is also worth noting, however, that, although specific remittance payments tend to be for small sums, the total amount of yearly remittances to Mexico from the United States, at around US\$ 21 billion, represents the second largest source of capital inflow into Mexico, second only to oil revenue. <sup>14</sup> For this reason, the matter is of considerable importance to the Mexican economy.

Although we do not believe that remittance payments are caught under the current definition of withholdable payments (because we do not believe that remittance payments constitute income described in *section 1473(1)(A)(i)*), we believe that it would be useful for Treasury and the IRS to clarify the point in order to avoid any uncertainty on the part of potential withholding agents. Particularly, we are concerned that a withholding agent faced with the task of determining whether a payment constitutes a “withholdable payment” within the meaning of *section 1473(1)(A)* might simply adopt a presumption that all outbound payments should be treated as withholdable payments. For that reason, we recommend that Treasury and the IRS consider a rule exempting certain *de minimis* transfers of funds via wire transfer or money orders from the definition of “withholdable payments.” Such a rule would be easier to administer than a rule that looked to whether a payment in fact met the current statutory definition of “withholdable payment.”

### **III. Rules for Retirement Plans**

The Notice indicates, in Section II.C, that Treasury and the IRS intend to exempt certain retirement plans from withholding under FATCA, on the grounds that such retirement plans pose a “low risk of tax evasion” within the meaning of *section 1471(f)(4)*. The Notice further states that Treasury and the IRS anticipate that a foreign retirement plan will be identified as posing a low risk of tax evasion only if the plan meets three requirements:

- (i) the plan must qualify as a retirement plan under the law of the country in which it is established;
  
- (ii) the plan must be “sponsored by a foreign employer;”  
and

(iii) the plan must not allow U.S. participants or beneficiaries other than employees that worked for the foreign employer in the country in which such retirement plan is established during the period in which benefits accrued.

In response to Treasury and the IRS's request for comments with respect to these requirements, we respectfully submit that the requirements raise several issues for financial entities that are known in Mexico as *Administradoras de Fondos de Retiro* (Retirement Fund Administrator or "AFOREs") and that are the primary vehicle for holding retirement funds in Mexico.

By way of background, each worker in Mexico is required to have an account with an AFORE, which operates in a manner comparable to that of a *section 401(k)* account in the United States, with certain notable differences. Each AFORE account is comprised of subaccounts for particular items, including retirement, employment termination due to old age, disability, and voluntary contributions (explained in more detail below). Workers, employers, and the government are each mandated by law to contribute specified amounts to certain AFORE subaccounts annually. Specifically, the employer must contribute annually an amount equal to two percent of the worker's salary to the worker's AFORE retirement subaccount and an amount equal to 3.150 percent of the worker's salary as a benefit related to employment termination due to old age. The worker is required to contribute 1.125 percent of his or her salary to an AFORE account, and the government contributes an amount equal to 7.143 percent of the employer's contributions. n15

Amounts contributed to an AFORE account will be further contributed to, and managed by, a highly regulated management company known as a *Sociedad de Inversion de Fondos Para el Retiro* or "SIEFORE." Although the investments chosen by the SIEFORE are subject to extensive government regulation and supervision (for example, requirements for diversification), the funds held in AFORE accounts may be invested in a wide variety of debt and equity securities.

An employee is not taxed on the mandatory amounts contributed to his or her AFORE account at the time of contribution, and income earned in respect of the AFORE investments is not taxed currently. In addition, an employee may make "voluntary contributions" to an AFORE account, which he or she may do with pre-tax funds up to approximately MX\$ 109,000 pesos (approximately US\$ 9,000) per year, and with after-tax funds for any amounts in excess of that limit. Income earned with respect to the voluntary contributions is not taxed currently. Currently, voluntary subaccounts represent a *de minimis* percentage of all funds held in AFOREs (less than one percent).

If an employee withdraws any amount from an AFORE account before retirement, he or she will pay income tax equivalent to the amounts contributed to the subaccount on a tax-free basis, as well as on gain allocable to the amounts withdrawn. However, once an employee retires (which he or she may do at age 65), the employee is allowed to withdraw certain amounts from his or her AFORE account (either from the subaccount for retirement and employment termination due to old age, or from any subaccount for voluntary contributions that the employee might have) and such withdrawals will be tax-free up to an aggregate lifetime maximum amount (currently approximately MX\$ 1,965,087 or

US\$ 165,000). Amounts in excess of that maximum are subject to a maximum 30-percent tax at the time of withdrawal. n16

In considering whether AFOREs meet the above-listed requirements contained in the Notice, we note that it is not clear that AFOREs are “sponsored by an employer” within the meaning of the Notice. Even though employers are required to contribute to their workers’ AFORE accounts, employers are neither required nor legally permitted to establish AFOREs for the benefit of their workers or to be responsible for the day-to-day administration of an AFORE. Typically, AFOREs are sponsored by financial institutions, and Mexican workers have the flexibility to choose among any number of AFOREs currently existing in Mexico. In this regard, AFORE accounts are comparable to “individual retirement accounts” in the United States.

In addition, AFOREs may not meet the requirement of prohibiting U.S. beneficiaries from participating “other than employees that worked for a foreign employer in [Mexico] during the period in which benefits accrued.” Because of the shared border between Mexico and the United States, we believe it is relatively common for some Mexican individuals, particularly in the Northern Mexican states, to have dual United States-Mexican citizenship while working and living full-time in Mexico with no intention of moving to the United States. Such individuals would be expected to open an AFORE account when employed by a Mexican employer. However, the annual contributions to the AFORE account would continue so long as the individual continued to work for that employer, even if the employer were to require the individual to work overseas for some period of time (e.g., were to send the employee to Brazil for some period of time to open an office).

We believe it would be appropriate that AFORE accounts be exempted from FATCA under *section 1471(f)*, because AFORE accounts present little opportunity for U.S. tax evasion. The mandatory contribution amounts are minimal, and there is no evidence that individuals have used the voluntary contribution mechanism to any significant degree (as discussed above, voluntary contributions represent a *de minimis* percentage of amounts contributed to AFORE accounts). Furthermore, we believe that the high degree of regulation of AFOREs and SIEFOREs by the Mexican government is likely to deter U.S. investors from using AFORE accounts as investment vehicles. Accordingly, we suggest that Treasury and the IRS consider exempting retirement plans that are regulated as such by the country in which they are established, and not just those plans that are employer sponsored. In addition, we suggest that an individual’s ability to accrue benefits in the plan when he or she is sent to work outside of the country in which the plan is established should not without more affect the exempt status of such plan, *provided that* the individual continues full-time employment of the company with whom he or she worked when he or she originally established the plan (*i.e.*, remains a *bona fide* employee).

In considering the “voluntary contributions” discussed above, we acknowledge that ~ although there is no evidence or reason to believe that such contributions have given rise to tax evasion ~ it is theoretically possible for a U.S. person with access to an AFORE account to hold substantial amounts in such account on a tax-deferred basis. To the degree that Treasury and the IRS were to become concerned that voluntary contributions could be used for tax evasion, we suggest that voluntary contributions could be distinguished from mandatory contributions for purposes of defining which types of retirement accounts can be exempt from FATCA under *section 1471(f)*. We believe that Mexican FFIs

would be able to determine which amounts held in AFORE accounts are with respect to mandatory contributions and which are with respect to voluntary contributions.

#### **IV. Difficulties in Consolidating Treatment of FFIs on a Worldwide Basis**

FATCA contains provisions indicating that the statute may be applied to FFIs on a consolidated basis ~ that is by treating an FFI and its affiliates a single, integrated entity. *Section 1471(e)* indicates that the requirements of an FFI Agreement would apply to the FFI's worldwide consolidated group, presumably with the result that a parent would be expected to agree to terms and bind its subsidiaries in all of its jurisdictions in the world. *Section 1471(d)(1)(B)* indicates that the determination of whether an account meets the US\$ 50,000 *de minimis* threshold is also to be determined by reference to all accounts held by a given account holder within an FFI's worldwide affiliated group. However, these provisions apply by their terms only "except as otherwise provided" by Treasury and the IRS.

We strongly encourage Treasury and the IRS *not* to adopt a consolidation approach in drafting rules for the implementation of FATCA, and are encouraged that the Notice seems to look only to individual FFIs on a standalone basis. First ~ and this is a point that has been raised by other commentators as well ~ a consolidation approach assumes that the information and computer systems among entities operating within a single affiliated group but in different legal jurisdictions will be compatible with each other and will be able to transmit information easily among themselves to a degree that simply is not the case.

In the case of Mexican banks that are members of the ABM, for example, many such banks (including the largest) existed for decades (and in some cases, for more than 100 years) as standalone entities with their own internal, standalone information reporting systems. Even though the majority of such banks were acquired by non-Mexican financial groups in the 2000s, the integration of the acquired banks' systems with those of the larger acquiring group has been limited for the most part to "big picture" matters, such as the production of quarterly financial reports. There simply was never any reason for a Mexican bank to integrate systems at the level of specific customer accounts or to require the software applications for accounts opened in Mexico to interface with customer account software in, say, Europe or Asia. To the contrary, the differences in legal requirements and regulatory requirements from jurisdiction to jurisdiction called instead for software that was specifically tailored to the needs of a given country and *not* for generic applications that could be used in a uniform manner in all countries in which a financial group may operate. Simply put, it is unrealistic and almost unfeasible for FFIs to be expected to determine on a global basis whether, for example, the identities and balances of decades-old accounts in Mexico match up to another individual somewhere across the globe, in an institution that had potentially also been in existence for decades before it happened to be purchased by the same parent company that purchased the Mexican entity.

Second, because legal and regulatory requirements vary significantly from jurisdiction to jurisdiction, we believe that ~ at least as a practical matter ~ the implementation of an FFI Agreement will also have to vary among jurisdictions, with the result that FFI Agreements may be most appropriately administered on a jurisdiction-by-jurisdiction basis. For example, in Section I, we discussed issues related to Mexican banking laws and suggested ways in which a Mexican FFI might be able to comply with the

intent of the FFI Agreement (if not with each specific requirement under FATCA to withhold on accounts or close accounts). We think it is quite likely that the appropriate behavior for a Mexican bank under an FFI Agreement could be quite different from the steps that an FFI might be expected to take operating under, say, the Chinese, Brazilian or Canadian regulatory systems. For that reason, we think that an approach that looks to individual FFIs on a standalone basis would allow the IRS and the FFIs to pursue a goal of uniform enforcement and a uniform understanding of how provisions should operated *within a given jurisdiction*, rather than to pursue the much less practical goal of uniformity within a worldwide financial group across multiple jurisdictions.

Third, we believe that it is in Treasury and the IRS's interests to encourage as many FFIs as possible to become participating FFIs. In that regard, it will be much easier for an FFI to commit to an FFI Agreement on its own behalf than to commit on behalf of a large, multi-jurisdictional financial group. For example, if there were one jurisdiction in the world that made it effectively impossible for an FFI operating there to comply with FATCA, then the parent of a large financial group with affiliates operating in such a jurisdiction presumably would be unable to sign an FFI Agreement, because it could not ensure compliance on the part of one specific subsidiary. If the parent of the group were then forced either to close down operations in the jurisdiction in question or to become a nonparticipating FFI, a consolidation approach to FATCA could have the result of *reducing* the amount of information reporting under FATCA on a worldwide basis. In addition, we are not sure that the parent FFI can legally bind its subsidiaries under Mexican law simply by signing the FFI Agreement on their behalf and without their own signing of the agreement.

Fourth, the advantages gained from a consolidation approach are not practically significant. The biggest obvious advantage to a consolidation approach is that it prevents a financial group from containing both FATCA-compliant entities that are not subject to withholding as well as non-compliant entities in the same group that are able to avoid the information reporting requirements of FATCA. Under such circumstances, Treasury and the IRS may be concerned that the participating FFIs could serve as conduits for withholdable payments to their non-compliant affiliates. We believe that such a concern is misplaced. If a participating FFI receives a withholdable payment, there is no reason why the FFI should be allowed to treat passthru payments to a non-participating affiliate any differently than payments to any other non-participating FFI. For that reason, the larger group should not be able to use its participating FFIs as "conduits" to off-shore U.S. accounts. From the perspective of a U.S. person seeking to "hide behind" a non-participating FFI, we therefore do not believe that it would matter to the U.S. person whether the non-participating FFI is a standalone entity or a member of a larger financial group. Finally, although it is possible that a U.S. person could abuse the \$ 50,000 *de minimis* threshold by holding small amounts through multiple entities located in multiple jurisdictions, we believe that such a risk is more theoretical than real.

For the reasons discussed above, we suggest that Treasury and the IRS *not* attempt to apply FATCA of a consolidated level, but instead allow FFIs to enter into FFI Agreements with the IRS on a standalone basis. To the degree consolidation makes sense from an administrative or compliance perspective, we believe that FFIs should be allowed to *choose* to enter into an FFI Agreement on a consolidated basis with whichever of its affiliates that it deems appropriate, but that consolidation should not be mandatory.

## V. Entities “Primarily Engaged” In Securities Trades

Section II.A.3 of the Notice indicates that the determination of whether an entity is “primarily engaged” in the business of investing, reinvesting, or trading securities and derivatives (and thus constitutes an FFI) will be made on a “facts and circumstances” basis and will *not* be determined by whether the activities of the entity rise to the level of a trade or business for other purposes under the Code. Although we certainly understand the need on the part of Treasury and the IRS to adopt such a “facts and circumstances” approach in order to maintain the administrative flexibility needed to address varying and potentially difficult fact patterns, we also note that this approach creates a fair amount of uncertainty for FFIs. For this reason, we suggest that Treasury and the IRS at a minimum provide for a clearly-defined safe harbor (or perhaps multiple safe harbors), so that foreign entities may know of specific cases where they may safely assume that an account holder or recipient of a payment is not an FFI.

For example, one potential safe harbor might exclude from the definition of FFI entities that: (i) do not regularly engage in investment or trading activities for customers and do not otherwise engage in securities dealing or derivatives dealing, and (ii) hold less than some specific percentage of their assets (e.g., 30 percent) in securities, derivatives and similar financial assets.

By the same token, the IRS could consider releasing a list of certain types of entities in certain jurisdictions that are presumed to be FFIs (e.g., entities established under the laws of various jurisdictions to engage in banking or investment activities) or presumed not to be FFIs. Such an approach would be comparable to the approach taken by Treasury and the IRS in the “check the box” regulations of listing specific entities that *are per se* corporations, and defining certain characteristics that cause an entity to be treated as corporation or partnership.

## VI. Rules Regarding Grandfathered Obligations and Certain Debt Obligations

As you know, the Notice provides that FATCA becomes effective on January 1, 2013, and only then for payments made under debt “obligations” issued after March 18, 2012. Treasury and the IRS have indicated their intent to issue guidance as to the meaning of “obligations.” The Notice also indicates Treasury’s and the IRS’ intention to issue regulations providing that an obligation entered into on or before March 18, 2012 will be considered outstanding on that date, and that any “material modification” of an obligation will result in it being treated as a newly issued obligation to which FATCA would apply. We respectfully request that such Regulations take into consideration the two points outlined below.

### A. Treatment of Revolver Lines of Credit as Pre-Existing Accounts

First, we respectfully submit that the regulations issued under this section specify that obligations under which a debtor makes multiple withdrawals and payments is not an “obligation,” if the initial contract establishing such arrangement was entered into prior to March 19, 2012. In other words, we

believe that revolver-lines of credit should be grandfathered if the original agreement is entered into before the effective date of March 19, 2012, and a drawdown on such a line of credit after March 19, 2012 should not make any part of the arrangement a separate “obligation” for purposes of FATCA.

This rule, which has been suggested by other commentators as well, would reflect the overall policy of not disrupting binding economic arrangements in place prior to March 19, 2012 and therefore would prevent taxpayers from, for example, having to consider the potential implications of FATCA now as they negotiate credit agreements without the benefit of final FATCA regulations. Such a rule similarly would obviate the need for potential renegotiations of credit agreements at a later date, once the contents of the final FATCA rules are known. Any such rule grandfathering credit agreements could provide an exception for “material modifications” of such agreements, on the theory that, once renegotiations of a credit agreement are underway, there is no need to except FATCA provisions from the scope of issues to be renegotiated by the parties. n17

### **B. Definition of “Material Modification”**

For purposes of determining whether an obligation properly is treated as outstanding on March 18, 2012, the Notice states that final rules will apply the standards contained in *Treasury regulation section 1.1001-3* in order to determine whether a modification of a debt instrument is a “material modification” that could give rise to a deemed retirement and reissuance of the debt instrument. While we acknowledge that the standards under *Treasury regulation section 1.1001-3* are intended to provide a set of very clear “bright line” rules that provide for a high level of administrability in the majority of likely cases, we also note that there are nonetheless not-uncommon cases where the regulations fail to provide clear guidance as to whether a modification is material or not for these purposes. n18 We are concerned that, in such cases, an FFI with little experience making sophisticated tax judgments of this type could be subjected to potential liability (e.g., if it determined that it was not supposed to withhold with respect to certain modified obligations and then discovered that the IRS disagreed with such determination) and request that the IRS and Treasury consider putting in place some mechanism whereby FFIs can establish certainty that they will not be liable for a mistake in U.S. tax judgment. For example, in the case of obligations issued by a U.S. obligor, it seems appropriate that withholding agents be able to rely on the determination of the obligor as to whether a modification constitutes a “material modification” within the meaning of *Treasury regulation section 1.1001-3* (since a U.S. obligor theoretically should have more experience with the U.S. tax system than an FFI). In other cases, such as debt issued by an FFI to another entity (where such debt constitutes a financial account under FATCA), it might be appropriate for the limited purposes of a single effective date to take the view that modifications that are not clearly labeled as “material modifications” under the rules of *Treasury regulation section 1.1001-3* should be presumed not to be material, except perhaps in certain clearly defined cases that Treasury and the IRS could enumerate and define.

## **VII. Mexican Investment Trusts as NFFEs**

With regard to “non-financial foreign entities” (“NFFEs”), the Notice contemplates that an NFFE “engaged in the active conduct of a trade or business” will be exempted from withholding under FATCA. While we support that general approach (largely because of our concerns about the effect of

FATCA on cross border cash flows, as discussed above in Section II), we are concerned by the approach that appears to be contemplated in Section III.B.3 of the Notice for NFFE's that are not deemed to be engaged in an active trade or business.

As an initial matter, the Notice does not make it entirely clear exactly what will constitute an "active trade or business," for these purposes - or how that definition will interact with the determination of whether an entity is "engaged in the business of investing, reinvesting or trading" for purposes of the definition of "FFI." It appears, however, that the "active trade or business" test is intended to isolate NFFEs that merely hold assets without actively managing them - e.g., family investment trusts and similar entities. Such entities, in turn, would be required to "specifically identify each individual, and each other specified U.S. person that has an interest in such entity either directly or [indirectly]." n19 This approach seems similar to the approach suggested for "documented FFIs" described in Section II.B.3 of the Notice, and to the concept also contained in that same section that certain "small FFIs" be treated as NFFEs and thus presumably required to provide information and to the identity of their owners.

The above-quoted requirement raises two questions for our member firms: first, we would like confirmation that the reference to "individuals" in the above-quoted language is intended to refer to U.S. citizens or residents, and does not require a specific identification of non-U.S. individuals. Second, we note that the language makes no reference to the ten-percent threshold contained in the definition of "substantial United States owner" in *section 1473(2)*, so that it has the effect of treating NFFEs as if they were FFIs responsible for reporting with respect to all U.S. account holders. Presumably this reflects a judgment that an NFFE that is not engaged in a trade or business is comparable to an FFI.

The treatment of family trusts and similar NFFEs under FATCA is of considerable importance to our member firms, because many Mexicans hold assets through family trusts, which serve certain Mexican tax and estate-planning goals. The individual Mexican beneficiaries of these trusts are very sensitive to confidentiality issues for reasons having nothing to do with evasion of either U.S. or other taxes. Many wealthy Mexicans consider financial confidentiality to be an issue of personal safety. In addition, because these trusts typically are *not* vehicles for investing in U.S. assets, an FFI would be unable to use withholding under FATCA as a means of encouraging a trustee to disclose the identities of its beneficiaries. For these reasons, we suggest that family investment trusts and similar NFFEs be allowed merely to certify that they have no specified U.S. persons as beneficiaries without having to disclose the specific identities of their non-U.S. beneficiaries or equity holders.

## VIII. Treatment of Passthru Payments

FATCA requires a participating FFI to withhold 30 percent of "passthru payments" made to a recalcitrant account holder (or certain other FFIs). *Section 1471(b)(7)* defines such payments as "withholdable payments" or any other payment "*to the extent attributable to a withholdable payment.*" (Emphasis added.) Section V.B. of the Notice requests comments on how best to determine when a payment is viewed properly as attributable to a withholdable payment. In this regard we would recommend that the standards adopted by Treasury and the IRS both: (i) provide clear standards that do not require

an FFI to make sophisticated qualitative tax judgments, and (ii) adopt a narrow definition of what it means for a payment to be “attributable to” a withholdable payment.

The need for clear and administrate rules is obvious, because FFIs should not be penalized under FATCA for incorrect but good faith exercises of tax judgment. In addition, from the perspective of systems implementation, the determination of whether a payment is “attributable to” a withholdable payment ideally would be made at the back-office level in a relatively mechanical fashion that does not require significant debate and tax analysis within the FFI.

A narrow definition of “attributable to” is similarly appropriate, because the need of FFIs to avoid uncertainty concerning their withholding obligations should outweigh the limited role that withholding on passthru payments plays in the overall operation of FATCA. Specifically, we believe that withholding by FFIs on passthru payments is only a secondary mechanism for ensuring compliance with FATCA, because in order for an FFI *ever* to withhold on an account holder under FATCA, there must be a payment to the account holder that somehow is linked to a U.S. financial asset. n20 To the degree that an account holder wishes to avoid withholding under FATCA, therefore, that account holder may do so by avoiding U.S.-related investments. A participating FFI with which the account is held, on the other hand, nonetheless would be required to subject that account holder to information reporting under FATCA ~ even without the leverage over the holder of being able to impose withholding. That FFI in turn would be motivated by a desire to avoid withholding on payments that it receives from U.S. sources. Accordingly, while it seems clear that withholding on an FFI in respect of withholdable payments is a primary mechanism for encouraging FFI to become participating FFIs, the “tool” of withholding on passthru payments is imperfectly matched to the task of encouraging information reporting and should not be pursued at the expense of other, more important goals.

There are many situations where a broad definition of “passthru payment” could give rise to considerable complexity under the FATCA rules. For example, there are many complex derivatives that an FFI might enter into that could provide exposure to U.S. securities or indices, but do so in an indirect manner such that there is no specific physical underlying security to which the payout on the derivative could be linked. Consider a derivative linked to the S&P 500, which the FFI writes to a customer and then hedges through the purchase of forward contracts, which do not give rise withholdable payments. Alternatively, consider an investment partnership that provides some exposure to U.S. assets, but only as part of a much larger pool of assets, so that the net payout of the partnership is only tangentially related to the performance of the U.S. assets. These two examples both present difficult conceptual issues of what it means for a payment to be “attributable to” another, and in such difficult situations, we believe that the bias of the rules should be in favor of finding payments *not* to be attributable to others. Such a bias would further the important goals of administrability and clarity, while recognizing the limited role that withholding on passthru payments serves in the overall administration of FATCA.

## **IX. Conclusion**

The ABM and the AMIB would like to reiterate that we appreciate the opportunity to provide comments on FATCA and the Notice. We wish to assure you that of our member firms are actively stud-

ying the issues they face or will face in attempting to comply with FATCA and that they are prepared ~ to the extent permitted under Mexican law ~ to take the necessary steps to bring themselves into compliance. To ease this process, and to further the reach of FATCA as a practical matter, we urge the Treasury and the IRS to issue regulations under FATCA that take into consideration the issues we have identified in this letter, particularly with regard to cases where there is a straightforward conflict between FATCA and an FFI's domestic laws. Please be advised that we will continue to review and consider FATCA and the guidance issued by Treasury and the IRS thereunder and will supplement this submission as we become aware of new issues and concerns.

We remain committed to being an active partner in helping Treasury and the IRS implement FATCA, and we look forward to meeting with you in Washington, D.C. on April 13, 2011 to discuss these issues further. In the mean time, please do not hesitate to contact any of us if you have any comments or questions.

Respectfully submitted,

Juan Carlos Jimenez Rojas, for the  
ABM

Respectfully submitted,

Efren del Rosal Calzada, for the  
AMIB

cc:

Michael Mundaca  
Assistant Secretary, Tax Policy, Department of the Treasury

Douglas Shulman  
Commissioner, Internal Revenue Service

William Wilkins  
Chief Counsel, Internal Revenue Service

Heather C. Maloy  
Commissioner, Large Business and International, Internal Revenue  
Service

Michael Plowgian  
Attorney Advisor, Office of the International Tax Counsel, Department  
of the Treasury

Jesse Eggert  
Attorney Advisor, Office of the International Tax Counsel, Department

of the Treasury

John Sweeney  
Senior Technical Reviewer, Associate Chief Counsel (Int'l), Internal  
Revenue Service

Mae Lew  
Special Counsel, Associate Chief Counsel (Int'l), Internal Revenue  
Service

**FOOTNOTES:**

n1

*2010-27 I.R.B. 326 (2010).*

n2

All specialized terms not herein defined shall have the meaning attributed to them by FATCA and the Notice.

n3

Unless indicated otherwise, all section references herein are to the Internal Revenue Code of 1986, as amended (the "Code") and to Treasury regulations promulgated thereunder.

n4

The translations of Mexican statutory language provided in this letter are our own. If Treasury and the IRS would find it useful, we would be happy to provide copies of the full statutory sections, both in Spanish and in English translation.

n5

Article 113b of the Mexican Law of Credit Institutions specifies the fine in reference to one day's worth of a minimum wage salary in Mexico. Thus, the applicable fine is specified as an amount between 500 and 50,000 "minimum wage days." As of this writing, the minimum wage in Mexico was MX\$ 59.62, or approximately USD\$ 5.

n6

Article 25 of the Mexican Law of Credit Institutions gives the Mexican Banking and Stock Markets Commission the ability to remove directors, officers, and agents of an institution that violates the Mexican Law of Credit Institutions.

n7

See Article 375 of the Mexican Law of Stock Markets.

n8

Note, however, that this may not always be an effective option for a Mexican broker. For example, in the event that a securities purchase were needed to allow a recalcitrant account holder to close out a short position, a failure on the part of the relevant broker to effect such purchase at the account holder's instructions could give rise to significant civil liability for the broker in the event the account holder suffered losses as a result of such failure.

n9

See AFP, "U.S., Mexico open first new border crossing in 10 years," (Jan. 12, 2010) *available at* <http://www.france24.com/en/20100112-us-mexico-open-first-new-border-crossing-10-years>.

n10

See U.S. Department of State, "Mexico", *available at* <http://www.state.gov/r/pa/ei/bgn/35749.htm> (Dec. 14, 2010).

n11

*See id.*

n12

*See id.*

n13

Even in that case, however, banks and other FFIs would need to engage in a significant overhaul of their information systems in order to implement such a rule.

n14

See *supra* note 10.

n15

Someone who is self-employed has the option of opening an AFORE account and contributing amounts in his or her capacity as both employee and employer, similar to the manner in which social security contributions are arranged for self-employed persons in the United States. However, unlike the case of social security, self-employed individuals are not required to open AFORE accounts, and we believe that AFORE accounts for self-employed persons are very rare.

n16

These provisions are set forth in Articles 150 and 168 of the Mexican Law of Social Security (*Ley del Seguro Social*) as well as Articles 140 and 182 of the Mexican Income Tax Law (*Ley del Impuesto Sobre la Renta*).

n17

If for some reason such a rule is unacceptable to Treasury and the IRS, Treasury and the IRS could consider giving revolver lines of credit an extended grace period, e.g., three years after the effective date of FATCA.

n18

For example, the modification of certain covenants may raise a question (often arising in U.S. transactions) as to whether or not the covenants constitute “customary accounting or financial covenants” within the meaning of *Treasury regulation section 1.1001-3(e)(6)*.

n19

See Section III.B.3 of the Notice.

n20

We understand that Manal Corwin has suggested an “allocation approach,” might be appropriate for determining which payments are “passthru payments.” (Alison Bennett, “Changes in FATCA Guidance Likely on U.S. Account Identification, Officials Say,” 46 Daily Tax Report G-2 (Mar. 9, 2011)). We assume, however, that she meant allocation within the context of payments that bear some economic or factual relationship to the relevant withholdable payments (e.g., distributions by investment funds of amounts representing withholdable payments the fund has received).

