

[TEXT OF THE FATCA COMMENT LETTER SUBMITTED BY  
SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION]

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RE: SIFMA Comments on *Notice 2011-34*

Ladies and Gentlemen,

The Securities Industry and Financial Markets Association (“SIFMA”) n1 welcomes the opportunity to submit comments in response to *Notice 2011-34*, regarding the regulations that are being developed to implement the provisions of the Foreign Account Tax Compliance Act (“FATCA”) that were included in section 501 of the Hiring Incentives to Restore Employment Act (the “HIRE Act”).

SIFMA shares many of FATCA’s objectives in improving offshore tax compliance and welcomes many of the approaches to the regulations outlined in *Notice 2011-34*. In the remainder of this letter, SIFMA

comments on the following topics in response to *Notice 2011-34*, to assist the Department of the Treasury and the Internal Revenue Service (“IRS”) with crafting regulations that accomplish FATCA’s goals without unnecessarily disrupting the operations of the capitalmarkets: n2

(1) *Transition Rules and Related Matters.*

The transition rules should provide a 2-year exemption from information reporting and a 3-year exemption from withholding, starting from the date the final regulations are published, and should be modified in other respects.

(2) *Passthru Payment Definition.*

The proposed “passthru payment percentage” (“PPP”) approach should be limited to payments made by investment fund foreign financial institutions (“FFIs”) to their owners.

(3) *Chief Compliance Officer (“CCO”) Certification Regarding Pre-Agreement Activities.*

The proposed CCO certification should be clarified and made prospective.

(4) *Deemed Compliant Foreign Financial Institutions (“DCFFIs”).*

The proposed deemed compliant rules for local banks and local FFI members of participating FFI groups should be simplified, and the general process for attaining DCFFI status should be confirmed and clarified.

(5) *U.S. Financial Institutions (“USFIs”).*

The rules applicable to USFIs should be clarified.

(6) *Regularly Traded Definition.*

The “regularly traded” definition for FATCA purposes should be modeled on the definition used under Treasury regulations section 1.7704-1.

(7) *CFCs and U.S. Branches of FFIs.*

Overlaps between the U.S. payor information reporting rules and FATCA should be clarified in the case of controlled foreign corporations (“CFCs”) and U.S. branches of FFIs.

(8) *Short-Term Debt.*

Exemptions from FATCA withholding should be provided for short-term debt.

(9) *Retirement Plans and Not-for-profit Entities.*

The proposed exemption from FATCA for retirement plans should be modified, and an exemption should be provided for not-for-profit entities.

(10) *Small FFIs.*

The proposed look-through approach for certain FFIs should be modified to be useful in the case of small FFIs.

(11) *Other Topics.*

Other technical comments.

**Comment 1: Transition Rules and Related Matters**

SIFMA recognizes that both *Notice 2010-60* and *Notice 2011-34* attempt to strike a balance between FATCA’s compliance goals and the very large compliance costs that will be imposed on FFIs and USFIs to implement those provisions. Under the Notices, this balancing is intended to be accomplished mainly through transition rules that allow FFIs to identify accounts as U.S. accounts or non-U.S. accounts using greater or lesser efforts depending on the nature of the accounts, whether they are new or preexisting accounts, and other factors.

SIFMA welcomes the efforts made in *Notice 2010-60* and *Notice 2011-34* to alleviate FFI and USFI compliance burdens. Nonetheless, SIFMA believes that these efforts will not be sufficient to avert significant disruptions to the capital markets, and reflect overly optimistic assumptions regarding the ability of FFIs and USFIs to implement FATCA’s mandates on a short time frame and with incomplete and shifting guidance regarding what those mandates will be. No proposed regulations have yet been released to implement any aspect of FATCA, and it appears that final regulations implementing FATCA are many months away. Although the changes that the Department of the Treasury and the IRS have made to the originally proposed due diligence required for preexisting accounts, as outlined in

*Notice 2010-60*, are in many respects helpful and responsive to industry comments, the outline of proposed transition rules and certain other matters contained in *Notice 2011-34* is incomplete, and differs markedly from the outline contained in *Notice 2010-60*.

Given the shifting and incomplete guidance to date, SIFMA believes that FFIs and USFIs simply will not be able to build the complicated and costly information technology and other compliance systems and procedures necessary to implement FATCA's rules until Treasury regulation are issued in final form. It would be both costly and wasteful for FFIs and USFIs to begin building compliance systems and procedures based on speculation as to how the final FATCA rules will operate, and the costs for a single multinational FFI or USFI to implement just the withholding provisions of FATCA have been estimated to be in the tens of millions of dollars. <sup>n3</sup> In addition, attempting to implement compliance systems and procedures before the rules are complete will inevitably lead to substantial confusion for foreign investors in the U.S. capital markets, who will be presented with uncertain and conflicting instructions by different FFIs and USFIs.

To provide manageable and realistic rules for FFIs and USFIs to implement FATCA's mandates, and to deal with other transition-related issues, SIFMA makes the following comments and recommendations regarding the transition rules:

(i) To give FFIs the time they will need to develop FATCA compliance systems and procedures, the transition rules should provide that, so long as an FFI becomes a participating FFI ("PFFI") in 2013 or earlier, and certifies in its FFI agreement that it will make diligent efforts to develop the compliance systems and procedures needed to implement FATCA, it may treat all of its accounts as non-U.S. accounts until the beginning of the first calendar year that is at least 2 years after the date that the portion of the FATCA regulations concerning account identification, classification and information reporting procedures is published in final form (so that information reporting on U.S. accounts by such PFFIs would commence only for such year). In this regard, FATCA gives the Department of the Treasury and the IRS clear authority to provide transition relief, among other places through their plenary authority to create exceptions to the definition of "specified United States person". <sup>n4</sup> SIFMA believes that 2 years will provide sufficient time for a diligent PFFI to build the necessary compliance systems and procedures to implement the rules that will be contained in the final FATCA regulations, and that even an extremely diligent PFFI will not be able to build such compliance systems and procedures on a reasonable

basis without this transition relief. If this transition relief is not provided, SIFMA is concerned that the result may be large-scale misclassification of accounts and erroneous reporting that will ultimately greatly increase both the IRS's and the financial community's costs in implementing FATCA, as well as wasteful expenditures by PFFIs who would have to potentially build and rebuild compliance systems and procedures. Ultimately, there may also be significant disruptions to the U.S. capital markets as a result of confusing foreign investors regarding their compliance requirements.

(ii) For similar reasons, SIFMA believes that withholding under FATCA should not apply until appropriate systems and procedures have been put in place to implement FATCA's account identification and classification requirements, and those systems and procedures have had a reasonable period of time to be fully implemented and stress tested. Furthermore, withholding should not apply until clients with U.S. indicia have had sufficient time to respond to any required documentation or information requests. Accordingly, the transition rules should further provide that, so long as an FFI becomes a PFFI in 2013 or earlier, certifies in its FFI agreement that it will make diligent efforts to develop the compliance systems and procedures needed to implement FATCA, and promptly begins identifying U.S. accounts after the expiration of the 2-year transition period described above, it need not withhold on any passthru payments until the beginning of the first calendar year that is at least 3 years after the date that the portions of the FATCA regulations concerning account identification, classification and information reporting procedures and the definition of passthru payment are published in final form. To ensure that PFFIs and USFIs remain on a level playing field, and because USFIs will ultimately need to make the same substantial investments to develop appropriate payee identification and classification and withholding systems and procedures, the transition rules should also provide that a USFI need not withhold on any withholdable payments until after such 3-year period. In this regard, FATCA gives the Department of the Treasury and the IRS clear authority to craft

such a transition rule, among other places through their plenary authority to create exceptions to the definition of “withholdable payment”.<sup>n5</sup> If such withholding transition relief is not provided, SIFMA greatly fears that the result may be large-scale erroneous withholding and numerous refund requests to the IRS that will ultimately greatly increase both the IRS’s and the financial community’s costs in implementing FATCA, as well as substantial disruptions to the U.S. capital markets. FATCA is not supposed to result in substantial actual withholding.<sup>n6</sup> If such withholding ultimately is imposed, the result may be to cause honest foreign investors to shun the U.S. capital markets. Even if that does not come to pass, the imposition of substantial actual withholding under FATCA would inevitably create great strains in the relationships among FFIs, USFIs, foreign investors, and U.S. issuers of securities as they fix the responsibility for bearing the economic burden of that withholding tax. Finally, SIFMA is hopeful that, with an additional year to see how the account identification, classification and information reporting provisions of FATCA turn out, it may be possible for PFFIs and USFIs to avoid many of the costs of building substantial withholding systems, because they will ascertain that significant withholding is indeed not required.

(iii) Even taking into account the proposed 2 to 3 year transition relief discussed above, SIFMA believes that it will take many years for all of the kinks to be worked out of the complicated new compliance systems and procedures that PFFIs and USFIs will need to develop to implement FATCA. As a consequence, it can be anticipated that, for example, requested documentation will be provided late, after a USFI or PFFI has been required to withhold on a withholdable payment or passthru payment. To avoid the IRS being inundated with refund requests while the new rules are implemented, the FATCA regulations should provide a system under which USFIs and PFFIs may themselves refund amounts withheld under FATCA if documentation failures are corrected in a reasonable time. SIFMA would suggest that such a system generally mirror the existing refund system under Treasury regulations

section 1.1461-2.

(iv) The transition rules outlined in *Notice 2010-60* and *Notice 2011-34* provide for various periods during which FATCA requirements are relaxed for preexisting accounts. n7 To avoid creating perverse incentives for PFFIs and USFIs to engage in needless activity or make uneconomic decisions to preserve the application of these transition rules, the transition rules should confirm that the following are and remain preexisting accounts:

- a. new subaccounts within a preexisting master account owned by the same accountholder(s);
- b. preexisting accounts moved from one PFFI or USFI to another PFFI or USFI within the same expanded affiliated group;
- c. preexisting accounts moved from one PFFI or USFI to another PFFI or USFI as part of a bulk transfer of accounts (e.g., in connection with the sale of a business); and
- d. more generally, any accounts for which existing know-your-customer (“KYC”) or anti-money-laundering (“AML”) information in respect of a preexisting account may be relied upon, and no new KYC or AML information would need to be sought.

(v) The transition rules outlined in *Notice 2011-34* would require a PFFI to apply additional compliance measures with respect to preexisting “private banking accounts” as well as preexisting high-value accounts, including a very laborious “diligent review” of both paper and electronic account files and other records held with respect to such accounts. n8 SIFMA understands the special relevance of private banking accounts in the FATCA context, and generally appreciates that the transition rules attempt to focus FFI compliance efforts on the accounts that are most likely to raise the issues that FATCA was designed to address. SIFMA believes, however, that the identification of “private banking accounts” under the proposed definition would

require enormous efforts, and that subjecting preexisting “private banking accounts” to additional compliance measures would not produce any substantial benefits for the U.S. government beyond those that will arise as a result of requiring the noted additional compliance measures with respect to preexisting high-value accounts. This is because the traditional “private banking” business services only high-value accounts with a threshold value well in excess of \$ 500,000. n9 The additional compliance measures for preexisting private banking accounts should accordingly be abandoned. In addition, SIFMA would suggest that, although a “diligent review” of both paper and electronic account files may be appropriate for a high-value account without documentation, the transition rules should clarify that the review for such an account need only consider static data, account opening data, KYC/AML data, or anything else that is pertinent to determining the current identification and classification of the owner of the account. Rather than, for example, applying to information regarding past transactions in the account, or information that is stale and not relevant to the current identification and classification of the owner of the account). In contrast, high-value accounts with documentation should be subject only to the search described in Step 4 of Section I.A.2 of *Notice 2011-34* (i.e., a review of electronically searchable information for specified U.S. indicia).

## **Comment 2: Passthru Payment Definition**

Notice 2011-34 contains a broad definition of passthru payment that is based on a straight percentage asset allocation method. Under this definition, all payments made by an FFI (other than payments made in its capacity as a custodian) that are not otherwise “withholdable payments” would be deemed to be passthru payments to the extent of the FFI’s “passthru payment percentage” or PPP. PPP is defined as the ratio of the FFI’s U.S. assets to its total assets, with look-through rules for cases in which an FFI holds interests in another “lower tier” FFI. n10 Custodial payments with respect to an interest in another FFI would be treated as passthru payments based on the issuer’s PPP. n11 The broad definition of passthru payment means that a PFFI could be required to withhold U.S. tax on many kinds of payments made to non-U.S. customers if those customers do not provide all of the requested information or refuse to waive certain local privacy law restrictions. In fact, a PFFI may have no contractual authority to perform the required U.S. withholding on such payments, and may accordingly be required to gross-up its customers for any U.S. tax withheld. Similarly, a PFFI may be required to withhold U.S. tax on many kinds of payments made in the ordinary course of business to other financial

institutions, for example, on interbank deposits, repos, and possibly commercial paper, if the recipient is an FFI that is not a PFFI (an “NPFFI”). Again, such withholding may exceed the PFFI’s contractual authority and it may be required to gross-up for any U.S. tax withheld. How this rule would function at all with respect to, e.g., bearer debt securities issued by a PFFI is entirely unclear; because identifying holders of bearer debt securities is by definition impossible in many cases, treating payments on such securities as passthru payments could effectively prohibit PFFIs from issuing such securities, and could substantially disrupt PFFI financing in markets where bearer securities are the norm. As a general matter, this broad definition of passthru payment would extend the reach of FATCA to entities and individuals that may have limited or no contact with the United States.

SIFMA appreciates the efforts that the Department of the Treasury and the IRS have made to craft a definition for passthru payments. SIFMA believes, however, that the PPP-based approach outlined in *Notice 2011-34* is only appropriate with respect to payments that (1) are made by a PFFI to the holder of an ownership interest therein; where (2) the PFFI is described in *section 1471(d)(5)(C)* (i.e., a vehicle that is primarily designed to hold assets and pass the returns thereon to investors) (an “investment fund PFFI”). With respect to other noncustodial payments made by PFFIs, particularly payments made by PFFIs engaged in active financial businesses (e.g., deposit taking, brokerage, securities dealing, etc.), the proposed definition is unworkable and exceeds the authority of the Department of the Treasury under FATCA. Regarding practicality, SIFMA believes that for large PFFIs engaged in, for example, active banking businesses, applying the proposed PPP look-through rules to the millions of payments that they make back and forth between each other would require extreme efforts. <sup>n12</sup> Regarding authority, *section 1471(d)(7)* only treats a payment as a passthru payment to the extent that it is a withholdable payment or is attributable to a withholdable payment. Payments made by investment fund PFFIs to their owners are being made out of the return on a distinct pool of assets to the indirect owners of those assets, and may to that extent be regarded as “attributable” to withholdable payments made or to be made on those assets. Other noncustodial payments made by PFFIs may have no relationship to underlying withholdable payments made or to be made on the PFFIs’ U.S. assets, and would in many cases be in no sense “attributable” to such underlying withholdable payments. <sup>n13</sup> Extending the PPP approach to such payments would accordingly be contrary to the statute. More generally, adopting such a broad rule would transform FATCA into, essentially, a regime of withholding on passthru payments made by PFFIs. The term “passthru payment” is mentioned exactly twice in the Joint Committee on Taxation (“JCT”) Explanation, and no substantive explanation at all is provided therein for the passthru payment rule. If Congress had intended such a sweeping result, SIFMA believes that the JCT Explanation would have provided greater clarity.

Taking the above into account, SIFMA makes the following comments and recommendations regarding the passthru payment definition:

- (i) The proposed PPP approach is generally reasonable and appropriate with respect to payments that (1) are made by a PFFI to the holder of an ownership interest therein; where (2) the PFFI is described in *section 1471(d)(5)(C)*. SIFMA believes that this aspect of the passthru payment definition should

be retained, but adjusted in certain respects as discussed further below.

(ii) The proposed PPP approach is not reasonable or appropriate with respect to other noncustodial payments made by PFFIs, particularly payments made by a PFFI engaged in an active financial business. For all such payments, the proposed passthru payment definition should accordingly be abandoned. Because the proper determination of which of such other PFFI payments should be treated as passthru payments raises very difficult issues, SIFMA would instead suggest that the Department of the Treasury and the IRS further study this matter, and defer issuing guidance on it until after they have completed the other aspects of the FATCA regulations. Whatever approach the Department of the Treasury and the IRS ultimately adopt for analyzing the passthru payment status of payments other than payments by investment fund PFFIs to their owners, that approach should apply prospectively (i.e., no portion of such payments should be treated as passthru payments until the final regulations implementing the approach are published).

(iii) In addition, SIFMA would suggest that, whatever approach is ultimately applied to determine the passthru payment status of PFFI payments as a general matter, the regulations should allow all PFFIs, including investment fund PFFIs, to elect to treat a fixed percentage of relevant payments they make as passthru payments if they so choose. Allowing a fixed percentage election may save some PFFIs significant time and effort in analyzing the factors that are ultimately thought relevant to passthru payment status. Furthermore, SIFMA believes that the goals of FATCA will be fully realized if any significant portion of a relevant payment is treated as a passthru payment, since the threat of a 30 percent withholding tax on even a small portion of the full amount of an investor's capital and profit with respect to an investment would create a huge incentive for the investor to comply with all applicable FATCA compliance procedures. In this regard, 10 to 20 percent might be an appropriate level for such a fixed percentage election.

(iv) In determining whether to treat payments as passthru payments, moreover, the regulations should take care not to treat some payments as passthru payments to any extent, whether under the general approach or under a fixed percentage election. For example, SIFMA does not believe that payments made on ordinary course bearer debt securities issued by PFFIs should be treated as passthru payments to any extent, since it would be impossible in many cases to perform any holder identification or information reporting on such securities, and SIFMA does not believe that FATCA was intended to prohibit the issuance of bearer securities by PFFIs in foreign markets.

(v) Consistent with the above, payments made or received by a PFFI in a custodial capacity should be treated as passthru payments to the extent that they consist of underlying withholdable payments or consist of payments made by underlying PFFIs and would be treated as passthru payments (under the PPP approach for owner payments made by investment fund PFFIs, under such other approach as the Department of the Treasury and the IRS subsequently develop for other PFFI payments, or under a fixed percentage election).

(vi) Even with respect to payments made to holders of ownership interests in investment fund PFFIs, the approach outlined above will require substantial efforts, both by investment fund PFFIs in determining their PPP, and by downstream PFFIs in applying that PPP to payments that they make that are either custodial payments in respect of such investment fund PFFI payments. To make this process workable, SIFMA would suggest that, instead of the quarterly publication suggested in *Notice 2011-34*, PPPs be published annually, 6 months after the close of the underlying investment fund PFFI's taxable year, and remain in effect for the entire 12-month period until the next publication date.

(vii) The rules should also clarify that a notional principal contract held by an investment fund PFFI will be treated as a non-U.S. asset for PPP purposes,

except to the extent that payments received by such investment fund PFFI in respect of the notional principal contract would be treated as U.S. source under otherwise applicable law (e.g., under *section 871(m)*).

(viii) Finally, in implementing the PPP approach for owner payments made by investment fund, PFFIs, and in developing a new passthru payment approach for other noncustodial PFFI payments, the Department of the Treasury and the IRS should take into account and confirm that the grandfather rule in Section 501(d)(2) of the HIRE Act prohibits passthru payment withholding to the extent that a passthru payment is itself made on an obligation of a PFFI that is outstanding on March 18, 2012.

### **Comment 3: CCO Certification Regarding Pre-Agreement Activities**

Notice 2011-34 would require the “chief compliance officer or another equivalent-level officer” of a PFFI to make various certifications to the IRS, including a certification that between the publication date of *Notice 2011-34* (May 9, 2011) and the effective date of the PFFI’s FFI agreement, the PFFI’s “management personnel” did not “engage in any activity, or have any formal or informal policies and procedures in place, directing, encouraging, or assisting account holders with respect to strategies for avoiding identification of their accounts as U.S. accounts” under the transition rules. SIFMA understands the desire to ensure that personnel of PFFIs do not engage in activities to subvert the transition rules and other relief contemplated by *Notice 2011-34*. SIFMA believes, however, that the proposed certification regarding pre-FFI agreement activities is very impractical, as FFIs have not had time to put proper processes in place to implement it, and *Notice 2011-34* does not provide sufficient information on how the requirement should be implemented. There is no clarification provided regarding what constitutes “management personnel,” and such term could conceivably be construed to include any employee who manages one or more other employees. Furthermore, the proposed certification is not on its face limited to ensuring that a PFFI does not have a policy of gaming the transition rules, and appears to require a certification that there has been no action, by any management personnel, that could be construed to meet the criteria. It would be virtually impossible for a CCO of a PFFI that did not learn of *Notice 2011-34* until after it was published to honestly make such a certification regarding all such actions and personnel. To make the proposed certification more practical, while still addressing the U.S. government’s legitimate concerns, SIFMA suggests that it be modified as follows:

(i) Confirming what SIFMA believes was intended by the certification requirement, a PFFI should only be required to provide a certification that the PFFI did not have any formal or informal policies or procedures in place that meet the noted criteria.

(ii) Certification should only be required for the period starting 90 days after the portion of the FATCA regulations containing the rule is published in proposed form.

(iii) In defining what sort of policies and procedures meet the criteria, the rules should focus on destruction of account-related documentation outside of a PFFI's preexisting document retention policies, as SIFMA believes that such activity gives rise to the most potential for abusive gaming of the transition rules.

#### **Comment 4: Deemed Compliant FFIs**

SIFMA welcomes the efforts that the Department of the Treasury and the IRS have made to create additional categories of deemed compliant FFIs under *section 1471(b)(2)* ("DCFFIs"), and continues to believe that the identification of appropriate categories of DCFFIs serves the interests of both the financial community and the U.S. government. This will reduce the need for the IRS to implement large numbers of FFI agreements. SIFMA makes the following additional comments regarding DCFFIs:

(i) *Notice 2011-34* would treat certain "local banks" and "local FFI members of participating FFI groups" as DCFFIs. To qualify as a "local bank" or "local FFI" for purposes of these exemptions, an FFI would be required to meet a number of criteria, including that it not solicit account holders or have any branches outside its country of organization. SIFMA believes that these requirements are too limiting, and will exclude most potential local banks and local FFIs from the exception. In this regard, a local bank or local FFI may for example solicit isolated account holders outside its country of organization where those account holders have an in-country connection. In addition, a local bank or local FFI may also maintain isolated branches outside its country of organization for the purpose of servicing account holders when they travel. In the case of local FFIs that are members of participating FFI groups, SIFMA also notes that the requirements do not appear to serve any identifiable purpose, since FATCA compliance by such a group would be conducted by one or more full PFFI members of the group. SIFMA accordingly suggests that these limiting requirements be dropped.

(ii) To be a “local bank”, an FFI must also not be engaged (or hold itself out as engaged) primarily in the business of investing, reinvesting, or trading securities and similar instruments. It is unclear whether local mortgage lending banks would meet this requirement. While a mortgage loan, as a debt instrument, would be treated as a security for FATCA purposes, a mortgage bank may view its primary role as making loans rather than investing in those loans. SIFMA suggests that this requirement be revised to make clear that mortgage lending and related trading activity does not constitute a prohibited activity.

(iii) *Notice 2011-34* contemplates that to become a DCFFI, a qualifying FFI must apply for DCFFI status with the IRS, obtain a DCFFI identification number from the IRS, and certify to the IRS every 3 years that it continues to meet the requirements for such treatment. SIFMA believes that this is a sensible process, assuming that applying for DCFFI status will be an instant, on-line transaction in which the DCFFI certifies to the relevant criteria (similar to the existing process for obtaining an EIN). To the extent that the Department of the Treasury and the IRS contemplate a more involved process (e.g., a written application, with documentary proof, that would be substantively reviewed by IRS personnel before a DCFFI number is issued), SIFMA believes that the benefits of DCFFI treatment would be sharply limited. SIFMA accordingly suggests that the process be implemented as an instant, on-line transaction as described above.

(iv) As noted in its prior comments, an additional category of foreign entity that SIFMA believes should be treated as a DCFFI is the category of existing securitization vehicles. Non-U.S. securitization vehicles have invested hundreds of billions of dollars in the U.S. economy, particularly in loans issued by small and mid-sized U.S. companies. In the absence of an exemption, a typical non-U.S. securitization vehicle that holds U.S. assets and issues its own securities would generally be treated as an FFI.

Unfortunately, it is quite likely that many existing securitization vehicles would be unable to enter into and comply with the requirements of an FFI agreement. This could lead to significant disruptions in the U.S. financial markets. For this purpose, SIFMA suggests that an exempt securitization vehicle should generally be defined as a limited-purpose, limited-duration vehicle that is established to hold a specific type of investment asset and to sell debt and/or equity interests to investors that receive cash flows generated by the assets of the vehicle. To ensure that the exemption does not create avenues for abuse, however, an entity should not be treated as an exempt securitization vehicle to the extent that it has a wide investment mandate or more than 50 percent of its debt and equity is held by related parties, such as family members.

(v) Finally, SIFMA believes that it will undermine the utility of the DCFFI regime if DCFFIs are required to calculate and publish a PPP, as contemplated in *Notice 2011-34*. SIFMA accordingly suggests that, to the extent a DCFFI is an investment fund PFFI (see *Comment 2, above*), its PPP should be deemed to be zero.

#### **Comment 5: USFIs**

Under FATCA, the financial world is essentially divided into FFIs and USFIs. While Notice 2010-60 and 2011-34 provide details regarding how PFFIs must identify, report, and withhold on their accounts, and how USFIs must identify and withhold on some payments to FFIs and NFFEs, many details regarding USFIs have not yet been provided. USFIs have the first compliance obligations under FATCA as the primary withholding agents for withholdable payments made to FFIs and NFFEs. For both FFIs and USFIs to begin creating the compliance systems and procedures necessary to implement FATCA, it is critical that additional guidance regarding the treatment of USFIs be provided as soon as possible. Among other matters, such guidance should address the following:

(i) What reporting, withholding, or other compliance obligations will a USFI have with respect to payments other than withholdable payments that it makes or processes with respect to an NPFFI or NFFE account? This would include, for example, non-U.S. source interest payments on securities held in a brokerage account at a USFI.

(ii) More generally, how will the overlap between the existing U.S. payor reporting rules be reconciled with FATCA in the case of USFIs?

(iii) How will an account maintained by a USFI (including an offshore branch of a USFI) with an FFI be treated? How will payments made by FFIs to financial intermediary USFIs be treated? This would include, for example, a payment made by an FFI in respect of securities that it has issued that are held for clearing purposes by the Depository Trust Clearing Corporation. In such a case, will it be sufficient for the financial intermediary USFI to present a Form W-9 to the FFI to avoid FATCA withholding on payments the USFI receives?

#### **Comment 6: Regularly Traded Definition**

FATCA provides various exemptions with respect to interests that are “regularly traded on an established securities market.”<sup>n16</sup> SIFMA believes that a consistent, broad definition should be provided for this phrase for all relevant purposes under FATCA, and suggests that the definition should be based on the existing definition provided for publicly traded partnership purposes in *Treasury regulations section 1.7704-1*. Utilizing this definition, an instrument should be treated as regularly traded on an established securities market if either: (a) the instrument is traded on an established securities market, within the meaning of *Treasury regulations section 1.7704-1(b)*;<sup>n17</sup> or (b) the instrument would be considered readily tradable on a secondary market or the substantial equivalent thereof, within the meaning of *Treasury regulations section 1.7704-1(c)(2)*,<sup>n18</sup> if such instrument were a partnership interest, and references to “partnership” and “interests in [the] partnership” in such regulation referred, instead, to the instrument.

#### **Comment 7: CFCs and U.S. Branches of FFIs**

In its prior comment letters, SIFMA suggested CFCs that are FFIs, as well as U.S. branches of FFIs, both of which are currently subject to full Form 1099 information reporting requirements as U.S. payors, should be treated as exempt from the FFI information reporting and withholding provisions of FATCA under *section 1471(b)(2)(B)*. The creation of such an exemption is directly supported by the FATCA legislative history, which recognized that U.S. payors already are subject to extensive information reporting requirements.<sup>n19</sup> *Notice 2010-60*, however, did not adopt this suggestion, explaining that the documentation and information reporting requirements to which U.S. payors are currently subject are less stringent than those that apply to FFIs.

Although the observation in *Notice 2010-60* may have some validity, SIFMA would nonetheless urge the Department of the Treasury and the IRS to reconsider this proposal to provide a level playing field at least between USFIs and U.S. branches of FFIs. SIFMA does not suggest, of course, that an FFI with a U.S. branch should be generally exempt from the FFI information reporting and withholding provi-

sions of FATCA. Rather, the idea would simply be that, as to accounts maintained at the U.S. branch of an FFI, the FFI should be able to elect to apply the information reporting rules applicable to USFIs (including both the existing U.S. payor rules and whatever additional rules are adopted for USFIs) rather than the FFI rules. For accounts maintained at non-U.S. branches of an FFI, as well as for payments a U.S. branch of an FFI receives on behalf of the FFI's foreign offices or customers of its foreign offices, the normal FFI rules should continue to apply.

For CFCs that continue to be treated as FFIs even though they are subject to the current U.S. payor information reporting rules, we urge the Department of the Treasury and the IRS to clarify the circumstances under which the filing of Forms 1099 for U.S. accounts under the U.S. payor rules is sufficient to meet the reporting requirements under FATCA. Care needs to be taken to eliminate overlap between these competing sets of information reporting rules.

### **Comment 8: Short-Term Debt**

As noted in SIFMA's prior comment letters, U.S. companies collectively derive trillions of dollars of funding through the issuance of short-term debt instruments (such as commercial paper) in foreign markets, to entities that would be treated as FFIs. U.S. companies rely on these foreign funding sources to support their operations which provide millions of jobs to the U.S. economy, as well as to support substantial domestic lending by U.S. financial institutions to large and small businesses, mortgagors, and credit card holders. To the extent that these foreign lenders receive little or no other U.S. source income, they may not be willing to enter into FFI agreements with the IRS. It can also be expected that they will be unwilling to incur any risk of a 30 percent withholding tax on the principal amount of their investments, which FATCA would create. As a consequence, such investors could substantially decline as a funding source for U.S. issuers.

As stated in its prior comments, SIFMA believes that the Department of the Treasury and the IRS should carefully balance the tax compliance objectives of FATCA against the need for U.S. issuers to readily finance themselves. Although many U.S. issuers may be able to replace the affected borrowings with funds from other sources (at possibly higher rates), the weaker or less creditworthy U.S. issuers may suffer funding shortfalls. In the case of U.S. financial institutions, such shortfalls could significantly limit their lending into the domestic market or even challenge their viability.

The Department of the Treasury and the IRS have clear authority to limit the scope of the withholdable payment definition. <sup>n20</sup> Furthermore, the FATCA legislative history suggests that an exclusion from the withholdable payment definition for payments in respect of short-term obligations may be appropriate and consistent with the goals of FATCA. <sup>n21</sup> Taking the above into account, SIFMA continues to recommend that the regulations exclude from the withholdable payment definition all interest and principal payments made in respect of debt of U.S. issuers with a term not exceeding 183 days. Such an exclusion would be consistent with longstanding exemptions for short-term debt instruments in other provisions of the Code and the Treasury regulations thereunder ~ exemptions which reflect a long-held belief that such instruments do not lend themselves to tax evasion ~ and would ensure that such payments can continue to be made to FFIs and NFFEs without withholding or the obtaining of any tax certifications. <sup>n22</sup> To ensure a level playing field between U.S. and non-U.S. issuers, and as also

contemplated by the FATCA legislative history, the exemption should also apply to short-term debt of FFIs, which should be excluded from the definition of financial account. n23

One reason that short-term debt instruments do not lend themselves to tax evasion is that, in a normal, non-inverted interest rate environment, they pay a very modest yield. n24 Moreover, since longer-term debt in such an environment pays a higher rate of interest, there is no opportunity to increase the yield on an investment in short-term debt through borrowing. As such, the benefits of a tax evasion strategy using an investment in short-term debt would generally be very small as compared to the principal amount of the investment.

Finally, to allay any concerns that a short-term debt exception could be abused by a continuous rollover of short-term debt, the regulations could provide that debt would be considered short-term only if payments thereon would qualify as short-term under the exemption from nonresident gross income and withholding tax in *section 871(g)(1)(B)(i)* (for which the same abuse considerations apply).

#### **Comment 9: Retirement Plans and Not-for-Profit Entities**

FATCA provides that withholding under *section 1471(a)* does not apply to any payment to the extent that the beneficial owner of such payment is part of a class of persons identified by the Department of the Treasury as posing a low risk of tax evasion. n25 Utilizing this authority, *Notice 2010-60* provides an exemption for “retirement plans,” defined as a plan that “(i) qualifies as a retirement plan under the law of the country in which it is established, (ii) is sponsored by a foreign employer, and (iii) does 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.” n26 Both *Notice 2010-60* and *Notice 2011-34* request comments regarding this definition.

SIFMA fully supports the exemption for retirement plans, which is similar to an exemption that SIFMA suggested in prior comments. As also previously noted, however, SIFMA believes that the proposed definition of qualifying plans is too narrow. In particular, the second and third requirements stated above are overly restrictive and would require a level of due diligence by USFIs and PFFIs to identify qualifying plans that is unprecedented and unnecessary. SIFMA is also concerned that the third requirement of the proposed definition would be unworkable for many multinational groups, which may have certain unified retirement plans for employees located in multiple jurisdictions. Moreover, it is not clear whether a superannuation fund or other fund maintained by a foreign government for its employees would qualify for the exemption. Finally, the proposed definition would appear to exclude the application of the exemption to collective investment vehicles maintained by multiple retirement plans (which are an increasingly common way in which retirement plans invest their assets).

As an alternative, SIFMA would suggest that a retirement plan be defined for purposes of the exemption as a corporation, partnership, trust, other entity, contractual arrangement, or pool of assets (including such an entity, arrangement, or pool maintained by a government) that is operated principally either (i) to administer or provide pension or retirement benefits or (ii) to earn income for the benefit of one or more entities, arrangements, or pools described in clause (i). n27 As such, the exemption

would extend both to non-U.S. retirement plans as well as to collective investment vehicles or arrangements created among non-U.S. retirement plans.

In addition, SIFMA suggests that a similar exemption be provided for not-for-profit entities, including any collective investment vehicle that is wholly owned by one or more not-for-profit entities, provided that such an entity complies with the certification rules applicable to NFFEs. For this purpose, a “not-for-profit entity” should be defined as any legal entity whose purpose is to safeguard the interests of its members or beneficiaries by way of mutual self-help, and which pursue political, religious, scientific, artistic, charitable, social, or similar objectives. A similar definition is used for KYC/AML purposes in some jurisdictions. n28

#### **Comment 10: Small FFIs**

In *Notice 2010-60*, the Department of the Treasury and the IRS proposed a process under which a USFI or PFFI could treat an FFI as a DCFFI if the USFI or PFFI: (1) specifically identified each individual, specified U.S. person, or excepted NFFE that had an interest in such FFI, either directly or through ownership in one or more other entities; (2) obtained from each such person the documentation that the withholding agent would be required to obtain from such person if the USFI or PFFI were directly dealing with such person; and (3) reported 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. n29 This proposal would be particularly useful for dealing with the large number of small FFIs in the world, rather than requiring them enter into FFI agreements. After considering the proposal, however, SIFMA believes that it needs to be modified to provide a useful method for dealing with small FFIs that are not required to enter into an FFI agreement. In particular, SIFMA suggests that the proposal be modified in the following three ways:

(i) The procedure should be invoked only upon a joint election by the USFI or PFFI and the small FFI, so that a clear obligation can be imposed on the small FFI to produce the needed information.

(ii) As there would seem to be little point in treating the small FFI as a DCFFI, the small FFI should simply be disregarded as an entity for FATCA purposes once the election is made. n30

(iii) Finally, it should be made clear that a small FFI covered by this process will not be required to apply to the IRS for approval of its status, to obtain a special FFI number, or to calculate, maintain, or certify the accuracy of a PPP.

#### **Comment 11: Other Topics**

SIFMA also submits the following miscellaneous comments on other topics:

(i) Where aggregation of accounts is required for FATCA purposes (e.g., for purposes of determining if an account meets a \$ 50,000 or \$ 500,000 threshold under the transition rules), such aggregation should be limited to situations where accounts are actually aggregated under current systems.

(ii) To the extent that the revised procedures for preexisting individual accounts or new individual accounts under the transition rules require a “written explanation” to support a claim of foreign status when the individual has a U.S. birthplace or submits a Form W-8BEN with a U.S. address on the form or the account requires a “written explanation” under the Chapter 3 withholding regulations, a standardized questionnaire should be created as a substitute for a free-form written explanation. The questionnaire should elicit the factual information necessary to establish that the individual is not a U.S. taxpayer. The questions and answers could be provided in a special section of a Form W-8BEN designed specifically for individuals.

(iii) Where one FFI (or USFI) agrees, under a contract, to act as a reporting/withholding agent for another FFI (or USFI), the accounts at the principal should not be treated as accounts of the agent for which the agent has statutory (as opposed to contractual) responsibility under FATCA. In addition, the FATCA regulations should confirm that, where one FFI (or USFI) agrees to act as a reporting/withholding agent for another FFI (or USFI), the agent should be able to rely on documentation maintained by the principal or other agents thereof.

(iv) For purposes of characterizing a foreign entity as an NFFE as opposed to an FFI on the basis of its type of business, a USFI or PFFI should be permitted to rely on any system of characterization (e.g., using industry codes) that it maintains for a substantial non-tax purpose.

(v) Payments for services rendered should be excluded from the definition of withholdable payment.

(vi) Because they provide no opportunity for abuse, non-interest bearing accounts should be excluded from the financial account definition.

\* \* \*

SIFMA appreciates your consideration of its collective views and concerns on the regulations that are being developed to implement the provisions of FATCA. Please do not hesitate to contact me at (202) 962-7333 or emccarthy@sifma.org if you have any questions or if we can be of further assistance.

Sincerely,

N. Ellen McCarthy  
Managing Director Government Affairs  
and Tax Counsel  
Securities Industry and Financial  
Markets Association  
Washington, D.C.

#### FOOTNOTES:

n1

The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.

n2

On August 11, 2010, SIFMA submitted comments regarding various aspects of the FATCA regulations, in response to *Announcement 2010-22* and *Announcement 2010-34*. In addition, on October 29, 2010, SIFMA submitted comments regarding various aspects of the FATCA regulations, in response to *Notice 2010-60*. Certain of these prior comments were with regard to topics that are not addressed in *Notice 2011-34*, and SIFMA presumes that they will be considered in due course. Certain other comments were with regard to topics that are addressed in *Notice 2011-34*, and certain aspects of those comments are repeated in this letter where appropriate.

n3

See “Next FATCA Guidance to Include Broad Set of Proposed Regs, Treasury Official Says,” 2011 TNT 103-9 (May 27, 2011).

n4

See section 1471(d)(1)(A) (“The term ‘United States account’ means any financial account which is held by one or more specified United States persons or United States owned foreign entities.”); section 1471(d)(3) (“The term ‘United States owned foreign entity’ means any foreign entity which has one or more substantial United States owners.”); section 1473(2) (defining “substantial United States owners” to include only certain specified United States persons); section 1473(3) (“Except as otherwise provided by the Secretary, the term ‘specified United States person’ means. . .”). The Department of the Treasury and the IRS need merely except all persons from the specified United States person definition until the noted date in the noted circumstances in order to provide the requested transition relief. Unless otherwise indicated, all section references herein are to sections of the Internal Revenue of 1986, as amended (the “Code”).

n5

See section 1471(d)(7) (“The term ‘passthru payment’ means any withholdable payment or other payment to the extent attributable to a withholdable payment.”); section 1473(1) (“Except as otherwise provided by the Secretary . . . [t]he term ‘withholdable payment’ means. . .”).

n6

See Joint Committee on Taxation Technical Explanation of the Revenue Provisions Contained in the HIRE Act, JCX-4-10 (“JCT Explanation”), at 40 (noting that the FATCA withholding tax is not intended to create an alternative to information reporting and that the IRS may require an FFI to achieve certain levels of reporting and compliance).

n7

See Sections III.B.2.a., III.B.3.a., and III.C.1. of Notice 2010-60 and Section I.A of Notice 2011-34.

n8

See Section I.A.2 of Notice 2011-34 (Steps 3 and 5). The rules do not define “diligent review”. For this purpose, a high-value account would generally be an account containing \$ 500,000 or more, and a “private banking account” would generally be any account that is maintained or serviced (i) by a private banking department; or (ii) as part of a private banking relationship (generally a re-

lationship in which one or more of the FFI's officers or employees are assigned to provide personalized services to individual clients that are not generally provided to account holders or to gather information about a client's personal, professional and financial histories in addition to the information ordinarily gathered with respect to the FFI's retail customers). Accordingly, the definition of "private banking account" may include accounts not held in a traditional or formal private banking department.

n9

In this regard, \$ 1 million would probably be a more traditional cut-off for a private banking account, but SIFMA does not believe that the difference would be material in terms of compliance burdens.

n10

See Sections II.A and II.B of *Notice 2011-34*.

n11

See Section II.C of *Notice 2011-34*.

n12

In many cases, these efforts would indeed be circular and, thus, infinite, as they would require, e.g., PFFI1 to look to the PPP of PFFI2 with respect to payments from PFFF2 to PFFI1, which would in turn depend on the PPP of PFFI1 with respect to payments from PFFI1 to FFI2, etc. Limiting the PPP approach to payments made to holders of ownership interests in investment fund PFFIs would strongly limit and perhaps eliminate such circularity.

n13

Indeed, such payments may in some cases be affirmatively not attributable to underlying withholdable payments (e.g., when they are secured solely by non-U.S. assets).

n14

See Section I.A.3 of *Notice 2011-34*.

n15

See Sections III.A and III.B of *Notice 2011-34*.

n16

See, e.g., *section 1471(d)(2)(C)* (exempting from the financial account definition any equity or debt interests “which are regularly traded on an established securities market”); *section 1472(c)(1)(A)* (exempting from FATCA withholding payments made to a corporate NFFE “the stock of which is regularly traded on an established securities market”); *section 1473(3)(A)* (exempting from the specified United States person definition “any corporation the stock of which is regularly traded on an established securities market”).

n17

*Treasury regulations section 1.7704-1(b)* defines an established securities market to include: (i) a national securities exchange registered under the 1934 Act; (ii) a national securities exchange exempted from registration under the 1934 Act; (iii) any foreign securities exchange that satisfies analogous regulatory requirements under the law of the jurisdiction in which it is organized; (iv) a regional or local exchange; and (v) an interdealer quotation system that regularly disseminates firm buy or sell quotations by identified brokers or dealers by electronic means or otherwise.

n18

*Treasury regulations section 1.7704-1(c)(2)* provides that interests in a partnership are readily tradable on a secondary market or the substantial equivalent thereof if: (i) interests in the partnership are regularly quoted by any person, such as a broker or dealer, making a market in the interests; (ii) any person regularly makes available to the public (including customers or subscribers) bid or offer quotes with respect to such interests and stands ready to effect buy or sell transactions at the quoted prices for itself or on behalf of others; (iii) the holder of an interest in the partnership has a readily available, regular, and ongoing opportunity to sell or exchange the interest through a public means of obtaining or providing information of offers to buy, sell, or exchange interests in the partnership; or (iv) prospective buyers and sellers otherwise have the opportunity to buy, sell, or exchange interests in the partnership in a time frame and with the regularity and continuity that is comparable to those in the (i)-(iii).

n19

See JCT Explanation at 41 (“Additionally, the Secretary may identify classes of institutions that are deemed to meet the requirements of this provision if such institutions are subject to similar due diligence and reporting requirements under other provisions in the Code. Such institutions may include certain controlled foreign corporations owned by U.S. financial institutions and certain U.S. branches of foreign financial institutions that are treated as U.S. payors under present law.”)

n20

See section 1473(1) (“Except as otherwise provided by the Secretary . . . [t]he term ‘withholdable payment’ means. . .”).

n21

See JCT Explanation at 45 (“The Secretary may determine that certain payments made with respect to short-term debt or short-term deposits, including gross proceeds paid[,] pose little risk of United States tax evasion and may be excluded from withholdable payments for purposes of this provision.”).

n22

Interest and gross proceeds payments on debt with a term of 183 days or less are generally exempt from current nonresident gross income and withholding tax, without any requirement for a certification from the recipient. See section 871(g)(1)(B)(i) (exempting payments on short-term debt from withholdable original issue discount); section 1441(b) (limiting withholding to income amounts, as opposed to principal payments). In addition, redemption payments in respect of debt with a term of 1 year or less are generally exempt from information reporting and backup withholding. See Treasury regulations section 1.6045-1(c)(3)(vii)(C) (exempting obligor payments in respect of short-term debt from broker reporting).

n23

See JCT Explanation at 43 (“It is anticipated that the Secretary may determine that certain short-term obligations, or short-term deposits, pose a low risk of U.S. tax evasion and thus, may not treat such obligations or deposits as financial accounts for purposes of this provision.”).

n24

Most short-term debt generally pays a yield that is only a modest spread over LIBOR or another similar index.

n25

See section 1471(f).

n26

See Section II.C. of Notice 2010-60.

n27

Cf. Paragraph 1(k) of Article 3 of the United States Model Tax Convention on Income (2006) (defining “pension fund” similarly for treaty purposes, including various exemptions from withholding tax).

n28

Cf. “Some Foreign Charities May Find Carveout Under FATCA, Treasury Official Says,” 2011 TNT 102-10 (May 26, 2011).

n29

See Section II.B.3 of *Notice 2010-60*.

n30

The Department of the Treasury and the IRS have full authority to disregard the FFI, among other places under their plenary authority to provide exceptions to the definition of “financial institution” and the class of entity subject to NFFE withholding. See *section 1471(d)(5)* (“Except as otherwise provided by the Secretary, the term ‘financial institution’ means. . . .”); *section 1472(c)(1)(G)* (exempting from NFFE withholding “any other class of persons identified by the Secretary for purposes of this subsection”).