

[TEXT OF THE FATCA COMMENT LETTER SUBMITTED BY
TAX EXECUTIVES INSTITUTE]

September 21, 2011

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Internal Revenue Service
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RE: Follow-Up Comments Regarding TEI Meeting on August 16, 2011 ~ Supplemental Recommendations on the Foreign Account Tax Compliance Act

Dear Ms. Corwin, Mr. Danilack, and Mr. Musher:

On behalf of Tax Executives Institute, thank you again for the opportunity to meet on August 16, 2011, with representatives of the Department of the Treasury and Internal Revenue Service to discuss important technical and administrative issues related to FATCA. We appreciated the candid conversation and the commitment to striking an effective balance between the legislative purposes of FACTA and its associated administrative and compliance burdens.

This letter addresses questions discussed at the meeting regarding certain exceptions to FATCA and potential self-certification procedures. Specifically, we provide comments on the following:

1. The potential exception for “hedging/financial centers of a non-financial group” (Financing Affiliates); n1
centers of a non-financial group” (Financing Affiliates); n1
2. The potential exception for foreign retirement plans; n2

3. Entity self-certification of exception qualifications; n3
and

4. The potential exception for payments made to non-financial foreign entities (NFFEs) in the “ordinary course” of a payor’s trade or business. n4

1. Exception for Financing Affiliates

Notice 2010-60 states that Treasury and the IRS intend to issue regulations to exempt Financing Affiliates from the definition of a foreign financial institution (FFI) under *section 1471(d)(5)*, as well as exempt payments beneficially owned by such affiliates from withholding under *section 1472(a)*. n5 The Notice provides that a Financing Affiliate is, in general, a “foreign entity that primarily engages in financing and hedging transactions with or for members of its expanded affiliated group (as defined in *section 1471(e)(2)*) that are not FFIs and that does not provide such services to non-affiliates. . . .” n6 The Notice also asks for comments about how Financing Affiliates “may be more specifically defined. . . .” n7

TEI previously suggested that the government use several activities typically engaged in by Financing Affiliates as criteria for identifying such affiliates for purposes of the exception to FATCA. n8 The discussion of this issue at our meeting, however, suggested that the activities and requirements of Financing Affiliates may not be properly understood; for example, there seems not to be a full appreciation that such affiliates routinely engage in transactions with entities that are not members of the expanded affiliated group. n9

At the meeting, we were asked to provide examples of foreign jurisdictions that may require a Financing Affiliate to engage in transactions with unrelated parties or, at a minimum, to hold itself out as willing to so engage, for such an affiliate to be able to conduct financing and hedging transactions with members of its expanded affiliated group. Although we did not find any specific regulatory requirements, we were able to confirm that Financing Affiliates periodically engage in transactions with unaffiliated persons for business reasons. For example, a Financing Affiliate may make a loan to a customer as part of a long-term relationship building effort. In addition, some Financing Affiliates are registered as a bank under their home country’s banking regulations. There are historical reasons for this, such as the difficulty that an industrial company had in obtaining loans from third parties, whereas companies that qualified as banks had easier access to credit markets.

Thus, we recommend that the exception for Financing Affiliates be framed to permit Financing Affiliates to perform services for unrelated parties as long as such services are *de minimis* when compared to the services provided to the expanded affiliated group. Further, we recommend that, for purposes of qualifying for the exception for Financing Affiliates, only the activities actually engaged in by the affiliate should be taken into account, not the broader group of activities the entity may be permitted to engage in pursuant to its organizing documents, including qualifying as a bank under home country law.

Finally, in addition to the activities described in our prior submission, n10 TEI believes that the following activities are indicative of status as a Financing Affiliate:

- Receiving deposits from related foreign subsidiaries that have excess available cash;
- Investing the cash from such deposits in an investment portfolio;
- Netting intercompany receivables and intercompany payables of related U.S. and foreign subsidiaries;
- Providing loans to those related foreign subsidiaries that require working capital or other short term funding; and
- Entering into derivative contracts to hedge currency exposure.

2. Retirement Plan Exception

Notice 2010-60 announces the intention of Treasury and the IRS to issue guidance providing that payments to certain foreign retirement plans are exempt from withholding under *section 1471(a)* because such plans pose a low risk of tax evasion, and requests comments regarding the definition of a retirement plan for this purpose. n11 TEI previously suggested that the class of foreign retirement plans set forth in *Notice 2010-60* was too narrow and recommended it be expanded to include plans with U.S. participants and beneficiaries that performed services in multiple foreign jurisdictions (rather than just the jurisdiction in which the plan is organized). We also recommended that plans eligible for the benefits of an income tax treaty with the United States ~ whereby U.S. source interest and dividends received by the plan are not subject to U.S. tax ~ also be eligible for the exception. n12

At our meeting, we discussed whether bilateral U.S. income tax treaties provide sufficient safeguards in respect of foreign retirement plans to ensure that the underlying policy goals of FATCA are effected, and were asked to recommend criteria to identify which plans are compatible with the information reporting objectives of Chapter 4. In response, TEI posits that the following criteria are indicative of a *bona fide* foreign retirement plan (or “pension scheme”):

- The plan is subject to local legal requirements concerning employee participation, coverage, or the levels or types of benefits provided;
- The plan is subject to regulation by the local jurisdiction’s taxation or labor authorities;

- The plan has maximum benefit limits imposed by local law (similar in nature to *section 415*); and
- The plan is subject to legal restrictions to prevent the use of plan assets or benefits for purposes other than retirement (except in cases of plan liquidations pursuant to local law).

3. Self-Certification for Exceptions

Notice 2010-60 requested comments on whether certain foreign entities should be permitted to self-certify their qualification for exceptions to Chapter 4 withholding. n13 TEI previously recommended that self-certification be permitted in several respects, including qualification for the potential holding company and retirement plan exceptions. n14 In addition, we suggested during our meeting that self-certification could be provided by a payee to a withholding agent via language in the legal agreement governing the payments that may give rise to a Chapter 4 withholding obligation, rather than through a separate IRS form. During our meeting, TEI was asked to suggest self-certification language to satisfy the policy objectives of FATCA while being compatible with ordinary business operations.

With respect to self-certification for the holding company and Financing Affiliate exceptions, U.S. persons and controlled foreign corporations (CFCs) make numerous withholdable payments to such related entities. In general, these payments consist of (i) dividends paid by a U.S. subsidiary to a foreign holding company or dividends from a CFC to an intermediate holding company; (ii) royalties paid to foreign holding companies; and (iii) interest and royalties paid to foreign Financing Affiliates. TEI recommends that the withholding agent be permitted to certify that the related foreign holding company or Financing Affiliate qualifies for specified exceptions to FATCA (as finally drafted by Treasury and the IRS). Since the foreign company is related to the withholding agent, the latter should be able to provide such a certification based on its knowledge of the related party; no signed statement from the payee should be necessary since the certification would be based on the withholding agent's knowledge.

If a certification based on personal knowledge is not acceptable, we recommend that the foreign holding company or Financing Affiliate be allowed to certify its eligibility for an exception through a separate statement that could be made available to the government upon request, which would include the following language:

Statement required under FATCA

The undersigned, a person authorized to sign for [Foreign Company X] hereby certifies that [Foreign Company X] is either [a company organized under the laws of Country X whose activities consist primarily of holding companies that are part of the XYZ Expanded Affiliated Group] or [a company organized under the laws of Country X whose activities consist primarily

of providing financing services to companies that are part of the XYZ Expanded Affiliated Group] as provided under *sections 1471 through 1474* and the regulations thereunder.

Further, since withholdable payments made by withholding agents to unrelated NFFEs consist primarily of royalties for the use of intangible property in the United States or for services provided in the United States, those payments should generally meet the contemplated active trade or business exception. It is unlikely, however, that a foreign vendor would be willing to sign a statement similar to one proposed above for holding companies and Financing Affiliates, since such vendors would generally not have knowledge of the cited provisions of the Internal Revenue Code and Treasury regulations.

Thus, instead of the quoted language above, TEI recommends that a withholding agent be permitted to have foreign vendors sign the following statement:

Statement required by FATCA

The undersigned, a person authorized to sign for [Foreign Vendor Company], hereby certifies that it is engaged in an active trade or business in an area other than the business of banking or the provision of other financial services.

4. Exception for Ordinary Course of Business Payments

Notice 2010-60 discusses a proposed exception to Chapter 4's documentation and information reporting requirements for "certain classes of payments, such as arm's-length payments made for goods or services in the ordinary course of the withholding agent's trade or business." n15 During our meeting, TEI was asked about the kind of information that could be provided by withholding agents to document that a withholdable payment was made in the "ordinary course" of the agent's business. We responded that since most ordinary course payments are made pursuant to a written contract, the contracts could be used as the primary documentation demonstrating the payment's qualification for any "ordinary course of business" exception to Chapter 4.

Upon reflection, we further suggest that a purchase order generated in a company's "purchasing system" would provide additional documentation of the payment's nature. In addition, purchases made pursuant to approved purchasing thresholds that depend on the employee's title, position, function, and overall level of responsibility would be indicative of an ordinary course payment. Finally, evidence of an ordinary course payment includes purchases made pursuant to a worldwide or regional purchase agreement negotiated by a company's procurement department, at predetermined volume or value thresholds.

5. Conclusion

Tax Executives Institute appreciates the opportunity to offer its views on key issues related to the development of regulations implementing FATCA. We look forward to commenting on future regulatory releases on this very important subject. Please do not hesitate to contact Michael J. Bernard, Chair, TEI IRS Administrative Affairs Committee, mikebe@microsoft.com, Paul Heller, Vice-Chair, IRS Administrative Affairs Committee, paul.heller@rbc.com, or Benjamin R. Shreck, TEI Tax Counsel, at 202-638-5601 or bshreck@tei.org, should you have any additional questions regarding this letter, or our previous comments regarding FATCA.

Sincerely yours,

Tax Executives Institute, Inc.
David M. Penney
International President
Washington, DC

Cc:

U.S. Department of the Treasury

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FOOTNOTES:

n1

See Notice 2010-60, 2010-37 I.R.B. 329, 331 (Sept. 10, 2010).

n2

Id. at 332-33.

n3

See, e.g., *id.* at 331 (requesting comments regarding what methods withholding agents could use to identify entities that qualify for certain exceptions to Chapter 4).

n4

Id. at 344.

n5

Id. at 331.

n6

Id.

n7

Id.

n8

See *Comments of Tax Executives Institute, Inc., on Notice 2010-60 relating to the Foreign Account Tax Compliance Act (FATCA) NOT-121556-10 Submitted to the Internal Revenue Service, October 19, 2010, at 6-7 (hereinafter “TEI October 2010 Comments”).*

n9

See *Comments of Tax Executives Institute, Inc., on Notice 2011-34 relating to The Foreign Account Tax Compliance Act (FATCA), NOT-121556-10, submitted to The Internal Revenue Service, June 7, 2011, at 8-9 (hereinafter “TEI June 2011 Comments”).*

n10

See TEI October 2010 Comments at 6-7. Some of the activities suggested here may overlap with, or be similar to, those noted in our prior submission.

n11

2010-37 I.R.B. at 332-33.

n12

TEI October 2010 Comments at 9.

n13

See, e.g., 2010-37 I.R.B. at 331 (requesting comments regarding what methods withholding agents could use to identify entities that qualify for certain exceptions to Chapter 4)

n14

See, e.g., TEI October 2010 Comments at 7 (relating to Financing Affiliates) and 9-10 (relating to retirement plans).

n15

2010-37 I.R.B. at 344.