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Re: Follow-Up From September 9, 2011 Meeting Regarding FATCA Guidance and Implementation

Dear Ms. Nishida and Messrs. Eggert, Plowgian, and Sweeney:

We appreciate the opportunity to have met with you and your colleagues on September 9, 2011 to continue our discussions of the important operational and implementation issues associated with the Foreign Account Tax Compliance Act ("FATCA") provisions of the Hiring Incentives to Restore Employment Act of 2010. At our meeting, we identified a few items for follow-up discussion, and this letter is intended to provide additional comment and detail on those items. In addition, as HSBC continues to review the practical implications of implementing FATCA, several questions have arisen for which further guidance or clarification would be welcomed, and these are also addressed in this letter. Our comments in this letter supplement comments previously provided in our submissions dated November 2010, January 2011, June 2011, and September 2011 (and in our meetings and other communications). To the extent not addressed in guidance to date, we continue to support those prior comments.

Overview

HSBC addresses the following issues in these comments:

1. *Diligent review.* HSBC reiterates its support for limiting the diligent review of pre-existing private banking and high value accounts to an electronic search for U.S. indicia, rather than a review of paper files.

2. ***Non-U.S. Funds.*** HSBC recommends that the proposed category for “local fund distributors” described in our September 2011 letter as a category of deemed compliant foreign financial institutions (“DCFIs”) be expanded to apply on a regional basis rather than a strictly local basis, when appropriate.
3. ***U.S. Indicia – U.S. Place of Birth.*** As detailed further in this letter, if the review of a preexisting account reveals a U.S. place of birth for a customer, HSBC recommends a risk-based approach to the further investigation of the citizenship of such customer.
4. ***Documenting Exceptions from FATCA.*** For purposes of establishing the statutory exceptions described in sections 1472(c) and 1473(3)¹, HSBC recommends, for reasons of administrative convenience and expediency, that corporations whose stock is listed on an exchange be deemed to satisfy the requirement that the stock is regularly traded on an established securities market.
5. ***Treatment of Sole Proprietors as Entities under FATCA.*** For purposes of the review of preexisting accounts under FATCA, HSBC recommends that “sole proprietors” and similar account holders be treated as entity, rather than individual, account holders. As a result of such classification, provided a sole proprietor is not a U.S. person or a foreign financial institution (“FFI”) and could be appropriately documented as being engaged in an “active trade or business,” a sole proprietor would be treated as an excepted non-financial foreign entity (“NFFE”).
6. ***Adequacy of Evidence of Nationality for Certain On-line Customers.*** HSBC requests that future guidance clarify that, in certain circumstances and applying appropriate procedures, physical documentation of the nationality of a customer will not be required and electronically verified evidence of nationality will be sufficient.
7. ***Clarification of Treatment of Jointly Held Accounts.*** HSBC requests that future guidance clarify that, in the case of a joint account in which one of the account holders is a properly documented U.S. person, a participating FFI (“PFFI”) would be required to report with respect to the account as a U.S. account and that such PFFI would not be required to withhold with respect to such account, even if the other joint account holder(s) have not provided their information.

¹ Unless otherwise indicated, all section references are to the Internal Revenue Code of 1986, as amended (the “Code” or IRC”), and to Treasury regulations promulgated thereunder.

Detailed Comments

1. Diligent Review

As previously articulated in comments submitted on September 6, 2011, HSBC strongly agrees with the view expressed by several other commenters that the diligent review of preexisting private banking and high value accounts should be limited to an electronic search of files for U.S. indicia without the additional burden of an expensive and time intensive manual review of paper files. This would alleviate a substantial administrative burden on PFFIs.

During our discussion of diligent reviews of preexisting accounts at our September 9, 2011 meeting, specific inquiries arose as to whether, and in what form, know-your-customer ("KYC") information is readily available, the extent to which changes in client data are continually tracked, and whether local tax identification numbers are obtained and stored. After reviewing internal operations in various business lines, HSBC's responses are as follows:

KYC Information. Generally, the availability of KYC information varies by jurisdiction and line of business (e.g., private banking generally will tend to have more information readily available than retail banking). Often, scanned KYC documents will be retained, but not in a form that would be electronically (or easily) searchable as part of a mass review. Some regions only hold such information in paper form.

Tracking of client data changes. Generally, such changes are picked up by periodic KYC reviews or when otherwise provided by the client or investor. Records are updated as appropriate when such information is received.

Local tax identification numbers. Generally, this information is not collected or readily available, unless pursuant to local KYC requirements.

Questions also arose as to what documentation requirements exist under the European Savings Directive. After reviewing local country implementation of the European Savings Directive, it has become clear that such documentation is largely determined by local country KYC/anti-money laundering requirements, rather than being established under a more generalized approach. Treasury and the IRS will be generally familiar with some of these requirements from the review of QI Agreement KYC Attachments.

2. Non-U.S. Funds

DCFFI Status. In our submission dated September 6, 2011, we proposed that the treatment of certain "local banks" as DCFFIs under section III.A of Notice 2011-34 be extended to "local fund distributors." Allowing certain local fund distributors to be treated as DCFFIs is consistent with the highly localized nature of the activities of the fund distributors that would qualify under the proposed test, and such treatment would appropriately reflect the low likelihood that such small firms would be in a position to enter into FFI agreements. Under the proposal, a local fund distributor would be granted DCFFI status if it:

- (i) is a purely local entity which has no branches outside of its country of organization;
- (ii) is not a member of an affiliated group of companies that has FFIs operating outside of the country in which such distributor is organized;
- (iii) does not market its services outside of its country of organization; and
- (iv) operates solely in its country of organization.

During our meeting in September, a question was raised as to whether an additional requirement should be added which would require such local fund distributors to ensure that they do not market to non-resident, non-participating FFIs ("NPFIs") or NFFEs. Such a requirement would be acceptable, *provided that* if a local fund distributor becomes aware of such a customer, a reasonable period for remediation and/or documentation is provided so that discovery of such an inadvertent customer would not compromise such fund distributor's DCFFI status.

Further, we reiterate our support for the proposal made by the European Fund and Asset Management Association ("EFAMA") in its June 2011 letter with respect to permitting a local fund distributor to certify to the funds with which it deals that it meets the requirements to be a DCFFI, rather than being required to provide an individual DCFFI certification to the IRS, thus alleviating a significant administrative burden to the funds distributors and the IRS.

Regional DCFFIs. In our letter dated June 7, 2011, HSBC recommended that four additional categories of DCFFIs be created. One of these categories would be a regional FFI that would meet the same criteria as a local member of a participating FFI group, as described in Notice 2011-34, except on a regional basis. HSBC also recommends that such a regional DCFFI approach be extended to regional funds and regional fund distributors described in our September letter. In the case of funds and fund distributors, HSBC believes that it would not be practical to restrict the concept of a localized business to a single country where that country is a member of a formal economic association such as the European Union ("EU"). Within the EU, EU law has primacy over the law of any member state, and therefore an expanded view of the application of the "local" DCFFI status to encompass operation in the EU as a whole, rather than limiting it to operation in an individual member state, is appropriate.

Regulatory and Business Limitations on Local Fund Distributors. During our discussion of funds at our September 9, 2011 meeting, a question was raised as to whether there were regulatory or other reasons for a fund distributor to be "local". HSBC understands that in general a fund distributor in a particular country will not wish to have clients resident in another country as the distributor could then be required to be licensed or registered by the financial regulator in that other country, in addition to being subject to its home country financial regulator, which would result in the incurrence of significant additional cost and regulatory risk.²

² For a discussion of the impact of licensing and other regulatory requirements on marketing restrictions for local fund distributors, see section 5 of the Annex to the e-mailed letter from EFAMA dated October 7, 2011 containing responses to specific questions from John Sweeney.

3. *U.S. Indicia – U.S. Place of Birth*

A U.S. place of birth is one of the significant items of U.S. indicia to be reviewed by an FFI as part of its review of preexisting accounts under the procedures set forth in Notice 2011-34. The Notice requires that an FFI request either a Form W-9 or a Form W-8BEN (or a substitute certification as may be provided in future guidance) and a non-U.S. passport or other government-issued evidence of non-U.S. citizenship, plus a written explanation regarding the account holder's renunciation of U.S. citizenship or the reason that the account holder did not acquire U.S. citizenship at birth ("the Explanation").

In our previous meetings with Treasury and the IRS, HSBC offered suggestions regarding what further diligence should be required from an FFI with respect to accounts when an electronic search or diligent review identifies a U.S. place of birth.³ In order to balance appropriately the risk of such an account holder being a U.S. person with the fact that the FFI employees who will be receiving and reviewing the Explanations will have no knowledge or expertise in U.S. citizenship and immigration laws, and to mitigate the customer relations issues and potential litigation risk in the case of account holders who indicate that they should not be categorized as U.S. persons despite their U.S. birthplace, HSBC recommends that there be objective procedures which would not require an evaluation of an Explanation and that clearly establish how such accounts are to be treated in the absence of required documentation.

Accordingly, HSBC suggests the following approach to requesting further documentation of the account holders' status:

If a client with a U.S. birthplace asserts that he/she is not a U.S. citizen, the FFI should not be required to request an Explanation and/or a copy of a certificate of renunciation (or other acceptable substitute documentation) from such client unless the account is (a) a private banking account, or (b) a high-value account (\$500,000 or more). In the latter case, an FFI should be able to rely on such Explanation as valid without further inquiry or on the certificate of renunciation (or other acceptable substitute documentation).

Alternatively, if the above proposal is not acceptable, an alternative approach would be to require the FFI:

- (a) to request and obtain an Explanation or a copy of a certificate of renunciation (or other acceptable substitute documentation) with respect to non-private banking accounts with values between \$50,000 and \$500,000, and the FFI should be entitled to rely on such Explanations as valid

³ It should be noted that in the case of an electronic search (which as discussed above we suggest should be allowed to satisfy the diligent review requirement in the case of private banking and high value accounts), the issue of a U.S. birthplace for preexisting accounts may not be relevant for many FFIs because they have not previously recorded this information in their electronic databases as it was not required for most local KYC purposes. However, our proposal will be relevant for those FFIs that recorded this data item, as well as for new accounts to the extent an Explanation may be required.

without further inquiry or on the certificate of renunciation (or other acceptable substitute documentation); and

- (b) with respect to private banking and high-value accounts, to request and obtain both an Explanation on which the FFI should be entitled to rely as valid without further inquiry and a copy of a certificate of renunciation or other acceptable substitute documentation.

A reasonable time period should be allowed for obtaining any additional documentation that may be required with respect to both preexisting and new accounts. Upon the lapse of such period, guidance should provide that the FFI treat such account as a U.S. account subject to reporting under FATCA even if a Form W-8 was provided.

4. Documenting Exceptions from FATCA.

Sections 1472(c) provides an exception from section 1472 for payments beneficially owned by "any corporation the stock of which is regularly traded on an established securities market," as well as corporate members of its expanded affiliated group. Section 1473(3) provides that the term "specified United States person" does not include "any corporation the stock of which is regularly traded on an established securities market" nor any corporate members of such corporation's expanded affiliated group. Following up on the discussion in our meeting for our further thoughts on documenting statutory exceptions from FATCA, HSBC recommends, for reasons of administrative convenience and expediency, that corporations whose stock is listed on an exchange be deemed to satisfy the requirement that the stock is regularly traded on an established securities market.⁴

5. Treatment of Sole Proprietors as Entities under FATCA

Many existing HSBC account holders are "sole proprietors" or "sole traders," who are not incorporated, or who are organized as a limited liability company with a single owner under local law but that are disregarded for U.S. tax purposes. If these accounts are treated as individual accounts, they would have to be reviewed (whether by electronic search and/or a diligent review), which will be a costly and burdensome process, especially since most such accounts will not be owned by a U.S. persons and therefore will not be subject to FATCA reporting. In connection with the diligent review of existing accounts only (i.e. not for purposes of documenting new accounts), HSBC proposes that such "sole proprietors" be treated as entities rather than as individuals. As a result of such classification, provided a sole proprietor is not a U.S. person or an FFI and could be appropriately documented as being engaged in an "active trade or business," such sole proprietor would be treated as an excepted NFFE. This would be an

⁴ There is precedent for this approach in a somewhat analogous situation as evidenced by the simplified procedures for determining qualified dividends for information reporting purposes on Form 1099-DIV when stock is "readily tradable on an established securities market" in the U.S. for purposes of Code section 1(h)(11). See Notices 2003-71 (common stock is considered readily tradable on an established securities market in the United States if it is listed on a national securities exchange), 2003-79 (extending the rule to stock other than ordinary or common stock), 2004-71 (extending the simplified procedures into 2004) and 2006-3 (extending the simplified procedures for 2005 and future years).

appropriate extension of the active trade or business exception applicable to entity customers as described in Notice 2010-60, Section III.B.3.a.(4a), and would greatly enhance the reasonableness of the review of preexisting accounts. In addition, by limiting this entity treatment to preexisting sole proprietor accounts, there should not be any risk that a U.S. individual purposely established such an account to avoid the application of FATCA.

6. Adequacy of Evidence of Nationality for Certain On-line Customers

In some instances, such as when customers avail themselves of on-line banking services, such customers do not provide physical copies of documentary evidence of nationality (e.g., passports) to HSBC when the account is created. Instead, the customer completes an on-line on-boarding process, and the customer's identity and nationality are verified electronically. The required information provided under this process would meet local KYC/AML requirements. In addition, it is anticipated that for new on-line accounts at HSBC, following the effective date of the FATCA requirements, if the on-boarding process reveals any U.S. indicia, a prospective on-line customer would be referred to a local bank branch to complete the on-boarding process. Therefore, the on-boarding process, in combination with electronic verification procedures in compliance with local requirements, should be sufficient to ensure that U.S. persons are able to establish new non-U.S. on-line accounts only when adequate identification documentation is provided to a local branch.

In light of the process described above, HSBC requests that upcoming FATCA guidance clarify that for preexisting and new on-line accounts, electronically verified evidence of nationality should be sufficient to satisfy the documentation requirements for FATCA purposes even though no physical documents were received or retained (except when U.S. indicia in the on-line application requires the applicant to complete the new account on-boarding at a local bank branch).

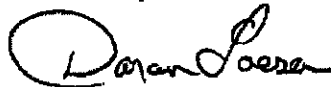
7. Clarification of Treatment of Jointly Held Accounts

Notice 2011-34, section I.A.2 provides "[w]ith respect to a jointly held account, each account holder will be attributed the full balance or value of the joint account for purposes of determining the combined balance or value of that account holder's associated accounts." HSBC requests clarification, in the case of a joint account in which one of the account holders is a properly documented U.S. person and the other account holder(s) has not provided documentation and cannot be identified, that the account be treated as a U.S. account and the entire account balance be reported with respect to the documented U.S. account holder as the primary account holder.⁵

⁵ This rule would be similar to the rule for joint accounts in Treas. Reg. sections 1.1441-1(b)(3)(vii)(A) and 1.1441-1(b)(9). See also Treas. Reg. sections 1.6049-5(d)(2)(iii) and 1.6041-4(b)

Thank you for your consideration of these comments. If you have any questions regarding the above or would like additional information, please contact me at (212) 525-6170 or doron.loeser@us.hsbc.com, or Meredith Berlin at (224) 544-6407 or meredith.a.berlin@us.hsbc.com.

Sincerely,



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