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Delivered Electronically

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RE: SIFMA Comments on Foreign Account Tax Compliance Act Provisions

Ladies and Gentlemen,

The Securities Industry and Financial Markets Association ("SIFMA")¹ welcomes the opportunity to submit the following initial suggestions 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 recently enacted Hiring Incentives to Restore Employment Act (the "HIRE Act").

The FATCA provisions impose a 30 percent withholding tax, which operates separately from the U.S. nonresident withholding tax imposed under

¹ SIFMA brings together the shared interests of securities firms, banks, and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services, and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

sections 1441 and 1442.² In general, the FATCA withholding tax applies to “withholdable payments” made to a foreign financial institution (an “FFI”), unless the FFI enters into an agreement with the IRS to comply with various information reporting and withholding requirements with respect to “U.S. accounts.” For this purpose, “FFI” is broadly defined to include foreign banks, brokers, and investment funds, including private equity and hedge funds as well as securitization vehicles.³ “Withholdable payments” include U.S. source dividends, interest (including original issue discount), and other “fixed or determinable annual or periodical” income, as well as any gross proceeds from the disposition of property that can produce U.S. source interest or dividends.⁴ “U.S. accounts” generally include depository accounts, custodial accounts, and non-regularly-traded equity or debt interests in an FFI held by a “specified U.S. person” or a “U.S. owned foreign entity.”⁵ FATCA also imposes related information reporting and withholding requirements in respect of payments made to non-financial foreign entities (“NFFEs”).⁶

The information reporting and withholding obligations under FATCA are different for FFIs and NFFEs. To escape withholding, an FFI must have in place an agreement with the IRS to identify which of its financial accounts are U.S. accounts, report annually on those accounts to the IRS, and withhold on “passthru payments” (withholdable payments made by an FFI and other payments made by an FFI that are attributable to withholdable payments received by the FFI) to account holders that refuse to identify themselves (and eventually close such accounts).⁷ An

² Unless otherwise indicated, all section references herein are to sections of the Internal Revenue of 1986, as amended (the “Code”).

³ See section 1471(d)(4) & (5); Joint Committee on Taxation Technical Explanation of the Revenue Provisions Contained in the HIRE Act, JCX-4-10 (the “JCT Explanation”), at 44 (“Accordingly, the term financial institution may include among other entities, investment vehicles such as hedge funds and private equity funds.”).

⁴ See section 1473(1).

⁵ See section 1471(d)(1).

⁶ See section 1472.

⁷ See sections 1471(b)(1)(D) and 1471(d)(7).

FFI must also withhold on passthru payments made to another FFI unless the other institution is itself FATCA compliant.⁸ An FFI can alternatively comply with FATCA by establishing that it does not have any U.S. accounts or accounts held by noncompliant FFIs. An NFFE escapes withholding on withholdable payments by certifying to the withholding agent that the NFFE does not have U.S. direct or indirect owners (subject to some minimum ownership thresholds) or identifying those owners. The principal goal of FATCA is to collect tax from U.S. taxpayers who have been evading their responsibilities by investing through FFIs and NFFEs in situations where information returns in respect of such U.S. investors have not been required to be filed.

SIFMA shares the objectives of FATCA, and the Obama Administration, in improving offshore tax compliance. In the remainder of this letter, SIFMA makes the following initial comments, which are designed to assist the Department of the Treasury and the IRS in crafting regulations that are effective in accomplishing FATCA's goals without unnecessarily disrupting the operations of the financial markets:

- (1) The regulations should exclude payments on short-term debt from the withholdable payment definition.
- (2) The regulations should provide that the following entities, among others, are exempt from the FFI information reporting and withholding provisions of FATCA pursuant to the authority granted under section 1471(b)(2)(B): (i) widely held collective investment vehicles; (ii) pension funds; (iii) existing securitization vehicles; and (iv) current reporting entities.
- (3) The regulations should exclude the following entities, among others, from the scope of the FFI definition, and instead treat

⁸ See section 1471(b)(1)(D).

them as NFFEs: (i) pure holding companies; and (ii) personal investment companies and other small investment vehicles.

- (4) The regulations should confirm that non-U.S. estates are not treated as FFIs, and specify the circumstances in which they are treated as NFFEs.
- (5) The regulations should provide phase-in periods for U.S. withholding agents and FFIs to apply FATCA to existing accounts.
- (6) The regulations should provide for the use of a common service provider by multiple U.S. withholding agents and FFIs for identifying FFIs, NFFEs, and U.S. accounts.
- (7) The regulations should apply the \$50,000 de minimis threshold for depository accounts held by individuals on a non-aggregated basis.
- (8) The regulations should contain workable rules for the FFI election to be withheld upon.
- (9) The regulations should clarify the grandfather rule for existing obligations.
- (10) The regulations should clarify the definition of “passthru payment.”
- (11) The regulations should clarify the definition of “gross proceeds.”

Comment 1: Provide Exclusion for Short-Term Debt

Many U.S. companies 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. These foreign funding sources are

relied on to support the operations of U.S. companies that 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 will likely not be willing to enter into information reporting and withholding 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 may create.⁹ As a consequence, such investors could substantially decline as a funding source for U.S. issuers.

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.¹⁰ 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.¹¹ Taking the above into account, SIFMA recommends 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

⁹ See also the discussion below under Comment 11.

¹⁰ See section 1473(1) (“Except as otherwise provided by the Secretary . . . [t]he term ‘withholdable payment’ means . . .”).

¹¹ 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.”).

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 certifications.¹²

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.¹³ 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).

In addition to the foregoing, SIFMA believes that there are a number of other types of payments that could be excluded from the definition of withholdable payment without compromising FATCA's effectiveness. Examples

¹² 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).

¹³ Most short-term debt generally pays a yield that is only a modest spread over LIBOR or another similar index.

include ordinary course payments to professional service providers and payments among members of a controlled group of corporations. SIFMA expects to submit more detailed comments on this topic in the future.

Comment 2: Treat Widely Held Collective Investment Vehicles, Pension Funds, Existing Securitization Vehicles, and Current Reporting Entities as Exempt Under Section 1471(b)(2)(B)

The FFI definition is extraordinarily broad, and there are accordingly a great many entities that could need to enter into information reporting and withholding agreements with the IRS. The Department of the Treasury and the IRS have clear authority, however, to limit the number of needed agreements by exempting certain FFIs from the FFI information reporting and withholding provisions of FATCA under section 1471(b)(2)(B).¹⁴ SIFMA believes that it would be beneficial to market participants and the IRS to treat a number of FFIs as exempt under this provision, in order to reduce the potential for a flood of information reporting and withholding agreements, and to avoid situations in which reporting will be impossible. To this end, SIFMA would suggest that the following entities, among others, be treated as exempt from the FFI information reporting and withholding provisions of FATCA under section 1471(b)(2)(B): (i) widely held collective investment vehicles; (ii) pension funds; (iii) existing securitization vehicles; and (iv) current reporting entities.

Widely Held Collective Investment Vehicles

The FATCA legislative history endorses the treatment of widely held collective investment vehicles as exempt from the FFI information reporting and

¹⁴ See section 1471(b)(2) (“A foreign financial institution may be treated by the Secretary as meeting the requirements of this subsection if . . . (B) such institution is a member of a class of institutions with respect to which the Secretary has determined that the application of this section is not necessary to carry out the purposes of this section.”).

withholding provisions of FATCA.¹⁵ Treating such investment vehicles as exempt is reasonable given the administrative difficulty of reporting and withholding for such investment vehicles, as well as the importance of such investment vehicles to the U.S. economy, to which they provide hundreds of billions of dollars of inbound investment. In this regard, the investment vehicles that SIFMA believes were intended by the reference in the legislative history typically have large numbers of investors and a high rate of investor turnover. In addition, interests in these investment vehicles often are held through distribution networks whereby the fund and its manager do not have knowledge of the beneficial owners of the interests, or any straightforward method of obtaining such information from the distributors. As a consequence, full compliance with the FFI information reporting and withholding provisions of FATCA would be a practical impossibility for many such investment vehicles, leaving them no choice but to disinvest from U.S. securities. To the extent that a vehicle or its transfer or paying agent has information regarding the identity of direct beneficial owners, however, SIFMA believes that it would be appropriate for such a vehicle to be required to enter into a limited information reporting agreement with respect to any direct investors that constitute U.S. accounts.

In their joint comment letter dated April 23, 2010, the European Banking Federation (the “EBF”) and the Institute of International Bankers (the “IIB”) proposed that widely held collective investment vehicles be treated as exempt from the FFI information reporting and withholding provisions of FATCA, and suggested that criteria along the following lines might be used to define what is widely held:

- (i) investment vehicles with more than 100 investors, so long as five or fewer more-than-10-percent investors do not own more than 50 percent of the vehicle;

¹⁵ See JCT Explanation at 41 (“For instance, it is anticipated that the Secretary may provide rules that would permit certain classes of widely held collective investment vehicles, and to the limited extent necessary to implement these rules, the entities providing administration, distribution and payment services on behalf of those vehicles, to be deemed to meet the requirements of this provision.”).

- (ii) investment vehicles that are regularly traded on an established securities market;¹⁶ and
- (iii) open-ended investment vehicles that are publicly offered in a regulated market and issue and redeem interests from investors.¹⁷

In its submission dated July 7, 2010, the European Fund and Asset Management Association (“EFAMA”) made a similar proposal, with similar criteria.

SIFMA supports the treatment of widely held collective investment vehicles (as well as entities providing distribution and payment services acting on behalf of those vehicles) as exempt from the FFI information reporting and withholding provisions of FATCA, and agrees that the criteria suggested by the EBF, the IIB, and EFAMA would be a good starting point for defining what is widely held. In addition to meeting the widely held test in accordance with the criteria noted above, however, SIFMA believes that it would be appropriate for such vehicles to be required to enter into a limited information reporting agreement under which they would comply with the FATCA information reporting requirements with respect to any direct investors that constitute U.S. accounts.

One reason that SIFMA believes the proposed widely held exemption would be appropriate and not undermine the goals of FATCA is that, in general, SIFMA believes that the potential for widely held collective investment vehicles to be used to facilitate tax evasion by U.S. persons is very limited. In particular, many

¹⁶ Cf. section 1471(d)(2)(C) (providing an effective exemption from FATCA for a collective investment vehicle the interests in which are all regularly traded on an established securities market, since such a vehicle would have no U.S. accounts as defined in FATCA).

¹⁷ We note, in this regard, that criteria along these lines would be consistent with the rule for establishing whether interests in a partnership are readily tradable on a secondary market or the equivalent thereof for purposes of publicly traded partnership status under Treasury regulations section 1.7704-1(h), the definition of marketable stock in Treasury regulations section 1.1296-2(d)(1), the definition of a small business corporation under section 1361(b)(1)(A), and the definition of a Real Estate Investment Trust under section 856(a)(5).

such vehicles operate with substantial restrictions, under U.S. and foreign securities law and otherwise, that prohibit or effectively prohibit the acquisition of interests in such vehicles by U.S. persons. In addition SIFMA anticipates that many interests in such widely held collective investment vehicles would be held through other FFIs that have entered into FATCA information reporting and withholding agreements (“compliant FFIs”). Compliant FFIs, of course, would be required to report on all of the investments that they held for U.S. accounts, including investments in widely held collective investment vehicles that were themselves treated as exempt from the FFI information reporting and withholding provisions of FATCA.

Whatever criteria are ultimately required to be satisfied to treat a widely held collective investment vehicle as exempt under section 1471(b)(2)(B), SIFMA would suggest that a withholding agent be permitted to treat an investment vehicle as satisfying the criteria so long as the vehicle provides a certification of its qualification, in which case the withholding agent should be permitted to rely on the certification for up to three years following the year in which the certification is signed in the absence of actual knowledge or a reason to know that it is no longer correct.¹⁸

Pension Funds

Non-U.S. pension funds have invested hundreds of billions of dollars in U.S. securities, and under the plain language of FATCA non-U.S. pension funds could be treated as FFIs. It makes little sense, however, to treat pension funds in the same way as other FFIs. Beneficiaries of a pension fund are not truly investors in the fund with an account that represents an ascertainable interest in the assets of the fund or any control over such assets. Rather, a pension fund invests for its own account, as a separate entity, in order to be able to make payments to beneficiaries that have no direct connection to the underlying investments. In addition, for many

¹⁸ Cf. Treasury regulations section 1.1441-1(e)(4)(ii) (providing a similar three-year rule for reliance on nonresident withholding certifications).

administrative and practical reasons it would be difficult or impossible for a great many pension funds to comply with the FFI information reporting and withholding provisions of FATCA. In particular, pension funds may have large numbers of beneficiaries, and may have no practical means of compelling such beneficiaries to comply with applicable identification and documentation requirements that were not contemplated at the time their pension benefits were created. Furthermore, income earned and assets held in a pension fund are not irrevocably allocated to particular beneficiaries. Finally, SIFMA is not aware of any pattern of tax evasion by U.S. persons that utilizes interests in pension funds. One reason this is undoubtedly true is that, as noted above, a beneficiary of a pension fund has no control over the investments made by the fund or the timing of payments that the beneficiary will receive (which will of course frequently be made long after the employment services are performed to which the payments relate).

As a consequence, SIFMA would suggest that the regulations treat pension funds as exempt from the FFI information reporting and withholding provisions of FATCA under section 1471(b)(2)(B). For this purpose, SIFMA would define a “pension fund” as a corporation, partnership, trust, other entity, contractual arrangement, or pool of assets that (i) is generally exempt from income taxation in the jurisdiction in which it was created or organized; and (ii) is operated principally either (A) to administer or provide pension or retirement benefits; or (B) to earn income for the benefit of one or more entities, arrangements, or pools described in clause (A).¹⁹ As such, the exemption would extend both to non-U.S. pension funds as well as to collective investment vehicles or arrangements created among non-U.S. pension funds (which are an increasingly common way in which pension funds invest). As discussed above, a withholding agent should be permitted to treat a pension fund as satisfying the criteria for the exemption so long as the pension fund provides a certification of its qualification, in which case the withholding agent

¹⁹ 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).

should be permitted to rely on the certification for up to three years following the year in which the certification is signed in the absence of actual knowledge or a reason to know that it is no longer correct.

Existing Securitization Vehicles

A “securitization vehicle” is an entity that issues equity and/or debt securities the payments on which are primarily funded by the cash flows from a discrete pool of financial assets acquired by the vehicle with the proceeds of a fixed amount of initial contributions.²⁰ 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 required FFI information reporting and withholding agreement, which could lead to significant disruptions in the U.S. debt markets.

In a typical securitization vehicle transaction, all aspects of the securitization vehicle’s activities are governed by a detailed trust indenture. The indenture specifies everything from the required features of the securitization vehicle’s assets to the making of payments to trustees and other service providers. In many cases, the indenture will both allow and require the securitization vehicle to acquire new assets over the course of its existence. As a practical matter, amendments to a securitization vehicle indenture are very difficult, as they require the consent of substantial supermajorities of affected investors.

²⁰ Cf. section 743(f) (defining a “securitization partnership” as a partnership “the sole business activity of which is to issue securities which provide for a fixed principal (or similar) amount and which are primarily serviced by the cash flows of a discrete pool (either fixed or revolving) of receivables or other financial assets that by their terms convert into cash in a finite period, but only if the sponsor of the pool reasonably believes that the receivables and other financial assets comprising the pool are not acquired so as to be disposed of”).

The trust indentures for existing securitization vehicles predate FATCA, and accordingly do not authorize or require any party on behalf of the securitization vehicle to perform the actions required of FFIs. The trust indentures also do not provide a means of paying for such activities. Although it might in theory be possible for the trust indenture of an existing securitization vehicle to be amended by a vote of the investors to permit the vehicle to enter into and comply with an FFI information reporting and withholding agreement, no party is likely to be designated to initiate such an amendment process, and there can be no guarantee that investors would agree to the required changes. In addition, it may be impossible for an existing securitization vehicle to force holders of outstanding debt and equity interests to comply with applicable identification and documentation requirements that were not contemplated at the time the trust indenture was executed and the securities were issued. Furthermore, in the event that an existing securitization vehicle subjected investors to withholding under an FFI information reporting and withholding agreement, the trust indenture could allow or require the vehicle to be terminated, since withholding of this type was not anticipated. The termination of these vehicles could lead to U.S.-issued securities being disgorged into the secondary market, flooding the market with assets and depressing the prices of such securities. Finally, even for securitization vehicles created after the enactment of FATCA, it will be very difficult to draft appropriate trust indenture provisions before the regulations implementing FATCA are issued in final form and it is clear what the vehicles must do.

Although it is true that the FATCA grandfather clause will exempt all debt obligations outstanding as of March 18, 2012,²¹ from the withholding tax, the grandfather clause alone will not be enough to help existing securitization vehicles, for a number of reasons. First, existing securitization vehicles have already invested in U.S.-issued debt that may be amended after March 18, 2012, and there is ambiguity as to how amendments after that date to debt that was originated prior to

²¹ See section 501(d)(2) of the HIRE Act.

that date (and, thus, properly within the grandfather clause) would be treated if the amendment is classified as a deemed reissuance under Treasury regulations section 1.1001-3.²² Second, existing securitization vehicle indentures generally prohibit investing in new assets that would be subject to a withholding tax (and for which no exemption is available), which would effectively preclude existing securitization vehicles from investing in debt originated after March 18, 2012.²³ Third, existing securitization vehicles have invested in revolving and other debt under which draws will be made after March 18, 2012, and could become subject to the withholding tax on this basis.²⁴ In this regard, the trust indentures for some securitization vehicles could allow or require the vehicles to be terminated in the event such a withholding tax were imposed, since withholding of this type was not anticipated.

The issues discussed above that would prevent an existing securitization vehicle from complying with the FFI information reporting and withholding provisions of FATCA would also prevent an existing securitization vehicle from complying with the NFFE certification requirements, in particular because the vehicle would generally not be able to identify the indirect owners of its securities traded in the secondary market.

Finally, SIFMA believes that existing securitization vehicles pose little risk of facilitating tax evasion by U.S. persons. The investors in securitization vehicle securities are predominantly U.S. and non-U.S. banks, insurance companies, and other institutional investors, rather than the U.S. individual investors that are the target of FATCA. Moreover, interests in securitization vehicles are mainly held through U.S. financial institutions and FFIs that SIFMA anticipates will be compliant FFIs. As such, the interests in such vehicles should not escape reporting.

²² As discussed below in Comment 9, SIFMA would recommend that the regulations make clear that such a deemed reissuance would not take the debt outside of the grandfather clause.

²³ See *CLO Interest*, Moody's Investors Service, pg. 8 (May 2010) (noting this prohibition and the consequences that may result due to its interaction with FATCA).

²⁴ See also the discussion below under Comment 9.

Based on the foregoing, SIFMA would suggest that securitization vehicles in existence on the date that the FATCA regulations are issued in final form be treated as exempt from the FFI information reporting and withholding provisions of FATCA under section 1471(b)(2)(B). For securitization vehicles created after the date that the regulations are issued in final form, no special exemptions or other provisions should be necessary, as such vehicles should generally be able to build the necessary ability to comply with FATCA into their trust indentures from the beginning. As discussed above, a withholding agent should be permitted to treat a securitization vehicle as satisfying the criteria for the exemption so long as the securitization vehicle provides a certification of its qualification, in which case the withholding agent should be permitted to rely on the certification for up to three years following the year in which the certification is signed in the absence of actual knowledge or a reason to know that it is no longer correct.

Current Reporting Entities

Foreign entities and U.S. branches that are considered U.S. payors under the current information reporting rules (e.g., U.S. branches of foreign banks and controlled foreign corporations)²⁵ are already required to file full Form 1099 reports with respect to income paid to U.S. persons. In addition, foreign partnerships that derive gross income that is either U.S. source or effectively connected with the conduct of a U.S. trade or business are already required to file Form 1065 and accompanying Schedule K-1 reports, which include extensive information regarding both U.S. and foreign source income allocable to U.S. partners. SIFMA believes that the Form 1099 and Schedule K-1 information reporting regimes generally provide the IRS with sufficient tax information where they apply. As a consequence, SIFMA would suggest that FFIs be treated as exempt from the FFI information reporting and withholding provisions of FATCA under section 1471(b)(2)(B) to the extent that they are subject to these regimes, as the FATCA

²⁵ Foreign branches of U.S. entities, of course, would not be treated as FFIs or NFFEs to begin with.

legislative history indeed supports.²⁶ As discussed above, a withholding agent should be permitted to treat an FFI as subject to the exemption to the extent that the FFI provides a certification that it is exempt, in which case the withholding agent should be permitted to rely on the certification for up to three years following the year in which the certification is signed in the absence of actual knowledge or a reason to know that it is no longer correct.

Comment 3: Treat Pure Holding Companies and Small Investment Vehicles as NFFEs Rather Than FFIs

As noted above, the FFI definition is extraordinarily broad, and there are accordingly a great many entities that could need to enter into information reporting and withholding agreements with the IRS. The Department of the Treasury and the IRS have additional clear authority, however, to limit the scope of the FFI definition by limiting the definition of “financial institution.”²⁷ If invoked, this authority would generally result in an excluded entity being treated as an NFFE.²⁸ Excepting additional entities from the FFI definition, and instead treating them as NFFEs, would benefit both market participants and the IRS, by further reducing the potential for a flood of information reporting and withholding agreements, and by allowing entities that can comply with the NFFE regime, but may not be able to comply with the FFI regime, to remain in existence. To this end, SIFMA would suggest that the following entities, among others, be treated as NFFEs

²⁶ See JCT Explanation at 41 (“Such [exempt] 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.”); *cf.* section 1471(d)(1)(C) (“[U.S. account] shall not include any financial account in a foreign financial institution if . . . the holder of such account is otherwise subject to information reporting requirements which the Secretary determines would make the reporting required by this section with respect to United States accounts duplicative.”).

²⁷ See section 1471(d)(5) (“Except as otherwise provided by the Secretary, the term ‘financial institution’ means . . .”).

²⁸ See section 1472(d) (“For purposes of this section, the term ‘non-financial foreign entity’ means any foreign entity which is not a financial institution (as defined in section 1471(d)(5)).”).

rather than FFIs: (i) pure holding companies; and (ii) personal investment companies and other small investment vehicles.

Pure Holding Companies

A company organized solely to hold interests in affiliates could be viewed as an FFI, but it seems highly unlikely that such an entity could be used to facilitate tax evasion by U.S. persons. Accordingly, SIFMA recommends that the regulations carve out from the FFI definition pure holding companies, defined as companies principally organized to hold interests in subsidiaries and without their own trades or businesses, and instead treat such companies as NFFEs. As discussed above, a withholding agent should be permitted to treat a pure holding company as an NFFE so long as the holding company provides a certification of its qualification, in which case the withholding agent should be permitted to rely on the certification for up to three years following the year in which the certification is signed in the absence of actual knowledge or a reason to know that it is no longer correct.

Small Investment Vehicles

There are many personal investment companies, family investment vehicles, and other small investment vehicles that would technically qualify as FFIs, but for which there would seem to be no policy reason to apply the FFI information reporting and withholding regime rather than the NFFE certification regime (or similar certification procedures), since a certification approach should be capable of identifying to the IRS any such small investment vehicles with significant U.S. owners who might be utilizing the vehicles for tax evasion purposes. In their joint comment letter dated April 23, 2010, the EBF and the IIB suggested that such small investment vehicles be excluded from the FFI definition, and proposed that criteria along the following lines might be used to define what is small:

- (i) any FFI with 25 or fewer investors; or

- (ii) any FFI where no investor has made more than \$50,000 of contributions.

SIFMA supports the treatment of small investment vehicles as NFFEs rather than FFIs, and agrees that the criteria suggested by the EBF and the IIB would be a good starting point for defining what is small. As an alternative, however, the Department of the Treasury and the IRS might consider implementing criteria for the definition of small investment vehicle that are consistent with those used for similar bank regulatory purposes. As discussed above, a withholding agent should be permitted to treat a small investment vehicle as satisfying whatever criteria are relevant so long as the vehicle provides a certification of its qualification, in which case the withholding agent should be permitted to rely on the certification for up to three years following the year in which the certification is signed in the absence of actual knowledge or a reason to know that it is no longer correct.

Comment 4: Confirm the Treatment of Estates

In some cases, a non-U.S. estate may be treated as an entity or legal person under non-U.S. law, and may conduct investment activities for many years pending resolution. SIFMA does not believe, however, that even such a non-U.S. estate was intended to be included in the FFI definition, as such an estate would not be in the “business” of accepting deposits, holding assets, or investing or trading.²⁹ To eliminate confusion, it would be helpful if the regulations could clarify that, to the extent a non-U.S. estate is treated as an entity, it is not treated as an FFI. In addition, it would be helpful if the regulations could clarify under what circumstances a non-U.S. estate will be treated as an entity (and therefore an NFFE) for purposes of FATCA.

²⁹ See section 1471(d)(5).

Comment 5: Phase-In Application of FATCA to Existing Accounts

FATCA will require an unprecedented level of U.S. tax information gathering and reporting by foreign entities which have not previously had any U.S. tax information reporting or withholding responsibilities, as they attempt to identify and report on their U.S. accounts. In addition, FATCA will require a similar amount of effort by U.S. withholding agents as they identify which of their accounts are subject to the FATCA withholding tax (e.g., because the account is an FFI that has not certified that it is a compliant FFI, or is an NFFE that has not provided an NFFE certification). Even for a seasoned U.S. financial institution, these efforts will be time consuming and expensive. For an FFI that has no existing U.S. tax information reporting systems, complying with these provisions will be a monumental task. In either case, compliance with FATCA will require the hiring of numerous additional employees, the creation of extensive new information technology systems, and the training of large numbers of current workers. The ability of U.S. withholding agents and FFIs to engage in such efforts on a short time frame cannot be presumed.

SIFMA believes that the implementation of the necessary compliance systems for FATCA will take several years, and will require extensive testing. In order to facilitate the development and perfection of the new systems, SIFMA recommends that the regulations provide phase-in periods for both U.S. withholding agents and FFIs.³⁰ For U.S. withholding agents, SIFMA would suggest that non-U.S. accounts in existence on the FATCA effective date be phased in over a 3-year period, so that a U.S. withholding agent would be required to identify 1/3 of its existing non-U.S. accounts per year for each year after such date, until all accounts had been identified 3 years after the effective date. For FFIs, SIFMA would suggest that accounts in existence on the FATCA effective date be phased in over a 5-year period,

³⁰ The Department of the Treasury and the IRS should have authority to implement such phase-in periods under their general FATCA regulatory authority, *see* section 1474(f) (“The Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the purposes of, and prevent the avoidance of, this chapter.”), as well as under the other provisions noted herein which allow the Department of the Treasury and the IRS to limit the withholdable payment and FFI definitions.

so that an FFI would be required to identify 20 percent of its existing accounts per year for each year after such date , until all accounts had been identified 5 years after the effective date. Prior to identifying an existing account (as a compliant FFI account, a U.S. account, a non-compliant NFFE account, etc.) in accordance with the phase-in, a U.S. withholding agent or FFI would not be required to perform any FATCA information reporting or withholding with respect to such account. In order to prevent clients from arbitraging the phase-in rules, SIFMA would also suggest that the regulations provide a single required objective methodology for picking the accounts to be phased in. One potential methodology would be to phase in accounts by account creation date. In either case, the phase-in period would not apply to accounts created after the FATCA effective date. These new accounts would become subject to applicable FATCA requirements as they are created.

It should be noted that the above proposal assumes that final regulations and a model FFI information reporting and withholding agreement are released well in advance of the FATCA effective date. If there are delays, it may be necessary to consider additional phase-in periods, and/or a general postponement of the FATCA effective date.

Comment 6: Allow Use of a Common Service Provider by Withholding Agents and FFIs

Regardless of whether the IRS adopts certification procedures, objective due diligence requirements, or other methods of establishing and verifying which category a given recipient of a payment falls into under the statutory regime, FATCA will require a great deal of additional data collection by withholding agents and FFIs in order to classify recipients as FFIs, NFFEs, or U.S. accounts. To make this process more manageable, SIFMA recommends that the regulations expressly provide for the optional use of a common service provider by multiple U.S. withholding agents and FFIs for identifying FFIs, NFFEs, and U.S. accounts, and specifically allow such withholding agents and FFIs to share information through such a common service provider for this purpose. U.S. information reporting and

withholding agents currently use common service providers for similar purposes.³¹ Given the very extensive new requirements imposed by FATCA, it will be even more important for U.S. withholding agents and FFIs to leverage such shared identification mechanisms in the future.

In general, SIFMA contemplates that FFIs, NFFEs, and account holders would deal directly with the common service provider, and provide applicable information and documentation directly to the common service provider. SIFMA also contemplates that the system would be subject to similar rules to ensure reliability as apply under the existing nonresident withholding rules.³²

**Comment 7: The \$50,000 De Minimis Threshold for Depository
Accounts Held by Individuals Should Be Applied on a Non-
Aggregated Basis**

FATCA provides a \$50,000 de minimis threshold under which a depository account held by an individual may be excluded from the U.S. account definition and treated as exempt from FFI information reporting and withholding.³³ In applying the threshold, however, the Department of the Treasury and the IRS are permitted (but not required) to aggregate all accounts throughout an FFI's expanded affiliated group.³⁴

³¹ Cf. Treasury regulations section 1.1441-1(e)(4)(ix)(A)(4) (providing for the use of common account databases).

³² See Treasury regulations section 1.1441-1(e)(4)(ix)(A)(4) (generally requiring (i) that a common system permit any withholding agent that uses the system to easily access data regarding the nature of documentation, the information contained in the documentation, and its validity; and (ii) that a withholding agent be able to easily transmit data into the system regarding any facts of which it becomes aware that may affect the reliability of the documentation).

³³ See section 1471(d)(1)(B)(ii).

³⁴ See section 1471(d)(1)(B) (flush text) ("To the extent provided by the Secretary, financial institutions which are members of the same expanded affiliated group shall be treated for purposes of clause (ii) as a single financial institution.").

SIFMA believes that it would not be practical or perhaps legal in certain jurisdictions for FFIs to collect the information necessary to aggregate the value of all depositary accounts across their expanded affiliated groups for purposes of applying the de minimis test. In this regard, the expanded affiliated group of a large FFI may include hundreds of different branches, business entities, and segments, located in numerous jurisdictions. FFIs do not currently maintain systems that can aggregate account information across such branches, business entities, and segments. The creation of such systems would be extremely expensive and difficult to implement and, even if the construction of such systems were practically achievable, their use may be impermissible under U.S. and non-U.S. securities, data protection, and other laws.³⁵ As a consequence, SIFMA would suggest that the de minimis threshold generally be applied on a non-aggregated basis, and that potential abuse concerns be addressed with a targeted anti-abuse rule that aggregates accounts that have been structured to avoid the purposes of FATCA.

Comment 8: Develop Workable Rules for FFI Election to Be Withheld Upon

FATCA allows an FFI to elect to be withheld upon rather than to itself comply with the FATCA withholding requirements in certain circumstances.³⁶ In their joint comment letter dated April 23, 2010, the EBF and the IIB noted that it may not be practical for an FFI to exercise the election to be withheld upon in all cases, because the entity that would need to process payments for the electing FFI (either a U.S. withholding agent or another FFI) may not have sufficient information regarding the transactions giving rise to the withholding obligation. As a

³⁵ For example, the sharing of relevant information may be prohibited under the so-called “Chinese Walls” required under U.S. securities laws. *See, e.g.*, 15 U.S.C. 78o(f) (2006) (requiring broker-dealers to adopt policies and procedures designed to prevent insider trading and tipping); 15 U.S.C. 80b-4a (2006) (requiring investment advisors to establish policies and procedures reasonable designed to prevent insider trading and tipping).

³⁶ *See* section 1471(b)(3).

consequence of this and other factors, the EBF and the IIB suggested that the regulations clearly specify how such an election would work and what effect it would have, and further recommended that the election be permitted only with the agreement of the entity that would process the withholding. The EBF and the IIB also noted that, under the terms of the election set forth in the Code, the electing FFI must waive any right under any U.S. tax treaty with respect to the amount to be deducted and withheld,³⁷ and suggested that this requirement would likely render the election useless if it meant that an FFI was required to give up another person's entitlement to treaty relief. As a consequence, the EBF and the IIB suggested that, if such was not what was intended by the statutory language, the regulations should clearly say what was intended. SIFMA supports the comments made by the EBF and the IIB regarding the FFI election to be withheld upon, and recommends that the regulations be developed in accordance with those comments.

Comment 9: Clarify Grandfather Rule for Existing Obligations

FATCA withholding taxes will generally apply to withholdable payments made after December 31, 2012,³⁸ except that withholding is not required for payments in respect of obligations outstanding on March 18, 2012.³⁹ The term "obligation" is not defined, and is in particular not expressly limited to debt instruments.

The purpose of the grandfather rule is to preserve, to the maximum extent possible, parties' expectations in respect of existing transactions and relationships. As such, SIFMA recommends that the term "obligation" be defined for purposes of the grandfather rule to include any obligation under a contract with a final maturity or termination date. This would include debt obligations, as well as

³⁷ See section 1471(b)(3)(C)(ii).

³⁸ See section 501(d)(1) of the HIRE Act.

³⁹ See section 501(d)(2) of the HIRE Act.

obligations under securities loans, repos, notional principal contracts, and professional services contracts, among other things.

The regulations should also clarify how the grandfather rule is to be applied with respect to transactions entered into under ISDA Master Agreements, Master Repurchase Agreements, Master Securities Lending Agreements, lending facilities providing for periodic issuances of loans, letters of credit, and other instruments, and other “framework” agreements under which multiple transactions may occur at different times. In a situation where both the framework agreement and the particular transaction are entered into on or before March 18, 2012, of course, SIFMA would anticipate that the transaction would be covered by the general rule for contracts entered into on or before March 18, 2012. In addition, however, SIFMA would suggest that, even where the particular transaction is entered into after March 18, 2012, the timing of the particular transaction should be ignored, and the transaction treated as within the grandfather rule, so long as the framework agreement was entered into on or before March 18, 2012, and has a final maturity or termination date no later than December 31, 2016.

In addition, consistent with the suggestion in the legislative history, SIFMA would recommend that the regulations make clear that a deemed reissuance of debt under Treasury regulations section 1.1001-3 will not take a debt instrument out of the grandfather clause if it would otherwise have been within it.⁴⁰

Finally, SIFMA would also suggest that “payments in respect of” an obligation be defined to include any payments paid by reference to an obligation.⁴¹ In particular, where the obligation in question is a loan, “payments in respect of” the obligation should include both payments of interest and principal, as well as

⁴⁰ See JCT Explanation at 49 (“It is anticipated that the Secretary may provide guidance as to the application of the material modification rules under section 1001 in determining whether an obligation is considered to be outstanding on the date that is two years after the date of enactment.”).

⁴¹ Cf. Treasury regulations section 1.892-3T(a)(1)(i) (providing an exemption under section 892 for “income from” investments in the United States in stocks, bonds, or other securities).

commitment fees, facility fees, amendment fees, and other common types of compensation typically paid to lenders in respect of loans.

Comment 10: Clarify Passthru Payment Definition

FATCA requires an FFI to withhold on passthru payments in some circumstances.⁴² For this purpose, a passthru payment is defined under FACTA as a withholdable payment or other payment to the extent attributable to a withholdable payment.⁴³ Thus, a withholdable payment that is received by an FFI but owned and paid to another person would result in a passthru payment. These types of cascading payments are common where a payment on a U.S. security passes through multiple nominee holders in the chain of ownership and FFIs should be able to determine when and how much to withhold from such payments. In contrast, SIFMA members are very concerned about the meaning and application of the phrase “to the extent attributable to a withholdable payment.” Absent needed clarification, this language could conceivably apply to any debt of an FFI or any equity interest in an FFI that is not treated as a passthrough entity (i.e., a foreign corporation) for U.S. tax purposes to the extent the FFI derives its income from a withholdable payment.

SIFMA urges the Department of the Treasury and the IRS to carefully consider how to clarify the definition of the term passthru payment so that it is applied in a clear and reasonable manner. If the term were to include payments made on debt or equity interests issued by an FFI that is not treated as a passthrough entity for U.S. tax purposes, withholding agents would need to know how much of such payments should be attributed to underlying withholdable payments received by the FFI, which information may not be readily available and the proportionality of amounts attributable to a withholdable payment could change with each payment on the issuer’s securities. SIFMA members seriously doubt that

⁴² See section 1471(b)(1)(D).

⁴³ See section 1471(d)(7).

this would be workable in the global process of collecting income on securities and passing it on to the ultimate owners.

To remedy this problem, SIFMA recommends that the Department of the Treasury and the IRS exclude certain “indirect” passthru payments from FATCA withholding. Thus, a passthru payment would include (i) payments made by an FFI acting in a custodial capacity with respect to underlying withholdable payments, (ii) payments made by an FFI that is treated as a passthrough entity for U.S. tax purposes with respect to underlying withholdable payments, and (iii) payments made by an FFI that are directly contractually allocable to underlying withholdable payments (“direct passthru payments”). However, payments made by an FFI that may in some indirect sense be attributable to withholdable payments received by the FFI (“indirect passthru payments”) should be excluded from the definition of passthru payment. An example of an indirect passthru payment would be a payment made on non-traded debt of a corporate FFI where some portion of the FFI’s general revenues consists of withholdable payments. For a direct passthru payment, SIFMA believes that it should be reasonably possible to determine the portion of the payment that is properly allocable to underlying withholdable payments, and to treat that portion as a passthru payment subject to FATCA withholding. For an indirect passthru payment, on the other hand, it would be very difficult to determine what portion, if any, of the payment is properly allocable to underlying withholdable payments. This will be particularly true where payments are made through tiers of financial intermediaries and the allocation information would need to be made public by the recipient of the underlying withholdable payment, and revised when it changes, or otherwise passed down through the chain of financial intermediaries. In addition, SIFMA would recommend that the passthru payment definition be amended to exclude a payment made by an FFI that is attributable to a withholdable payment that is exempt from FATCA requirements. One circumstance in which this clarification would be relevant would be with respect to passthru payments attributable to underlying withholdable payments on obligations that benefit from the grandfather clause (since the grandfather clause

does not itself exclude payments on grandfathered obligations from the withholdable payment definition, and passthru payments in respect of such underlying payments could otherwise be subject to FATCA withholding).

Finally, SIFMA would also suggest that, in situations where an FFI is generally exempt from FATCA requirements (e.g., under section 1471(b)(2)(B)), the passthru payment definition be amended to exclude any payments made by that FFI or other FFIs that are directly or indirectly attributable to withholdable payments received by the exempt FFI. Otherwise, a payment made by an FFI at the end of a long chain of payments could perhaps be treated as a passthru payment on the basis of a withholdable payment received by an exempt FFI at the start of the chain, which would eliminate the benefit of the exemption.

Comment 11: Clarify Gross Proceeds Definition

As noted above, SIFMA believes that the implementation of the necessary compliance systems for FATCA will require the hiring of numerous additional employees, the creation of extensive new information technology systems, and the training of large numbers of current workers. One way in which the Department of the Treasury and the IRS could facilitate this process would be to coordinate the FATCA rules, to the extent possible, with existing withholding and information reporting requirements, so that U.S. withholding agents and FFIs can leverage their existing systems. Although SIFMA expects to make additional specific suggestions along these lines in future comments, one extremely important idea that it has identified would be to coordinate the definition of gross proceeds under FATCA with the gross proceeds that are currently subject to broker reporting under section 6045.

“Withholdable payments” under FATCA include U.S. source dividends, interest (including original issue discount), and other “fixed or determinable annual or periodical” income, as well as any gross proceeds from the disposition of property that can produce U.S. source interest or dividends. The term “gross proceeds” is not specifically defined in FATCA. Under current law, brokers are

required to file information returns in respect of certain gross proceeds payments, and have developed extensive compliance systems to perform this function.⁴⁴ As a consequence, SIFMA would suggest that the definition of gross proceeds for purposes of FATCA be conformed to the definition of gross proceeds under section 6045, excepting items of gross proceeds that are not subject to reporting thereunder (which existing compliance systems of course exclude).⁴⁵ Consistent with this approach, SIFMA would further suggest that a payment only be treated as gross proceeds of a disposition if the disposition constitutes a reportable sale under the section 6045 regulations.⁴⁶

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,

A handwritten signature in black ink, reading "N. Ellen McCarthy". The signature is written in a cursive, flowing style.

N. Ellen McCarthy
Managing Director
Securities Industry and Financial Markets Association

⁴⁴ See section 6045.

⁴⁵ See Treasury regulations section 1.6045-1(d)(5) (definition of gross proceeds); Treasury regulations section 1.6045-1(c)(3) (exceptions from reporting).

⁴⁶ See Treasury regulations section 1.6045-1(a)(9) (definition of “sale”).