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RE: SIFMA Follow-Up Comments from July 15 Meeting

Ladies and Gentlemen,

The Securities Industry and Financial Markets Association ("SIFMA")¹
appreciated having the opportunity to meet with representatives of the Department

¹ The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to

of the Treasury and the Internal Revenue Service (“IRS”) on July 15, 2011, regarding the regulations that are being developed to implement the provisions of the Foreign Account Tax Compliance Act (“FATCA”) that were included in section 501 of the Hiring Incentives to Restore Employment Act (the “HIRE Act”).

SIFMA shares the objectives of FATCA in improving offshore tax compliance. SIFMA also welcomes many of the approaches to the FATCA regulations that are outlined in Notice 2010-60, Notice 2011-34, and Notice 2011-53. In the remainder of this letter, SIFMA comments on the following topics to follow up on matters discussed during our July 15 meeting.² The goal of these comments is to assist the Department of the Treasury and the IRS in crafting regulations that are effective in accomplishing FATCA’s goals, are commercially viable, and will not unnecessarily disrupt the operations of the financial markets.

(1) *Transition Rules and Related Matters*

- (a) Although the general delays in the application of FATCA proposed in Notice 2011-53 are welcome accommodations of industry concerns, the transition timeframe should be modified so that the first required information reporting under FATCA would be due in March 2015 based on 2014

support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.

² On August 11, 2010, SIFMA submitted comments regarding various aspects of the FATCA regulations, in response to Announcement 2010-22 and Announcement 2010-34. Thereafter, on October 29, 2010, and June 7, 2011, SIFMA submitted comments in response to Notice 2010-60 and Notice 2011-34, respectively.

year-end account balances, and the first required withholding under FATCA would occur in January 2015.

- (b) The regulations should confirm that all of the other exemptions and procedures in Notice 2010-60 and Notice 2011-34 will continue to apply to the extent that they would extend any required information reporting or withholding date, and should also better coordinate such other exemptions and procedures with the transition timeframe.
- (c) The special transition rules for high-value and private banking accounts should be limited to high-value accounts only.
- (d) Other technical comments.

(2) *Passthru Payments*

The proposed passthru payment percentage (“PPP”) approach should be limited to payments made by investment fund foreign financial institutions (“FFIs”) to their owners. For other FFIs, passthru payments should initially be limited to payments that are structured as a fixed percentage of underlying withholdable payments. In implementing the PPP approach for investment fund FFIs, the Department of the Treasury and the IRS should also consider a number of refinements and clarifications to the PPP rules outlined in Notice 2011-34.

(3) *Securitization Vehicles*

It is critical that the regulations treat securitization vehicles as deemed compliant FFIs (“DCFFIs”).

(4) *Short-Term Debt*

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

(5) *Other Technical Comments*

Comment 1: Transition Rules and Related Matters

SIFMA recognizes that the transition rules proposed in Notice 2010-60, Notice 2011-34, and Notice 2011-53 were intended to strike a balance between FATCA’s compliance goals and the very heavy compliance burdens that will be imposed on FFIs and U.S. financial institutions (“USFIs”) in order to implement FATCA. SIFMA also appreciates the general delays in the first required FATCA information reporting and withholding proposed in Notice 2011-53, which will assist FFIs and USFIs in creating the extensive compliance systems that will be necessary to implement FATCA. Nonetheless, SIFMA believes that the currently proposed transition rules remain insufficient to avert significant disruptions to the international financial markets, and continue to reflect overly optimistic assumptions regarding the ability of FFIs and USFIs to implement FATCA’s mandates in a short time frame after implementing regulations are issued.

Consistent with SIFMA’s prior comments and the discussion at the

July 15 meeting, SIFMA makes the following further comments with respect to transition rules and related matters:

- (i) Pursuant to Notice 2011-53, the first required information reporting under FATCA in respect of new accounts, documented U.S. accounts, and private banking accounts would generally be delayed until September 2014, and would be based on 2013 year-end balances. While this delay is a welcome development, SIFMA does not believe that the proposed transition timeframe will be sufficient to give FFIs and USFIs the time that they will need to develop necessary compliance systems. To give FFIs and USFIs this needed time, the transition timeframe should be adjusted so that the first information reporting under FATCA, for any account, would occur in March 2015 (rather than September 2014), based on 2014 (rather than 2013) year-end balances (but subject to further delay based on the exemptions and procedures in Notice 2010-60 and Notice 2011-34, as discussed below). The additional delay in information reporting would be only 6 months, but the effect would be to give FFIs and USFIs 2 full years to implement their FATCA compliance systems (assuming final regulations are issued in 2012), which SIFMA believes is the minimum necessary. And, notwithstanding the delay, the IRS would benefit from 2 full years of FFI and USFI efforts to identify U.S. accounts. In this regard, SIFMA does not believe that FFIs or USFIs should generally require more than 3 months after an applicable year-

end in order to do FATCA information reporting with respect to that year, and that it would be very beneficial to have the FATCA information reporting deadline occur at the same time as the deadline for Chapter 3 information reporting.

- (ii) Notice 2011-53 would similarly delay the first required withholding under FATCA to January 2014, and this first withholding would be limited to payments of U.S. source FDAP. Withholding in respect of other types of withholdable payments, as well as passthru payments that are not themselves payments of U.S. source FDAP, would then commence in January 2015. Consistent with its suggestion above regarding information reporting, SIFMA suggests that the first required withholding in respect of U.S. source FDAP payments under FATCA begin in January 2015 (rather than January 2014), with withholding on other withholdable payments and passthru payments beginning in January 2016 (rather than January 2015) (and, again, subject to further delay based on the exemptions and procedures in Notice 2010-60 and Notice 2011-34, as discussed below). In this regard, SIFMA would also strongly suggest that the initial withholding in respect of U.S. source FDAP payments in January 2015 be limited to U.S. source FDAP payments that are currently subject to withholding under the Chapter 3 withholding rules,³ in order to allow FFIs and

³ See, e.g., Treasury regulations section 1.1441-2(a)(2) (exempting payments of interest or OID on bank deposits); Treasury regulations section 1.1441-2(a)(3) (exempting payments of interest or OID on short-term obligations); Treasury regulations section 1.1441-2(a)(6) (exempting payments in respect of OID other than in a redemption); Treasury regulations section 1.1441-2(b)(2)(i)

USFIs to leverage their existing systems to the maximum possible extent.

- (iii) Under the transition timeframe proposed above, all FATCA information reporting and withholding would be based on full calendar years and January 1 start dates, rather than partial years beginning at a mid-year date (which would be possible under the transition timeframe proposed in Notice 2011-53). SIFMA strongly believes that having January 1 start dates for all FATCA obligations will greatly aid FFIs and USFIs in implementing needed compliance systems at the least cost and ensuring accurate FATCA information reporting and withholding.
- (iv) The transition timeframe proposed above would also apply consistent first-possible-reporting dates to all accounts, both preexisting and newly formed. Again, SIFMA strongly believes that having uniform first-possible-reporting dates for all accounts will greatly aid FFIs and USFIs in implementing needed compliance systems at the least cost and ensuring accurate FATCA information reporting.
- (v) The transition timeframe proposed above would also give FFIs and USFIs a 1-year information reporting shakeout period before any FATCA withholding would be required on new types of payments (i.e., payments other than payments of U.S. source FDAP that are already subject to Chapter 3 withholding). SIFMA believes that this 1-year

(treating gains from the sale of property as non-FDAP, and thus generally exempting payments of gross proceeds of a sale that are not attributable to OID, with limited exceptions).

difference will be very important in allowing FFIs and USFIs to focus on their first-year information reporting requirements without the distraction of needing to implement withholding on the new sorts of payments to which FATCA withholding will apply. As discussed in its prior comments, SIFMA also believes that this additional time will give FFIs and USFIs an opportunity to explore and evaluate how extensive and pervasive the special FATCA withholding systems will need to be, which may help them avoid large and unnecessary compliance costs.

- (vi) In implementing the transition timeframe proposed above, the regulations should confirm that all of the other exemptions and procedures in Notice 2010-60 and Notice 2011-34 will continue to apply to the extent that they would extend any required information reporting or withholding date, and should also more generally coordinate such other exemptions and procedures with the transition timeframe. It appears that while the clear intent of Notice 2011-34 was to provide for a general delay in all reporting and withholding deadlines, earlier IRS guidance in certain circumstances actually would relax deadlines further and more appropriately. For example, under Notice 2010-60, if a participating FFI's (PFFI's) initial examination of its accounts reveals that a customer's name clearly indicates that the customer is an FFI, the PFFI is supposed to ask the customer to provide an FFI EIN and a certification that the customer is also a PFFI; if not received, the PFFI is required (within 1 year of its

agreement coming into effect) to request documentation from the customer confirming the customer's status. If that documentation is not received within 1 year of the request, the PFFI is required to treat the customer as a non-participating FFI. Thus, withholding would apply to the account, but the withholding generally couldn't apply until at least 2015 under Notice 2010-60, which would be after the general first required withholding date (January 2014) under Notice 2011-53. SIFMA believes that Notice 2011-53 should not be read to require withholding in this example earlier than would have been required under Notice 2010-60, since Notice 2011-53 expressly references applying the rules of Notice 2010-60 and Notice 2011-34 several times in describing the newly proposed general delay in FATCA information reporting and withholding. It would be helpful, however, if this point could be expressly confirmed, and if the various rules could be more generally clarified. In order to avoid further increasing compliance costs, SIFMA would suggest that the best way to coordinate the rules would be to preserve the general concepts of the exemptions and procedures in Notice 2010-60 and Notice 2011-34 (subject, of course, to SIFMA's other comments), while ensuring that delays are built into the rules on a general basis. Thus, with respect to the rule in Notice 2010-60 noted above, withholding would initially have been delayed until 2015 under Notice 2010-60 rather than the 2013 date that would have applied under the default timeframe in the FATCA statute. If FATCA withholding is generally

delayed until 2016 in accordance with SIFMA's transition timeframe proposed above, the rule noted above should be clarified to result in a delay in withholding until 2018.

- (vii) As discussed during the July 15 meeting, SIFMA's proposed transition timeframe is premised, like the transition timeframe proposed in Notice 2011-53, on the issuance of final FATCA regulations during the summer of 2012. To the extent that the FATCA regulations are finalized later, it will be critical that all start dates be postponed by at least 1 full year for every year or portion of a year by which the final regulations are delayed. Thus, if the regulations are not finalized until the fall of 2012, the transition timeframe proposed above would need to be adjusted so that the first information reporting under FATCA, for any account, would occur in March 2016 based on 2015 year-end account balances. If the final regulations do not arrive during the summer of 2012, it will simply not be possible for FFIs and USFIs to implement the necessary compliance systems even on SIFMA's proposed transition timeframe described above, and such timeframe will need to be further delayed to prevent significant disruptions to the international financial markets.
- (viii) In this regard, the Department of the Treasury and the IRS should be aware that implementing FATCA compliance systems will require many complex tasks, including but not limited to: (1) designing and constructing relevant IT systems; (2) enhancing account on-boarding procedures; (3) enhancing electronic databases of static account data

and developing search queries; (4) educating sales forces as well as numerous personnel in legal, compliance, operations, and technology support functions; and (5) developing and implementing client communications strategies. For the most part, FATCA will require that larger FFIs and USFIs implement these tasks on a global basis, involving systems and personnel on a mass scale with respect to business units and back offices around the globe. Completing all of these tasks for such a global FFI or USFI will take a very significant amount of time. Indeed, based on information from its members, SIFMA believes that just the first of the five tasks noted above, designing and constructing the relevant IT systems, may take a large FFI or USFI 1.5 years or more.

- (ix) In addition, as discussed in SIFMA's prior comments and at the July 15 meeting, very few of these tasks can be undertaken in an efficient or meaningful way until the final regulations are issued—it will not be possible to do most aspects of FATCA implementation piecemeal. In particular, it will simply not be possible even to start significant implementation until critical holes in the guidance to date have been filled, including but not limited to: (1) clarification of who the relevant withholding and/or reporting agent is in multiple agent situations; (2) clarification of the definition of financial account, including relevant exceptions; (3) clarification of the definition of withholdable payment, including relevant exceptions; (4) clarification of the treatment of trusts; and (5) clarification of the reporting duties of USFIs. In this

respect, FATCA is fundamentally different from the recent cost basis regulations, which were an addition to the existing U.S. payor reporting rules and for which the general scope was both much more tightly focused and much more developed by the time that regulations were issued. FATCA is a new, incredibly sweeping regime of information reporting and withholding, which will apply to many payments and entities that have not previously been subject to any similar requirements. Moreover, FATCA is in some respects fundamentally a due diligence / documentation process. Performing due diligence based on an incomplete proposed set of rules would be entirely pointless, as the whole process would need to be repeated if the final rules made any changes that required analysis of different criteria, documents, etc. Stated another way, FFIs and USFIs will be unwilling to commit significant resources to implementation efforts until the Department of the Treasury and the IRS provide assurance that there will be no further changes that would require redoing prior work.

- (x) The transition rules outlined in Notice 2011-34 and Notice 2011-53 would require an FFI to apply additional compliance measures with respect to preexisting “private banking accounts” as well as preexisting high-value accounts, including a very laborious “diligent review” of both paper and electronic account files and other records

held with respect to such accounts.⁴ SIFMA understands the special relevance of private banking accounts in the FATCA context, and generally appreciates the fact that the transition rules attempt to focus FFI compliance efforts on the accounts that are most likely to raise the issues that FATCA was designed to address. As discussed in its prior comments and at the July 15 meeting, however, SIFMA continues to believe that the identification of “private banking accounts” under the proposed definition would require enormous efforts, and that subjecting preexisting “private banking accounts” to additional compliance measures would not produce any substantial benefits for the U.S. government beyond those that will arise as a result of requiring the noted additional compliance measures with respect to preexisting high-value accounts. This is because the traditional “private banking” business services only high-value accounts with a threshold value well in excess of \$500,000.⁵ Under the very broad definition of “private banking account” in Notice 2011-34, however, SIFMA believes that the number of accounts with a

⁴ See Section I.A.2 of Notice 2011-34 (Steps 3 and 5). The rules do not define “diligent review”. For this purpose, a high-value account would generally be an account containing \$500,000 or more, and a “private banking account” would generally be any account that is maintained or serviced (i) by a private banking department; or (ii) as part of a private banking relationship (generally a relationship in which one or more of the FFI’s officers or employees are assigned to provide personalized services to individual clients that are not generally provided to account holders or to gather information about a client’s personal, professional and financial histories in addition to the information ordinarily gathered with respect to the FFI’s retail customers). Accordingly, the definition of “private banking account” may include accounts not held in a traditional or formal private banking department.

⁵ In this regard, \$1 million would probably be a more traditional cut-off for a private banking account, but SIFMA does not believe that the difference would be material in terms of compliance burdens.

threshold value below \$500,000 that would qualify as “private banking accounts” would be enormous (running into many millions of accounts for even a single large FFI), and that extending any significant additional compliance burdens to such accounts would multiply the FATCA compliance costs of FFIs many times beyond what they otherwise would be.

- (xi) During the July 15 meeting, the Department of the Treasury and the IRS mentioned one potential benefit to the U.S. government of imposing additional compliance burdens on “private banking accounts” with a threshold value below \$500,000, which is that such a rule would avoid situations where a true private banking relationship with a threshold value of at least \$500,000 would escape additional compliance burdens as a result of being split up into several related accounts with individual values below that level. Rather than solve this problem by subjecting very large numbers of accounts with values below \$500,000 to more rigorous but very costly additional compliance burdens, SIFMA suggests that the noted concern could be adequately addressed with a limited rule that simply aggregates all accounts maintained under a single private banking relationship for purposes of the \$500,000 threshold. Such a rule would be much easier for FFIs to implement, and would achieve substantially the same goal.
- (xii) Where an additional “diligent review” of account files is required for a high-value account, SIFMA would further suggest that FFIs should be

given the choice of either (1) doing a search that is limited to electronic account files, if those files meet certain criteria; (2) doing a search of both paper and electronic account files (as proposed in Notice 2011-34); or (3) simply obtaining definitive documentation from account holders. For this purpose, SIFMA recommends that electronic account files should qualify for option (1) if they reflect the name, citizenship, residence, and mailing address of each beneficial owner of each account. With regard to the three choices, SIFMA has found that certain of its members prefer each of the three approaches in their individual circumstances. Since each approach should produce substantially the same result from the perspective of the U.S. government, allowing different FFIs to choose their preferred approach should allow FFIs to reduce their compliance costs without undermining the purpose of the additional compliance rule for high-value accounts.

- (xiii) As discussed at the July 15 meeting, where searches of paper account files is required, SIFMA recommends that the transition rules confirm that only recent documents need be searched (e.g., documents no more than 5 years old), and that any search need only extend to documents that are relevant to determining an account holder's name, citizenship, residence, or mailing address. Such a confirmation would materially reduce the cost of creating and implementing necessary FFI compliance systems.

Comment 2: Passthru Payments

Notice 2011-34 contains a broad definition of passthru payment that is based on a straight percentage asset allocation method. Under this definition, all payments made by an FFI (other than payments made in its capacity as a custodian) that are not otherwise “withholdable payments” would be deemed to be passthru payments to the extent of the FFI’s “passthru payment percentage” or “PPP”. PPP is defined as the ratio of the FFI’s U.S. assets to its total assets, with look-through rules for cases where an FFI holds interests in another “lower tier” FFI.⁶ Custodial payments with respect to an interest in another FFI would be treated as passthru payments based on the issuer’s PPP.⁷ This broad definition of passthru payment means that a PFFI could be required to withhold U.S. tax on payments made to non-U.S. customers if those customers do not provide all of the requested information or refuse to waive certain local privacy law restrictions. In fact, a PFFI may have an existing contractual obligation to gross-up its customers or counterparties for any U.S. tax withheld, and therefore the PFFI, rather than the uncooperative recipient, would bear the economic burden of the withholding. Similarly, a PFFI may be required to withhold U.S. tax on payments made in the ordinary course of business to other financial institutions, for example on interbank deposits, repos, swaps, and possibly commercial paper, if the recipient is an FFI that is not a PFFI (an “NPFFI”). Again, the PFFI may be contractually required to gross-up the NPFFI for any U.S. tax withheld.

⁶ See Sections II.A and II.B of Notice 2011-34.

⁷ See Section II.C of Notice 2011-34.

As discussed in SIFMA's prior comments and at the July 15 meeting, the definition of passthru payment proposed in Notice 2011-34 may be workable and appropriate, subject to certain refinements, with respect to payments that (i) are made by an FFI to the holder of an ownership interest therein; where (ii) the FFI is described in section 1471(d)(5)(C) (i.e., a vehicle that is primarily designed to hold assets and pass the returns thereon to investors) (an "investment fund FFI"). With respect to other payments, however, particularly payments made by FFIs engaged in active financial businesses (e.g., deposit taking, brokerage, securities and derivatives dealing, etc.), SIFMA continues to strongly believe that the proposed definition both is unworkable and exceeds the authority of the Department of the Treasury and the IRS under the FATCA statutory language because it would impose withholding on payments that are not "attributable to" withholdable payments.

Furthermore, as discussed at the July 15 meeting, the extensive scope of potential passthru payment withholding proposed in Notice 2011-34 appears to have caused many FFIs to reevaluate their willingness to become PFFIs.

The proposed passthru payment withholding would apply to payments that FFIs (and all traditional tax analysis) regard as non-U.S. source and beyond the legitimate jurisdiction of the U.S. government. In addition, the proposal would create a completely unlevel playing field among PFFIs with different PPPs as well as between PFFIs and USFIs. Regarding the latter point, whereas a PFFI with U.S. assets could be required to withhold on practically any payment that it made (e.g., payments under interest rate swaps), a USFI would be able (under current law) to make many of the very same payments without any FATCA or other

withholding. This difference has been well noted, and is particularly objectionable to FFIs. More generally, however, both USFIs and FFIs believe that the inherent lack of a level playing field among PFFIs with different PPPs as well as between PFFIs and USFIs will encourage customers, particularly in derivative transactions, to shop for a dealer that is a USFI or is a PFFI with the lowest PPP. Such “counterparty shopping” may occur even among PFFI customers, as they try to minimize their own PPPs by preferring transactions with PFFIs with low PPPs (and in this case avoiding transactions with USFIs). All of SIFMA’s members, both USFIs and FFIs, deplore the potential for such uneconomic, tax-driven factors to drive what should be solely business decisions.

As a consequence of the extensive and inherently non-even-handed nature of the potential passthru payment withholding proposed in Notice 2011-34, SIFMA has received several anecdotal accounts that FFIs with limited connections to the United States (e.g., solely investments in U.S. Treasury securities) are actively considering forming large blocks of FFIs that will (1) not invest in any U.S. securities; (2) not become PFFIs; and (3) only engage in transactions with other FFIs that similarly completely divest themselves from the United States and do not become PFFIs. As a practical matter, it would also be possible for such blocks of NPFFIs to deal with USFIs (under current law) or with PFFIs that have very low PPPs, since in each case there would be no or minimal withholding. This fact underscores the very real possibility that such blocks of NPFFIs will indeed be able to arise and be viable. SIFMA cannot conceive how it is in the interest of the U.S. government to discourage FFIs from becoming PFFIs, and believes that a more

restrained definition of passthru payment that is in accordance with the FATCA statutory language would greatly alleviate the concerns that are driving FFIs to contemplate a boycott of the PFFI program.

Consistent with the anecdotal evidence of growing FFI resistance to the passthru payment withholding proposal contained in Notice 2011-34, SIFMA's members have also already observed a significant chilling effect in the markets with respect to transactions that could become subject to such withholding. Parties are already avoiding such transactions, and engaging in extensive commercial and legal negotiations regarding the allocation of the risk of such withholding where it cannot be avoided. As a result, commercially beneficial transactions are being sidelined or delayed, solely because of the U.S. government's actions. Once again, SIFMA believes that a more restrained definition of passthru payment that is in accordance with the FATCA statutory language would reduce the economic destruction that the U.S. government is already causing.

As a general matter, SIFMA believes that a more reasonable passthru payment definition should fulfill each of the following criteria: (1) be consistent with the FATCA statutory language; (2) have a clear, bright-line rule set; (3) be tailored narrowly to capture only those types of payments that the Department of the Treasury and the IRS believe pose a high risk of tax evasion; (4) allow the simplest possible implementation from a systems perspective; (5) encourage compliance; and (6) ensure a level playing field. Consistent with these goals, the suggestions in SIFMA's prior comment letters, and the discussion at the July 15 meeting, and the

discussion above, SIFMA makes the following further comments with respect to the definition of passthru payment:

- (i) Consistent with SIFMA's prior comments, the proposed PPP approach should be limited to payments that (1) are made by an FFI to the holder of an ownership interest therein, where (2) the FFI is an investment fund FFI described in section 1471(d)(5)(C).
- (ii) To the extent that the Department of the Treasury and the IRS determine that passthru payment withholding needs to apply to payments by FFIs in addition to those described above, particularly payments made by an FFI engaged in an active financial business, the passthru payment definition should initially be limited to payments that are structured as a fixed percentage (i.e., on a "delta-1" basis) of underlying withholdable payments (whether or not actually received by the FFI, but including, of course, withholdable payments received and passed on by the FFI in a custodial capacity). The Department of the Treasury and the IRS should then observe the operation of the definition over at least a few years before considering whether any other types of payments might be properly added to the definition in the case of non-investment-fund FFIs. Regarding its proposal, SIFMA believes that the passthru payment rule was fundamentally intended to prevent an undocumented accountholder or NPFFI from receiving indirectly a withholdable payment that it could not receive directly without withholding. As a consequence, the definition should be

limited to payments that truly “pass through” the full economics of underlying withholdable payments. For investment fund FFIs, SIFMA believes that the PPP approach is a reasonable proxy for this standard. For non-investment-fund FFIs, SIFMA believes that other types of payments, such as payments on derivatives, pose a lower risk of tax evasion for a variety of reasons. For example, parties to a derivative bear the credit risk of their counterparties. An NPFFI seeking to obtain exposure to U.S. debt or equity instruments through derivatives without withholding would be required to bear significant credit risk with respect to its overall portfolio. With respect to individuals, investing derivatively may be an unattractive alternative because it requires more documentation and therefore is less common among individuals than simply buying and selling securities. In addition, many derivatives that provide exposure to U.S. securities do not provide the same economic exposure as purchasing the related security (e.g., options) and are not a suitable alternative to buying the securities. For these reasons, SIFMA believes that only a clear rule limited to payments that are structured as a fixed percentage of underlying withholdable payments would be appropriate.

- (iii) Even for investment fund FFIs, SIFMA believes that the PPP approach will require further refinement, and that implementing it will take an enormous amount of work. Among other issues, such refinements will need to address the following questions:

- How are derivative transactions valued (e.g., notional size vs. mark-to-market value)?
- How are non-publicly traded assets valued?
- How is the U.S. or non-U.S. characterization of derivative transactions determined?
- How are non-U.S. assets held through U.S. flow-through entities (e.g., partnerships) treated?
- What is a custodial asset? In particular, are securities transferred to a PFFI under a repo held in a custodial capacity?

In addition, SIFMA believes that it will simply be too difficult for any large investment fund FFI to implement the PPP approach on a true asset-by-asset basis, and that such detail is not required.

- (iv) Implementing passthru payment withholding will require an enormous amount of work, regardless of whether an FFI is an investment fund FFI and must apply the PPP approach, or is a non-investment-fund FFI and must apply the “delta-1” approach. To give FFIs the time that they need to implement necessary systems, and consistent with the approach in Notice 2011-53 and SIFMA’s comments on the transition timeframe above, withholding on such passthru payments should accordingly not begin until January 2016. SIFMA also recommends that the passthru payment definition not be addressed in the proposed regulations or the first iteration of the final regulations, in order to give the Department of the Treasury, the IRS,

and the industry additional time to study the matter. As long as withholding on passthru payments is delayed until 2016, SIFMA believes that an additional year spent in refining the definition will not prevent FFIs from having sufficient time to implement it, and will likely improve their ability to do so by eliminating unnecessary complexity.

Comment 3: Securitization Vehicles

The proper treatment of securitization vehicles (also sometimes synonymized with “special purpose vehicles” or “SPVs”) is one of the biggest issues currently facing FFIs and USFIs in thinking about potential FATCA compliance systems. Consistent with its prior comments, SIFMA continues to believe that it is critical that the regulations include an exemption under which existing securitization vehicles are treated as DCFFIs. In addition, SIFMA can see no reason why a similar exemption could not be extended to new securitization vehicles.

- (i) In this regard, non-U.S. securitization vehicles have invested hundreds of billions of dollars in the U.S. economy, particularly in loans issued by small and mid-sized U.S. companies. In the absence of an exemption, a typical non-U.S. securitization vehicle that holds U.S. assets and issues its own securities would generally be treated as an FFI. Unfortunately, it is quite likely that many existing securitization vehicles would be unable to enter into and comply with the requirements of an FFI agreement. As explained in more detail in SIFMA’s prior comments, securitization vehicles are typically

governed by very restrictive indentures or other similar arrangements. The existing documents for such vehicles will likely not contemplate or permit the vehicles to take steps necessary to comply with FATCA, and amendments to such documents may be difficult or impossible to obtain. If such vehicles are treated as FFIs but are not able to become PFFIs, the vehicles could be required to liquidate, which could lead to significant disruptions in the international financial markets, including particularly the markets for debt issued by U.S. borrowers.

- (ii) For purposes of the exemption, SIFMA suggests that a securitization vehicle should generally be defined as a limited purpose, limited duration vehicle that is established to hold a specific type of investment assets and to sell debt and/or equity interests to investors that receive cash flows generated by the assets of the vehicle. In order to ensure that the exemption does not create avenues for abuse, however, an entity should not be treated as an exempt securitization vehicle to the extent that it has a wide investment mandate or more than 50 percent of its debt and equity is held by related parties, such as family members.
- (iii) For new securitization vehicles, the purpose of the exemption would be to minimize unnecessary compliance burdens by entities that have no employees and are not designed to engage in any significant activities, in circumstances where FATCA information reporting and withholding by the securitization vehicle itself would serve no

purpose. In this regard, SIFMA believes that it would be appropriate to structure an exemption for new securitization vehicles that was limited to securitization vehicles all of the securities in which are held through USFIs or PFFIs. As such, all appropriate U.S. tax reporting and withholding could be done by such USFIs or PFFIs, and there would be no need to impose such burdens on the securitization vehicle, which is not well suited to bear them. In addition, the IRS would be relieved from having to enter into unnecessary FFI agreements with thousands of securitization vehicles in circumstances where such agreements would result in no additional information reporting.

- (iv) In implementing the exemption, SIFMA further suggests that securitization vehicle DCFFIs should not be required to calculate PPPs. One potential way this might be done would be to define the PPP of an existing securitization vehicle DCFFI as 0, and to treat the PPP of a new securitization vehicle DCFFI as either 0 or 100, depending on whether the securitization vehicle holds any U.S. assets.

Comment 4: Short-Term Debt

Consistent with SIFMA's prior comments, an exemption from FATCA withholding should be provided for short-term debt for the following reasons:

- (i) U.S. companies collectively derive trillions of dollars of funding through the issuance of short-term debt instruments (such as commercial paper) in foreign markets, to entities that would be treated as FFIs. 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 may not be willing to enter into FFI agreements with the IRS. It can also be expected that they will be unwilling to incur any risk of a 30 percent withholding tax on the principal amount of their investments, which FATCA would create. As a consequence, such investors could substantially decline as a funding source for U.S. issuers.

- (ii) As stated in its prior comments, SIFMA believes that the Department of the Treasury and the IRS should carefully balance the tax compliance objectives of FATCA against the need for U.S. companies 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.
- (iii) As implicitly recognized by Notice 2011-53, the Department of the Treasury and the IRS have clear authority to limit the scope of the withholdable payment definition.⁸ Furthermore, the FATCA

⁸ See section 1473(1) (“Except as otherwise provided by the Secretary . . . [t]he term ‘withholdable payment’ means . . .”).

legislative history suggests that an exclusion from the withholdable payment definition for payments in respect of short-term obligations is appropriate and consistent with the goals of FATCA.⁹ Taking the above into account, SIFMA continues to recommend that the regulations exclude from the withholdable payment definition all interest and principal payments made in respect of debt of U.S. issuers with a term not exceeding 183 days. Such an exclusion would be consistent with longstanding exemptions for short-term debt instruments in other provisions of the Code and the Treasury regulations there under—exemptions which reflect a long-held belief that such instruments do not lend themselves to tax evasion—and would ensure that such payments can continue to be made to FFIs and NFFEs without withholding or the obtaining of any tax certifications.¹⁰ To ensure a level playing field between U.S. and non-U.S. issuers, and as also contemplated by the FATCA legislative history, the exemption

⁹ See Joint Committee on Taxation Technical Explanation of the Revenue Provisions Contained in the HIRE Act, JCX-4-10 (“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.”).

¹⁰ 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).

should also apply to short-term debt of FFIs, which should be excluded from the definition of financial account.¹¹

- (iv) 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.¹² 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.
- (v) Finally, to allay any concerns that a short-term debt exception could be abused by a continuous rollover of short-term debt, the regulations could provide that debt would be considered short-term only if payments thereon would qualify as short-term under the exemption from nonresident gross income and withholding tax in section 871(g)(1)(B)(i) (for which the same abuse considerations apply).

Comment 5: Other Technical Comments

SIFMA also makes and reiterates the following additional comments:

¹¹ See JCT Explanation at 43 (“It is anticipated that the Secretary may determine that certain short-term obligations, or short-term deposits, pose a low risk of U.S. tax evasion and thus, may not treat such obligations or deposits as financial accounts for purposes of this provision.”).

¹² Most short-term debt generally pays a yield that is only a modest spread over LIBOR or another similar index.

- (i) *Chief Compliance Officer Certification.* Notice 2011-34 would require the “chief compliance officer or another equivalent-level officer” of a PFFI to make various potentially unworkable certifications to the IRS, including, apparently, a certification that, between the public release date of Notice 2011-34 (April 8, 2011) and the effective date of the PFFI’s FFI agreement, the PFFI’s “management personnel” did not “engage in any activity, or have any formal or informal policies and procedures in place, directing, encouraging, or assisting account holders with respect to strategies for avoiding identification of their accounts as U.S. accounts” under the transition rules.¹³
- Consistent with its prior comments, SIFMA continues to believe that (1) the certification requirement should require a PFFI only to provide a certification that the PFFI did not have any formal or informal policies or procedures in place that meet the noted criteria; (2) the certification should only be required for the period starting 90 days after the pertinent FATCA regulations are published, at least in proposed form; and (3) in defining what sort of policies and procedures meet the criteria, the rules should focus on destruction of account-related documentation outside of a PFFI’s preexisting document retention policies, as SIFMA believes that such activity gives

¹³

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

rise to the most potential for abusive gaming of the transition rules.

- (ii) *DVP/RVP Transactions.* The regulations should contain clear rules delineating responsibility for information reporting and withholding in the case of delivery-versus-payment/receipt-versus-payment transactions. Consistent with the current U.S. payor information reporting rules,¹⁴ information reporting and withholding under FATCA in respect of such transactions should generally be done by the USFI/PFFI receiving the gross proceeds from a sale against delivery of the securities sold (as opposed to the executing broker).
- (iii) *Agent Issues.* Consistent with SIFMA's prior comments, the regulations should make clear that, where one FFI (or USFI) agrees, under a contract, to act as a reporting/withholding agent for another FFI (or USFI), the accounts at the principal should not be treated as accounts of the agent for which the agent has statutory (as opposed to contractual) responsibility under FATCA.
- (iv) *USFI Coordination Issues.* While Notice 2010-60, Notice 2011-34, and Notice 2011-53 provide details regarding how FFIs must identify, report, and withhold on their accounts, and how USFIs must identify and withhold on some payments to FFIs and NFFEs, many details regarding USFIs have not yet been

¹⁴ See Treasury regulations section 1.6045-1(c)(3)(iv).

provided. In this regard, USFIs have the core compliance obligations under FATCA as the primary withholding agents for withholdable payments made to FFIs and NFFEs.

Consistent with its prior comments, SIFMA continues to believe that, in order for both FFIs and USFIs to begin creating the compliance systems and procedures necessary to implement FATCA, it is critical that additional guidance regarding the treatment of USFIs be provided as soon as possible. Among other matters, such guidance should address the following: (1) what reporting, withholding, or other compliance obligations a USFI will have with respect to payments other than withholdable payments that it makes or processes with respect to an NPFFI or NFFE account (including, e.g., non-U.S. source interest payments on securities held in a brokerage account at a USFI); (2) more generally, how the overlap between the existing U.S. payor information reporting rules will be reconciled with FATCA in the case of USFIs; (3) how an account maintained by a USFI (including an offshore branch of a USFI) with an FFI will be treated; and (4) how payments made by FFIs to financial intermediary USFIs will be treated (including, e.g., payments made by an FFI in respect of securities that it has issued that are held for clearing purposes by the Depository Trust Clearing Corporation). In addition, SIFMA believes it is critical that the transition timeframe, as

proposed in Notice 2011-53, be modified as discussed above, so that it is clarified with respect to USFIs. To preserve a level playing field, it should be made clear that USFIs will benefit from all of the same extensions as FFIs with respect to any reporting or withholding duties.

- (v) *Chapter 3 / Chapter 4 Coordination.* SIFMA believes that the regulations should make greater efforts to coordinate Chapter 3 and Chapter 4 withholding and information reporting than has thus far been suggested in Notice 2010-60, Notice 2011-34, and Notice 2011-53. One particular suggestion would be to allow information reporting and withholding agents to satisfy their Chapter 4 duties through the Chapter 3 system, at least until information reporting or withholding under FATCA is required in respect of payments other than payments of U.S. source FDAP that are currently subject to Chapter 3 information reporting and withholding.

* * *

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 [_____] or [_____] if you have any questions or if we can be of further assistance.

Sincerely,

[_____]
[_____]

Securities Industry and Financial Markets Association