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January 11, 2010

Sen. Max Baucus, Chair
Senate Finance Committee
U.S. Senate
Washington, DC 20510

Sen. Charles E. Grassley
Ranking Minority Member
Senate Finance Committee
U.S. Senate
Washington, DC 20510

Rep. Charles B. Rangel, Chair
House Ways and Means Committee
U.S. House of Representatives
Washington, DC 20515

Rep. Dave Camp
Ranking Minority Member
House Ways and Means Committee
U.S. House of Representatives
Washington, DC 20515

Re: Comments on the Foreign Account Tax Compliance Legislation

Gentlemen:

We write to convey the comments of the New York State Bar Association Tax Section concerning certain aspects of Title V of the proposed "Tax Extenders Act of 2009" ("Title V").[1] These comments

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[1] The principal drafter of this letter was Andrew Solomon, with substantial contributions from Kimberly S. Blanchard, S. Douglas Borisky, Edward E. Gonzalez, David Hariton, David S. Miller, Erika W. Nijenhuis, Michael Schler and Diana Wollman. The letter may be cited as New York State Bar Association Tax Section, *Comments on the Foreign Account Tax Compliance Legislation* (Report No. 1199, Jan. 11, 2010).

Opinions expressed herein are those of the Tax Section of the New York State Bar Association, and do not represent those of the New York State Bar Association unless and until they have been adopted by the Association's House of Delegates or its Executive Committee.

address certain limited issues arising from the manner in which the statute is drafted. We anticipate that we will be submitting a report on implementation once the statute has been adopted.

Title V would significantly modify and expand the scope of current reporting and withholding regimes under US tax law in order to identify and deter US tax evasion and improve US taxpayer compliance. Title V is a revised version of the proposals set forth in the original version of the Foreign Account Tax Compliance Act of 2009 (H.R 3933, S. 1934, "FATCA"). We applaud the changes made by the House of Representatives to the original version of FATCA and incorporated in Title V. The revisions in the legislation would generally make the new rules more practicable and, in certain areas, would provide greater authority to the Treasury Department to implement the rules in a flexible manner and to provide exemptions where appropriate.

We support Congress in its efforts to prevent US tax avoidance and increase transparency in the global financial system and are encouraged by the changes made in Title V in comparison to FATCA. We are concerned, however, that certain issues that were either not addressed or only partially addressed in the revised legislation may, if not further revised, have unintended negative consequences. In short, certain aspects of Title V may limit the government's ability to achieve the stated objectives of the legislation and/or make it more difficult than necessary for US persons to access international capital markets. The purpose of this letter is to highlight these issues and to suggest clarification or changes to Title V's statutory language in order to make Title V more effective and compliance with the new requirements more feasible for a greater number and variety of foreign entities.

As discussed further below, we make the following recommendations:

- Due to the novelty and complexity of the information reporting and withholding provisions of Title V, there will be a need for substantial amounts of guidance from Treasury in order to ensure that it is implemented in a way that does not unnecessarily adverse affect the US and global capital markets. In order to give Treasury appropriate flexibility to tailor the new rules, there is a need for expanded Treasury regulatory authority (and/or the legislative history should be clarified to make it clear that the Treasury has been granted authority) sufficient to deal with issues such as – (1) what happens when a foreign financial entity cannot obtain the information required by a Section 1471(b) agreement, (2) what procedures a foreign financial entity may use to determine the status of a payee as a foreign financial entity and/or a United States owned foreign entity, (3) how the indirect ownership rules for determining when an account held by a foreign entity are to be applied and whether they can be relaxed in appropriate cases, (4) that it may be necessary for Section 1471(b) agreements to provide different rules for the diverse types of entities covered by the new reporting rules, (5) better integrating the existing Qualified Intermediary rules with the new rules of Title V, and (6) dealing with potentially abusive situations. We also recommend certain changes to and clarifications of the effective date

provisions relating to these rules. Finally, we have three suggestions with respect to specific aspects of the reporting and withholding rules.

- With respect to the repeal of the foreign targeted obligation rules, we have two recommendations, one relating to the imposition of the excise tax and the other with respect to effective dates,

- With respect to the new provision for tax return disclosure of interests in "Specified Foreign Financial Assets" we reiterate our prior comments and recommendations, generally to the effect that the statutory rules regarding reporting of foreign accounts by account holders should be overhauled to reduce duplication and to clarify many uncertainties; and

- With respect to expanded PFIC reporting, we believe that there is no need for the requirement and would suggest that it be dropped from Title V.

I. Third-Party Information Reporting & Withholding

Title V, by adding Sections 1471 – 1474 to the Internal Revenue Code, would create two new programs intended to encourage foreign financial entities to report information about their US customers and other US account holders to the IRS and induce non-financial foreign entity payees receiving US-source income to obtain and report information about their beneficial owners. Foreign financial entities receiving US source payments would be required to enter into an information reporting agreement with the Treasury Department, which would generally require the foreign financial entity to report certain information regarding US accounts held by a "specified United States person" or by a foreign entity that has one or more "substantial United States owners." Non-financial foreign entities receiving US source payments would need to certify that they do not have a "substantial US owner" or provide information about such "substantial US owner" to persons from whom they receive certain "withholdable payments". Compliance with these reporting requirements would be effectuated by a proposed 30% withholding tax on "withholdable payments" made to non-compliant foreign entities, subject to certain alternative withholding requirements where foreign financial entities are unable to obtain information from recalcitrant account holders or noncompliant foreign financial entities. Withholdable payments would include US-source interest, dividends and the like, as well as the proceeds from the sale or disposition of assets generating such US-source income.

A. General Comment – Need for Expanded Regulatory Authority

The main objective of these new reporting and withholding regimes is to generate relevant information about US taxpayers and taxable income that the IRS can use to identify and prevent US tax evasion. We understand that the withholding tax is not intended to raise revenue in its own right but rather is meant to incentivize foreign entities to share information with the IRS. William J. Wilkins, IRS Chief Counsel, testified to this effect before the House Ways and Means Subcommittee on Select Revenue Measures:

> Under the bill [referring to FATCA], a [non-qualifying intermediary] would be subject to withholding unless it enters into an agreement with the IRS and complies with the associated reporting, due diligence, and verification obligations with regard to its direct and indirect US customers. The bill would, therefore, create a strong incentive for global foreign financial institutions to provide the IRS with the information it needs to ensure that US account holders are complying with US tax laws.[2]

Accordingly, the legislation will achieve its objective only if the threat of a withholding tax on US investments causes disclosure of the relevant information about US persons (including information about the non-US investments and income of US persons). Because disclosure is sought from foreign persons that are not generally subject to US jurisdiction, disclosure cannot be mandated but must be incentivized.

We appreciate that the revised legislation has made the new requirements significantly more workable for the financial services industry and has given the Treasury Department much of the authority it needs to implement the rules in a practical and flexible manner. However, we strongly urge that the legislation be amended, or the legislative history be clarified, to provide the Treasury Department greater authority to modify the rules and phase in the requirements in a manner that will encourage compliance from a broad cross-section of foreign financial entities. This is critical, because the legislation's success depends on drawing a large number of entities from each of various categories of foreign financial entities into voluntary compliance and cooperation with the Treasury Department.

As a general matter, we believe that the Treasury Department will need to take into account, in developing regulatory guidance with respect to these rules, the limitations and concerns of different types of foreign financial entities. While the choice many foreign entities will be forced to confront is the same—(1) comply with the reporting rules (if they are able to do so) or (2) avoid doing business with US customers and abstain from investing in assets that would generate US-source income (unless the foreign entity chooses to bear the brunt of the withholding tax and gross up its clients for any such withholding)—the reaction of different types of foreign financial entities will vary, depending on the nature of the entity (bank, clearing house, securities dealer, public or private investment fund or securitization vehicle), its geographical and business focus, its size, and the various jurisdictions under whose laws such entity (or the affiliated group to which it belongs) operates. For example, while major global banks would likely be compelled for business reasons to comply with the new rules, the requirements may be too onerous for small banks or local investment funds and hedge funds that invest exclusively or primarily in European or Asian markets. Accordingly, in order to attract a critical mass of foreign financial entities into compliance with the new rules, the reporting and

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[2] From the Prepared Statement of William J. Wilkins, IRS Chief Counsel Before the House Ways and Means Subcommittee on Select Revenue Measures on the "Foreign Account Tax Compliance Act of 2009," November 5, 2009, p. 3.

withholding systems under Chapter 4 will need to be designed in a nuanced way adaptable to the varying legal, business, geographic, financial and other such considerations of different types of entities.

Otherwise, there is a danger that if compliance with these rules becomes too costly for a significant class of foreign entities, the rules become self-defeating. If fewer foreign financial and non-financial entities participate, US tax evaders will actually have more options (*i.e.*, more options than they would have had in a system with less costly rules and wider participation by more foreign entities), and fewer accounts will be subject to reporting and disclosure. Foreign financial entities opting out of the system would also be costly to the US economic system; the only effective way for a foreign financial entity to avoid these rules would be to avoid investing in assets that produce US-source income, thus potentially depressing the market for US securities. Further, such disinvestment may leave Americans residing abroad with fewer banking options and may lead to a fragmented market if noncompliant banks choose to shun US investments and thereby drive investors interested in investing in US assets to migrate their accounts to compliant banks. In this context, we note that it appeared that, prior to the changes made by Title V, some foreign financial entities were disinvesting from US securities and turning away American customers, based on their perceptions of what the requirements of FATCA would entail. (To the extent that this is not currently the case, it may be a product of the extended effective dates in Title V, or the belief that they will have the time and resources to comply with the ultimate form of the rules that are adopted.) In many cases, foreign financial entities may resort to such measures not because they are interested in facilitating US tax evasion but because they do not have the resources or appetite to sustain the costs of compliance with the complex information gathering, reporting and withholding provisions under the new reporting and withholding regimes.

The balance between robustly encouraging compliance and deterring foreign investment in the US is a delicate one that will require significant fine-tuning over time, and therefore, we believe that the Treasury Department needs to be granted as much authority as possible to implement the legislation in a manner that encourages compliance rather than disinvestment. We appreciate that the revised legislation has broadened the scope of the Treasury Department's regulatory authority in several significant areas, but we believe that, in addition, the Treasury Department needs to have expanded authority to address the following:

1. **Greater clarification and guidance is required on addressing the situation where a foreign financial entity cannot obtain the information required by a Section 1471(b) agreement because of recalcitrant account holders or noncompliant foreign financial entities: Treasury should be given more authority to address this issue.**

   It may not always be possible for foreign financial entities to obtain and/or provide the information required by a Section 1471(b) agreement. For example, such information sharing may be prohibited by data privacy rules or the confidentiality laws of other jurisdictions. While proposed Section 1471(b)(1)(F) would require a foreign financial entity to close an account where disclosure of the requisite information is prohibited under foreign law and a valid waiver is not obtained from

the relevant holder, this is not always a feasible option. First, some countries do not allow customers to waive privacy laws. Second, a foreign financial entity may be subject to legal or contractual restrictions on closing accounts, particularly where the "account" is a debt or equity interest subject to restrictions on redemption. In addition, under the rules of Section 1471(e), some foreign financial entities may be "affiliates" of other foreign financial entities that they do not control and from whom they cannot (for practical, commercial or legal reasons) obtain the requisite information or force closure of the relevant account at their "affiliate".

The revised legislation addresses a foreign financial entity's withholding obligations in the situation where it is unable to obtain information from an account holder—the foreign financial entity must either (1) elect to be withheld on withholdable payments paid to it to the extent such payments are allocable to accounts held by noncompliant holders or (2) withhold on any passthru payments (*i.e.*, withholdable payments or payments attributable to withholdable payments) that it makes to noncompliant holders. The legislative history indicates that withholding is not intended to function as an alternative to information reporting, and indicates that the Treasury may require some level of reporting by the foreign financial entity and/or that the entity, make reasonable efforts to obtain the information or close accounts. The statute, however does not make it clear to what the extent the Treasury can take these (or other factors) into account in deciding not to revoke an agreement and/or penalize the foreign financial entity.

We believe that the determination of whether a foreign financial entity is in compliance with the general requirements of Section 1471 should depend on the nature of the foreign financial entity, the time when the account of the recalcitrant account holder or noncompliant foreign financial entity was established, the proportion of recalcitrant account holders and noncompliant foreign financial entities to the investor base of the relevant foreign financial entity, and other similar factors. A one-size-fits-all approach to assessing compliance would not be appropriate, as various factors impinge on the ability of a foreign financial entity to be in compliance with these requirements when its direct or indirect account holders refuse or are unable to comply. Accordingly, we believe that the Treasury Department should be explicitly authorized to determine to what extent compliance with the procedures set forth in Section 1471(b)(1)(D) and Section 1471(b)(3) should be deemed to satisfy the requirements of Section 1471(b)(A) and the requirements of the agreement entered into under Section 1471(b). In that regard, we strongly recommend that the legislative history note the importance of considering the factors described above in making this determination and the need, therefore, for the Treasury Department to have the authority to flexibly implement the rules to take into account these considerations.

As a more general matter, we recommend that the legislation direct the Treasury Department to set standards for Section 1471(b) agreements that encourage foreign financial entities to enter into such agreements and that do not punish foreign

financial institutions that are making good-faith efforts to comply with the requirements. In addition to the authority granted to the Treasury Department to exempt certain classes of institutions under proposed Section 1471(b)(2), the Treasury Department should also have the power to exempt different types of transactions from these requirements. Either in the statute or legislative history, it should be made clear that revocation of a Section 1471(b) agreement should not follow from *de minimis* failures of compliance and that the Treasury Department should have broad authority to excuse failures to obtain the requisite information where reasonable efforts have been made by the foreign financial institution.

2. **Greater clarification and guidance is required in addressing what procedures a foreign financial entity may use to determine the status of a payee as a foreign financial entity and/or a United States owned foreign entity: Treasury should be given more authority to address this issue.**

   For the reasons expressed in point 1, above, the Treasury Department should also have authority to promulgate rules regarding the types of statistical, documentary and other mechanisms on which foreign financial entities can rely on to establish the status of a payee as a foreign financial entity (compliant or otherwise) or a foreign non-financial entity, and/or to establish the status of a foreign entity as a United States owned foreign entity. Treasury should be given explicit authority to determine that reliance on these procedures (and reporting based on the results obtained) may satisfy the obligation of a compliant foreign financial entity to obtain and report the information required by Section 1471(a)(1)(A), (C) and (E). It would be useful if the legislative history could express the expectation that the Treasury Department will publish lists of compliant foreign financial entities (Section 1474(c)(2) permits such lists but does not require them).

3. **The indirect ownership rules for determining when an account held by a foreign entity is a United States account are not specified in the statute with sufficient clarity, and the 0 percent threshold for determining whether a foreign investment entity has a "substantial United States owner" may be unworkable in many situations; Treasury should be given more authority to address these issues.**

   Given the inherent difficulty of tracing beneficial ownership through tiers of entities, the Treasury Department needs to be granted clear authority to apply these rules in a sensible way to minimize cost and encourage foreign financial entities to enter into Section 1471(b) agreements. In particular, the Treasury Department should have authority to "call off" the look-through process in cases where tax abuse is unlikely to be present, where ownership tracing is too burdensome or where it is unclear (because of indirect ownership through a chain of ownership that includes financial and non-financial entities) whether the 0 percent or 10 percent ownership threshold applies. For example, the Treasury Department should be able to decide that (i) tracing through foreign publicly-traded companies or through US privately-held companies subject to information reporting is not needed, and/or (ii) in determining whether a

foreign investment entity indirectly has a substantial United States owner, the 10 percent rule (rather than the 0 percent rule) applies to the shareholders of a non-financial foreign entity that owns an interest in a foreign investment entity that is directly subject to the 0 percent threshold. While the Treasury has authority under section 1471(f)(4) to exempt certain classes of foreign financial institutions from the withholding tax, it is not clear that this authority extends to modify the specific threshold requirement. We would recommend that this be clarified in the statute or legislative history.

In addition, we would recommend that the Treasury Department be given the authority (or that the legislative history clarify that 1471(f) gives the Treasury authority) to increase the 0 percent threshold either generally or in specified types of situations where tax avoidance is unlikely to be present. This authority should be coupled with ability to impose aggregation rules – that is, to treat a foreign entity as having a substantial United States owner if in the aggregate it is directly or indirectly owned by specified United States persons that collectively own more than a specified percentage (greater than 0) of the foreign financial entity. This rule would permit relaxation of the general rule, but still require reporting where foreign entities are established as investment vehicles for US persons but no one shareholder exceeds the 10 percent threshold applicable to non-financial foreign entities.

Finally, the Treasury Department should also be authorized to promulgate rules regarding the types of statistical, documentary and other mechanisms (as an alternative to certification by the ultimate owners of the foreign financial entity) that foreign financial entities can rely on to establish the existence or non-existence of substantial US owners of foreign entities.

4. **The legislation seems to contemplate a one-size-fits-all Section 1471(b) agreement for all foreign financial entities, notwithstanding the diverse types of entities covered by the rules. The Section 1471(b) agreements should be sensitive to the type of financial entity to which it applies and the environment in which it operates.**

The definition of a "foreign financial institution" covers entities as different as global universal banks, large mutual funds held by numerous investors, special purpose securitization vehicles and small family investment companies. It covers institutions operating in sophisticated financial centers and developing economies; in countries with internal reporting systems designed to prevent tax evasion and/or money-laundering and countries without such systems; in jurisdictions where information-sharing is routine and others where it is problematic; in countries that are close allies of the United States and countries that are not. The Treasury Department should have explicit authority to take these differences into account in drafting Section 1471(b) agreements.

The Treasury Department should also be authorized to coordinate implementation of these agreements with local banking and securities regulators and tax authorities,

through the competent authority provisions of tax treaties and tax information exchange agreements and through international organizations. In particular, the Treasury Department should be authorized to share information collected through the Section 1471 process and the regular information reporting systems (including information collected on Form 1042 and 1042-S) with foreign jurisdictions as part of the process of encouraging non-US tax administrators to cooperate with the information gathering requirements of Sections 1471 and 1472. The system will not operate properly if financially significant jurisdictions find that the information collection and reporting required by Section 1471 violates their consumer data protection or bank secrecy laws.

5. Integration with Existing QI Regime.

The Treasury Department, either explicitly or in the legislative history, should be given the authority, in order to carry out the purposes of both Chapter 3 and the new Chapter 4 of the Internal Revenue Code, to modify the rules under the new Chapter 4 as necessary or appropriate so that the rules are integrated and consistent with the existing QI regime under Chapter 3. While proposed Section 1471(d)(1)(C) would allow the Treasury to exempt an account from reporting if the Treasury Department determines the holder of such account is otherwise subject to information reporting requirements that would render Section 1471 reporting duplicative, we believe this authority should be expanded so that the Treasury has the explicit authority to harmonize the two reporting regimes even in circumstances where the Chapter 4 requirements do not duplicate the Chapter 3 requirements. Stated somewhat differently, the Treasury Department should have the specific authority to modify the rules under Chapter 4 as necessary to make the requirements consistent with the QI regime where it determines that those rules are sufficient and appropriate. This regulatory discretion would facilitate the elimination of potentially inconsistent or unnecessarily burdensome reporting requirements for financial institutions that currently participate in the QI regime.

6. Abusive transactions

We believe that the provisions added to Title V concerning passthru payments in Section 1471(a)(1)(D) will assist in deterring some abusive transactions. Nonetheless, because reporting applies only with respect to United States accounts, and withholding only applies to recalcitrant account holders and noncompliant financial institutions, there are still avoidance transactions that may be possible. For example, no provision of the legislation expressly precludes the following type of arrangement: an account held by a foreign non-financial institution that has no United States owners would not expressly be subject to withholding or reporting even if the funds invested by the foreign non-financial institution had been loaned in a back-to-back or conduit-type arrangement to the foreign non-financial institution by a specified United States person.

The Treasury Department should be explicitly authorized to combat abusive transactions, including by requiring withholding on payments made in connection with abusive transactions as if such payments were passthru payments, or by treating debt holders of a foreign entity as owners of the foreign entity, where such withholding or characterization is needed to prevent abuse.

B. General Comment – Effective Date Flexibility

Financial entities and non-financial entities will need time to implement the requirements imposed by Sections 1471 – 1474. Many of these requirements will be set forth in regulations, which may not be available immediately. Given the complexity and delicacy of the task, those regulations will take time to draft and will need to be fully vetted when released in proposed form (likely more than once). After the substance of the rules is available, implementation of the necessary compliance systems will take considerable effort, and some requirements may take financial entities and the IRS longer to implement than others.

We appreciate that the revised legislation has deferred the effective date of these provisions to December 31, 2012, but we strongly recommend that the Treasury Department have the express authorization to extend the effective date, in whole or in part, as it deems necessary or appropriate. To this end, the legislative history should acknowledge the significant amount of time that will be required for the Treasury Department to issue the necessary extensive guidance implementing the rules under Chapter 4 and the time the financial services industry will need to understand the rules and prepare procedures and systems in order to comply with the rules. This flexibility will give the Treasury Department time to prepare the necessary guidance, which it may decide to phase in over time, and will give the financial services industry time to prepare for compliance and for a critical mass of Section 1471(b) agreements to be signed.

Proposed Section 1474(d)(2) would grandfather "any amount to be deducted or withheld from any payment under any obligation outstanding" on the date two years after the date of the enactment of the Title V. The legislation is ambiguous in two important ways: first, it should clarify what is intended to be covered by the statutory term "obligation". In particular, it is not clear whether only debt obligations would constitute an "obligation" for this purpose or whether contractual obligations (like licenses or annuities) or equity securities would constitute "obligations" subject to grandfathering. We would recommend that, except as provided in regulations, the term "obligation" should include all contractual obligations (debt and other contractual obligations such as licenses and annuities) but should exclude equity securities. Second, we strongly recommend that the legislation clarify that a "payment under any obligation" under Section 1474(d)(2) includes any payments of proceeds from the sale, redemption or other disposition of an obligation. Without greater clarity on the precise nature of which payments and which obligations are to be grandfathered under Section 1474(d)(2), we are concerned that the grandfathering provision may not be fully effective in avoiding market disruption during the period that the precise requirements under Title V are being developed. In the absence of clarification, issuers and investors would not know whether or not they are subject to these rules. Accordingly, we strongly recommend that Congress revise the language of

Section 1474(d)(2) to clarify the definition of an "obligation" and to explicitly provide that payments of proceeds on the sale, redemption or other disposition of an obligation are included as grandfathered payments under Section 1474(d)(2).

In addition, we would recommend that the two-year grandfathering provision apply to any "obligation" issued pursuant to a commitment undertaken by the issuer of the obligation, or an option granted to the issuer by the lender/holder/counterparty of the issuer, during the two-year period. We are concerned that grandfathering only obligations outstanding during that period may inadvertently make it difficult for US borrowers to obtain, during the two-year period, revolving credit facilities, loan commitments (*e.g.,* loans that can be drawn only after certain benchmarks are met, rather than by a date certain), and stand-by credit facilities and letters of credit.

C. Specific Comments

1. Definition of a "Financial Account"

- Under proposed Section 1471(d)(2)(C), any equity or debt interest in a financial institution, other than interests regularly traded on an established securities market, would constitute, unless otherwise provided by the Treasury Department, a "financial account" for purposes of the information reporting and withholding rules under Section 1471.

  We would recommend that the presumption be reversed for conventional debt (not including deposits) and equity interests of conventional financial institutions even if they are not publicly traded. We would exclude from the definition of "conventional debt" debt instruments that provide for payments linked to equity or other non-debt indices that might provide the opportunity for conduit and similar arrangements. The conventional debt or equity of a bank or securities dealer is in principle no different from the debt or equity of a non-financial institution. Obviously, limitations may be appropriate, and the Treasury Department should have regulatory authority to provide otherwise.

- Under proposed Section 1471(d)(2)(A), a depositary account maintained by a financial institution is *per se* a financial account. This would apparently include overnight and other short-term deposits that one bank may maintain with another bank, and other wholesale short-term deposit arrangements that major institutions (pension funds, multinational corporations) may use for cash management purposes.

  If the Treasury Department determines that these types of transactions have little tax avoidance risk, it should have the explicit authority to exempt these types of arrangements (and other arrangements that are unlikely to allow for abuse) from the definition of financial accounts. By its terms, the language of Sections 1471(f) and 1471(b)(2)(B) may be insufficient to permit this type of exemption,

as it allows exemption of classes of persons from the reporting/withholding rules but not classes of transactions. Similarly, although the legislative history discusses exceptions to be provided in regulations for short-term obligations, it is not clear that this extends to short-term depositary obligations subject to proposed Section 1471(d)(2)(A).[3] Accordingly, we recommend that the grant of regulatory authority in section 1471(d)(2)(C) ("except as otherwise provided by the Secretary") apply to all of section 1471(d)(2) and not just to subsection 1471(d)(2)(C).

2. Exception for Payments to Publicly Traded Entities.

Section 1472(c)(1)(A) provides a general exemption from withholding (except as provided in regulations) for payments to publicly traded non-financial entities. Congress should expand this exception so that it covers a foreign non-financial entity if all of its relevant debt and equity interests are held through a US clearing system (like DTC) or a foreign clearing system (*e.g.*, Euroclear or Clearstream) if the system has a Section 1471(b) agreement in place. This would be appropriate because any US shareholder of the foreign non-financial entity would be subject to reporting under Chapter 3 or the other provisions of Chapter 4.

For the same reason, a similar rule should be provided under Section 1471 such that a foreign financial entity would be deemed to have entered into a Section 1471(b) agreement or be exempted from the requirement of entering into the agreement if all of its relevant debt and equity securities were held by a relevant clearing system. This exemption would apply only to debt and equity of a foreign financial entity, and not to a foreign financial entity's outstanding deposits or customer accounts, assuming that those deposits or customer accounts were not held by clearing organizations.[4] The exemption would not increase the risk of US tax evasion, as reporting would be ensured by the clearing system (or its members) being obligated to report the required information under Chapter 3 (in the case of a US clearing system) or Section 1471 (in the case of a foreign system).

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3 *See* Staff of the Joint Committee on Taxation, *Technical Explanation of H.R. 4213, the "Tax Extenders Act of 2009" as Introduced in the House of Representatives on December 7, 2009* at 132 (Dec. 8, 2009).

4 Because deposits and customer funds are rarely held through clearing systems, it is likely that this exemption would benefit foreign financial entities that are investment funds or securitization vehicles. Banks and brokers would still be subject to the full requirements of FATCA with respect to deposits and customer accounts, but would not be subject to more onerous requirements to identify their shareholders or bondholders than other foreign financial institutions.

3. Treaty Override Issue

We do not believe that it is the intention of Title V to override treaty obligations of the United States. The "limitation of benefit" articles of many US treaties permit a foreign corporation to qualify for treaty benefits if it has either specified types of foreign investors or US investors. That is, under many US treaties, having US investors is not merely permitted but in fact encouraged in the sense that it helps a foreign entity to qualify for the benefits of the treaty. Many treaties also grant benefits to corporate residents of the other contracting jurisdiction without regard to the identity of the corporation's shareholders. The statutory language of Section 1474(b)(3) should therefore be revised to clarify that in the case of any beneficial owner of a payment seeking a refund or credit, the beneficial owner will not be required to identify its substantial United States owners (if any) as a precondition to receiving the refund, if, by reason of a treaty obligation of the United States, it is entitled to such a refund without so identifying its substantial United States owners. In the absence of such a limitation, the statute would effectively be overriding the relevant treaty. This may be considered particularly offensive by the other contracting jurisdiction, as the limitation of benefits provisions of US income tax treaties are often intensely negotiated.

We do not believe that there would be the same concern if the obligation to identify beneficial owners was softened, so that a refund would be allowed if the relevant beneficial owner of the payment had either identified its substantial United States owners or had made reasonable efforts to determine the identity of any substantial United States owners that it might have but those efforts turned out to be unsuccessful. Accordingly, we would recommend that the requirement to identify substantial United States owners be so limited in any case where refusal to grant the refund or credit would otherwise violate a treaty obligation of the United States.

II. Repeal of "Foreign-Targeted" Bearer Bond Provisions

Under current law, "foreign-targeted obligations" in bearer form (as determined for US federal income tax purposes) that comply with certain requirements with respect to their offer and sale outside the US are exempt from the TEFRA sanctions on bearer bonds, *i.e.*, (i) denial of interest deductions to the issuer; (ii) an excise tax on the issuer equal to 1% of the obligation's principal amount multiplied by the number of years to maturity; and (iii) denial to the foreign holders of such obligations the exemption from the 30% US withholding tax on interest generally available for portfolio interest paid on US-issued debt. Title V would repeal this exemption for "foreign-targeted obligations" in bearer form (excluding bonds if the rights to principal and

interest payments under the bond are transferred through a dematerialized book entry system, in which case the bonds would be treated as registered bonds under the Title V).[5]

In essence, this change in law would require US issuers to issue bonds worldwide in registered form to avoid the imposition of a 30% withholding tax on non-US holders. The effect of requiring US issuers to issue bonds in registered form for tax purposes is to require the beneficial owners of the bonds to certify as to their non-US status (on IRS Form W-8 BEN) or otherwise comply with rules designed to establish that status, unless, under proposed Section 871(h)(2)(B)(ii)(II), the Treasury Department affirmatively determines that such certification is not required. We believe that the revised legislation gives the necessary authority to the Treasury Department to exempt this certification requirement where appropriate and applaud this grant of additional authority to the Treasury.

In addition, we appreciate that the revised legislation has significantly restricted the applicability of the excise tax on bearer bonds so that bearer bonds issued by non-US issuers are exempted from the excise tax, so long as (i) there are arrangements reasonably designed to ensure that the bonds will be sold or resold only to non-US persons, (ii) interest is payable only outside the US, and (iii) there is a legend on the face of the obligation to the effect that any US person who holds the obligation will be subject to limitations under the US income tax laws. However, we believe that the application of the excise tax is still over-broad, as the new rule would require foreign issuers issuing bearer debt to foreign investors to add a US tax legend to the bearer obligation, even where there is no connection to the US markets or US investors at all. Under current law, the legend is not required if the issuance satisfies the TEFRA C rules.[6] Accordingly, we believe that the exemption from the excise tax should conform to existing rules. In addition to the exemption from the excise tax for obligations meeting the three requirements of the TEFRA D rules described above, we believe that obligations that conform to the TEFRA C rules should also be exempt, so that foreign issuers would be exempted from the application of the excise tax if they are issued outside the US, interest is payable only outside the US, and the issuer is not significantly engaged in US commerce with respect to the issuance.

We appreciate that the revised legislation has amended the effective date so that the new rules will apply to obligations issued after 2 years from the date of the enactment of Title V. However, we would recommend that the Treasury Department be granted the authority to phase in the effective date of these provisions as it deems necessary or appropriate, particularly with

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5 In this regard, the use of the term "dematerialized obligation" may not be technically correct. It is apparent from the legislative history that the term was meant to include obligations that are in "global" bearer form, *i.e.,* are represented by a single global note in bearer form that is held by a financial institution for the account of the obligation's various beneficial owners and that trades through notations made in the records of that financial institution. As a technical matter, such global securities are not usually covered by the term "dematerialized". Perhaps another term, "book-entry" securities, for example, could be used in the statute, or the legislative history could state that "global" securities would be considered "dematerialized" for this purpose.

6 *See* Treasury Regulations Section 1.163-5(c)(1)(ii)(B).

respect to certain select markets where it may not be feasible to issue registered debt or collect taxpayer certifications. Significant time will be required in order for various foreign markets and clearing systems to develop mechanisms for handling Forms W-8 processing and for US companies to adapt their capital-raising plans to accommodate the repeal of the foreign-targeted bearer bond exemption. In addition, issuers will need considerable time to unwind and/or revise their debt programs to adapt to the new rules.

III. Other Reporting Requirements

A. Tax Return Disclosure of Interests in "Specified Foreign Financial Assets"

Title V would require individual US taxpayers who hold an interest in a "specified foreign financial asset" to disclose the asset and certain related information on an attachment to their tax return if, at any time during their taxable year, the aggregate value of all such assets exceeds $50,000 (or any higher amount prescribed by the Treasury Department). Such assets would include a "financial account" maintained at a "foreign financial institution," and, to the extent not held in an account at a "financial institution," a stock or security issued by a non-US person, and any interest in a "foreign entity." Title V does not override the current FBAR requirements.

We reiterate our general recommendations on a similar reporting requirement under the Administration's Fiscal Year 2010 Revenue Proposals, which were set forth in our previous report on the Administration's proposals.[7] In summary, we support a modified version of this requirement, which would require the taxpayer to file the FBAR itself, or a duplicate copy, with its tax return, rather than a separate form with the same information. While it would be preferable if the taxpayer were required to make only a single filing, if duplicate filings are required, we recommend that they have the same due date. For a fuller discussion of our recommendations in this regard, please see our prior reports on this issue.[8]

B. New PFIC Self-Reporting Requirement

Under current law, a holder of PFIC stock is required to report information about its PFIC holdings if it receives direct or indirect distributions from a PFIC or if it makes a "reportable election" (including an election to treat a PFIC as a "qualified electing fund"). Title V would require any person who is a shareholder in a PFIC to file an annual report containing "such information as the Secretary may require." We note that the revised legislation authorizes the

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7 *See* "Report on Qualified Intermediary and Related Withholding and Information Reporting Legislation Proposed by the Administration," dated September 10, 2009, available at http://www.nysba.org/Content/ContentFolders20/TaxLawSection/TaxReports/1189Rpt.pdf.

8 *See* the report cited above, in footnote 7, as well as "Report on the Rules Governing Reports on Transactions with Foreign Financial Agencies (FBARs)," dated October 30, 2009, available at http://www.nysba.org/Content/ContentFolders20/TaxLawSection/TaxReports/1194Rpt.pdf.

Treasury Department to modify or provide exemptions to this reporting requirement, which is a welcome revision. However, the majority of members of the Executive Committee of the Tax Section that considered the question believe that this separate reporting requirement is unnecessary and should be removed from the legislation, because the requisite information is already being generated under current reporting requirements which are triggered by the relevant events that would give rise to information that would be of value to the IRS. In the absence of a relevant event, a PFIC reporting obligation would have little function other than possibly to result in taxpayer penalties if the form is accidentally omitted or completed incorrectly. A significant minority, however, believed that the provision was harmless even if not of much benefit to the Treasury.

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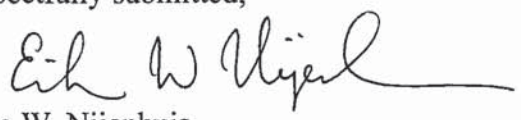
We appreciate your consideration of our comments. Please let us know if you would like to discuss these matters or if we can assist you in any other way.

Respectfully submitted,



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