NEW YORK STATE BAR ASSOCIATION
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January 12, 2012

The Honorable Emily S. McMahon
Acting Assistant Secretary
(Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, D.C. 20224

The Honorable Douglas H. Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, D.C. 20224

Re: Report on IRS Notice 2011-34[1] and IRS Notice 2011-53[2]

Dear Ms. McMahon, Mr. Wilkins and Mr. Shulman:

We are pleased to submit New York State Bar Association Tax Section Report No. 1253. This report conveys the recommendations and comments of the tax section of the New York State Bar Association

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1 Internal Revenue Bulletin 2011-19 (May 9, 2011) ("Notice 2011-34").

2 Internal Revenue Bulletin 2011-32 (August 8, 2011). ("Notice 2011-53" and collectively with Notice 2011-34, the "Notices").

regarding certain aspects of Notice 2011-34, and IRS Notice 2011-53, and responds, in part, to the request for comments set out in Notice 2011-34.

The recommendations and comments in this report address certain limited issues arising from the Notices, particularly those involving passthru payments, deemed compliance, the treatment of private banking relationships and the application of the rule requiring compliance by all foreign financial institution members of an expanded affiliated group . On November 16, 2010, we submitted a report on Notice 2010-60,[3] and appreciate that the Internal Revenue Service ("IRS") and Treasury Department have released guidance that is consistent with certain recommendations made in that report. Although this report does not repeat our prior recommendations, we remain supportive of the recommendations we made in our report on Notice 2010-60.

We continue to support the efforts of Congress, the IRS and the Treasury to prevent U.S. tax avoidance, and understand that developing a set of rules that are workable for financial institutions and achieve the statute's goals is a difficult task.

The report makes several recommendation with respect to the Notices.

Reevaluate the Approach that Notice 2011-34 Takes Toward Passthru Payments

We recognize that the "percentage of total assets" approach to passthru payments, proposed in Notice 2011-34 encourages foreign financial institutions ("FFIs") to sign an information reporting agreement with the IRS and Treasury Department (such an agreement, an "FFI Agreement," FFIs that sign an FFI Agreement, "Participating FFIs" and other FFIs, "non-participating FFIs"). We are concerned, however, that this approach may result in rules that extend beyond what Congress intended, and, as we discuss in the report, have other ramifications that were not intended by either Congress or the Treasury Department.

As a result, we recommend that the IRS and Treasury Department reconsider and narrow the approach taken in Notice 2011-34 with respect to passthru payments. In particular, we suggest:

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[3] Internal Revenue Bulletin 2010-37, (August 27, 2010). *See* New York State Bar Association Tax Section, Report on IRS Notice 2010-60 (Report No. 1224, November 16, 2010).

1. limiting the requirement that Participating FFIs withhold on passthru payments (other than certain passthru payments made on derivatives) to cases where payments are made to "financial accounts";[4]

2. for payments made to financial accounts of non-participating FFIs (but not recalcitrant account holders), limiting passthru payment withholding to Participating FFI payors that are investment-type entities that have a significant percentage of their assets in U.S. investments, or at most, to all Participating FFI payors that have a significant percentage of their assets in U.S. investments;

3. that the IRS and Treasury Department consider a "tracing" rule for certain passthru payments on derivatives (some consideration might also be given to treating derivatives as accounts, but that does not resolve some of the issues we have identified);

4. that the IRS and Treasury Department consider adopting a requirement that U.S. financial institutions ("USFIs") withhold on passthru payments, so that foreign instituitions are not subject to more burdensome rules than USFIs; and

5. that the "passthru payment percentage" calculation rules be simplified to provide that Participating FFIs (other than investment-type entities) be permitted to use a fixed percentage as their passthru payment percentage, if the percentage approach is retained for such non-investment type FFIs.

Remove the Focus in the "Deemed Compliance" Rules on a "Local" Bank's Jurisdiction of Incorporation

As proposed, the "deemed compliance" rules in Notice 2011-34 limit the ability of "local" banks to do business with customers organized or located in jurisdictions other than the country where the local bank is incorporated. In our view, this proposal is likely to place severe

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[4] Under the Act, a "financial account" is generally a depository or custodial account, and any equity or debt instrument issued by an FFI that is not publicly traded. *See* Section 1471(d)(2).

constraints on small banks' ability to benefit from these rules by, for example, effectively requiring that banks operating near national borders choose between either (i) not using the deemed compliance route or (ii) closing the accounts of any customers who reside in neighboring jurisdictions. In addition, we recommend that there be "deemed compliance" options for (i) Participating FFI affiliates that operate in multiple jurisdictions if they agree to comply with the rules applicable to single-jurisdiction local affiliates (*i.e.*, agreeing to not maintain accounts for nonresidents, U.S. persons and non-participating FFIs, and transferring any such accounts that are found to a Participating FFI affiliate) and (ii) "local" branches of FFIs.

Allow "Low-Value" Private Banking Accounts to Be Excluded from the "Private Banking" Rules, and Consider Foreign Law and Other Legal Restrictions in Establishing Account Classification Rules

We agree with the IRS and Treasury Department's decision, in Notice 2011-34, to focus the due diligence required by the Act on "private banking" and "high-value" accounts. However, we believe that the definition of a "private banking account" in Notice 2011-34, which includes any account serviced by a department providing "services not generally provided to account holders," would be clearer and more administrable if private banking accounts were limited to accounts that meet or exceed a specified dollar threshold. In our view, formulating a precise, non-monetary standard to define a "private banking account" that applies across jurisdictions and banking institutions will be difficult, and is unnecessary to achieve the goals of the Act. We anticipate that "low-value private banking accounts" are likely to present little tax evasion risk, and that such accounts could be appropriately managed under the rules for retail relationships.

Provide Certain Exemptions for Certain Members of Expanded Affiliated Groups That Cannot Be "Controlled"

In certain circumstances, it may be impractical for all FFIs in an affiliated group to become Participating FFIs, or for a "lead" FFI in each group to oversee the compliance of each member with the Act. Accordingly, we recommend that the IRS and Treasury Department provide guidance allowing affiliated groups of FFIs to include non-participating FFIs in cases where the parent of the group lacks actual control over that affiliate. It may be appropriate, however, to have anti-avoidance rules such as deemed common control when a Participating FFI refers business to an affiliate.

Provide Guidance Extending the Due Diligence Deadlines for USFIs

Notice 2011-53 extended the account due diligence deadlines applicable to Participating FFIs. Although the IRS and Treasury Department may intend to do so, we believe it would be helpful for guidance to clarify that this timetable is also applicable to USFIs.

We appreciate your consideration of the report and our recommendations.

Sincerely,

Jodi J. Schwartz

cc:

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