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Report No. 1362
January 19, 2017

The Honorable Mark Mazur
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable John Koskinen
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable William M. Paul
Acting Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: *Reserved Portions of the FATCA Final Regulations: Foreign Passthru Payments Withholding*

Dear Messrs. Mazur, Koskinen and Paul:

I am pleased to submit to you this letter[1] on a topic related to the reserved sections of the final Treasury regulations under Sections 1471

[1] The principal drafter of this letter was Andrew P. Solomon, with assistance from Michael Orchowski, John Narducci and Orla O'Connor. Helpful comments were received from Erika W. Nijenhuis and Michael L. Schler,. This letter reflects solely the views of the Tax Section of the New York State Bar Association ("**NYSBA**") and not those of the NYSBA Executive Committee or the House of Delegates.

through 1474 of the Internal Revenue Code (commonly referred to as "**FATCA**"), proposed on February 15, 2012, adopted on January 17, 2013 (corrected on September 9, 2013), amended on February 28, 2014, and amended again most recently on January 6, 2017 (the "**Final Regulations**").

The Department of the Treasury ("**Treasury**") and the Internal Revenue Service (the "**IRS**") have continued to exercise a tremendous effort to provide prompt, useful guidance to foreign financial institutions ("**FFIs**") and other market participants under FATCA, as well as to enter into intergovernmental agreements ("**IGAs**") related to the implementation of FATCA, and we commend you for doing so.

In this letter, we have addressed a topic under the Final Regulations that has been reserved: reporting and withholding on so-called "foreign passthru payments".

Our principal recommendation is that nothing be done to change the current status of withholding on passthru payments. As further described below, we believe that, with the widespread adoption of IGAs, the principal problems that foreign passthru payment withholding was meant to solve likely have been adequately addressed. In any event, whether this is the case will only become clearer after the IRS and Treasury have had the opportunity to review the information that will be submitted under the Final Regulations and the IGAs with respect to foreign passthru payments made in 2015 and 2016 to persons not participating in FATCA. Furthermore, given general international developments at the OECD, the Global Forum on Transparency and Exchange of Information for Tax Purposes and the FATF (Financial Action Task Force), other more targeted solutions may be fairer and more effective than imposing foreign passthru payment withholding, depending on the nature of the problems discovered.

Background: Passthru Payments

Statutory Provisions. In general, under FATCA, unless an exception applies, a withholding agent must withhold 30% U.S. tax on certain payments made to an FFI. Withholding is not imposed, however, if the FFI enters into an agreement with the U.S. government (an "**FFI Agreement**"), requiring, among other things, the FFI to withhold 30% U.S. tax on payments that it makes to certain of its account holders (*i.e.*, those who refuse to provide the FFI with certain required information (so-called, "**recalcitrant account holders**")) and to "nonparticipating" FFIs ("**NPFFIs**"). More specifically, Section 1471(b)(1)(D) of the Internal Revenue Code specifies that, under the terms of an FFI Agreement, in order for an FFI to be a "participating" FFI (a "**PFFI**") and be exempt from the 30% FATCA withholding tax, it must agree, among other things, to withhold 30% tax on so-called "**passthru payments**" that it makes to recalcitrant account holders and NPFFIs.

Under FATCA, a passthru payment is defined as "any withholdable payment or other payment to the extent attributable to a withholdable payment",[2] and a withholdable payment is defined, except as otherwise provided by the Secretary of the Treasury, as any U.S. source fixed or determinable, annual or periodical ("**FDAP**") income together with gross proceeds from a sale or other disposition of property of a type that can produce U.S. source interest or dividends.[3] Note that the Secretary is explicitly given authority to exclude payments from treatment as withholdable payments,[4] and that there is no statutory definition of what it means for a payment to be "attributable to a withholdable payment", presumably allowing the Secretary to define what that means under the specific grant of regulatory authority with respect to FATCA in Section 1474(f) of the Code or the general grant of authority to the Secretary to prescribe all "needful" rules and regulations under Section 7805(a) of the Code.

Notices 2010-6, 2011-34 and 2011-53. Administratively, the IRS and Treasury first asked, in Notice 2010-60, for comments concerning the methods that a PFFI could use to determine whether any payments it makes are attributable to withholdable payments for purposes of Section 1471(b)(1)(D), including any associated information reporting that would be needed to implement the selected method. In that Notice, in soliciting comments, the IRS and Treasury first stated what they believed to be the purposes of passthru payment withholding:

> One of the purposes of requiring withholding on passthru payments is to permit an FFI that has entered into an FFI Agreement to continue to remain in compliance with its agreement, even if some of its account holders have failed to provide the FFI with the information necessary for the FFI to properly determine whether the accounts are U.S. accounts and perform the required reporting, or, in the case of account holders that are FFIs, have failed to enter into an FFI Agreement. The rule also encourages FFIs that do not invest directly in the United States or that do

2 Section 171(d)(7) of the Internal Revenue Code of 1986, as amended (the "**Code**").

3 Section 1473(1) of the Code. An exception from the definition of withholdable payment applies for income and gain that is effectively connected with a U.S. business, and, for purposes of determining whether interest is U.S. source, the special sourcing rule of Section 861(a)(1)(B) of the Code for interest paid by foreign branches of U.S. financial institutions does not apply. *Id.*

4 This is in addition to the authority given to the Secretary (i) to exempt from withholding payments made to classes of persons identified by the Secretary as posing a low risk of tax evasion, Section 1471(f)(4) of the Code, (ii) to exempt from the FATCA reporting requirements any account otherwise subject to information reporting that would make FATCA reporting duplicative, Section 1471(d)(1)(C) of the Code, and (iii) generally to "prescribe such regulations or other guidance as may be necessary or appropriate to carry out the purposes of" FATCA. Section 1474(f) of the Code.

> not hold U.S. assets that produce withholdable payments, but which benefit from investments that produce payments that are attributable to withholdable payments, to enter into an FFI Agreement.[5]

The identified purpose of passthru payment withholding was to encourage participation by FFIs and potentially recalcitrant account holders in the FATCA regime: in the absence of U.S. jurisdiction over the relevant foreign activities, the threat of a 30% withholding tax was intended to induce account holders to turn over account information to PFFIs and to increase the potential cost of noncompliance for FFIs failing to become PFFIs.

Commentators generally responded by proposing a tracing rule to determine whether payments were attributable to withholdable payments, but, in Notice 2011-34, the IRS and Treasury rejected that proposal on the grounds that it did not serve the purpose of Section 1471(b)(1)(D) identified above:

> Treasury and the IRS have received several comments proposing that a payment attributable to a withholdable payment should include only payments that are either withholdable payments or directly traceable to withholdable payments. These approaches would not, however, be consistent with the purposes underlying the passthru payment concept. As described in Notice 2010-60, one purpose of the passthru payment rule is to encourage FFIs to enter into FFI Agreements if they hold investments that produce payments that are attributable to withholdable payments, even if they do not directly hold assets that produce withholdable payments. Without such a rule, participating FFIs could be used as "blockers" through which non-participating FFIs might benefit from indirect investment in U.S. assets…without being subject to withholding or entering into an FFI Agreement. The approach suggested by the comments described above would largely limit the definition of passthru payments to payments that would constitute withholdable payments and thus would fail to address account holders who invest in U.S. assets indirectly… Accordingly, Treasury and the IRS have not adopted the limited definition of a passthru payment proposed in such comments.[6]

In Notice 2011-34, as indicated above, the IRS and Treasury first identified the problem of "blockers": PFFIs "fronting" for NPFFIs, and converting otherwise withholdable U.S. source FDAP income received by the "blocker" into non-withholdable foreign source income paid by

5 Notice 2010-60, I.R.B. 2010-37, Section V.B. (Aug. 27, 2010), *supplemented and superseded by* Notice 2011-34, I.R.B. 2011-19 (Apr. 8, 2011).

6 Notice 2011-34, Section II, I.R.B. 2011-19 (Apr. 8, 2011).

the "blocker". For example, a PFFI investment company holding U.S. bonds could issue debt to an NPFFI bank. Without the rule regarding passthru payments attributable to withholdable payments, IRS and Treasury feared that there would be no incentive for the NPFFI bank to enter into an FFI Agreement. Because the NPFFI bank would receive foreign-source interest on the PFFI's debt, that interest would not constitute a "withholdable payment" subject to FATCA withholding tax. As a result, the NPFFI bank effectively would be able to invest in U.S. assets without participating in the FATCA reporting system. There would be no real incentive for those NPFFIs to enter into an FFI Agreements.

Accordingly, the IRS and Treasury stated in Notice 2011-34 that they intended to promulgate regulations that, in general, would provide that a payment made by an FFI (the payor FFI) would be a passthru payment to the extent of: (i) the amount of the payment that was a withholdable payment (*i.e.*, the amount that was U.S. source FDAP); plus (ii) the amount of the payment that was not a withholdable payment multiplied by (A) in the case of a "custodial" payment, the "passthru payment percentage" of the entity that issued the instrument held in custody, or (B) in the case of any other payment, the passthru payment percentage of the payor FFI.[7]

A PFFI's passthru payment percentage was to be based on the FFI's total assets and U.S. assets, as of the relevant quarterly testing dates, and to be determined by dividing the sum of the FFI's U.S. assets held by the FFI on each of the four quarterly testing dates prior to the relevant payment, by the sum of the FFI's total assets held on those dates. The quarterly testing date for an FFI was to be either the last redemption date of the quarter (for entities that conducted redemptions at least quarterly) or the last business day of the quarter (for all other entities), in either case determined in accordance with the FFI's fiscal year. The amount of total assets and U.S. assets was to be determined based on financial statements provided by the FFI to holders of interests in the relevant FFI, but the determination of which assets were U.S. assets was based in part on a relatively complicated set of rules meant to take into account tiering: situations where one PFFI held interests in another PFFI.[8] In general, in determining its own passthru payment percentage, a PFFI had to look to the published passthru payment percentage of any PFFI in which it held an interest in order to determine what percentage of that asset was a U.S. asset.

In order to make possible the necessary calculations, PFFIs were to be required to publish their quarterly passthru payment percentage within 3 months of the end of the relevant quarter.

7 *Id.*, Section II.A.

8 *Id.*, Sections II.B.1, 3–4.

Any PFFI that did not calculate and publish its passthru payment percentage in the required manner was to be deemed to have a passthru payment percentage of 100 percent.[9]

Notice 2011-53,[10] as revised, provided further relief with respect to the timing of FATCA implementation, in light of the "numerous comments concerning the practical difficulties in implementing aspects of [FATCA] within the time frames provided." Among other delayed starting dates, the Notice provided that PFFIs would not be required to withhold on passthru payments that were not withholdable payments (*i.e.*, there would be no withholding on foreign passthru payments) to the extent those payments were made before January 1, 2015, and PFFIs would not be required to publish their passthru payment percentages before the first quarter of 2014.

Accordingly, as of the middle of 2011, the Treasury and IRS were apparently still looking principally to the 30% FATCA withholding tax to compel foreign financial institutions to sign FFI agreements with the U.S. Treasury and, implicitly, to deal with the problem of "blockers". The Notice, however, did observe that "a number of stakeholders have noted that complying with certain provisions may require coordination with a number of foreign governments. Treasury and the IRS have met with stakeholders and foreign governments to understand the specific administrative and legal challenges that must be addressed and the time necessary to do so."[11] In particular, among other legal challenges, the FATCA reporting and passthru payment withholding requirements were in conflict with the requirements of a number of foreign laws (concerning, among other things, data privacy and the effect of foreign laws on domestic transactions) and, even where such restrictions did not apply, were considered by many foreign governments to be an unjustified extraterritorial extension of U.S. tax jurisdiction over foreign financial institutions located in those jurisdictions.

In response to these concerns, by the beginning of 2012, the discussions with foreign governments began to bear fruit with the development of IGAs between the United States and a foreign government that rely on the relevant foreign law and international agreements (rather than agreements with foreign financial institutions and a punitive withholding tax) to obtain the desired information on U.S. account holders.[12]

9 *Id.*, Sections II.B.1, 5.

10 I.R.B. 2011-32 (July 25, 2011).

11 *Id.,* Section I.

12 The first public discussion of the approach eventually taken was announced by Emily S. McMahon, Acting Assistant Secretary for Tax Policy, at the Annual Meeting of our own section of NYSBA on January 24, 2012. She described the challenge and response as follows:

Intergovernmental Agreements. The process of reaching so-called "Intergovernmental Agreements" with respect to FATCA compliance difficulties first bore fruit on February 8, 2012, when the G5 (France, Germany, Italy, Spain and the U.K.) and the United States issued a Joint Statement setting out an agreement to explore an intergovernmental approach to improving international tax compliance and implementing FATCA.[13] Following further negotiations, on July 26, 2012, the G5 and United States issued a further Joint Statement announcing the publication of the "Model Intergovernmental Agreement to Improve Tax Compliance and to Implement FATCA" (The Model Agreement).[14] This Agreement took a fundamentally changed approach to the enforcement of FATCA reporting. Rather than imposing compliance through a private law agreement (*i.e.*, through FFI Agreements between the U.S. Treasury and various foreign financial institutions) back-stopped by the threat of a 30% withholding tax on non-compliant persons NPFFIs and recalcitrant account holders), compliance was to be required under foreign public law. That is, the foreign jurisdictions with which the U.S. Treasury signed Intergovernmental Agreements would impose compliance with the FATCA due diligence and reporting regime un-

> A second challenge presented by FATCA is that certain of its key components conflict, to varying degrees, with privacy or other laws in many countries. In some countries, for example, financial institutions may be unable—under their country's existing laws—to comply with the core requirement that they report customer information directly to the IRS. The requirement to withhold on passthru payments presents a similar challenge.
>
> To address this set of issues, foreign governments could make changes to their own internal laws to accommodate FATCA reporting (as was done in the case of the Qualified Intermediary program). Alternatively, we have indicated that we are open to exploring an intergovernmental approach to FATCA implementation that would address legal impediments to direct reporting.
>
> To that end, Treasury's international team has already begun conversations with a number of our major trading partners about bilateral approaches to overcome legal impediments and facilitate compliance. A key element of these efforts has been to explore the possibility that financial institutions of a particular country could report the information required by FATCA to their home country government, which would then transmit the information to the IRS, in order to overcome legal obstacles to direct reporting.

Tax Analysts Document Number 2012-1536, 2012 WTD 17-30.

13 U.S. Treasury Department Press Release, "Joint Statement from the United States, France, Germany, Italy, Spain, and The United Kingdom Regarding an Intergovernmental Approach to Improving International Tax Compliance and Implementing FATCA" (Feb. 8, 2012), Tax Analysts Document Number 2012-2510, 2012 WTD 27-35.

14 Joint Communiqué by France, Germany, Italy, Spain, The United Kingdom and The United States on the Occasion of the Publication of the "Model Intergovernmental Agreement to Improve Tax Compliance and Implement FATCA" (July 26, 2012), Tax Analysts Document No. Doc 2012-15913, 2012 TNT 145-26.

der their own domestic law, require the financial institutions over which they had jurisdiction to report on U.S. accounts to their own tax authorities and automatically report the information so collected about U.S. accounts to the IRS under existing (or newly agreed) information sharing protocols.[15] As a *quid pro quo* for agreeing to enforce FATCA, among other things, the so-called "partner jurisdictions" would obtain exemption from the withholding tax for the financial institutions over which they had jurisdiction, and those financial institutions were excused from the requirement to sign a FFI Agreement with the U.S. Treasury and the concomitant obligation to withhold on passthru payments.[16]

These IGAs, however, recognized the problem of "blockers" described above, and two provisions were included in the Model Intergovernmental Agreement (subsequently labeled a Model 1 Agreement, in light of the model developed with Japan and Switzerland described below) in order to address this issue. First, there was a provision intended to allow the United States to judge the extent to which "blockers" were in fact a real issue. For the years 2015 and 2016, a "reporting" FFI in a partner jurisdiction was required to report to its domestic tax authority (which in turn would report to the IRS) the name of each Nonparticipating Financial Institution to which it had made payments and the aggregate amount of such payments.[17] Second, under the Model Intergovernmental Agreement, the parties to the IGA committed themselves to work together, along with other partner jurisdictions, "to develop a practical and effective alternative approach to achieve the policy objectives of foreign passthru…withholding that minimizes burden."[18]

A similar route using intergovernmental agreements was also followed with Japan and Switzerland. Joint Statements between the United States and Japan, on the one hand, and the United States and Switzerland, on the other, were released on June 21, 2012. These statements outlined an alternative approach to FATCA compliance. Financial institutions in Japan and Switzerland would be exempted from FATCA withholding and from the obligation to withhold on foreign passthru payments. In exchange, Japan generally agreed to (A) "direct and enable" finan-

15 Model Intergovernmental Agreement to Improve Tax Compliance and Implement FATCA (July 26, 2012), Tax Analysts Document No. Doc 2012-15912, 2012 TNT 145-28.

16 *Id.*

17 Agreement between the Government of The United States of America and the Government of The United Kingdom of Great Britain and Northern Ireland to Improve International Tax Compliance and to Implement FATCA ("**UK IGA**") Article 4.1(b) ; Model Intergovernmental Agreement (July 26, 2012 version) Article 4.1(b).

18 UK IGA Article 6.2; Model Intergovernmental Agreement (July 26, 2012 version) Article 6.2.

cial institutions in Japan to register with the IRS and comply with FATCA guidance issued by Japan's Financial Service Agency that would include requirements that are "consistent with" the obligations of PFFIs under FATCA, including (i) performing due diligence to identify U.S. accounts, (ii) annual reporting (directly to the IRS) of information about U.S. accounts, and (iii) annual reporting (directly to the IRS) of aggregate information about recalcitrant accountholders; and (B) accept requests from the IRS regarding Japanese FFI recalcitrant account holders, which were reported to the IRS by Japanese FFIs on an aggregate basis.[19] Similarly, Switzerland generally agreed to (A) "direct" Swiss financial institutions to conclude FFI Agreements with the U.S. Treasury and "enable" those financial institutions to comply with the obligations so undertaken, and (B) accept and honor group requests by the IRS for additional information under the relevant provision of the Swiss-U.S. tax treaty about U.S. accounts identified as recalcitrant and reported to the IRS by Swiss FFIs on an aggregate basis.[20]

Proposed Regulations – Blockers Revisited. At the same time as the U.S. Treasury released the first Joint Statement with the G5, the IRS and Treasury promulgated proposed regulations on FATCA compliance.[21] Those proposed regulations acknowledged the difficulties ("the costs, administrative complexity and legal impediments") that PFFIs would have in identifying and withholding on passthru payments.[22] Accordingly, the proposed regulations reserved on the question of foreign passthru payment withholding,[23] stated that foreign financial institutions (other than intermediaries with respect to certain U.S. source withholdable payments) would not be required to withhold tax on payments made to account holders or NPFFIs before

[19] "Joint Statement from the United States and Japan Regarding a Framework for Intergovernmental Cooperation to Facilitate the Implementation of FATCA and Improve International Tax Compliance", Tax Analysts Document No. 2012-13338, 2012 TNT 121-26.

[20] "Joint Statement from the United States and Switzerland Regarding a Framework for Cooperation to Facilitate the Implementation of FATCA", Tax Analysts Document No. 2012-13335, 2012 TNT 121-25.

[21] REG-121647-10, 77 Fed. Reg. 9021 (Feb. 15, 2012).

[22] Preamble Section "Explanation of Provisions" I.A.8, 77 Fed. Reg. at 9028.

[23] Prop. Regs §§ 1.1471-4(b)(3); -5(h)(2); Preamble Section "Explanation of Provisions" VI.G, 77 Fed. Reg. at 9036.

January 1, 2017,[24] and discussed the existence of the negotiations with foreign governments that could eliminate the obligation to withhold on foreign passthru payments entirely.[25]

As a result of the reservation in the Proposed Regulations on the definition of foreign passthru payment, the provisions of Notice 2011-34 regarding the calculation and publication of passthru payment percentages were not picked up by the Proposed Regulations. Nonetheless, the Preamble to the Proposed Regulations requested comments on ways to reduce the burdens associated with the calculation of passthru payment percentages,[26] and proposed an interim rule for calendar years 2015 and 2016 that required PFFIs to report annually to the IRS the aggregate amount of foreign source FDAP and certain other payments made to each NPFFI to which the PFFI made payment.[27] The purpose of this interim rule was, in the absence of withholding, "to reduce incentives for nonparticipating FFIs to use participating FFIs to block the application of the [FATCA] rules."[28] Again, the ability of PFFIs to front for NPFFIs is identified as the rationale for imposing withholding tax on foreign passthru payments and becomes the rationale for imposing temporary, additional reporting obligations on PFFIs.

At the same time, the Preamble to the Proposed Regulations identified a second "blocker" issue that would make foreign passthru payment withholding avoidable. This blocker scenario involved the use of U.S. withholding agents, and arose from the FATCA statutory provisions with respect to withholding. U.S. withholding agents, under FATCA, are not generally required to report or withhold on foreign source payments. A PFFI could therefore make a foreign source foreign passthru payment to a U.S. withholding agent that, in turn, could make a payment free of FATCA reporting or withholding to a NPFFI. The Preamble reports as follows, requesting comments on possible approaches to address the issue:

> In addition, future guidance will prevent U.S. and territory financial institutions from serving as "blockers" with respect to foreign passthru payment reporting and withholding. The Treasury Department and the IRS are aware that, because a U.S. withholding agent is currently required to withhold only with respect to withholdable payments, while a participating FFI is generally required to withhold on all

[24] Preamble Section "Explanation of Provisions" I.A.8, 77 Fed. Reg. at 9028; Preamble Section "Explanation of Provisions" II.B.1, 77 Fed. Reg. at 9028.

[25] Preamble Section "Background" II, 77 Fed. Reg. at 9023; Preamble Section "Explanation of Provisions" I.A.5, 77 Fed. Reg. at 9027.

[26] Preamble Section "Explanation of Provisions" XIX.E, 77 Fed. Reg. at 9041.

[27] Preamble Section "Explanation of Provisions" X, 77 Fed. Reg. at 9039; Prop. Regs §1.1474-1(d)(2).

[28] Preamble Section "Explanation of Provisions" I.A.8, 77 Fed. Reg. at 9028.

> foreign passthru payments, this creates the potential for FFIs to use U.S. withholding agents as "blockers" for foreign passthru payments made to nonparticipating FFIs. The Treasury Department and the IRS are assessing various options to address this issue, including expanding the definition of withholdable payments, or requiring FFIs to perform withholding on foreign passthru payments made to U.S. withholding agents acting as intermediaries.[29]

To sum up: the Proposed Regulations pointed in two opposed directions. On the one hand, in connection with the Intergovernmental Agreement initiative, there was the prospect of eliminating foreign passthru payment withholding entirely, and relying on foreign law to compel production of the relevant U.S. account information sought under FATCA rather than the 30% withholding tax. There was also a clear acknowledgement in the Proposed Regulations that identifying and withholding on foreign passthru payments in the manner outlined in Notice 2011-34 involved significant "costs, administrative complexity and legal impediments" and, even under that method, there remained the problem of U.S. withholding agents potentially serving as "blockers" to avoid withholding. Likewise, there was a desire, repeatedly expressed in the Preamble, for ideas on how to simplify foreign passthru payment identification and withholding, and implicitly an acknowledgement that the "costs, administrative complexity and legal impediments" of foreign passthru payment withholding, if sufficiently large, could themselves defeat the purpose of foreign passthru payment withholding, which was to encourage foreign financial institutions to become PFFIs. On the other hand, there remained the concern that, without an effective means of piercing through blocker entities, some foreign financial institutions would, through the use of blockers, seek to avoid FATCA and refuse to sign FFI Agreements, rather than report on U.S. account holders.

The Final Regulations. Insofar as passthru payments are concerned, the three sets of "final" FATCA regulations (those promulgated on January 17, 2013,[30] on February 20, 2014[31] and December 30, 2016[32]) largely followed the approach of the Proposed Regulations. The definition of "foreign passthru payment" was left "reserved",[33] and the obligation to withhold on these

[29] Preamble Section "Explanation of Provisions" XIX.E, 77 Fed. Reg. at 9041.

[30] T.D. 9610, 78 Fed. Reg. 5874 (Jan. 28, 2013), *corrected by* 78 Fed. Reg. 55202 (Sept. 10, 2013).

[31] T.D. 9657, 79 Fed. Reg. 12811 (Mar. 6, 2014), *corrected by* 79 Fed. Reg. 37175 (July 1, 2014).

[32] T.D. 9809, 82 Fed. Reg. 2124 (Jan. 6, 2017).

[33] Treas. Reg. §1.1471-5(h)(2).

payments postponed at least until Regulations were promulgated defining that term.[34] Meanwhile, extensive changes to the Proposed Regulations were made to facilitate the use of Intergovernmental Agreements, and the Preamble to the January 2013 final regulations indicated that the IRS and Treasury were strongly committed to the Intergovernmental Agreement approach.[35]

The Success of the Intergovernmental Agreement Approach. The process of negotiating and signing Intergovernmental Agreements has been wildly successful. As of September 2016, over 110 Intergovernmental Agreements had been initialed or signed with various foreign jurisdictions.[36] All major U.S. trading partners save Russia have initialed or signed FFI Agreements with the United States, and even Russia, with whom negotiations for an IGA have been suspended because of Russia's occupation of Ukrainian territory, has passed a law permitting its banks to comply with FATCA even in the absence of an FFI Agreement.[37]

In addition, FATCA-like compliance efforts have been sponsored by the OECD and the Global Forum on Transparency and Exchange of Information for Tax Purposes (the "**Global Fo-**

[34] Treas. Reg. §1.1474-(b)(4); *see also* Treas. Reg. §1.1471-2(b)(2)(i)(B) ("Solely for purposes of a foreign passthru payment, the term grandfathered obligation also includes any obligation that is executed on or before the date that is six months after the date on which final regulations defining the term foreign passthru payment are filed with the Federal Register."). The current regulations, effective January 6 of this year, provide that a PFFI is not required to withhold tax on a foreign passthru payment made to a recalcitrant account holder or a NPFFI before the later of January 1, 2019, or the date of publication in the Federal Register of final regulations defining the term foreign passthru payment. T.D. 9809, Section I.D.1, 82 Fed. Reg. at 2133.

[35] Preamble Section "Background" IV.B.1:

> The Treasury Department and the IRS believe that IGAs represent efficient and effective ways of implementing the requirements of chapter 4 and will continue to conclude bilateral agreements based on the two models [sc. of intergovernmental agreements] with interested jurisdictions. In addition, the Treasury Department and the IRS continue to receive comments strongly supporting the approach to FATCA implementation embodied in the IGAs. The Treasury Department and the IRS remain committed to working cooperatively with foreign jurisdictions on multilateral efforts to improve transparency and information exchange on a global basis.

78 Fed. Reg. at 5877.

[36] Tax Analysts FATCA Expert, IGA Status, www.taxnotes.com/FATCA-expert/IGA-status (current as of Sept. 23, 2016).

[37] Kristen A. Parillo, *New Russian Law Permits FATCA Compliance*, TAX NOTES TODAY, Doc. No. 2014-16328, 2014 TNT 126-2 (July 1, 2014).

rum"). As of the beginning of November 2016, under the auspices of the Global Forum, 101 jurisdictions (not including the United States) have committed to the Global Forum's Automatic Exchange of Information (AEOI) Standard, which requires automatic exchange of information regarding financial accounts among participating members.[38] Implementing this effort will be monitored by an expert panel, and procedures for comprehensive reviews under a framework to be developed are part of this initiative.[39] The FATF, which proposes global standards for anti-money laundering (AML) and combating the financing of terrorism (CFT) and evaluates compliance globally, is also coordinating its transparency projects in the AML/CFT arena with those of the Global Forum, and hopes to coordinate its beneficial ownership standard with that of the Global Forum.[40] Finally, under the OECD's "Common Reporting System", and the multilateral treaty sponsored by the OECD to implement it, account information about foreign account holders will be exchanged automatically by at least 50 jurisdictions in 2017.[41]

These efforts by the Global Forum, FATF and OECD are an important part of the existing landscape for the United States and its efforts to pursue Intergovernmental Agreements. The information sought by the United States about offshore accounts held by its taxpayers is not fundamentally different from that sought by other jurisdictions with respect to their taxpayers. As it becomes more usual for all jurisdictions to exchange information automatically about nonresident account holders, it becomes less and less feasible for noncompliant financial institutions to operate successfully in places where U.S. investors are likely to want to place funds.

Effect of Intergovernmental Agreements on Need for Foreign Passthru Payment Withholding

If every jurisdiction participates in the intergovernmental agreement system with the United States, it is clear that the problem of "blockers" disappears. Under the terms of the Intergovernmental Agreements and foreign law, foreign financial institutions are required to supply

[38] Statement of Outcomes, 9th Meeting of the Global Forum on Transparency and Exchange of Information for Tax Purposes, Tbilsi, Georgia, 2-4 November 2016, Annex 2, www.oecd.org/tax/transparency/statement-of-outcomes-GF-plenary-2016.pdf.

[39] *Id.* at ¶ 7.

[40] FATF, Beneficial Ownership, FATF Report to the G20 (Sept. 2016), www.fatf-gafi.org/media/fatf/documents/reports/G20-Beneficial-Ownership-Sept-2016.pdf..

[41] OECD Press Release, "Over 1300 relationships now in place to automatically exchange information between tax authorities" , www.oecd.org/tax/exchange-of-tax-information/over-1300-relationships-now-in-place-to-automatically-exchange-information-between-tax-authorities.htm. (Dec. 22, 2016)

information about U.S. account holders either through their domestic tax authority (Model 1 agreements) or directly to the IRS (Model 2 Agreements). If every jurisdiction imposed these reporting obligations on its own financial institutions, effectively it would mean that all FFIs were required to become PFFIs (or the equivalent – a "reporting Model 1 FFI") or establish an exemption from reporting either under the Final Regulations or an applicable intergovernmental agreement. Blockers could no longer be used to exempt NPFFIs from withholding because all FFIs would effectively be required, as either Model 1 or Model 2 FFIs, to report on U.S. account holders (except, of course, for entities entitled to exemption.) To the extent that the purpose of imposing withholding on foreign passthru payments is to discourage the use of blockers and encourage the FFIs to become PFFIs, the widespread adoption of intergovernmental obligations accomplishes that objective without the "costs, administrative complexity and legal impediments" discussed in the Preamble to the Proposed Regulations.[42]

Even without universal compliance, it is unclear whether the remaining noncompliant jurisdictions are attractive to U.S. tax evaders, and whether they can enter into "blocking" arrangements with participating and reporting foreign financial institutions.[43] The reporting on

[42] See above at page 9. It should be emphasized that the legal impediments mentioned in the Proposed Regulations are significant. For FFIs not exempted by an IGA, in the absence of foreign local law allowing withholding on foreign passthru payments, FFIs may well be unwilling to sign FFI agreements that could require them to violate local law. Imposing such withholding could therefore force some PFFIs to terminate their FFI agreements and become noncompliant.

[43] In terms of important financial centers, there is none that currently appears to be noncompliant. As for tax havens, a number of Pacific Islands have not yet concluded, or expressed and intention to conclude, an IGA with the United States, but they have not been the focus of US tax avoidance, and therefore it may be only a matter of time before they agree to an IGA. (Almost all the typical tax havens in Europe and the Caribbean have either signed an IGA or announced their willingness to so do.) The following jurisdictions that were on the list of tax havens published by the OECD in 2000 neither have signed up to FATCA nor are in discussions with the United States. If followed by an asterisk, however, it means they have committed to the OECD's system for the automatic exchange of financial account information, so presumably would be willing to sign up for a FATCA IGA as well if sufficiently pressured:

> Andorra*, Belize*, Cook Islands*, Liberia, Maldives, Marshall Islands*, Monaco*, Nauru*, Niue*, Samoa*, Tonga, Vanuatu*.

See Organisation for Economic Co-operation and Development, *Towards Global Tax Co-operation, Report to the 2000 Ministerial Council Meeing and Recommendations by the Committee on Fiscal Affairs, Progress in Identifying and Eliminating Harmful Tax Practices*, at 17, www.oecd.org/ctp/harmful/2090192.pdf.

payments to NPFFIs required under the various IGAs and the Final Regulations will no doubt provide some insight into this issue.

Even if a problem is detected, however, the response of the United States would have to be undertaken through renegotiation of the various IGAs that, as of now, exempt most foreign financial institutions from having to withhold on any foreign passthru payments. Given the extent of international cooperation in this area, passthru payment withholding may not be the best method to encourage a jurisdiction's participation in a system for the automatic exchange of account information. With passthru payment withholding, compliance costs are imposed on compliant institutions in order to isolate the noncompliant. It may make more sense, if there remains a problem, directly through international action to isolate financial institutions in noncompliant jurisdictions from all or parts of the global financial system, through "naming and shaming", blacklists and similar actions that would impose costs on the noncompliant rather than the compliant. Futhermore, if there remains a problem, such directed action would address the issue of "U.S. blockers" discussed above and identified in the Proposed Regulations of 2012, for which other solutions would appear to be burdensome on U.S. withholding agents.[44]

Finally, even without resort to such measures, there are less burdensome options under FATCA for dealing with "blockers" than geneally imposing withholding on foreign passthru payments. If the Treasury and IRS continue to have concerns about PFFIs in non-IGA jurisdictions acting as "blockers", they could amend the Final Regulations by adding anti-abuse rules that would give the IRS power (a) to require certain PFFIs (or PFFIs from certain jurisdictions) to continue to report payments to non-PFFIs (under current regulations, this reporting is required only for 2015 and 2016), and (b) to terminate an FFI Agreement if the relevant PFFI were serving as a blocker for NPFFIs to a significant degree. With that authority, if the IRS requires continued reporting and sees large payments by the PFFI to non-PFFIs, it could use its power under the FFI agreement to make inquiries about the activity and, ultimately, if the entity is serving essentially as a "blocker", terminate its FFI Agreement.

Apparently, that would leave only Liberia, the Maldives and Tonga as truly resistant jurisdictions. It is unclear the extent to which they would be attractive locations for placing investments or have financial institutions that would be trusted by potential U.S. tax avoiders. (Also, Sint Maarten and Lebanon appear not to be far along in their discussions with the US over FATCA, but they were not listed as tax havens by the OECD in 2000, and they have agreed to implement automatic exchange of information under the OECD CRS system).

44 See above at page 10.

We very much appreciate your consideration of our recommendations and would be happy to discuss them with you or provide additional assistance.

Respectfully submitted,

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