

THE ASSOCIATION OF GLOBAL CUSTODIANS

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STATE STREET BANK AND TRUST COMPANY

COUNSEL AND SECRETARIAT TO THE ASSOCIATION:

BAKER & MCKENZIE LLP

EUROPE  
ATT: ARUN SRIVASTAVA  
100 NEW BRIDGE STREET  
LONDON EC4V 6JA, ENGLAND  
INT'L TEL: 44 20 7919 1000

GLOBAL  
ATT: ROBIN TRUESDALE  
815 CONNECTICUT AVENUE, N.W.  
WASHINGTON, D.C. 20006  
TEL: 202 452 7000  
FAX: 202 452 7074

WWW.THEAGC.COM

November 29, 2010

CC:PA:LPD:PR (NOT-121556-10), Room 5203  
Internal Revenue Service  
PO Box 7604  
Ben Franklin Station  
Washington, DC 20044.

**Re: Comments on Notice 2010-60 and on Foreign Account Tax  
Compliance Act (FATCA) Provisions of the Hiring Incentives to  
Restore Employment (HIRE) Act**

Dear Sir or Madam:

I am pleased to provide the attached comments prepared by a working group of the Association of Global Custodians ("AGC") on certain of the FATCA provisions of the HIRE Act.

As you may know, the AGC is an informal group of ten global banking institutions with affiliates and branches in numerous countries that provide global custody services and related securities asset-servicing functions to cross-border institutional investors around the globe. AGC members are listed on the letterhead above.

Our comments focus on FATCA issues of particular concern to custodians. These comments supplement our letter of September 8, 2010 regarding custodian concerns relating to withholding obligations with respect to specified notional principal contracts under new Code section 871(l), of which a copy is attached.

If you have questions concerning the attached comments or would like to discuss any of these issues further, please feel free to contact either myself or Lisa Chavez at

Northern Trust as an initial matter. We are also happy to set up a meeting or conference call with all AGC FATCA working group members at your request.

Sincerely yours,



Carol A. Dunahoo  
Baker & McKenzie LLP  
Counsel to the AGC  
(202) 452-7049

cc: The Honorable Michael Mundaca, Assistant Secretary (Tax Policy),  
U.S. Department of the Treasury  
Stephen E. Shay, Deputy Assistant Secretary for International Affairs,  
U.S. Department of the Treasury  
Manal Corwin, International Tax Counsel, U.S. Department of the Treasury  
Michael J. Caballero, Deputy International Tax Counsel,  
U.S. Department of the Treasury  
Karl T. Walli, Senior Counsel (Financial Products),  
U.S. Department of the Treasury

The Honorable Douglas Shulman, Commissioner of Internal Revenue  
Steven A. Musher, Associate Chief Counsel (International),  
Internal Revenue Service  
Michael Danilack, Deputy Commissioner (International)  
Internal Revenue Service

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### **Supplemental Comments**

#### **Selected Issues Relating to Foreign Account Tax Compliance Act (FATCA) and Notice 2010-60**

The Association of Global Custodians ("AGC") is pleased to provide these supplemental comments on selected issues regarding the Foreign Account Tax Compliance Act ("FATCA") provisions of the Hiring Incentives to Restore Employment Act (the "HIRE Act"), and the guidance provided by IRS Notice 2010-60, released on August 30, 2010. We appreciate the openness of the IRS and Treasury to feedback from industry participants on the FATCA provisions, and your active solicitation of input. We support the general objectives of FATCA, and hope that, with some of the clarifications suggested below, the principles of the HIRE Act may be carried forward in an effective, practical and administrable manner.

#### **The Association of Global Custodians**

As you may know, the AGC is an informal group of ten global banking institutions.<sup>1</sup> AGC members have affiliates and branches in numerous countries that provide global custody services and related securities asset-servicing functions primarily to cross-border institutional investors around the globe.

#### **Executive Summary**

The AGC is aware that many other industry groups whose members are also impacted by the FATCA provisions and other commentators have already submitted extensive comment letters to the IRS and Treasury prior to the release

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<sup>1</sup> The members of the AGC are listed on the letterhead above.

of Notice 2010-60 and have or will likely comment on the Notice as well. Many of the concerns expressed by these other commentators are shared by our members, and we agree with many of the suggestions and ideas highlighted in their letters to date. However, for the purposes of this comment letter, the AGC thought it would be most useful to focus narrowly on a few key issues that we have identified as impacting global custodial banks, which we view as key priorities for guidance and which we believe may not have been fully addressed in other comment letters that have been submitted to date.

As discussed in additional detail below, the AGC respectfully requests further consideration and guidance from the IRS and Treasury on the following issues:

1. Guidance is needed on how custodians and other withholding agents will be able to identify whether clients are "foreign financial institutions" ("FFIs") or "non-foreign financial entities" ("NFFEs"), as those terms are defined for FATCA purposes. The AGC suggests that the IRS permit reliance on self-certifications to this effect and provide clear presumption rules, such as rules based on an "eyeball approach," to facilitate the electronic account review process envisaged by Notice 2010-60.

2. Guidance is needed on how custodians and other withholding agents will be able to identify which FFIs are "participating" FFIs. The AGC suggests that the IRS permit reliance on self-certifications, or, if such reliance alone is not permitted, provide an electronically available database of participating FFIs and a mechanism for notifying withholding agents promptly of a change in qualified status.

3. Treasury and IRS should consider carving out entities that present a low risk of tax evasion or abuse from the definition of "foreign financial entity." The exclusion proposed by Notice 2010-60 for retirement plans is welcome but is in need of expansion.

4. The IRS should adopt an efficient, simplified refund process, separate from the full tax return filing process, to handle instances of excess withholding under FATCA. This should be accomplished through the provision of a grace period in the first instance and subsequently through the provision of simplified refund procedures to provide an efficient system for expedited refunds by the IRS.

5. The IRS and Treasury should address areas where there is a potential for duplication in information reporting, which will be exacerbated when the FATCA withholding and reporting provisions go into effect.

6. We have identified a number of points on which the account identification and documentation procedures described by Notice 2010-60 need clarifications, simplification and coordination with the existing documentation standards under Chapter 3 for withholding of nonresident tax and Chapter 61 for backup withholding.

7. We believe that the application of withholding to a recalcitrant account is a sufficient deterrent to noncompliance. The status of an FFI should not be jeopardized by performing withholding when required to do so. The withholding of a 30 percent tax should suffice to collect U.S. tax revenues that might otherwise be lost.

8. AGC members are concerned about the broad scope of withholding requirements with respect to "passthru payments." Clear guidance is needed as to what types of payments are subject to withholding under these provisions. The information needed to identify a payment as subject to withholding under Chapter 4 also needs to be readily available or easily determinable. We recommend that a passthru payment attributable to a withholdable payment generally be limited to one that is "directly traceable" to a withholdable payment.

9. Treasury and IRS should consider whether withholding agents should be required in all cases to accept an "Election to be Withheld Upon," and in particular whether the election should be available for co-mingled or pooled accounts. In view of the significant administrative burdens, AGC recommends making the election to be withheld upon a mutual agreement between the FFI and the downstream withholding agent.

10. IRS should develop a modified Form W-8, or series of Forms W-8, to streamline the process of self-certification and reduce administrative burdens and costs for investors, participating FFIs, and U.S. withholding agents; and should resolve longstanding disputes with respect to whether inconsequential errors on Forms W-8 should cause the forms to be treated as invalid.

## **Discussion**

Further to the above, the AGC is pleased to provide the following specific comments and recommendations:

### **1. Identifying foreign financial institutions versus non-foreign financial entities**

Many commentators have emphasized the need for payors to be able to differentiate between compliant and non-compliant FFIs. However, AGC

members are concerned in the first instance with lack of clarity regarding the definitions of “foreign financial institutions” (“FFIs”) and “non-foreign financial entities” (“NFFEs”). FATCA sets forth entirely separate regimes for the due diligence and reporting requirements applicable to withholdable payments made to foreign entities that are FFIs, as opposed to those that are NFFEs. As a result, a custodian will first need to know whether the recipient is an FFI or an NFFE.

Notice 2010-60 sets forth a series of steps that must be taken to determine whether a pre-existing entity account is to be treated as held by an FFI.<sup>2</sup> Accounts must first be reviewed for indicia of U.S. status. Then all account holders not treated as U.S. persons are presumed foreign and the FFI (or USFI) must determine whether the entity’s name (or other information readily available in electronically searchable files) “clearly indicates that the entity is an FFI.” Entities so identified are treated “tentatively” as FFIs and must be asked to provide documentation indicating whether they are a participating FFI, a deemed-compliant FFI, a non-participating FFI, an entity described in section 1471(f), or an NFFE. However, the Notice does not describe the type of information that would clearly indicate that an entity is an FFI, and the AGC recommends that the IRS develop a set of clear presumption rules to be used for this purpose.

The FFI presumption rules might follow an “eyeball test” approach, setting forth specific words that when included in the name of an entity would result in the entity being presumed to be an FFI (*e.g.*, bank, trust, fund). Such an eyeball test has been successfully used to identify foreign financial institutions as exempt recipients for Form 1099 reporting purposes. USFIs and FFIs are going to need clear guidance on how to determine whether a payee or account holder should be treated as an FFI for NFFE, based on name alone, as they will not likely have other information available to determine whether a payee or account holder is engaged in the activities that would make them a “financial institution” as defined in section 1471(d)(5).

AGC recommends that the IRS and Treasury allow a self-certification process for new entity accounts, whereby withholding agents can rely on a certification provided by an entity as to its status as either an FFI or an NFFE (*e.g.*, on a Form W-8BEN or other Form W-8 revised for this purpose). A certification on the relevant Form W-8 would be signed under penalty of perjury, so the risk of false certifications by foreign entities is low. In addition, where withholding agents do not collect Forms W-8 for new accounts, and rely instead on documentary evidence, the presumption rules designed for use in identifying

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<sup>2</sup> See Notice 2010-60 at section III.B.3.a.

FFIs through review of electronically searchable files described above should be permitted to be relied upon.

In addition, foreign entities will need clear guidance on how to determine whether they are considered FFIs or NFFEs under the FATCA provisions, so that they can accurately complete certifications with confidence. In particular, detailed guidance is needed with respect to what it means to be engaged "primarily" in the business of investing, reinvesting or trading in securities, partnership interests, or commodities. The IRS may also want to consider an expedited ruling process whereby foreign entities in doubt of their FFI versus NFFE status may request an IRS ruling on the question.

## **2. Identifying which clients are "participating foreign financial institutions" ("participating" FFIs)**

Similarly, the AGC requests that future guidance clarify how withholding agents will be able to identify whether payees are deemed compliant FFIs or are "participating" FFIs that have entered into an agreement with the IRS. AGC members would prefer that such guidance provide for self-certifications. However, if withholding agents are not permitted to rely solely on certifications, the AGC would echo suggestions made by other organizations that the IRS publish a list of participating FFIs that may be relied upon by withholding agents. The AGC offers the following suggestions in this connection:

- The list should be electronically available and updated regularly by the IRS. It should assign each participating FFI a unique identifying number, to avoid confusion (for example, in cases where FFIs such as investment funds have similar names that may be difficult to differentiate). The list should contain the full name and the EIN of each FFI.
- The IRS and Treasury should consider whether a participating FFI determination letter or other documentation could be provided to participating FFIs for them to provide to withholding agents during the period before their name is included in a formal database.
- The database should ideally be available through a web-based application at no cost to the user.
- Guidance should also specify the applicable due diligence standard for withholding agents relying on participating FFI certifications and the published list. For example, in cases where participating FFI status is revoked, notification should be provided in a manner that does not impose an unmanageable administrative burden on withholding

agents. Any such notice system would need to be timely and should not require withholding agents to review the list to determine FFIs that have been removed. IRS should consider whether notices regarding FFIs removed from the list of participating FFIs could be sent electronically via email or similar means to registered users of the list to increase timeliness and efficiency.

### **3. Carve-outs from FFI regime**

Treasury and IRS should consider carving out entities that present a low risk of tax evasion or abuse from the definition of "foreign financial entity," including pension funds.

We note that Notice 2010-60 proposes that payments beneficially owned by retirement plans will be exempt from withholding where the retirement plan (i) qualifies as a retirement plan under the law of the country in which it is established, (ii) is sponsored by a foreign employer, and (iii) does not allow U.S. participants or beneficiaries other than employees that worked for the foreign employer in the country in which such retirement plan is established during the period in which benefits accrued.

We would urge Treasury and IRS to consider the restrictive nature of these conditions. Specifically, condition (i) does not take into account various national pension scheme arrangements. Condition (ii) would exclude retirement plans operated for employees of branches of U.S. banks (and other organizations) as there is not a "foreign employer", even though the retirement plan would be regarded as an entirely separate legal entity from the plan sponsor. And condition (iii) would seem to disqualify a retirement plan where there is a U.S. dependent "beneficiary" linked to an employee covered by the plan. In conclusion, we would suggest that condition (i), expanded to include national pension scheme arrangements, should be considered sufficient to qualify a retirement plan for this exception.

### **4. Refund process**

Once the Chapter 4 withholding provisions go into effect, they are likely to cause many more instances of excess withholding of tax, especially in the initial period. To require an investor to file a full U.S. tax return to obtain a refund of Chapter 4 withholding tax in every such case would likely be too burdensome on investors, as well as on the IRS tax return processing system. To address this potential overwithholding, we request that Treasury and IRS develop a simplified, separate refund form and procedure that can be easily used by both FFIs and their underlying investors to obtain refunds where due in an efficient manner.

*a. Refunds issued by FFIs*

We believe that a pragmatic approach to situations of overwithholding on clients' accounts would be to allow withholding agents themselves to refund clients within a given grace period. This refund could then be offset against the withholding agent's future tax deposits. For example, a withholding agent could be permitted to refund a client's account within the same tax year in which the overwithholding situation has occurred.

This approach should alleviate a large portion of the administrative burden a high number of tax refunds could impose on the IRS.

*b. Refunds issued by IRS*

While many situations of overwithholding can be addressed using the above-mentioned method, there will inevitably be situations where overwithholding will need to be addressed by the IRS instead. Accordingly, the IRS and Treasury also will need to develop and provide guidance on an efficient and expedited process for refunds. We would urge that a simplified form and process separate from the full tax return process be developed for this purpose, to ensure that such refunds will be provided in an efficient manner where due. This will be critical to the long-term administration and viability of the FATCA withholding system.

**5. Potential for duplication in reporting**

The AGC also requests that forthcoming guidance on FATCA address situations of duplicative information reporting, which we believe will only be exacerbated by the new FATCA withholding provisions.

*a. Offshore Funds Formed as Partnerships*

As an example of duplicative reporting, a custodian paying a nonwithholding foreign partnership (NWFP) is currently required to issue Forms 1099 for the U.S. non-exempt recipient partners of the NWFP.<sup>3</sup> In addition to that reporting, the foreign partnership itself would generally be required to file a Form 1065 and issue Schedules K-1 to its U.S. partners.<sup>4</sup>

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<sup>3</sup> Treas. Reg. sections 1.6049-5(d)(3) and 1.6045-1(g).

<sup>4</sup> Treas. Reg. sections 1.6031(a)-1(b) and 1.6031(b)-1T.

Under the new FATCA reporting rules, the fund would be an FFI, and would be required to perform FATCA information reporting (or full Form 1099 reporting) if the partnership is a participating FFI.<sup>5</sup>

Guidance should eliminate potential duplicative reporting between the upstream payors and the partnership in such an instance. The AGC recommends that guidance be issued that removes the information reporting requirements of a withholding agent, payor or broker (collectively, "payer") under Chapter 4 and Sections 6041 through 6049 of the Code, provided the payer knows that the payments are accounted for on Schedules K-1 filed with the IRS.<sup>6</sup> Payer reporting in addition to Schedules K-1 creates an unnecessary burden and expense to the payer. It also provides misleading information to the partner, who should rely on the more complete Schedule K-1. An upstream payer should be permitted to rely on a written representation by the partnership that the partnership issues Schedules K-1 to remove the payer's reporting obligations under Chapter 4 and Sections 6041 through 6049. Alternatively, a payer making a payment to a foreign partnership should be permitted to rely on the participating FFI status of the foreign partnership to remove the payer's obligation under Sections 6041 through 6049 to file Forms 1099 for the U.S. partners of the partnership. Accordingly, a custodian paying a NWFP would not be required to issue Forms 1099 for the partners of the NWFP provided that the custodian establishes that the partnership is a participating FFI, regardless of whether the custodian knows whether the Schedule K-1 requirements have been satisfied. There would be no need for Forms 1099 to be issued by the custodian in that situation because the partnership will be required to either issue Schedules K-1 or meet the reporting requirements under Section 1471(b), either of which will result in disclosure of the U.S. partners and the payments to the IRS.

*b. Offshore Funds Treated as Corporations for U.S. Tax Purposes*

Duplicative reporting may also arise in the case of a fund treated as a foreign corporation for U.S. tax purposes. Under Chapter 4, the fund itself will be an FFI, and will be required to identify and report on its U.S. investors and U.S.-owned investors. In addition, the fund may have a transfer agent that is itself an FFI also subject to the Chapter 4 U.S. account identification and reporting rules

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<sup>5</sup> Code section 1471(b).

<sup>6</sup> Authority eliminating Form 1099 reporting if Schedule K-1 is issued already exists for certain payments. See Treas. Reg. sections 1.6045-1(c)(3)(v) for redemptions reported on Form 1065 and 1.6041-3(f) for profits paid to individual partners reported on Schedule K-1. Authority eliminating duplicative reporting should be broadened to cover all payments under Chapter 4 and Sections 6041 through 6049 that are accounted for on Schedule K-1.

with respect to the same group of “account holders” (*i.e.*, the investors in the fund to whom the transfer agent makes payments on behalf of the fund).

Under existing rules in Sections 6041 through 6049, a U.S.-owned transfer agent is a controlled foreign corporation (“CFC”), which is treated as a “U.S. payor” or “U.S. middleman,”<sup>7</sup> and is required to report certain payments to U.S. persons under those provisions. The Notice makes it clear that CFCs will be treated as FFIs and will be subject to the FFI reporting requirements. As a result, unless this duplication is dealt with in the regulations, a CFC would report the same information twice. To eliminate this unnecessary duplicative reporting, the AGC recommends that future guidance specify that a CFC treated as an FFI will satisfy its reporting obligations as a “U.S. payor” or “U.S. middleman” under Sections 6041 through 6049 and as an FFI under Section 1471(b)(1)(C) if it provides the reporting described in either paragraph (1) or (2) of Section 1471(c).

Any other situations resulting in duplicative information reporting should be similarly eliminated.

## **6. Documentation requirements**

Notice 2010-60 at Section III provides a preliminary description of the framework under which participating FFIs and USFIs may be expected to collect information and identify the owners of financial accounts. While we welcome this advance look at what the account identification and documentation rules might be, we find that the step-by-step description of responsibilities needs clarifications, simplification and perhaps most importantly coordination with the existing documentation standards under Chapter 3 for withholding of nonresident tax and Chapter 61 for backup withholding. The objective should be to rationalize these regimes, so that they work together. For example, once the foreign status of an account is established with documentation under FATCA then no additional documentation should be required to establish foreign status under these other two regimes.

### ***a. Transition Periods***

The Notice distinguishes between new accounts and pre-existing accounts (accounts that exist on the date the FFI agreement becomes effective). Further it distinguishes between accounts for individuals and accounts for entities. For existing accounts in the name of individuals, the Notice would allow up to two years for documenting the status of accounts that have certain U.S. indicia and up to five years for obtaining documentary evidence of foreign status

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<sup>7</sup> Code section 1471(e); Treas. Reg. sections 1.6049-5(c)(5) and 1.6045-1(a)(1).

from accounts without such U.S. indicia. However, the Notice would only allow up to two years for documenting the status of the owners of entity accounts. We recommend that the transition period for collecting required documentation from existing accounts be set at a minimum of five years. Treasury and IRS should also consider extending the five-year period where an FI has a very large number (e.g., in excess of 1 million) of undocumented accounts. This would simplify and ease the administration of the documentation process for existing accounts.

For existing accounts in the name of a presumed foreign individual, Step 4 would require an FFI to "solicit" specified documentation from undocumented accounts that have certain U.S. indicia in the first year, and treat accounts that do not respond within one year from the date of the request as recalcitrant. In contrast, for existing accounts in the name of a presumed foreign entity and tentatively classified as an FFI, Step 3c would require an FFI to solicit an FFI EIN and certification of participating FFI status and if no response is received within the first nine months, then the FFI would be required to solicit documentation indicating whether the entity is a participating FFI, a deemed-compliant FFI, a non-participating FFI, an entity described in section 1471(f), or an NFFE. If such documentation is not provided within one year after the date of the request, the FFI would be treated as a non-participating FFI as of such date. We believe that the time frames for making solicitations should be simplified and made uniform. The proposed two solicitations within the first year to presumptive FFIs could be collapsed into a single solicitation. The completion dates for all steps in the documentation process should be regularized by making the end date on December 31 of the year in which the task must be completed and the period for completion of the specified task(s) should be a minimum of one year (not nine months or three months). Then, the undocumented accounts would be treated as recalcitrant beginning on the first day of the next year.

*b. Substantiation of Foreign Status When the Account Has U.S. Indicia*

Notice 2010-60 specifies in step 3 of Section III.B.2.a (Pre-existing Accounts) and step 4 of Section III.B.2.b (New Accounts) six indicia of potential U.S. status for individuals. Then in step 4 of Section III.B.2.a (Pre-existing accounts) and step 5 of Section III.B.2.b (New Accounts), the Notice divides these indicia into two categories and requires different grades or levels of documentation to prove foreign status, depending on the perceived likelihood that individuals with the specified indicia are in fact U.S. persons. For example, if the individual has a residence address or a place of birth in the United States, the individual would need to provide both a Form W-8BEN and documentary evidence to establish foreign status. However, if the individual has only an "in care of" address or a P.O. address that is the sole address on file for the account, the individual would need to provide either a Form W-8BEN or documentary evidence of foreign status. We believe that the grading of indicia of

U.S. status is unnecessary and will make the administration of the documentation standards under Chapter 4 confusing and very difficult, if not impossible, for FFIs to administer and explain to account holders. There should be no distinction among different indicia of U.S. status. The same documentation should be required to be provided to establish foreign status no matter which type of U.S. indicia exists.

In addition, future guidance under Chapter 4 on the documentation required to substantiate foreign status when indicia of U.S. status are present needs to be coordinated and reconciled with the existing requirements under Treas. Reg. section 1.1441-7(b)(5) and (8). If, for example, an individual presents a Form W-8BEN but has a residence address or a mailing address in the United States, the withholding agent cannot rely on the Form W-8BEN unless it has or obtains (1) documentary evidence (which does not contain a U.S. address) of foreign status and (2) a reasonable explanation in writing that supports the claim of foreign status. Treas. Reg. section 1.1441-7(b)(5)(i)(A)(1). We believe that documentary evidence alone should be sufficient to substantiate a claim of foreign status on a Form W-8BEN both for purposes of Chapter 3 and Chapter 4. Furthermore, where a withholding agent receives one piece of documentary evidence for an account that has a mailing or residence address in the United States, a second piece of documentary evidence or a Form W-8BEN should be sufficient to substantiate the claim of foreign status. See section 1.1441-7(b)(8)(ii)(A). There is no public guidance on what facts or representations should be included in such an explanation and there are no established standards for a withholding agent to determine the acceptability of the explanation. As a result, there is generally little value added in such explanatory letters. Accordingly, we recommend that the requirement under Chapter 3 to obtain a reasonable explanation to confirm foreign status be eliminated.

*c. The "Documentary Evidence" Standard*

Notice 2010-60 does not define the term "documentary evidence." It is also not entirely clear from the context of its use in the Notice that the term excludes beneficial owner certificates (*i.e.*, Forms W-9, Form W-8BEN, Form W-8ECI or Form W-8EXP). First, we recommend that future guidance distinguish between beneficial owner certificates and documentary evidence, as do the existing regulations under Codes sections 1441 and 6049. See especially, Treas. Reg. 1.1441-1(c)(17). This is important because FIs need to know when beneficial owner certificates are required and when documentary evidence is sufficient. One of the biggest reasons for objections to FATCA outside the United States is the fear that Treasury/IRS will require an FFI to collect beneficial owner certificates from all beneficial owners, including owners of non-financial foreign entities. This would be especially troublesome where the account does

not expect to receive any U.S. source income or transact in U.S. securities. The fact that the official IRS forms and their instructions are not available in any foreign languages (except for the Spanish version of Form W-9) is another obstacle to obtaining withholding tax certificates in some foreign countries. We believe that it is critical to the general acceptance of FATCA to make it very clear that beneficial owner certificates are generally not required under Chapter 4. FFIs should be able to rely on documentary evidence in lieu of beneficial owner certificates, unless there is reason to believe that such documentary evidence alone is not sufficient to determine the U.S. tax status of an account.

Second, we recommend that the definition of "documentary evidence" contained in Treas. Reg. section 1.6049-5(c)(1) and (4) be adopted for purposes of Chapter 4, with certain clarifications and amendments. The documentary evidence standard applies under Chapters 3 and 61 to payments made outside the United States to offshore accounts and to sales of securities effected outside the United States. Documentary evidence is defined as documentation sufficient to identify the payee and the status of the person as a foreign person and "includes, but is not limited to" documentary evidence described in Treas. Reg. section 1.1441-6(c)(3) or (4). These provisions describe documentary evidence as (1) a certificate of tax residence issued by a tax official in the country in which the taxpayer claims to be a resident and has filed his most recent tax return, (2) a government issued document that identifies an individual by name, address and photograph, and (3) government issued document that includes the name of an entity and the address of its principal office. For individuals, documentary evidence should be defined to include passports where the country of issuance is clearly identified, even if a home address of the individual is not stated on the passport. For entities, a certificate of incorporation in a particular country should be acceptable even if the address of the principal office does not appear on the certificate. Future guidance should also clarify that any formation document, including memorandums of association, articles of incorporation, operating agreements or trust agreements would be acceptable as documentary evidence even though such documents are not in fact "issued" by a foreign government or are not "filed" with a government authority. It should be sufficient to demonstrate the foreign status of an entity to provide evidence of organization, incorporation, creation or governance under the laws of a foreign country. In addition, an FFI that is also a QI should be able to rely on the types of documentation identified in the attachment to the QI agreement for the country in which the QI operates for purposes of documenting the foreign status of an account holder or its owners under Chapter 4.

Treasury regulation 1.1441-6(c)(4) states that if the documentary evidence provided by an individual was issued more than three years before it is presented to the withholding agent, then it may be relied on as proof of residence only if additional evidence (*e.g.*, a bank statement, utility bill or medical bill) of residence

in that country is provided. While such additional evidence might be needed to prove residence in a particular country when making a treaty claim, future guidance should clarify that such additional evidence is not needed to prove the foreign status of an individual under Chapters 3, 4 or 61, because residence in a particular foreign country is not needed to prove non-U.S. residency. Future guidance should also clarify that documentary evidence may be relied on, even if it is older than three years, provided that it has not expired at the time it is presented. Many countries, including the United States, issue passports for a term of ten years. Just because a passport is more than three years old does not make it less reliable documentation of foreign status.

Finally, it is not practical or realistic in today's electronic age to expect documentary evidence to always be collected from individuals "in person" in the form of "original documents or certified copies thereof" as described in Treas. Reg. 1.1441-6(c)(4)(i). Future guidance should make clear that any documentary evidence that is collected and maintained for purposes of Chapters 3, 4 or 61 can consist of photocopies, scanned documents, or pdf files submitted through a secure email or posted to a secure web site.

*d. Deposit Accounts*

The statutory definition of a Financial Account includes "any depository account" maintained by a financial institution. Section 1471(d)(2)(A). In fact, banks may hold deposits that are not interest bearing, either because of business policy or because of local law prohibitions. In many such cases, current law (including U.S. tax law) does not require banks to obtain any documentary evidence or beneficial owner certifications for non-interest bearing accounts. If the regulations under FATCA were to require that financial institutions solicit documentation from non-interest bearing accounts, it is likely that few account holders would be responsive. Further, we believe that it is beyond the scope of the tax law to require solicitations of documentation that would prove the U.S. tax status of the account holder or its owners when no gross income is expected to be generated by the account. Accordingly, we urge Treasury and IRS to create an exception to the requirement to solicit any documentation from deposit accounts, including both pre-existing and new accounts, so long as the accounts remain non-interest bearing. If circumstances change and a deposit account becomes interest bearing or otherwise produces gross income, then, that change in circumstances could trigger a solicitation requirement.

*e. Solicitations of Pre-existing Accounts*

Notice 2010-60 appears to require that a participating FFI solicit and obtain documentation within a period of two or five years from all pre-existing entity accounts (other than exempted organizations) and individual accounts or

else treat these accounts as recalcitrant accounts. For an FFI that has been entitled to rely on presumptions of foreign status in the absence of documentation based on the existing regulations under Chapters 3 and 61, especially in connection with payments of foreign source income and gross proceeds, this mandate is quite daunting. Not only would solicitations of U.S. tax documentation to a large number of existing accounts be expensive, they would necessarily cause significant disruptions to business as usual, generate confusion and concern among honest foreign persons that do not invest in U.S. securities and would require documentation that is not needed under local law. To make this task more palatable, we recommend that solicitations of U.S. tax documentation from existing accounts be required only if the specified indicia of U.S. status are present. Then, the solicitations would be more appropriately targeted to suspected U.S. persons and might be seen as more justifiable.

## **7. Recalcitrant accounts**

We understand that Treasury and IRS intend that the prospect of 30 percent withholding under Chapter 4 be an inducement to foreign financial institutions and non-financial foreign entities to comply with the reporting and disclosure requirements for U.S. accounts. If the threat of withholding is an effective enforcement mechanism, then, in theory there should be relatively little actual withholding under Chapter 4. We note that withholding of 30 percent of the gross proceeds from the sale or redemption of U.S. securities will be a powerful motive for foreign entities to comply. This is because the withholding would be imposed without regard to whether there was a gain or loss realized on the sale, but is imposed on the "gross" amount of the sale proceeds. Thus, withholding would operate as a harsh penalty for non-compliance.

Notice 2010-60 requests comments specifically on what measures should be taken to address long-term recalcitrant accounts, including whether, and in what circumstances, Treasury and IRS should consider terminating FFI Agreements due to the number of recalcitrant account holders remaining after a reasonable period of time. The Notice recognizes that FFIs are largely dependent on the cooperation and integrity of their clients in complying with the disclosure and documentation rules of Chapter 4. We believe that the application of withholding to a recalcitrant account, even if long-term, is a sufficient deterrent to noncompliance. In our experience with backup withholding and U.S. nonresident withholding, we can say with confidence that clients generally act expeditiously to provide any documentation needed to stop withholding, especially when the amounts subject to withholding are significant, as they would be under Chapter 4. Further, the status of an FFI should not be jeopardized by performing withholding when required to do so. The withholding of a 30 percent tax under Chapter 4 should be an adequate method of collecting U.S. tax revenues that might otherwise be lost.

Even if there is an FFI with a significant number of long-term recalcitrant accounts, we believe that it is not appropriate to apply a mechanical test, based on the number of recalcitrant accounts or the value of the assets held in such accounts, to determine whether a participating FFI's status should be terminated. A mechanical test does not allow for the possibility that there may be circumstances beyond the control of the FFI that could warrant the maintenance of a significant number of recalcitrant accounts. For example, there may be prohibitions under local law or simply insurmountable legal obstacles to selling assets and closing a recalcitrant account. The owners could be unknown or known but unavailable for contact due to the lack of a valid current address. In some countries, there is no law requiring that the assets be escheated to the local government even after a lengthy period of time of lack of contact with the asset owner. We believe it should be sufficient for a participating FFI to demonstrate that it has made the required solicitations for information or documentation respecting an account holder and that it is withholding under Chapter 4 when required.

#### **8. Passthru payments**

A participating FFI is required to withhold on "passthru payments" made to a (1) a recalcitrant account holder, (2) a non-participating FFI, or (3) an FFI that elects to be withheld upon. Section 1471(d)(7) defines "passthru payment" to mean any withholdable payment or any other payment "to the extent attributable to a withholdable payment." AGC members are concerned about the scope of this withholding requirement. For the Chapter 4 withholding to be applied in the same manner across all FFIs, there is a need for clear and objective guidance as to what types of payments are subject to withholding. Furthermore, the information needed to identify a payment as subject to withholding under Chapter 4, such as character and source of the income, needs to be readily available through normal income processing channels or security identifiers.

As a general principle, our members recommend that a passthru payment attributable to a withholdable payment be considered one that is "directly traceable" to a withholdable payment.

The simplest case is where a FFI acts as a custodian or nominee holder of securities owned by other persons. The FFI would collect and pay over to the account holder the income from the security to which the holder is entitled. This is the traditional type of passthru payment. If the security pays U.S. source income, then, the income paid to the account holder would be a withholdable payment.

The second case is where the security represents an equity interest in an entity that is a flow-through entity for U.S. tax purposes (e.g., a partnership or a grantor trust). In this case, the character and source of income paid to the flow-through entity retains its character when allocated or distributed to the partners or grantor(s) in proportion to their ownership of the entity. Since the character and source of the income passes through to the owners of the flow-through entity, there is a tax basis for directly tracing the income received by flow-through entity and allocated to the owners for tax purposes.

The third case is where the security represents ownership in an entity that is not a flow-through entity. Generally, this would be foreign entities that are treated as corporations for U.S. tax purposes, including certain foreign mutual funds or other collective investment vehicles. The concern here is that it would not be possible for an FFI to determine the proportion of a distribution from a foreign corporation that is derived from U.S. source income earned by the distributing corporation, especially where the corporation has income of many types from many different sources. There is simply no practical way for an amount of U.S. source earnings to be tracked to a distribution to its shareholders, particularly because of differences in the timing of the earnings and the distribution, and interim changes in who are the shareholders. We sincerely believe this would be an insurmountable task to determine what portion of a distribution from a foreign corporation is attributable to U.S. source earnings of that corporation.

Even if it were possible for the distributing corporation to determine what portion of each distribution was attributable to its U.S. source earnings, there is no reliable way to make sure that this information is passed down the chain of intermediaries to the custodian or nominee that actually has a withholding obligation. For a withholding tax to be consistently applied, such information must be readily available to custodians or be easily determinable from the basic characteristics of the security. Accordingly, we request that attribution to a withholdable payment be limited to payments that are directly traceable to U.S. source payments made by the distributing entity under existing tax principles.

## **9. Election to be Withheld Upon**

Under section 1471(b)(3), a participating FFI may elect, subject to any requirements imposed by the Secretary, to have a withholding agent withhold on withholdable payments or passthru payments made to it, rather than act as a withholding agent for passthru payments it makes to its account holders. As part of this Election to be Withheld Upon, a participating FFI must agree to notify the withholding agent of its election and provide such information as may be necessary for the withholding agent to determine the appropriate amount to deduct and withhold. The electing FFI must also agree to a waiver of any right

under any U.S. treaty with respect to any amount deducted and withheld pursuant to the election.

Notice 2010-60 requested comments as to the appropriate scope of the election to be withheld upon. In particular, comments were requested as to the types of financial accounts for which an election should be available, and the types of information an electing FFI would need to provide to a withholding agent so that the appropriate amount of tax withholding could be determined and deducted.

The AGC notes that FFIs may be reluctant to make the election due to the requirement to waive treaty benefits. However, where an FFI desires to make such election, the burden on the downstream withholding agent could be significant and impossible to administer, in particular for pooled accounts. The following examples are intended to illustrate the challenges that certain types of accounts may present.

*Example 1: FFI is an NQI:* Where the FFI is treated as a Chapter 3 NQI under an existing agreement with its custodian, the election would be feasible if the NQI has established separate accounts on the custodian's system. In this scenario, it is envisioned that the FFI could simply direct the custodian via its withholding statement to set the account associated with an underlying recalcitrant account holder at the 30 percent withholding rate. However, the custodian's systems may not be able to apply a blended rate to an account with multiple underlying beneficial owners, and such systems are expensive to develop and maintain.

*Example 2: FFI is a Partnership:* Where the FFI is a nonwithholding foreign partnership under Chapter 3, the election to be withheld upon presents greater challenges because it is not possible to segregate the assets of a partnership into separate accounts according to each partner's tax withholding rate. While some custodians with sophisticated sub-accounting systems are able to support pooled accounts with multiple underlying beneficial owners with different withholding rates, this capability requires systems that can calculate and apply blended withholding rates.

As a result of the above, AGC recommends making the Election to be Withheld Upon a mutual agreement between the FFI and the downstream withholding agent. Withholding agents without the capability to support multiple withholding rates within a single account should not be forced to develop such capabilities in anticipation of an FFI deciding to make this election.

## **10. Development of modified Forms W-8**

As noted above, it is essential that withholding agents have useful mechanisms to properly identify whether an entity or class of entity should be excluded from the FATCA reporting provisions. This determination should not be subjective in nature.

The AGC considers that the provision of a self-declaration or a modified Form W-8 would streamline the process and reduce administrative burdens and costs for investors, participating FFIs, and U.S. withholding agents.

In particular, the AGC considers that the Form W-8BEN, in its current format, is complicated for investors to complete. Simplification measures—for example, the creation of a series of W-8 forms specifically for, but not limited to, individuals, pension funds, and corporations—would alleviate some of these burdens. We would be happy to provide further input regarding these suggestions.

In addition, to reduce the frequency with which account holders are deemed U.S., or categorized as recalcitrant, for failure to provide a **valid** Form W-8, IRS should reconsider many of the positions currently being taken by audit teams with respect to inconsequential errors on Forms W-8. For example, should a Form W-8BEN for a legal entity be treated as invalid where the “capacity” line has not been completed, but the withholding agent has documentation proving the signer is an officer of the entity? Should a Form W-8BEN obviously completed by an individual be treated as invalid because the “individual” box is not checked on line 3? Should a Form W-8BEN obviously completed by a corporation be treated as invalid because the “corporation” box is not checked on line 3, even where Articles of Incorporation have been provided? It should be noted that outstanding disputes over validity of W-8s under Chapter 3 will carry over into Chapter 4 and need to be resolved.

## **Conclusion**

The AGC greatly appreciates the opportunity to provide the comments set forth above on the FATCA provisions. We hope they are of some assistance as you formulate guidance and regulations to implement the new rules, and we would welcome the opportunity to discuss these points further as you proceed.

THE ASSOCIATION OF GLOBAL CUSTODIANS

THE BANK OF NEW YORK MELLON  
BROWN BROTHERS HARRIMAN  
CITIBANK, N.A.  
DEUTSCHE BANK  
HSBC SECURITIES SERVICES  
JPMORGAN  
NORTHERN TRUST  
RBC DEXIA INVESTOR SERVICES  
STANDARD CHARTERED BANK  
STATE STREET BANK AND TRUST COMPANY

COUNSEL AND SECRETARIAT TO THE ASSOCIATION:

BAKER & MCKENZIE LLP

EUROPE  
ATT: ARUN SRIVASTAVA  
100 NEW BRIDGE STREET  
LONDON EC4V 6JA, ENGLAND  
INT'L TEL: 44 20 7919 1000

GLOBAL  
ATT: ROBIN TRUESDALE  
815 CONNECTICUT AVENUE, N.W.  
WASHINGTON, D.C. 20006  
TEL: 202 452 7000  
FAX: 202 452 7074

WWW.THEAGC.COM

September 8, 2010

Michael Mundaca  
Assistant Secretary for Tax Policy  
United States Department of the  
Treasury  
1500 Pennsylvania Avenue, NW  
Washington, D.C. 20220

Stephen E. Shay  
Deputy Assistant Secretary for  
International Affairs  
United States Department of the  
Treasury  
1500 Pennsylvania Avenue, NW  
Washington, D.C. 20220

Manal Corwin  
International Tax Counsel  
United States Department of the  
Treasury  
1500 Pennsylvania Avenue, NW  
Washington, D.C. 20220

Michael J. Caballero  
Deputy International Tax Counsel  
Office of Tax Policy  
United States Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, D.C. 20220

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

Steven A. Musher  
Internal Revenue Service  
Associate Chief Counsel  
(International)  
1111 Constitution Avenue, NW  
Washington, D.C. 20224

Michael Danilack  
Deputy Commissioner  
International (LMSB)  
Internal Revenue Service  
1111 Constitution Avenue, NW  
Washington D.C. 20224

Re: **Comments on Foreign Account Tax Compliance Act (FATCA)  
Provisions of the Hiring Incentives to Restore Employment (HIRE) Act**

Dear Ms. Corwin and Messrs. Caballero, Danilack, Mundaca, Musher, Shay, and Shulman:

I am pleased to provide the attached comments prepared by a working group of the Association of Global Custodians ("AGC") on certain of the Foreign Account Tax Compliance

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Act (FATCA) provisions of the Hiring Incentives to Restore Employment Act (the "HIRE Act"). As you may know, the AGC is an informal group of ten global banking institutions with affiliates and branches in numerous countries that provide global custody services and related securities asset-servicing functions to cross-border institutional investors around the globe. AGC members are listed on the letterhead above.

We appreciate the openness of the IRS and Treasury to feedback from industry participants on the FATCA provisions and your active solicitation of input on these important issues. As discussed in further detail in the attached comments, the AGC respectfully requests that the IRS and Treasury clarify that financial intermediaries which are not a counterparty to a derivatives transaction should not be considered the withholding agent for purposes of new Internal Revenue Code Section 871(I). Published guidance is urgently needed on this issue as the effective date of the withholding provisions on "specified notional principal contracts" ("SNPCs") is September 14, 2010. If you have questions concerning the following comments or would like additional information, please contact the undersigned or Lisa Chavez, Northern Trust. Members would also be pleased to arrange a conference call if that would be helpful to you.

Sincerely yours,



Carol A. Dunahoo  
Baker & McKenzie LLP  
Counsel to the AGC

# THE ASSOCIATION OF GLOBAL CUSTODIANS

September 8, 2010

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## COMMENTS:

### Request for clarification of applicability of derivatives provisions to intermediaries

Notice 2010-60, which was just released on August 27, 2010, provides preliminary guidance on a number of priority issues involving the implementation of the new FATCA withholding provisions, and solicits comments on a number of issues. The AGC intends to submit comments in response to Notice 2010-60 prior to the November 1, 2010 deadline. However, at this time, AGC members believe it important to draw your attention to an issue that relates to provisions effective September 14, 2010 that was not addressed to Notice 2010-60. Members believe this issue uniquely affects global custodian banks; requires urgent priority guidance; and has not been previously addressed in other comment letters that have been submitted.

The HIRE Act provisions which provide that a payment made pursuant to a "specified notional principal contract" that is directly or indirectly contingent upon or determined by reference to the payment of a dividend from U.S. sources will be treated as a U.S. source dividend, are effective beginning September 14, 2010, and will create a withholding tax obligation on payments previously excluded from withholding as non-U.S. source. As such, the AGC believes that there is a particularly urgent need for guidance regarding who is responsible for tax withholding under these new provisions, which are set forth in new Section 871(l) of the Code.

The term "specified notional principal contract" ("SPNC") is defined in Section 871(l)(3)(A) as any notional principal contract ("NPC") where (1) the party to the contract entitled to receive a payment contingent upon or determined by reference to the payment of a dividend from U.S. sources (the long party) transfers the underlying security to another party (the short party), which in turn will transfer the underlying security back to a long party entitled to the dividend equivalent payment; (2) the underlying security is not publicly traded; (3) the underlying security is posted as collateral by a short party with the long party in connection with a contract; or (4) the contract is identified as a specified notional principal contract in regulations to be issued.

Section 871(l)(7) specifically provides that each person that is a party to a contract that provides for a dividend equivalent payment shall be treated as having control of such payment for purposes of Chapter 3 and Chapter 4. Existing regulations under Chapter 3 provide that a "withholding agent" is responsible for withholding, and that a "withholding agent" generally means any person that has the control, receipt, custody, disposal, or payment of an item of income subject to withholding.<sup>1</sup> Guidance is urgently needed to address the interaction of new Section 871(l)(7) with the existing definition of "withholding agent".

A custodian may be considered a "withholding agent" with respect to a dividend equivalent payment under Chapter 3 as a person that has receipt and/or custody of such payment. However, a custodian will not be a party to the contract for a SNPC, and as stated

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<sup>1</sup> Treas. Reg. Section 1.1441-7(a)(1).

## THE ASSOCIATION OF GLOBAL CUSTODIANS

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below, will not have sufficient information to determine whether a payment is made pursuant to a SPNC or to determine the amount of withholding. Language in the Joint Committee on Taxation's Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3310, the "Hiring Incentives to Restore Employment Act," Under Consideration by the Senate (JCX-4-10) (February 23, 2010), (the "Joint Committee Technical Explanation"), indicates an intent to place the withholding responsibility on only the parties to the transaction, rather than on the custodians or other intermediaries, because only the counterparties have "control of the payment" for this purpose.<sup>2</sup> Accordingly, guidance is urgently needed to confirm that a custodian or other intermediary or agent that has receipt and/or custody of a payment made pursuant to a SNPC will not be a "withholding agent" under Chapter 3 or Chapter 4 where such custodian is not a party to the contract.

Placing the withholding obligation for dividend equivalent payments made pursuant to a SNPC with the parties to the contract as set forth in Section 871(l)(7) is also consistent with the practicalities of these transactions. Custodians and other financial intermediaries or agents are not likely to have sufficient information about the terms of the underlying contract to know whether a notional principal contract meets any of the first three criteria of Section 871(l)(3)(A) noted above. Rather, this information would be specifically within the knowledge of the counterparties to the swap transaction. In addition, intermediaries typically see only the net payment made on a notional principal contract transaction, not the gross amount (on which withholding would be required pursuant to Section 871(l)(5)). As such, AGC recommends that the Treasury and the IRS issue guidance clarifying that custodians and other intermediaries that are not parties to the contract are not considered "withholding agents" for purposes of Chapter 3 or Chapter 4 with respect to dividend equivalent payments made pursuant to SNPCs.

### Conclusion

The AGC greatly appreciates the opportunity to provide the comments set forth above on the FATCA provisions, and members hope they are of assistance as you formulate guidance and regulations to implement the new rules.

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<sup>2</sup> The Joint Committee Technical Explanation states: "For purposes of chapter 3 . . . and chapter 4 . . . , each person that is a party to a contract or other arrangement that provides for the payment of a dividend equivalent is treated as having control of the payment. Accordingly, Treasury may provide guidance requiring either party to withhold tax on dividend equivalents."