



June 28, 2011

Timothy Geithner, Secretary  
US Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, DC 20220

Douglas H. Shulman  
Commissioner  
Internal Revenue Service  
1111 Constitution Avenue, NW  
Washington, DC 20224

**Re: Implications of the Foreign Account Tax Compliance Act (FATCA)**

Dear Sirs:

The International Council of Securities Associations (ICSA) is the global forum for the trade associations and self-regulatory organizations that represent and/or regulate the securities industry.<sup>1</sup> We welcome the opportunity to provide the United States Treasury Department and the Internal Revenue Service with initial comments regarding the Foreign Account Tax Compliance Act ("FATCA"), which was enacted into law on March 18, 2010 as part of the Hiring Incentives to Restore Employment Act.

ICSA is a global organization and therefore our concerns about FATCA are focused primarily on the legislation's potential impact on the global securities market. ICSA members fully support FATCA's overarching goals of preventing tax evasion and promoting financial transparency. However, the route that the US has chosen to achieve this objective would impose significant compliance costs on all foreign financial institutions, costs which in the aggregate would most likely exceed any revenue benefit that the US is likely to enjoy as a result of FATCA. Moreover, in a number of jurisdictions, financial institutions would be in breach of their own data privacy and other laws if they were to comply with FATCA.

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<sup>1</sup> ICSA is composed of trade associations and self-regulatory organizations that collectively represent and/or regulate the vast majority of the world's financial services firms on both a national and international basis. ICSA's objectives are: (1) to encourage the sound growth of the international securities markets by promoting harmonization in the procedures and regulation of those markets; and (2) to promote mutual understanding and the exchange of information among ICSA members. More information about ICSA is available at: [www.icsa.bz](http://www.icsa.bz)

In Appendix A to this letter we have provided a list of specific issues related to the implementation of FATCA which we suggest the Treasury and/or IRS need to take into consideration. These include:

1. Excessive and disproportionate compliance costs that will be faced by foreign financial institutions that must comply with the FATCA when compared with the potential revenue benefit for the U.S. Treasury;
2. Serious conflicts between the requirements imposed on foreign financial institutions by FATCA and data protection/privacy laws and other legal requirements that many financial institutions are subject to in their home jurisdictions;
3. Setting new, unilateral standards for beneficial ownership, thereby undercutting the multilateral negotiations carried out under the leadership of the Financial Action Task Force (FATF), the global standard setter for anti-money laundering regulations; and,
4. Possible reductions in investment choices for U.S. investors and on the ability of US corporate borrowers to access external debt markets, both of which could reduce capital inflows to the US.

In addition to the above issues, we are aware that in April of this year the IRS issued Notice 2011-34, which provides supplemental guidance on the documentation, reporting and withholding requirements under the FATCA. We appreciate and welcome some of the changes that were proposed in the most recent Notice. However, ICSA members have a number of concerns about the revised procedures described in the Notice. These concerns are summarized in Appendix B to this letter.

In closing, ICSA members respectfully suggest that the Treasury and IRS, and ultimately the U.S. Congress, should seriously consider the issues discussed in this letter as well as comments contained in the numerous letters submitted by other associations, firms and governments which point out the extreme compliance costs that will be involved in the implementation of FATCA and the conflicts that exist between the requirements of FATCA and data privacy laws in many jurisdictions. Above all, we urge the US Government to consider the extent to which FATCA, as a unilateral measure with substantial extra-territorial consequences, is inconsistent with the G20's emphasis on building a coherent global framework for financial markets and institutions.

In light of the issues addressed in this letter and in submissions from other commentators, we urge the US Government to delay implementation of the FATCA until a more suitable approach can be developed. Rather than the unilateral approach taken by FATCA, we suggest that a more appropriate approach would be the development of a global framework that would allow the US and other governments to obtain information regarding income paid to citizens of their countries by foreign financial institutions which is in harmony with each jurisdiction's existing laws and does not create an excessive compliance burden for financial institutions. This approach, which would be developed through negotiations between governments and not through negotiations and agreements between the IRS and private entities, would be consistent with the G20's emphasis

on building a coherent global framework for financial markets, a policy approach has been and continues to be strongly supported by the Obama administration.

We would be pleased to discuss the issues addressed in this letter with any representative from the U.S. Treasury and/or IRS. Please do not hesitate to contact me at your earliest convenience.

Regards,



Kung Ho Hwang  
Chairman  
International Council of Securities Associations (ICSA)

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## **Appendix A**

### **A. Problems Associated with Implementation of FATCA**

#### **1. Excessive compliance costs when compared with potential revenue benefit**

Some of the new legislation will have far reaching and extraterritorial effects and in some cases transfers significant regulatory burden from the US authorities to financial intermediaries, including a great many financial intermediaries that are already subject to a comprehensive regulatory regime in their home jurisdictions. In some cases this will pose significant compliance cost issues for those financial institutions.

- FATCA will effectively compel all foreign financial institutions (FFIs) to enter into an agreement with the IRS that would require them to report annually certain customer information and to withhold and pay to the IRS a 30% withholding tax on customers of those institutions who are US companies or US citizens that have not supplied certain information to the foreign financial institution.
- Failure to enter into this agreement or after having entered into this agreement, to comply with the provisions of the Act, would expose foreign financial institutions to a 30% withholding tax on the gross amount realised on the disposal of US assets. As a result, FATCA will compel foreign financial institutions to screen their existing customer database to identify clients that are US companies or individuals who are US persons.

FATCA goes further than just requiring financial institutions to identify US companies and citizens. Financial institutions must be able to prove that their non-US clients are in fact not US companies or citizens or people born in the US. This requirement would apply not just to new accounts, but to many existing accounts as well, especially where clients may have US indicia on file, such as a U.S. mailing address (with some proposed exceptions). However, querying the nationality of customers is not part of the identification and verification of identity of customers under current anti-money laundering (AML) requirements in most jurisdictions.

FFIs will face considerable challenges in meeting the FATCA requirement to identify US persons, as defined by the IRS, on an annual basis. Currently, in order to meet their AML obligations, financial institutions review and update client's details according to the perceived risk category of the customer, with high risk clients being reviewed more frequently than low risk clients. This risk-based approach to AML/CFT has been endorsed by the Financial Action Task Force (FATF), which is the global standard setter for AML/CFT regulations. However, in order to comply with FATCA, FFIs will have to develop and follow new procedures so that they can review the identity of a far larger number of clients on an annual basis than they currently do.

Even when these new procedures to identify and annually review the identity of "US persons" are put in place, as required under FATCA, FFIs will still face substantial difficulties in ascertaining whether their customers are actually US persons or not. Where required to do so as part of their AML and customer due diligence (CDD) obligations, financial institutions generally

verify the identity of their clients by requesting sight of the client's passport, national identity document or government issued driving licence when that document includes a photograph. However, the IRS will be aware of the weaknesses inherent in using any of these documents to determine whether an individual is a US citizen or resident. US passport holders with dual nationality may well proffer, for quite legitimate reasons, a local passport to validate their identity. Similar considerations will affect the use of a national identity card or a driving licence. In other words, an FFI cannot eliminate the possibility that any person who offers these documents to validate his/her identity is not a US person.<sup>2</sup>

Moreover, the definition of specified U.S. persons contained in the FATCA legislation encompasses foreign visitors who satisfy the substantial presence test. We understand that the test of whether an individual has a "substantial US tax presence" is based on whether or not a person has spent a weighted average of more than 183 days in the US over the past three calendar years, including at least 31 days in the past year. However, financial institutions generally do not collect such information as part of their initial or ongoing CDD assessment. In order to obtain this information, FFIs would have to explain the definition of a "substantial US tax presence" to their customers and then rely on the individual in question being able to both understand the definition and answer the question honestly. The FFI itself would not be able to verify the answer since it would not have access to the necessary documentation. In addition, given that the answer to the question may change from year to year, FFIs will need to identify such persons on an annual basis although they will not have access to the information that would allow them to actually verify if the customer were telling the truth or not.

The definition of specified U.S. persons contained in the FATCA legislation also includes "green card holders". However, financial institutions are generally not required to request the details of a person's green card status as part of their initial or ongoing CDD process, as that information provides no benefit in assessing any AML risk that the individual poses. Therefore, to comply fully with the legislation, FFIs will have to attempt to identify those existing and new customers who are green card holders without being able to independently verify the information that is given to them by the customers.

A further challenge that FFIs will face in identifying "US persons" is due to the fact that financial institutions often rely on other financial institutions for their CDD validation, particularly where business is conducted on a referral or agency basis or where the FFI's have a mutuality of interest in a transaction. This process, termed "reliance on third parties", is generally accepted practice for securities firms and has been endorsed by both the International Organization of Securities Commissions (IOSCO), which is the global standard setter for securities market regulation, and the FATF.<sup>3</sup> Under FATCA, however, in order to minimise the

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<sup>2</sup> To validate an individual's address, FFIs will often request sight of an account statement from a bank, correspondence with local tax authorities or copies of invoices from utilities, such as light or heat. Should an individual choose not to disclose an address in the US, by, for example offering documents with non US addresses, FFIs will not be able to assert that the individual is not a US resident. A similar issue arises where FFI's validate the identity of an individual by electronic means, which is generally based on a voter's register or a property register. Validation of identity by this means does exclude the possibility that the individual in question is a "US person" as defined by the IRS.

<sup>3</sup> For example, see Article 5 of IOSCO's "Principles on Client Identification and Beneficial Ownership for the Securities Industry".

risk of suffering a 30% withholding tax on its income and assets proceeds arising in the US, FFI's would have to duplicate CDD checks previously performed by another FFI on the same customer, which in turn will further raise the compliance costs that FATCA will impose on FFIs. In addition to the significant compliance costs that FFIs will face under FATCA, there may also be a substantial tax revenue loss for governments in other jurisdictions. Profits for many FFIs are likely to be substantially reduced because of the sharp and significant increase in compliance costs that will be necessitated by FATCA, particularly in the next few years as FFIs prepare for the implementation of FATCA. We are aware that the European Commission has raised this issue with the US government because it is concerned about the possible revenue impact of FATCA on governments within the European Union. We are not able to quantify the likely impact of the increased compliance costs on government revenues in other jurisdictions, but are concerned that it could be significant in some cases.

ICSA members understand the US government's concerns regarding the use of offshore accounts and entities by certain persons to evade US tax.<sup>4</sup> However, regulatory requirements must strike a reasonable balance between increasing US tax revenue by identifying tax evasion by US persons, and the additional financial burden and operational risks that will be imposed upon FFIs as well as the tax loss that may be suffered by governments outside of the US. We are concerned that the additional cost and operational risk faced by FFIs as a result of FATCA as well as the tax losses that may be suffered in some jurisdictions outside of the US will be disproportionate to the additional U.S. tax revenues that are likely to be generated by FATCA.<sup>5</sup>

## **2. Potential conflicts with data protection/privacy laws and other domestic laws**

It appears likely that many if not all major non-US financial institutions will be captured by the requirement to be FATCA compliant due to their US exposures. As a result they will need to report all their US client dealings to the IRS and withhold 30% of US based income including gross proceeds of sales, from clients and counterparties that decline or for any reason do not cooperate with their US client identification regime. However, in a large number of countries, the legal basis on which they will be able to report their US client dealings and/or withhold 30% of US based income is not clear at this time. Indeed, there are a number of jurisdictions where financial institutions are expressly prohibited from undertaking these actions by data privacy and other national laws.

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<sup>4</sup> This is a concern shared by the governments of many countries, and as a result we have observed increased global efforts and inter-governmental cooperation through the inclusion of tax information exchange provisions in many new income tax treaties and protocols to existing treaties, as well as an increase in the number of tax information exchange agreements between countries that do not have income tax treaties in effect.

<sup>5</sup> One possible consequence, among many, is that many FFIs will not find it economically feasible to enter into FFI agreements with the IRS and as such, will not continue to operate as Qualified Intermediaries under the Qualified Intermediary regime implemented by the IRS, at great cost to both the IRS and the financial industry, over a decade ago. For example, a large FFI Group could easily be operating in more than 50 countries and may have multiple legal entities within each of those countries that might enter into FFI Agreements. Whereas there are currently approximately 5,500 entities that have QI Agreements with the IRS, given the broad definition of FFI, there are potentially hundreds of thousands of entities that could be in position to enter into FFI Agreements with the IRS. It has been estimated that over 250,000 FFIs may exist worldwide.

For example, in Japan disclosure of personal information to a third party without the consent of the customer is prohibited by the Act on the Protection of Personal Information. If a customer did not consent to the disclosure, it would be difficult if not impossible for FFIs based in Japan to withhold funds from the customer's accounts based on a "FFI agreement" with the US government, since that agreement would not have any legal basis in Japan. Furthermore, closing the customer's account because of the customer's lack of consent would be extremely difficult since that action would also not have a legal basis in Japan. In short, the FFI would either be in breach of Japanese laws if it were to comply with FATCA, or breach FATCA and then be subject to substantial penalties.

Similarly in Australia, under the Australian Privacy Act every identified US person would need to consent to the disclosure of their personal information by the FFI to the US government. If such consent were not forthcoming, then under Chapter 4 of FATCA those accounts would need to be closed. However, as is the case in many other jurisdictions, a financial intermediary taking such an action in Australia would violate the country's anti-discrimination legislation since the financial intermediary would be closing an account on the basis that the customer was a US citizen, which could be seen by that individual and by the courts as a discriminatory action.<sup>6</sup>

FFIs based in the EU would also face criminal prosecution as well as civil claims over breaches of data protection laws if those FFIs were to comply with FATCA.<sup>7</sup> In the absence of direct EU legislative action, the FATCA obligations placed on FFIs means that those FFIs face a significant risk of customer claims of non-compliance with data protection and banking confidentiality obligations. FFIs based in the EU are particularly concerned about their obligations regarding the "fair and lawful" processing of customers' personal data and the rules prohibiting data transfers to non-EU countries, including the US, that do not meet "adequacy" for data standards. In addition, as in a number of other jurisdictions, EU-based financial institutions would violate the EU's anti-discrimination laws if they were to close the accounts of non-compliant customers on the basis of those customers being US citizens or firms. Indeed,

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<sup>6</sup> Even the collection of information with consent would not be consistent with the design principles of the Australian anti-money laundering/counter terrorism financing regime, which does not require the collection of nationality information and together with the racial discrimination legislation, protects customers of financial intermediaries and all other providers of goods and services from discrimination on the grounds of race, color, descent, national or ethnic origin, and immigration status. The issue is complicated further by the negative identification test under FATCA that requires that all accounts are assumed to be held by US persons unless the financial intermediary can prove otherwise. This requires the collection and provision of data even in the absence of indication of US citizenship. Under Australian law financial intermediaries cannot compel customers retrospectively to provide further information other than the information initially provided under statutory identification checks. This will possibly result in a requirement to report most Australian financial intermediaries' customers (numbering in the many millions) as it will not be possible to prove they are not US citizens.

<sup>7</sup> The US Government will be aware of the importance that the European Commission ("the Commission") and the governments of the 27 Member States place on compliance with their respective data protection laws. This importance was recently demonstrated in EU debates over the transfer of airline passenger name record ("PNR") and access to individual bank transaction data processed by the Society for Worldwide Interbank Financial Telecommunication ("SWIFT"). In both these cases, the USG sought direct access to information held by EU based organisations, for the respective purposes of tracking terrorist suspects and the potential financing of terrorism. To address potential problems with EU data protection laws, specific legal frameworks were negotiated between the Commission and the USG in order that data could be transferred in a manner compatible with EU law.

financial intermediaries taking such an action would face the risk that a local court would force them to offer services to US citizens and passport holders while also possibly imposing criminal sanctions.

In the three jurisdictions referenced above, there does not appear to be any readily available means that would allow FFIs to claim a general exemption under their data protection obligations to facilitate a wide ranging disclosure of account holder data directly from FFIs to United States authorities, without those account holders having a meaningful ability to object. We are aware that this ‘catch 22’ situation also exists in other jurisdictions.

### **3. Setting new, unilateral standards for beneficial ownership requirements**

FATCA requires FFIs to have in place systems and procedures to provide reasonable assurance that the FFI does not have any substantial United States persons who beneficially own at least 10% of any corporate client of the FFI, which is a considerably more rigorous standard than is in effect in most jurisdictions in the world, including the US. Fortunately, there are a number of “exemptions” that FFIs can use for existing corporate accounts in order to avoid having to ascertain beneficial ownership. However, in cases where beneficial ownership must be ascertained, FFIs will actually face significant challenges and costs in meeting this requirement.

Under guidelines set by FATF, regulated financial institutions are required to identify, and in some cases, verify the identity of beneficial owners. However, while FATF sets global standards on AML matters, jurisdictions around the world interpret these standards in a variety of ways. For example, the European Union requires financial institutions to identify, and verify in some circumstances, beneficial owners who own or control 25% of a corporate client unless that corporation has its securities listed on a stock exchange, is part of a listed group of companies or is a financial services firm that is regulated for AML purposes. In contrast, the United States authorities only require that beneficial owners are identified and verified when financial services firms offer correspondent banking services to foreign banks and when offering private banking facilities to clients with at least \$1 million to invest.

Regardless of the level of ownership that must be verified, the beneficial ownership requirement is problematic because financial institutions face considerable difficulties in verifying the details of beneficial owners since they usually have no independent means of obtaining the information that they would need, in large part because many jurisdictions do not collect or publish the necessary information in their corporate registers. FATF members, including representatives of the US Treasury, are well aware of this issue and are indeed so concerned with the lack of a global harmonised approach to beneficial ownership requirements that they are currently reviewing the standards in order to promote greater international coordination.<sup>8</sup>

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<sup>8</sup> Whilst FFIs face difficulties in verifying beneficial ownership details of corporations domiciled in many non-US jurisdictions, they also face similar problems when dealing with corporations domiciled in some US jurisdictions such as Nevada and Wyoming. ICSA notes with interest the Incorporation Transparency and Law Enforcement Assistance Bill recently introduced into the US Senate by Senator Carl Levin which, if enacted, would give the US Government, but not any private sector institutions, the ability, on the presentation of a subpoena, to demand the disclosure of the identity of a corporation’s beneficial owners. ICSA members are well aware of the dichotomy of one arm of the US Government requiring non US financial services firms to identify and verify beneficial owners of

In addition to the problems that FFIs will face in verifying beneficial ownership as required by FATCA, we also note that the FATCA would in effect supplant beneficial ownership guidelines that have been established through multilateral negotiations under the FATF by establishing a new, much more onerous requirement for the identification of beneficial ownership. This is despite the fact that US authorities do not require the same level of verification of beneficial ownership from financial institutions based in the US as would be required of FFIs under FATCA. It is also despite the fact that FATF itself is reviewing its guidelines on beneficial ownership precisely because its members are aware that financial institutions generally do not have access to the information that would allow them to identify and verify the identity of beneficial owners at any level, much less at the 10% level that would be mandated under FATCA.

#### **4. Possible reduction in investment choices for US investors and on the ability of US corporate borrowers to access external debt markets**

FATCA may also have the effect of reducing investment choices for US investors while also limiting the ability of US firms to access external debt markets, both of which would lead to a reduction in capital inflows to the U.S.

Investment choices for US investors may be limited as a result of the FATCA because some FFIs may decide to close the accounts of existing US clients and refused to take on any new US clients, while also disinvesting in US securities and disassociating from counterparties who invest in US securities. Some FFIs may decide to take this action in response to the substantial compliance costs that the firms would incur in order to comply with the FATCA. Others may take the action out of concern for the impact on their clients, as it may be difficult to justify the additional burdens and costs being placed on non-U.S. account holders who are not invested in U.S. securities as a result of FATCA. These issues may well be exacerbated by the proposed “passthru payment” concept described in the IRS Notice 2011-34, which could result in overwithholding and/or penalties for non-U.S. persons who would then be required to file a reclaim with the IRS. The ultimate impact of the legislation itself and the most recent guidance could be to reduce investment options for US investors while also potentially reducing the level of capital inflows to US securities markets.

In addition, FATCA may limit the ability of US corporate borrowers to access external debt markets, which in turn could reduce both funding for US firms and capital inflows to the U.S. This is due partly to the fact that the FATCA requirement to withhold against non-compliant intermediaries may cause investors holding bonds issued by US firms to bear the burden of the withholding tax.<sup>9</sup> In the context of intermediated holding chains common in debt capital market transactions, these investors would bear the burden of the FATCA imposed withholding tax

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their corporate clients around the world, but that other arms of the US government being, at present, unable to identify the beneficial owners of many US domiciled companies nor to assist private sector organisations in this regard.

<sup>9</sup> This is particularly important since withholding of portfolio interest may be complex and expensive to reclaim for sophisticated investors in jurisdictions with compatible tax treaty provisions or even impossible in the absence of such tax treaty provisions or, practically speaking, in the case of relatively unsophisticated retail investors.

because they would not have: (1) knowledge of the identity of intermediaries further up the holding chain; (2) authoritative knowledge of the compliance or otherwise of their immediate custodian; (3) knowledge (authoritative or not) of the compliance or otherwise of intermediaries further up the holding chain; and/or (4) the ability to influence the structure of the holding chain further up from their immediate custodian.

As a result of the additional tax burden caused by FATCA, both sophisticated and retail investors may prefer debt issued by non-US borrowers, which in turn would limit the ability of US corporate borrowers to fund themselves from external debt markets while also reducing capital inflows to the US.<sup>10</sup>

US borrower's ability to access external debt markets will also be adversely impacted if, as a result of FATCA, they are unable to issue bonds in bearer form.<sup>11</sup> This is an important issue because FATCA repealed the relevant tax exemptions that were granted for certain bearer bonds issued by US borrowers by the Tax Equity and Fiscal Responsibility Act (TEFRA).<sup>12</sup> As a result, beginning on 19 March 2012, US issuers will only be able to issue bonds that are either: (1) in registered form; or (2) in bearer form held in a dematerialized book-entry system or other systems that are to be specified by the US Treasury<sup>13</sup>. In the absence of clarity as to which of these other systems are eligible, US issuers will be disadvantaged in external debt markets.<sup>14</sup>

## **B. Going forward**

As noted in the attached letter, ICSA members are aware that the FATCA legislation was passed last year and that the IRS has issued guidance regarding implementation of FATCA. However, given the issues addressed in this document and in submissions from other commentators, we urge the US administration to delay implementation of the FATCA until a more suitable

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<sup>10</sup> In this respect, the development of workable implementing procedures sufficiently ahead of the 2013 deadline for implementation of FATCA would be helpful so that US issuers would not be adversely impacted by any market perception of withholding risk. These implementing procedures should, inter alia, enable the end investors to easily obtain certainty as to the FATCA-compliant status of the whole of their intermediated holding chain, or, at least, enable each accountholder to obtain certainty as to the status of its immediate intermediary further up the chain. ICSA understands the IRS intends to maintain a database that will enable FATCA-compliant intermediaries (i.e. participating and deemed compliant FFIs) to be identified. This is a welcome first step and ICSA looks forward to seeing further detail on the workings of this database.

<sup>11</sup> For a variety of reasons, domestic investors in a large number of markets are accustomed to purchasing bonds in bearer form.

<sup>12</sup> In an effort to encourage foreign demand for US corporate debt, in 1982 Congress passed the Tax Equity and Fiscal Responsibility Act ("TEFRA"). Under TEFRA, issuers of debt instruments in bearer form generally are denied deductions for U.S. federal income tax purposes for interest paid with respect to such debt instruments and are subject to an excise tax. Various sanctions also apply to holders. The aforementioned sanctions, however, do not apply with respect to bearer debt instruments that are issued under circumstances in which they are unlikely to be sold to U.S. persons.

<sup>13</sup> Bonds held in a dematerialized book-entry system or other system specified by the US Treasury will be deemed to be in registered form for US tax purposes and therefore will not be subject to the US tax sanctions previously applied under TEFRA.

<sup>14</sup> This problem would be substantially resolved, for example, if US issuers were able to issue bonds in global bearer form deposited with a 'common depository' or 'common safekeeper' for the two International Central Securities Depositories, Euroclear and Clearstream (combined assets under custody of €1.8 trillion at end 2010).

approach can be developed. At the very least, we suggest that the Treasury and IRS should consider measures that could at least partially mitigate some of the problems associated with the FATCA.

In particular, we suggest that Treasury and/or the IRS should grant regulatory safe harbour for FFIs who are attempting to comply with FATCA. This is important since the implementation of FATCA by the financial community will require extraordinary commitments of time and resources. It will not be possible to commence most of the implementation tasks (which may include the modification of hardware and software, recruitment of IT personnel and/or engagement of outside consulting firms, performance of database searches, solicitation of information from customers, coordination among FFIs within the same FFI Group, preparation of procedures and manuals, and training employees) until most of the guidance is finalized. It will likely take 18-24 months for FFIs to complete these implementation tasks. Moreover, these rules will likely need to be phased in over a period of years if they require manual due diligence searches or the solicitation of information from existing accountholders. As such, we are concerned about whether or not it is feasible for the implementation deadline of January 1, 2013 to be met.

In addition, we urge the Treasury and the IRS to adopt a risk-based approach to the greatest extent possible by focusing the administrative requirements of FATCA on areas of greatest compliance risk, and to leverage existing information sharing agreements wherever possible. We believe that the policy goals of FATCA can only be achieved effectively and efficiently if they can be accomplished through automated electronic searches, and not through manual, paper-centric due diligence efforts for multiple indicia of U.S. status that may depend upon a detailed understanding of U.S. tax rules and the subjective interpretation of non-legally trained staff. We also strongly suggest that the substantial presence test should be excluded from the definition of specified U.S. persons, since only the relevant authorities in the United States would ordinarily have the information necessary in order to verify such status.

ICSA members are aware that there are a great many other modifications to FATCA that have been suggested by other associations, firms and governments. We would support any measures that could be taken by the US Treasury and IRS that would lessen the short-term impact of the FATCA of FFIs, given the substantial compliance costs that are involved in order for firms to comply with the FATCA and the relatively short time that they have in order to achieve full compliance.

Ultimately, however, we respectfully suggest that regardless of any modifications that can be made, the FATCA is fundamentally flawed for all of the reasons outlined in this document. FATCA's policy objective of reducing tax evasion through greater information is shared by many governments as well as by all ICSA members. However, we believe that the costs resulting from implementation of FATCA, for the U.S. financial market as well as for the global financial market, would far outweigh the revenue benefits. Instead, we would support the development of an internationally consistent approach toward reducing tax evasion, possibly under the leadership of the Financial Stability Board, which would allow the US and other governments to obtain the information that they need but which was consistent with each jurisdiction's laws and did not create an excessive compliance burden for financial institutions.

## Appendix B

### Comments on IRS Notice 2011-34 “Supplemental Notice to Notice 2010-60 Providing Further Guidance and Requesting Comments on Certain Priority Issues Under Chapter 4 of Subtitle A of the Code” (the “Notice”)

#### 1. Revised Procedures for Identification of Preexisting Individual Accounts

We are concerned about the revised procedures for identification of preexisting individual accounts as described in section I.A of the Notice which we believe will misdirect FFI resources toward conducting manual due diligence on the files of accountholders who present a low-risk of U.S. tax evasion, without any electronic pre-screening for U.S. indicia.

In general, while we support the concept of applying a targeted, risk-based approach to the identification of U.S. accountholders among preexisting individual accounts, we disagree with the adoption of any approach that requires the manual search of paper or electronic files (i.e. any due diligence that cannot be conducted by an automated electronic search). We strongly recommend that in the interest of accuracy and efficiency, that Treasury and the IRS reconsider the proposed procedures in the Notice that would require “diligent reviews of the paper and electronic account files and other records” as suggested in sections I.A.2. Step 3 “Private Banking Accounts” and Step 5 “Accounts of \$500,000 or More”. We respectfully suggest that the searches conducted with respect to these targeted accounts should be limited to automated electronic searches for U.S. indicia with follow up for additional due diligence and/or documentation where U.S. indicia is present.

However, in the event that Treasury and the IRS ultimately conclude that some form of manual due diligence is required with respect to initial searches of targeted subsets of accounts, we have provided further comments below.

##### *A. Definition and Obligations with respect to Private Banking Accounts*

**Definition of “private banking”:** The definitions of “private banking account” and “private banking relationship” are extremely broad, and could include accounts that are neither high net-worth accounts nor at a high-risk for tax evasion. By including all-encompassing terms that may be interpreted differently by FFIs, such as “wealth management” or “investment advisory” services, the definition of private banking in the Notice could potentially include all securities accounts, including discount brokerage accounts for some financial institutions, excluding only basic accounts without any level of advisory services.

We are concerned that efforts put toward identifying U.S. persons among preexisting accounts using the broad definition in the Notice will actually misdirect efforts and resources toward accounts that are neither high-risk nor high net-worth. We do not recommend redrafting the definition to narrow or clarify it, as it may be difficult to define “private banking” in a manner that works for all industry segments in all jurisdictions; we believe that the policy goals of FATCA would be better achieved by removing the definitions associated with “private banking” and Step 3 of the proposed identification procedures to instead focus on conducting due diligence

with respect to accounts that exceed a designated threshold amount (see recommendation below with respect to threshold levels).

**Families:** The proposed definitions for identification of U.S. persons in preexisting accounts, and Step 3 of the procedures, includes language that implies obligations to expand due diligence to the families of individual clients. However, it is not clear to what extent family members would be implicated by indicia of U.S. status with respect to a preexisting accountholder and vice versa. We request further clarification on this point, and recommend that family members of account holders only be included in the identification process where the client has taken steps to link the account to a family member.

**Responsibility for Searches and Due Diligence:** If Treasury and the IRS maintain the view that manual due diligence of certain preexisting account files is required to identify U.S. persons (beyond electronic searches), we do not believe that such due diligence can effectively or efficiently be carried out at the relationship management level. Currently, AML and KYC documentation paperwork are administered at the relationship level, however, it is our understanding that all documentation is centrally stored and located, and vetted for approval centrally by compliance personnel. This is particularly true for securities dealers associated with large affiliated financial groups, something that is recognized in the Notice in the sections dealing with FFI Agreement execution and the proposed centralized compliance option.

Centralized compliance and tax personnel will have the required knowledge of U.S. indicia and documentary evidence. Also, search and due diligence requirements may be less effective where FFIs experience turnover of relationship managers, a frequent occurrence among large FFI groups. We recommend that future guidance and regulations provide flexibility for firms to determine which internal personnel will carry out the required searches and due diligence, and specifically not to require this due diligence to be carried out at the relationship management level.

### ***B. Obligations with respect to accounts based on size thresholds***

As mentioned in a previous section of this appendix, we believe that a targeted approach to identifying U.S. persons among preexisting accountholders is a more effective and efficient way of carrying out the policy objectives of FATCA. We maintain that automated electronic searches of account files is the best way to balance the costs of implementation with the policy objectives, and we urge Treasury and the IRS to limit searches of preexisting accounts to electronic searches.

However, if Treasury and the IRS require enhanced manual due diligence with respect to non-electronically searchable account documentation, we recommend that Step 3 of the proposed procedures (“private banking accounts”) either be removed altogether or combined with Step 5 (“accounts of \$500,000 or more”) in a way that would ensure that the only accounts subject to manual due diligence are clearly defined as accounts that exceed a certain threshold dollar amount. We also recommend that this threshold dollar amount be raised to \$1 million dollars, following the precedent set in the definition of “private banking account” in the USA Patriot

Act.<sup>15</sup> This would satisfy the policy objective of targeting only accounts of high net-worth and high-risk individuals, and do so in an efficient and standardized fashion. It would remove subjectivity with respect to FFIs around the world in their interpretation of “private banking accounts”.

### ***C. Certifying Completion of Customer Identification Procedures***

The Notice proposes that the chief compliance officer or another equivalent-level officer of the FFI (a responsible officer) must certify to the IRS when the FFI has completed the proposed procedures with respect to preexisting individual accounts. While we do not disagree with the concept of certification of compliance with agreed upon procedures and the adoption of written policies and procedures, we believe that portions of the proposed certification require attestation that would go beyond the knowledge and control of the responsible officer. For example, while a responsible officer could certify as to the completion of required searches and the development of internal procedures prohibiting their employees from engaging in avoidance behavior, it would be practically impossible for the responsible officer to certify that employees had not engaged in this kind of behavior, especially on a retroactive basis (to the date of the Notice’s publication). As such, we recommend that this portion of the certification component (certifying that management personnel did not engage in avoidance behaviour) either be removed in its entirety, or at a minimum, removing the retroactive aspect of the certification and including a “knowledge” qualifier.

## ***2. Passthru Payments***

### ***A. General comments***

While we understand the policy objective of Treasury and the IRS to discourage the use of participating FFIs as “blockers” through which non-participating FFIs might indirectly invest in U.S. assets, we respectfully disagree with the approach taken in the Notice with respect to the determination of passthru payment percentages (**PP%**) and believe that the policy goal of deterrence could be achieved without the excessive administrative burden we foresee connected with the passthru payment concept proposed in the Notice. The current Notice would place an extremely large burden upon compliant FFIs, when it should be more appropriately borne by the non-compliant accountholders and FFIs.

### ***B. Administration of Passthru Payments***

We suspect that the proposed approach to passthru payments in the Notice has been developed to address concerns of the fund industry with respect to the administrability of a tracing approach for passthru payments. However, we have concerns that the proposed approach will not be appropriate or administrable for securities dealers or other FFIs (such as banks) where these FFIs are engaged in active business, and where a calculation of the FFI’s U.S. assets at a particular

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<sup>15</sup> *International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001* [title III, § 301 et seq., of the *Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA PATRIOT ACT)*, Pub. L. No. 107-56 (Oct. 12, 2001) at (§ 312(a)(i)(4)(B)).

moment in time may not be an appropriate indicator of indirect investment in the U.S. For example, a non-U.S. fund may invest in U.S. based companies as part of its portfolio of investments (and appropriately disclosed as such in required documentation), therefore making a PP% an appropriate proxy for indirect U.S. investment; however, a non-U.S. bank may own various U.S. assets, but it would be an illogical step to conclude that a shareholder in that bank intended to invest indirectly in U.S. assets, especially when those assets may not be fully disclosed to the shareholder. In that instance, PP% as described in the Notice would not be an appropriate proxy for indirect U.S. investment, and becomes a more arbitrary number – and one that requires a great deal of administrative cost to calculate.

The complex nature of the passthru payment definition and the calculation of the PP% means that it will be almost impossible to explain to a recalcitrant account holder why a withholding was made on investment (particularly if the investment is in a non-U.S. FFI), and how the withholding was calculated. ICSA members are concerned about client service issues, and in some jurisdictions anticipate legal challenges made by account holders who hold FFI investments who discover that a portion of their income or proceeds on these investments has been withheld and remitted to U.S. tax authorities, without there being any basis for doing so under local tax law or negotiated U.S. tax treaties, and potentially without permission under existing contracts that account holders have entered into with the FFI.

### *C. Recommendations*

The concept of “passthru payment” should only be applied to payments flowing through custodial accounts, where the FFI can look through to the underlying investment. FFIs should not be calculating PP%, but should instead be treated in essentially similar fashion (with respect to non-custodial payments) like any other operating non-financial foreign entity. We understand that Treasury and the IRS are concerned about participating FFIs that could be used as “blockers” through which non-participating FFIs might benefit from indirect investment in U.S. assets; however, we do not believe that the passthru payment concepts outlined in the Notice will be effective in addressing this concern, and that for FFIs that have active operating businesses, the costs and complexity will outweigh the benefits.

Finally, we believe that the resources and efforts that are being focused on passthru payments may have the unintended consequence of delaying the entire FATCA implementation. It will be more important for Treasury and the IRS to focus its efforts over the next 12-18 months on the rules necessary for successful implementation of the search and documentation portion of FATCA. After initial implementation of search and documentation, FFIs, Treasury and the IRS will know how many non-participating FFIs exist, and FFIs will know how many recalcitrant accounts require reporting and withholding. As such, we strongly recommend that Treasury and the IRS consider deferring any further guidance or regulations implementing the non-withholdable portion of the passthru payment, including the PP%, until the portions of FATCA dealing with the identification of U.S. persons, documentation and reporting have been finalized. A phased-in approach will allow Treasury, the IRS and FFIs to develop strategies for dealing with any non-participating FFIs or recalcitrant account holders in ways that are effective and administrable for different segments of the financial industry.