

By Electronic Delivery

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RE: FATCA Proposed Regulations

Dear Ms. Corwin, Mr. Danilack, and Mr. Musher:

The Investment Company Institute¹ strongly supports administrable rules that implement, consistent with Congressional intent, the Chapter 4 reporting and withholding rules.² The progress made by the Proposed Regulations³ in developing administrable rules is commendable. The proposals

¹ The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (“ETFs”), and unit investment trusts (“UITs”). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$13.3 trillion and serve over 90 million shareholders.

² This letter refers to Chapter 4’s rules as “FATCA reporting” and “FATCA withholding” rules because they first were included in legislation known as the Foreign Account Tax Compliance Act (“FATCA”).

³ <http://www.irs.gov/pub/newsroom/reg-121647-10.pdf>

made in this letter, we submit, would enhance both the effectiveness and the administrability of the FATCA reporting regime.

I. Introduction

Our members – investment companies registered for sale in the U.S. under the Investment Company Act of 1940 (the “1940 Act”) and the shareholders in 1940-Act registered funds⁴ – are impacted both directly and indirectly by FATCA. The direct impact arises from those fund shareholders treated under FATCA as foreign financial institutions (“FFIs”), non-financial foreign entities (“NFFEs”), or foreign persons. The indirect impact arises primarily from concerns that foreign governments might adopt FATCA-like rules for U.S. funds investing in their markets. The Joint Statement issued on February 8 by the U.S., France, Italy, Germany, Spain, and the United Kingdom, while a positive development on many levels (and one we support strongly), arguably increases the likelihood of this result. For these reasons, and others, we have a strong interest in continuing to support your effort to develop administrable rules. The time that you already have spent with us and others on these issues is appreciated greatly.

This letter, unlike our detailed comments on Notice 2011-34,⁵ focus on only a few issues. First, and most importantly, we urge that all amounts attributable to a U.S. fund be treated as having a U.S. source, at the fund’s election, only to the extent of the fund’s investments in U.S.-source assets. The substantial delay in imposing withholding on foreign passthru payments, while granted for sound policy reasons and appreciated greatly by foreign funds, exacerbates exponentially the competitive concerns that we raised previously.

Second, we suggest several changes to the customer documentation requirements. Our proposals will enhance administrability without diminishing compliance.

Third, we suggest an alternative approach for improving further on the many positive changes made by the Proposed Regulations in the treatment of retirement accounts. Specifically, the Final Regulations should state that, except to the extent provided by the Secretary, any retirement plan organized under a country’s laws for the principal purpose of saving for retirement will be eligible for treatment as a certified deemed compliant FFI, will be treated as an exempt beneficial owner, and will be excluded from the definition of financial account

Finally, we suggest additional transition relief. Under our proposal, FATCA’s requirements would begin to apply no sooner than one full calendar year after the FATCA regulations are finalized.

⁴ 15 U.S.C. §§ 80a-1 *et seq.*

⁵ See ICI Letter on Notice 2011-34, dated June 6, 2011.

II. RIC Withholdable Payments

A. Background

The ICI's June 6, 2011 comment letter on Notice 2011-34 discussed in detail the organization and operation of U.S. funds that are registered under the 1940 Act and are treated for U.S. tax purposes as regulated investment companies ("RICs").⁶ Rather than repeat those details here, that portion of the June 6 letter is included for your reference as Attachment A.

B. A RIC's Withholdable Payment Amount Should be Based Upon Its Underlying Assets

1. *The Regulations Place U.S. Funds at a Substantial Competitive Disadvantage*

The U.S. industry has only one RIC-specific concern with FATCA. This concern, however, involves a significant competitive disadvantage – and one that is exacerbated substantially by the Proposed Regulations – for those U.S. funds (such as exchange-traded funds) that are marketed abroad. Specifically, the U.S. industry is concerned that all amounts attributable to a U.S. fund apparently⁷ are treated as generating 100 percent U.S.-source payments irrespective of the fund's underlying portfolio investments.

Our competitive concern is that participating PFFIs ("PFFIs") that are distributing both U.S. and non-U.S. funds will encourage foreign investors to invest in non-U.S. funds to improve their customer experience by reducing the *possibility* that FATCA withholding will be imposed on them should documentation deficiencies develop. For example, if the PFFI offers two funds investing exclusively in Asia, the PFFI may advise foreign investors to invest in the non-U.S. fund (for which the foreign passthru payment percentage will be zero) rather than in the U.S. fund (for which the withholdable payment/passthru payment percentage will be 100 percent). Concerns about FATCA might lead to this recommendation even when the U.S. fund has lower fees and better performance.

This concern is exacerbated substantially by the many-year delay provided by the Proposed Regulations before any withholding is imposed on payments made by a foreign fund to a recalcitrant account holder. The Proposed Regulations, as you know, do not define the term "foreign passthru payment" and delay withholding on foreign passthru payments until at least 2017.

⁶ Subchapter M of the Internal Revenue Code (26 U.S.C. §§ 851 *et seq.*) provides the general tax regime for RICs.

⁷ In one limited respect, the Proposed Regulations could be read to provide a "look-through" approach for determining the extent to which a RIC's payment is treated as having a U.S. source. Specifically, in determining the extent to which a RIC distribution would constitute "gross proceeds," Prop. Treas. Reg. § 1.1473-1(a)((3)(ii)(C) refers to Prop. Treas. Reg. § 1.1473-1(a)((3)(ii)(A); this latter provision states in part that "stock issued by a domestic corporation is property of a type that can produce dividends from sources within the United States *if* a dividend from such corporation would be from sources within the United States (emphasis added)."

The ICI, to be clear, does not object to the relief provided to foreign funds by the Proposed Regulations. We are quite concerned, however, that the competitive disadvantage discussed above has been exacerbated substantially by this delay. For example, because of the delayed imposition of withholding on foreign passthru payments, an individual with documentation issues who invests in a foreign fund investing exclusively in U.S. securities will have no possibility of FATCA withholding while full U.S. withholding would apply if the individual invested instead in a U.S. fund. This competitive disadvantage will last at least until 2017. For a U.S. fund holding non-U.S. assets, the disadvantage is perpetual.

C. Proposal

1. *In General*

To address these concerns, we request that RICs be provided with an election to treat the portion of any payment as withholdable based upon the portion of the RIC's underlying portfolio that consists of assets generating U.S.-source payments. Thus, for example, a RIC that invested only in non-U.S. securities and received income only from these non-U.S. securities would not make *any* withholdable payment and no payment attributable to this RIC (either a distribution made by this RIC or the proceeds from a disposition of an interest in this RIC) would be treated as a passthru payment.

RICs would *not* be required to make this election. Indeed, unless a RIC has both a significant foreign shareholder base and a portfolio with substantial non-U.S. investments, this election almost surely would not be made. For those RICs concerned about the competitive disadvantage, however, the election is quite important. FATCA should not be available for use by foreign distributors as a tool to encourage foreign investors seeking exposure to non-U.S. securities to purchase foreign, rather than U.S., funds holding comparable securities.

We submit that this proposal will not encourage tax evasion by U.S. persons. In all cases, RICs and PFFIs will be required to obtain information necessary to determine whether an accountholder is a U.S. person and to report fully on such persons. Moreover, the responsible officer of a PFFI will be required to certify that the FFI's management personnel do not encourage or assist U.S. persons in hiding their identities.

2. *Detailed Proposal*

As the Proposed Regulations did not discuss the calculation of a passthru payment percentage, our detailed proposal – provided in Attachment B to this letter – references Notice 2011-34's discussion of how a non-U.S. fund might calculate such a percentage. Because foreign funds will not be required to calculate a foreign passthru payment for several years, if ever, our suggestions are limited to U.S. funds.

III. Customer Documentation Issues

A. Introduction

Financial institutions expend considerable effort ensuring their compliance with all applicable customer identification requirements. This effort is compounded when information must be collected to satisfy different legal requirements,⁸ when different types of information must be collected or reviewed,⁹ when information collected may be relied upon (*i.e.*, is valid) for different time periods,¹⁰ and when information must be retained for different time periods.¹¹

Our comments below focus on three broad areas. First, we encourage efforts to maximize global harmonization of tax compliance and treaty relief measures and government-to-government information-sharing arrangements. Second, we support steps taken in the Proposed Regulations to reduce some of the more burdensome and novel customer identification requirements that were contained in the IRS Notices that preceded the Proposed Regulations. Third, we suggest several additional modifications to these rules to reduce further the burdens imposed on financial institutions without reducing FATCA's tax compliance objectives.

B. Maximizing Global Harmonization of Tax Compliance and Treaty Relief Measures

Financial institutions with a global focus – because they have cross-border activities or investments and/or a client base that is not purely domestic – have a very keen interest in customer identification rules and government-to-government information-sharing protocols that are as harmonized as possible across jurisdictions. The Organization for Economic Cooperation and Development (“OECD”) for several years has brought together tax compliance experts from governments and financial institutions from around the globe to address these issues. Through the so-called TRACE project,¹² considerable progress has been made in developing a framework for harmonizing customer identification procedures (including a standardized investor self declaration

⁸ Customer information might be collected to comply with know-your-customer (“KYC”) rules, anti-money-laundering (“AML”) rules, domestic tax-reporting requirements, and/or requirements to establish eligibility for reduced withholding under an income tax treaty.

⁹ For some purposes, one simple form of identification may be adequate. In other cases, detailed forms requiring certification of various attributes or qualifications for specific treatment may be required.

¹⁰ Countries providing for investor self declarations (“ISDs”) allow reliance upon the certifications for different periods. In some countries, reliance is permitted indefinitely for some types of certifications while other types of certifications must be renewed every few years.

¹¹ Because different countries have different statutes of limitations, it is inevitable that record retention periods will vary across jurisdictions.

¹² TRACE is an acronym for Tax Relief and Compliance Enhancement.

(“ISD”) that could be used on a reciprocal basis) and simplifying procedures for verifying to governments the status (*e.g.*, residence) of a financial institution’s customers. The United States, as you know, has taken a leading role in this effort.

We strongly support the work of the TRACE project as a vehicle for providing enhanced tax relief and for improving tax compliance in an administrable manner that benefits both governments and business. We also recognize that the FATCA legislation imposes deadlines that prevent global harmonization in the near term. Consequently, our comments below recommend a number of ways in which the FATCA regulations should be modified to improve harmonization without reducing compliance.

The Joint Statement issued on February 8 by the United States, France, Germany, Italy, Spain, and the United Kingdom regarding an intergovernmental approach to FATCA implementation is an encouraging start. More work needs to be done. First, the dialogue between these six governments should be expanded promptly to include business representatives who have been working with these governments for several years on compliance enhancement. FATCA’s requirements are so extensive, and affect financial institutions in so many different ways, that governments cannot possibly develop administrable rules without substantial business input. Second, as soon as feasible, the dialogue should be expanded further to include other governments and business representatives from these additional jurisdictions. A global solution requires a global dialogue. This dialogue should commence expeditiously.

C. Support for Progress Made in Proposed Regulations

The Proposed Regulations addressed in several significant ways the general business concern that the compliance burdens placed on business by the stringent due diligence requirements outweighed any associated compliance benefits by an overwhelming margin. One such example was elimination in the Proposed Regulations of the enhanced requirements that the IRS Notice would have imposed on “private banking accounts.” We also support the new rules that impose substantial additional due diligence (in the absence of clear indicia of U.S. ownership) only on “high-balance” accounts (*e.g.*, \$1 million, in many situations).

Two clarifications are needed. First, the Final Regulations should make absolutely clear that the \$50,000 threshold below which an account need not be treated as a U.S. account applies to all accounts. The preamble to the Proposed Regulations states that preexisting individual accounts “with a balance or value that does not exceed \$50,000 are exempt from review.”¹³ Several government officials, speaking on their own behalf at industry meetings, have restated the position taken in the

¹³ Proposed Regulations, page 22.

preamble. The \$50,000 exception to U.S. account status,¹⁴ however, is limited to accounts that meet conditions A, B, and C – where condition A is that the account be “a depository account.”¹⁵

Second, the Final Regulations should make absolutely clear that the \$50,000 threshold applies for all FATCA purposes. As drafted, the Proposed Regulations provide that the \$50,000 threshold is an exception to U.S. account status only for certain individual accounts of participating FFIs.¹⁶ As the term U.S. account is used throughout the Proposed Regulations, including in the rules for restricted funds,¹⁷ and as the term is defined only once, the definition surely was meant to apply for all purposes.

These drafting ambiguities should be corrected. As the preamble and several government officials effectively have acknowledged, accounts with small balances are of insufficient concern to warrant the due diligence requirements that FATCA otherwise would impose. It would be absurd if a depository account with a \$50,000 balance was deemed to be of no concern while a securities account with a balance of \$500 was of concern. The dollar threshold exception from U.S. account status should apply equally to all types of financial accounts and for all FATCA purposes.

D. Additional Specific Recommendations

1. *Reliance By Multiple Funds on a Single Form W-8*

We appreciate that all funds with a common manager (*e.g.*, funds that are part of the same “fund complex”) may rely upon a W-8 provided to any fund in that complex.¹⁸ To eliminate ambiguity, it would be helpful for the Final Regulations to note that this “shared W-8” rule – which already is provided for information reporting by U.S. funds¹⁹ – applies to all funds in a complex regardless of whether the funds are organized in the same country.

¹⁴ See Prop. Treas. Reg. § 1.1471-5(a)(4)(i).

¹⁵ The definition of depository account in Prop. Treas. Reg. § 1.1471-5(b)(3)(i) appears too narrow to include a securities account.

¹⁶ Prop. Treas. Reg. § 1.1471-5(a)(4)(i)(B).

¹⁷ Prop. Treas. Reg. § 1.1471-5(f)(1)(i)(D)(5).

¹⁸ Prop. Treas. Reg. § 1.1471-3(c)(6)(vi).

¹⁹ Treas. Reg. § 1.1441-1(e)(4)(ix)(3).

2. *Documentary Evidence Burdens for Certified Deemed Compliant FFIs*

We are very concerned about various FATCA requirements that effectively require financial institution employees to make tax compliance determinations based upon subjective requirements that may require specialized legal or financial training. The final FATCA regulations should limit a financial institution's due diligence obligations to making judgments based upon objective standards – such as verifying that a form has been signed or that appropriate boxes for claiming status have been checked.

The Proposed Regulations impose upon financial institutions the very substantial obligations both to collect and to examine documentary evidence to support investor certifications. Documents would be required, under the Proposed Regulations, from certified deemed compliant FFIs (such as nonregistering local banks) and from exempt beneficial owners (such as retirement funds, nonprofit organizations, and funds restricted to exempt beneficial owners). The types of documentary evidence that a firm's employees would be required to examine could include financial statements, annual reports, articles of incorporation, and government certifications.

Determining whether these documents support the status claimed may require both specialized training, as noted above, and command of a foreign language (since documentary evidence provided by a foreign client easily could be in a language that the firm's employee cannot read). The requirement to review financial statements, organizing documents, etc., can introduce substantial potential liability (including an obligation to pay all amounts that should have been collected from the investor whose documentation in fact did not support the status claimed) and will impose costs far exceeding any compliance benefits.

Consequently, we suggest that the Final Regulations eliminate the requirement to collect and review documentary evidence to support certifications made by certified deemed compliant FFIs and exempt beneficial owners. If the Final Regulations nevertheless require firms to collect documentary evidence, the firms should be permitted to rely upon the evidence provided unless the person reviewing the evidence knows or has reason to know that the evidence provided does not support the status claimed. Alternatively, the firms should be permitted in all cases to rely upon a letter from counsel attesting to the FFI's status. We also would support allowing certified deemed compliant FFIs to register with the IRS and receive an FFI-EIN.

3. *Other Documentary Issues*

We have six other document-related suggestions. First, financial institutions should be permitted to rely upon copies and electronic images (such as PDFs) of completed forms. Customer information today routinely is collected through electronic means. Electronic documents that financial services firm risk managers have determined are adequate for business purposes should be adequate for tax compliance purposes as well. Substantial burdens will be imposed if firms must

change their business practices and, for FATCA purposes only, collect only paper originals or faxed copies of investor certifications and/or supporting documentary evidence.

Second, any documentary evidence collected by a financial institution to support a W-8 should remain valid, and should not need to be “refreshed,” even if (such as in the case of a passport) its validity expires before the W-8 itself expires. The additional burdens that will be placed upon financial institutions to monitor the expiration dates of both W-8s and underlying documentary evidence seem unlikely – absent knowledge or a reason to know that the investor’s status has changed – to enhance tax compliance. Requiring that in all cases both the W-8 and the documentary evidence be valid currently could increase substantially the number of times that information must be solicited from clients. The more times a client is required to update information, the more times it is possible that the client inadvertently will fail to respond. Failure to respond will subject a client to withholding that otherwise would not have been imposed. Absent actual knowledge or a reason to know that a client’s status has changed, a financial institution should be permitted to rely upon documentary evidence collected until the associated W-8 expires.

Third, strong consideration should be given to extending the time period for which W-8s and any documentary evidence collected only for FATCA purposes remain valid. One approach would be to permit continued reliance unless the financial institution knows or has reason to know that an investor’s status may have changed. This “exception redocumentation” would limit the number of new recalcitrant account holders that would appear on a financial institution’s books every time a W-8 or piece of documentary evidence expired without being updated.

Fourth, the documentation requirements for entities wholly owned by exempt beneficial owners should not obligate the entity to pass along the associated documentation for each underlying participant in the investment fund. Rather, a self-certification from the entity should suffice. This proposal is consistent with the certification requirements that apply to registered deemed compliant funds. If this requirement is not changed, withholding agents potentially will be asked to validate hundreds of pages of documentation relating to entities that are considered to pose no risk of tax evasion. We submit that a fund operating in this manner will have robust procedures in place to ensure that all participating investors are exempt. We suggest that the IRS may gain additional comfort on this issue if the entity attests to its procedures in a penalties of perjury statement that is associated with signing the W-8.

Fifth, we suggest that a U.S. phone number not be treated, in itself, as sufficient indicia of U.S. ownership. Non-U.S. investors have U.S. phone numbers for a wide range of personal reasons. As the number of such investors, we understand, is high, substantial additional compliance burdens will be imposed if a U.S. phone number, without more, is sufficient to trigger additional due diligence regarding an account.

Finally, we urge that financial institutions be required to check the continuing validity of an FFI-EIN no more frequently than annually. A clear and manageable standard is needed regarding a financial institution's obligation to review FFI-EINs that have been verified, upon receipt, as valid.

IV. Retirement Accounts

A. Introduction

We support the many significant improvements made by the Proposed Regulations to the treatment of retirement plans and accounts. The Proposed Regulations effectively recognize that the typical foreign retirement account does not provide U.S. persons with the ability to hide assets.

Special consideration must be given to retirement plans because they generally must be operated under their home-country laws for the primary purpose of preserving plan participants' retirement savings. The obligations that FATCA imposes on financial institutions to withhold in certain situations and to close accounts in others, however, are inconsistent with the laws under which these plans are organized.

We recognize the difficulty of crafting rules that distinguish effectively between vehicles that might allow for assets to be hidden and those that would not allow for such behavior. In the case of retirement plans and accounts that are organized under a country's laws for the principal purpose of saving for retirement, however, no line-drawing should be required. All such plans and accounts should be treated as deemed compliant, as exempt beneficial owners, or as excluded from the definition of financial account.

While many of the requirements contained in the Proposed Regulations (which are based on U.S. principles) are not problematic, a few requirements create significant, if not overwhelming, difficulties for certain types of retirement accounts. Each problematic area is discussed below. While we suggest targeted changes for some of these issues, we submit that a more comprehensive and effective solution should be provided. This solution would accommodate arrangements that are designed to meet specific local requirements and the financial needs of local workers.

Specifically, the Final Regulations should state that, except to the extent provided by the Secretary, any retirement plan organized under a country's laws for the principal purpose of saving for retirement will be eligible for treatment as a certified deemed compliant FFI, will be treated as an exempt beneficial owner, and will be excluded from the definition of financial account. Any concerns that certain types of plans should not be treated as eligible could be addressed by the "except to the extent provided" provision.

B. Specific Concerns

1. *The Five-Percent Participant Interest Limit*

The Proposed Regulations condition a retirement fund's eligibility for treatment – under one of the certified deemed compliant FFI categories²⁰ and one of the exempt beneficial owner categories²¹ – on the fund not having a single beneficiary with a right to more than five percent of the entity's assets. In the case of certain large plans, this limitation creates an unnecessary compliance-monitoring requirement. In the case of certain smaller plans, this limitation can cause plans to flip in and out of qualification.

For certain large plans, the five-percent limit can impose a compliance monitoring requirement even when it is highly unlikely that a participant could have that significant an interest. The Chilean pension fund system, for example, requires mandatory contributions by approximately seven million individuals to fund mandatory pension accounts that are managed by one of six providers. Rather than force each of these providers to monitor account sizes, we suggest (as an alternative to the five-percent limit) that this requirement be satisfied if the assets are held solely for the beneficiary of a government-designed, broad-based pension system.

For certain smaller plans, the five-percent limit can preclude a plan from qualification in the first instance; the five-percent limit also can cause the plan to flip in and out of qualification as participants enter or leave the plan and/or as asset values of investment options change. To illustrate the difficulty of this well-intentioned test, consider the treatment of a very small plan that acquires a 20th participant. This plan no longer can qualify for treatment as a deemed compliant retirement plan under Prop. Treas. Reg. § 1,1471-5(f)(2)(ii)(A)(2) because it has more than 19 participants. The plan cannot satisfy the requirements for treatment as a deemed compliant retirement plan under Prop. Treas. Reg. § 1,1471-5(f)(2)(ii)(A)(1), however, unless each of the 20 participants has exactly the same five-percent interest in the plan's assets. Given our example of a 20th participant joining the plan, it is clear that at least one (and probably several) of the other plan participants will exceed the five-percent limit.

The difficulties created by the five-percent limit would be ameliorated at least somewhat if the limitation were increased to ten percent.

2. *Plans that Allow for Excess Contributions*

We appreciate greatly that the Proposed Regulations allow contributions of up to 100 percent of earned income without causing a plan to fail to qualify for the exception to the definition of

²⁰ Prop. Treas. Reg. §§ 1.1471-5(f)(2)(ii)(A)(1)(ii).

²¹ Prop. Treas. Reg. §§ 1.1471-6(f)(1)(ii)(C).

financial account, for certified deemed compliant FFI status, or for exempt beneficial owner status.²² Certain types of government-mandated plans, including some in Australian and Hong Kong, allow for contributions in certain instances that are not limited to earned income. Some others allow for “unused amounts” in one year to be rolled over to subsequent years. As we understand you will receive detailed submissions from several national associations, including those in Australia and Hong Kong (among others), we will not attempt to describe other countries’ plans here. What is clear, however, is that these plans cannot be used by U.S. persons to hide assets. Hence, the limitation tied to earned income is both extremely problematic and unnecessary.

3. *Plans that Incur Annual Taxation*

We also appreciate other enhancements made by the Proposed Regulations to the ability of retirement plans to qualify as certified deemed compliant FFIs or as exempt beneficial owners. The requirement that a fund not be taxable,²³ we understand, is problematic for Australian superannuation funds – which are taxed at a concessionary rate of 15 percent. Because these funds will be addressed in the Australian association’s submission, we will not attempt to describe those plans here. Clearly, some taxation of a retirement plan’s income should not disqualify the plan from qualifying as a certified deemed compliant FFI or as an exempt beneficial owners.

4. *Arrangements to Earn Income for Benefit of Exempt Plans*

The definition of a retirement account should be expanded to include any arrangement to earn income for the benefit of one or more exempt pension plans. These arrangements currently are treated as exempt retirement accounts in the U.S.’ income tax treaties with Canada and the United Kingdom and should be treated as such for FATCA purposes as well.

V. **Transition Issues**

We appreciate the transition relief provided by the Proposed Regulations. More transition relief, however, is necessary.

Funds and financial institutions will need sufficient time, after final FATCA regulations are issued, to comply with the new and detailed obligations that will be imposed on them. Firm’s “FATCA teams” involve business executives, securities lawyers, tax lawyers and other tax compliance personnel, communications personnel, operations and computer systems personnel, and many other experts from offices around the globe. Their compliance efforts have been diligent and undertaken in

²² Prop. Treas. Reg. § 1.1471-5(b)(2)(i)(A) (exception to definition of financial account); Prop. Treas. Reg. § 1.1471-5(f)(2)(ii)(A)(1)(i) (certified deemed compliant FFI); and Prop. Treas. Reg. § 1.1471-6(f)(1)(ii)(B) (exempt beneficial owner).

²³ See, Prop. Treas. Reg. §§ 1.1471-5(f)(2)(ii)(A)(1)(iii) and 1.1471-6(f)(1)(ii)(D).


good faith. The Final Regulations, however, will need to be studied closely and implemented carefully.

To address these concerns, we request that FATCA's requirements apply no sooner than one full calendar year after the FATCA regulations are finalized. Under our proposal, finalization of the regulations in 2012 would cause FATCA's reporting requirements to apply beginning with payments made in calendar year 2014. Similarly, because the timeline provided by the Proposed Regulations calls for FATCA's withholding rules to apply beginning one calendar year after the FATCA reporting rules become effective, it would follow under our proposal that FATCA withholding would begin on January 1, 2015. All of the Proposed Regulations' other requirements, such as receiving customer documentation on specific forms, would apply no sooner than January 1, 2014.

* * *

We would like to discuss this letter's proposals with you. The time spent already by you and your staffs with us and others is appreciated greatly. As the industry will need substantial lead-time to implement final FATCA regulations, I will contact you shortly to discuss the timing for our next meeting. Please feel free, at any point, to contact me for additional information or to discuss our proposals. My direct dial number is 202/326-5832. Many thanks.

Sincerely,

A handwritten signature in black ink, appearing to read "Keith Lawson", with a long horizontal flourish extending to the right.

Keith Lawson
Senior Counsel – Tax Law

Attachments

cc: Michael Caballero
J. D. Carroll
Ron Dabrowski
Jesse Eggert
Josephine Firehock
Kathryn Holman
Quyen Huynh
Patricia McClanahan
Danielle Nishida
Doug O'Donnell
Michael Plowgian
Danielle Rolfes
John Sweeney
www.regulations.gov (IRS REG-121647-10)

ATTACHMENT A
ICI COMMENT LETTER ON FATCA PROPOSED REGULATIONS

ORGANIZATION AND OPERATION OF REGULATED INVESTMENT COMPANIES

I. RICs are Investment Pools

U.S. funds registered under the 1940 Act generally are treated for U.S. tax purposes as regulated investment companies (“RICs”). Subchapter M of the Internal Revenue Code¹ provides the general tax regime for RICs.

RICs are investment vehicles that provide individuals and entities with asset diversification and professional management at costs far lower than the average investor could achieve by investing directly in the same securities held by the RIC. In essence, investors pool their assets through the RIC to improve their investment return. Each RIC shareholder effectively has an undivided interest in the RIC’s assets.

RICs generally calculate each day the net asset value (“NAV”) of their shares. The NAV reflects each investor’s interest, on a per-share basis, in the RIC’s assets. RICs that may be purchased pursuant to continuous public offerings and redeemed upon shareholder demand (referred to in the 1940 Act as “open-end investment companies” and known colloquially as “mutual funds”) price their shares at the NAV. Thus, a mutual fund shareholder effectively can liquidate his or her undivided interest in the fund’s assets every day at the net value (after accrued expenses) of those assets.

II. Distribution of RIC Shares

RICs typically are publicly offered only in the U.S. In very limited situations, a few RICs have been offered for public sale in specific jurisdictions.² The shares of many RICs (such as “exchange-traded funds” or “ETFs”) trade on stock exchanges. Some RICs, particularly institutional funds and those holding bonds, may acquire shareholders through private placements.

While the overwhelming majority of all investors in RICs are U.S. persons (whose status has been documented by valid taxpayer identification numbers (“TINs”)), the non-U.S. investment in RICs is not inconsequential; even a very small percentage of the over \$13 trillion invested in RICs is a large amount. Foreigners invest in RICs both directly and through FFIs; foreign institutional investment (*e.g.*, from foreign pension plans) is important to many ICI members.

¹ 26 U.S.C. §§ 851 *et seq.*

² A few RICs have been offered for public sale in Germany, where relatively comparable tax treatment for German investors in U.S. and German funds eliminated a significant competitive disadvantage for U.S. funds.

RICs may be created for different distribution channels and/or different types of investors. RICs often are created for distribution to individual investors purchasing through the retail market (“retail funds”). Other RICs are created primarily for distribution to institutional investors, such as employer-sponsored retirement plans, charities, and corporate cash management offices (“institutional funds”). In many cases, RICs will have separate classes of shares for retail and institutional investors.

The typical RIC has thousands of shareholders; some RICs have hundreds of thousands of shareholders. RIC shareholders may hold their shares directly with the RIC’s transfer agent. More commonly, the shares are held through an intermediary who often holds the shares in a nominee account. RICs often have hundreds or thousands of intermediary shareholders.

Nominee accounts include street name accounts set up by brokerage firms, banks, and financial planners for their customers and those set up by so-called “fund supermarkets,” which are created by financial services firms to invest their clients’ assets in other firms’ RICs. Nominees may hold for other nominees; financial planners can hold their clients’ assets in an account with another nominee, such as a fund supermarket, that will be the shareholder of record at the RIC level. Because customer identity information is a valuable commercial asset, firms with the customer relationship may utilize the nominee account structure to shield the client’s identity from competitors, including RICs and the financial services firms that manage RICs. The nominee account structure, importantly, does not shield client information from the IRS.

III. The Tax Treatment of RICs and Their Shareholders

RICs effectively are required to distribute annually essentially all of their income and gains. These distribution requirements are found in Code sections 852³ and 4982.⁴

U.S. individuals and other taxpaying persons investing in RICs are taxed upon (1) the receipt of RIC distributions (whether received in cash or reinvested in additional RIC shares) and (2) the disposition of RIC shares. Backup withholding under Code section 3406 is imposed on all reportable

³ Under Code section 852, a RIC must distribute with respect to its taxable year at least 90 percent of its income (other than net capital gain). The remaining 10 percent of ordinary income, and all capital gain, may be retained. All retained income, however, is taxed at regular corporate tax rates. Because a RIC that incurs corporate tax provides a lower return than one that does not incur such tax, RICs generally attempt to distribute all of their income.

⁴ U.S. tax law imposes an excise tax (under Code section 4982) on any RIC that does not distribute essentially all of its income during the calendar year in which it is earned. To eliminate any excise tax liability, a RIC must distribute by December 31 an amount equal to the sum of: (1) 98 percent of its ordinary income earned during the calendar year; (2) 98.2 percent of its net capital gain earned during the 12-month period ending on October 31 of the calendar year; and (3) 100 percent of any previously-earned amounts not distributed during the prior calendar year. A tax of 4 percent is imposed on the amount, if any, by which the RIC’s required distribution exceeds the amount actually distributed. The excise tax, in effect, acts as an interest charge on undistributed amounts. RICs typically seek to avoid this charge by electing to distribute their income currently.

payments (including dividends and gross proceeds from securities dispositions) made to persons who have not furnished a TIN or have furnished a TIN determined to be incorrect.

Foreign investors incur tax on their RIC investments pursuant to Code section 1441. Importantly, a foreign individual investor will be treated as a U.S. person who has not provided a valid TIN, and hence will be subject to Code section 3406 backup withholding, unless the person has provided appropriate documentation (*e.g.*, a valid IRS Form W-8) establishing the person's status as foreign.

ATTACHMENT B
ICI COMMENT LETTER ON FATCA PROPOSED REGULATIONS

PROPOSAL FOR CALCULATING A RIC PASSTHRU PAYMENT PERCENTAGE

I. Calculating the Passthru Payment Percentage for Share Dispositions

The ICI supports the approach taken in Notice 2011-34 of using U.S. and non-U.S. asset percentages in determining the passthru payment percentage for share dispositions. Among other things, this approach will provide the RIC investor with FATCA treatment comparable to that of the direct investor who sells the same securities that are in the RIC's portfolio on the date the RIC interest is sold or redeemed. Comparable treatment is important because it allows RICs to demonstrate to their customers that the RIC structure is not in any way disadvantaging the RIC investor vis-à-vis the direct investor. In effect, the Notice's approach treats the disposition of the investor's RIC shares as a disposition of his or her undivided interest in the RIC's assets.

We also support the use of average portfolio composition to determine a RIC's passthru payment percentage. By requiring portfolio composition averaging, the Notice reduces potentially significant swings in a RIC's passthru payment percentage (if a RIC moves actively into and out of the U.S. securities markets based upon expected relative returns between U.S. and foreign markets). These passthru payment percentage swings might be confusing to shareholders and/or cause any recalcitrant account holder to manipulate the timing of redemptions to minimize FATCA withholding.

Using the portfolio composition for a RIC's last four fiscal quarters, regardless of the time period over which a RIC investor held RIC shares, also is appropriate.¹ FATCA withholding is not designed to be precise; it is designed to ensure reporting on U.S. persons. The costs of attempting to build a computer system to tie testing dates to the period during which a person was a RIC shareholder would be astronomical.

The Notice's approach would be far more administrable for RICs and their distributors, however, if the disposition percentage applied to all RICs for a longer, and more uniform, period. Because of the large volume of shareholder transactions, the most effective withholding system will be highly automated. Such a system will operate more effectively the fewer times that a passthru payment percentage needs to be updated and the more uniform the period for which the percentage applies.

¹ We would not oppose using more quarters, such as the last twelve, if regulators determined that a longer measurement period was necessary.

Consequently, we suggest that the passthru payment percentage for dispositions of a RIC's interests be based upon the RIC's last four fiscal quarters that end before December 31 and that this percentage apply for the entire subsequent calendar year.

Example 1. Assume a RIC with a calendar-year-end. This RIC's last fiscal quarter before December 31, 2014 is September 30. Thus, the passthru payment percentage for this RIC for 2015 would be based upon the average of the four quarterly determinations made on: September 30, 2014; June 30, 2014; March 31, 2014; and December 31, 2013.

Example 2. Assume a RIC with a November 30 year-end. This RIC's last fiscal quarter before December 31, 2014 is November 30. Thus, the passthru payment percentage for this RIC for 2015 would be based upon the average of the four quarterly determinations made on: November 30, 2014; August 31, 2014; May 31, 2014; and February 28, 2014.

This proposal, we submit, would have three substantial benefits. First, it would allow the percentage to be determined before it becomes applicable,² so that the percentage could be disseminated throughout the RIC's distribution network and inputted into withholding systems before that percentage is applied to dispositions by recalcitrant account holders. Second, by applying the percentage for an entire calendar year, the proposal would minimize distributor confusion caused by different RICs having different fiscal quarter-ends and hence having their passthru payment percentages expire on different dates. Third, an annual (rather than quarterly) percentage would reduce by seventy-five percent the number of times that the withholding percentages for RICs making this election would need to be updated.

The benefits of an annual passthru payment percentage for dispositions of RIC shares, we submit, outweigh any imprecision caused by less frequent updating. As noted above, the purpose of FATCA withholding is not to collect any precise amount of tax; the purpose is to ensure reporting on U.S. persons. Our proposal accomplishes this objective just as well as the approach taken in the Notice. An annual percentage likewise will not lead to manipulation. Each quarterly percentage applies for four quarters under both the Notice's approach and our suggestion. The only difference is in the quarters to which the quarterly percentage applies. Finally, the Notice provides an anti-abuse rule that allows Treasury and the IRS to disregard transactions designed to manipulate an FFI's passthru payment percentage.

² The Notice may or may not produce this result. As we read the Notice, a participating FFI must calculate its passthru payment percentage each quarter and disseminate that information within three months after the quarterly testing date. If the percentage applies for the quarter following the last quarterly testing date, this information almost surely would not be available to distributors for dispositions occurring early (or perhaps even late) in the next quarter.

II. Calculating the Passthru Payment Percentage for Distributions

Calculating a passthru payment percentage for distributions based upon the RIC's assets, as proposed by the Notice, does not provide RIC shareholders with treatment comparable to that received by direct investors in the same underlying securities. Comparable treatment is important, as noted above, because it allows RICs to demonstrate to their customers that the RIC structure is not in any way disadvantaging the RIC shareholder vis-à-vis the direct investor.

We suggest that FATCA regulations address these concerns by permitting a RIC to elect³ to determine its passthru payment percentage for distributions made to its investors based upon the sources of the income that is distributed.⁴ This approach, in effect, would allow an electing RIC to trace the source of the income being distributed for FATCA purposes. Any RIC that determined that the benefits of additional precision described above did not justify the costs of adopting a tracing approach would not make the election.

The formula for determining the passthru payment percentage for RIC distributions should be based upon a proportionate allocation between gross income from U.S. and foreign sources of income received by the RIC during the period in which the RIC earned the income it is distributing.⁵ By requiring that proportionate gross (rather than net) income to be used in the calculation, the possibility of manipulation should be negated. The anti-abuse relief provided by the Notice to the IRS should be available here as well to address any concerns that might arise.

Example 3. Assume a RIC that distributes its income annually, in December. Further assume that the RIC bases its annual distributions on its net income received through November 30 of that year (so that the per-share distribution can be calculated, approved, declared to shareholders of record, and paid by December 31). For the period December 1, 2013 through November 30, 2014, 40 percent of the RIC's gross income (*e.g.*, dividends, interest, and net gains from securities sales) is from U.S. sources and the remaining 60 percent

³ The election must be crafted to prevent manipulation. Because concerns might arise, initially, about how the election might work, perhaps the first election would be for a specified number of years (*e.g.*, three years, unless revoked with the Commissioner's consent). Subsequent elections (perhaps automatic, unless revoked by the FFI) might be for a single year or for another specified number of years.

⁴ To the extent that distributions to different classes within a CIV vary by amount (such as because of the manner in which the differing expenses of each class are allocated to the relevant class), the sources of the income distributed to the classes might vary. To the extent that differences arise, we propose that the CIV be permitted to elect to apply the tracing proposal on a class-by-class basis.

⁵ In determining the tracing percentage for distributed gains, the CIV would take into account only net gains (and not gross proceeds) from the disposition of U.S.-source and non-U.S.-source portfolio securities (determined by reference to the issuer).

is from non-U.S. sources. Thus, 40 percent of the RIC's 2014 distribution would be a passthru payment.

Example 4. Assume a RIC that distributes its income quarterly – in March, June, September, and December. Further assume that the RIC bases its quarterly distributions on its net income received through the end of the preceding month (February, May, August, and November). For the period December 1, 2013 through February 28, 2014, 15 percent of the RIC's gross income (*e.g.*, dividends, interest, and net gains from securities sales) is from U.S. sources and the remaining 85 percent is from non-U.S. sources. Thus, 15 percent of the RIC's March 2014 quarterly distribution would be a passthru payment.

III. Additional Elective Simplification Suggestions

Two additional simplifying suggestions are offered for your consideration. We would be pleased to discuss these suggestions with you in additional detail.

First, we suggest that a RIC be permitted to elect to treat its passthru payment percentage as the maximum U.S. investment permitted by the RIC's prospectus. If the RIC cannot invest more than 20 percent of its assets in U.S. securities, for example, it should be permitted to simplify FATCA's application by always treating its passthru payment percentage as 20 percent. While it seems inconceivable that a RIC would violate its prospectus to report a passthru payment percentage lower than the otherwise-applicable percentage, the Notice's anti-abuse mechanism would be available to address any abusive situation that were to arise.

Second, because of the difficulties of imposing FATCA withholding on small amounts, we suggest that any RIC with a passthru payment percentage below a *de minimis* threshold, such as five or ten percent, be permitted to treat its passthru payment percentage as zero. To the extent that the FATCA withholding amount is too small to serve as an effective tool for ensuring reporting, treating a RIC as having a passthru payment percentage of zero would reduce the burden of implementing FATCA.