

## Summary of ICI Global Comments on FATCA Proposed Regulations

### Introduction

The Foreign Account Tax Compliance Act (“FATCA”) was enacted in 2010 to ensure that U.S. persons holding assets through accounts with foreign financial institutions (“FFIs”) comply with their U.S. tax obligations. The tax compliance regime created by FATCA imposes substantial burdens on funds and other FFIs. The FATCA regime, among other things, imposes new customer documentation and identification reporting responsibilities on FFIs and requires withholding on U.S.-source payments to certain persons. Persons subject to FATCA withholding include FFIs that are not “FATCA compliant” and individuals whose identities as U.S. or non-U.S. cannot be determined after various steps are taken (so-called “recalcitrant account holders”).

The U.S. Treasury Department and the U.S. Internal Revenue Service (“IRS”) issued Proposed Regulations to implement FATCA on 8 February 2012. Also on 8 February, the United States, France, Germany, Italy, Spain, and the United Kingdom issued a Joint Statement regarding an intergovernmental agreement (“IGA”) approach for implementing FATCA and improving international tax compliance on a reciprocal basis.

ICI Global filed its comment letter on these Proposed Regulations on 30 April. The letter discusses issues of particular importance to funds and proposes modifications to the Proposed Regulations to address the industry’s concerns. The IGA announced by the Joint Statement also is addressed in the ICI Global letter.

### FATCA’s Application to Funds

The letter describes how we understand FATCA applies to investment funds.<sup>1</sup> If a fund has direct individual investors, the fund can be FATCA compliant only by (1) entering into an agreement with the IRS and becoming a participating foreign financial institution (“PFFI”) or (2) satisfying the registered deemed compliant FFI requirements to be treated as a “restricted fund.” If a fund does not have any direct individual investors, it may be eligible to become FATCA compliant as (1) a PFFI or (2) a restricted fund, or (3) by satisfying the registered deemed compliant FFI requirements to be a qualified collective investment vehicle (a “qualified CIV”).

The letter focuses in detail on the difficulties that funds will encounter in trying to satisfy the requirements in the Proposed Regulations for registering as either a restricted fund or as a qualified CIV. Absent fairly substantial changes to these requirements, it may be less burdensome for at least some funds to sign agreements with IRS and become PFFIs.

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<sup>1</sup> One or more additional methods may be available for an FFI to become FATCA compliant once countries enter into reciprocal agreements with the United States.

## Transition Relief

The first substantive issue raised by the letter involves the need for the FATCA implementation dates to be postponed. The letter explains that transition relief is necessary to address both general and registered-deemed-compliant-FFI-specific FATCA issues.

General relief is necessary for all FFIs because it seems highly unlikely that there will be sufficient time, between the date FATCA regulations are finalized and when they begin to apply under the timeline provided by the Proposed Regulations, for all FFIs to become FATCA compliant. To address this general concern, ICI Global requests that FATCA's requirements apply no sooner than one full calendar year after the FATCA regulations are finalized.

More targeted relief is necessary for funds seeking to register as deemed compliant FFIs. To address the additional challenges that these funds will face in becoming registered deemed compliant FFIs, we request that provisional registration be permitted. Specifically, a fund should be permitted to register as a deemed compliant FFI based upon an intention to distribute only through eligible distributors and allow direct investment only from eligible investors. This provisional registration period, we suggest, should last for one year beyond the date that FATCA otherwise applies to the fund.

## Registered Deemed Compliant FFI Issues

A substantial portion of the ICI Global letter focuses on the requirements a fund must meet to register as a deemed compliant FFI. The letter first addresses "general" considerations applicable to both the qualified CIV and the restricted fund categories of deemed compliant FFI. The letter then discusses issues specific to each of these two deemed compliant FFI categories.

### *General Considerations*

The letter makes four general requests regarding the rules applicable to funds as registered deemed compliant FFIs. First, because funds may be required to accept representations from thousands of distributors and investors (some of which may be PFFIs, registered deemed compliant FFIs, or certified deemed compliant FFIs), we suggest that funds generally be permitted to rely on representations received subject to a know/reason to know standard. Second, the Final Regulations should provide for situations in which a fund no longer qualifies for a specific category of registered deemed compliant FFI status. Third, comparable "cure" provisions, to remedy post-registration qualification deficiencies, should be provided for all categories of registered deemed compliant FFI status. Finally, clarification would be appreciated regarding the nature of a country's securities regulation that is required for a fund to be "regulated."

### *Qualified CIV Category of Deemed Compliant FFI*

The qualified CIV category – which appears designed for funds without individual investors on the share register<sup>2</sup> – includes tightly-drawn restrictions on the types of eligible distributors for a qualified CIV and the types of eligible investors in a qualified CIV. We recommend that the list of eligible distributors be expanded to include two types of certified deemed compliant FFIs: nonregistering local banks and FFIs with only low-value accounts. We also make several recommendations for expanding the categories of eligible investors. Under one such recommendation, all certified deemed compliant FFIs, including all retirement plans and exempt organizations, should be eligible direct investors in a qualified CIV.

### *Restricted Funds*

The letter requests several changes to the requirements for a “restricted fund.” Several of these suggestions address the requirements to be a “restricted distributor,” which is one type of distributor for a restricted fund. First, we urge that the restricted distributor single-country restriction be modified to allow (a) all European Union (“EU”) member states to be treated as a single country and (b) a distributor that operates only in FATF-compliant countries and/or in countries that the IRS determines have standards reasonably equivalent to those of FATF-compliant countries to be treated as a restricted distributor. Second, we urge substantially higher limits on the assets and gross revenues of qualifying “restricted” distributors. Third, a re-qualification grace period of 90 days should be provided if a distributor that fails to meet one of the restricted distributor tests reasonably expects to re-qualify. Fourth, we request clarification that a restricted fund may rely on a distributor’s claim of restricted distributor status unless the restricted fund knows or has reason to know that the claim is invalid. Finally, we urge that a restricted fund be permitted in all cases to receive seed capital from a U.S. manager or a U.S. affiliate of a non-U.S. manager.

### The Intergovernmental Agreement

The letter expresses ICI Global’s strong support for initiatives, such as the Tax Relief and Compliance Enhancement (“TRACE”) project undertaken by the Organization for Economic Cooperation and Development (“OECD”), to enhance tax relief and improve tax compliance in an administrable manner that benefits both governments and business. While the IGA approach discussed in the Joint Statement 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. Second, as soon as feasible, the dialogue should be expanded further to include other

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<sup>2</sup> The types of funds that this category of registered deemed compliant FFI appears to cover include: (1) a fund the interests in which can be held only through a centralized securities depository (“CSD”) which is a participating FFI; (2) a so-called institutional fund, the interests in which may be held only by institutions such as pension funds; and (3) a fund sold only through distributors that are FFIs. These funds do not have direct individual investors or direct entity investors that might have substantial U.S. owners.

governments and business representatives from these additional jurisdictions. A global solution requires a global dialogue. This dialogue should commence expeditiously.

The letter also discusses the fifth category of registered deemed compliant FFI – specifically, an FFI that is incorporated or organized in an IGA country. In developing requirements for this fifth category of registered deemed compliant FFI, we urge consideration of the likely need for many funds and their distributors to register under this fifth category and another category (*e.g.*, as a restricted fund). The Final Regulations will need to address the overlap between these various categories of registered deemed compliant FFIs.

### Fund Structure Issues

#### *Clarify Relationship Between Funds and Their Advisor and Service Providers*

We recommend several changes to clarify the treatment of funds as FFIs. First, the Final Regulations should state affirmatively that each fund, regardless of the form in which the fund is organized under local law, is a separate FFI. Second, the Final Regulations should state affirmatively that each fund is distinct from its advisor (which may or may not be an FFI) and that funds with a common investment manager are not part of an expanded affiliated group. Finally, it would be helpful for the Final Regulations to clarify that the fund, rather than a transfer agent acting on a fund's behalf, is the FFI with respect to directly-registered shares.

#### *Umbrella Funds*

We propose that all FFI rules be applied at the sub-fund level. FATCA is not administrable if the rules are applied at the level of the umbrella fund.

#### *Publicly-Traded Funds*

The letter addresses two issues unique to publicly-traded funds such as exchange-traded funds. First, we request clarification of the statute's application to the situation in which shares of a publicly-traded fund are purchased on an exchange and then re-registered in the investor's name directly on the share register of the fund. Second, to minimize the likelihood that a fund would move into and out of "regularly-traded" status, we request that a fund be permitted to look to the average of its trading volume over the past three calendar years rather than just over the past calendar year.

#### *Centralized Compliance Option*

We recommend that a centralized compliance option be provided in Final Regulations. Funds, as discussed in the letter, would benefit more from a centralized compliance option than would corporate affiliates.

## Retirement Plans and Accounts

The letter supports the many significant improvements made by the Proposed Regulations to the treatment of retirement plans and accounts. The typical foreign retirement account does not provide U.S. persons with the ability to hide assets. 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. While we suggest targeted changes for some of these issues, we submit that a more comprehensive and effective solution should be provided. Specifically, we suggest that the Final Regulations 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 treated as a deemed compliant FFI, as an exempt beneficial owner, and as excluded from the definition of financial account.

## Documentation Issues

The documentation issues discussed in the letter fall into three broad areas. First, the letter encourages efforts to maximize global harmonization of tax compliance and treaty relief measures and government-to-government information-sharing arrangements. The intergovernmental agreement that was discussed in the 8 February Joint Statement, and its relationship to the OECD's TRACE project, is discussed in this section of the letter. The letter also supports 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. Finally, the letter suggests several additional modifications to these rules to reduce further the burdens imposed without impairing FATCA's tax compliance objectives.

## Foreign Passthru Payments

We support strongly the decision reflected in the Proposed Regulations to delay imposition of withholding on foreign passthru payments until at least 2017.

## Consent to Be Withheld Upon

The option provided to a PFFI by the legislation to elect to be withheld upon, rather than to withhold on payments it makes to recalcitrant account holders or non-participating FFIs, is extremely problematic for funds that otherwise would not need to build withholding systems. We urge that this PFFI election be subject to affirmative consent by the fund.

## Transition Relief

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. 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.