

By Electronic Delivery

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RE: FATCA and Notice 2011-34

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

The Investment Company Institute¹ strongly supports administrable rules that implement, consistent with Congressional intent, the new reporting and withholding rules of Chapter 4 of the Internal Revenue Code.² The progress made by Notice 2011-34 (“the Notice”) in developing

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 \$13.41 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”).

administrable rules is commendable. The proposals 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 funds³ – are impacted both directly and indirectly by FATCA. The direct impact arises from any fund shareholders that are treated under FATCA as foreign financial institutions (“FFIs”), non-financial foreign entities (“NFFEs”), and 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. To the extent that FATCA works well for non-U.S. funds investing in the U.S., a precedent will have been established that would support workable FATCA-like rules that could be used by foreign governments for U.S. funds and others. Another concern is that, were final FATCA regulations viewed by foreign investors as unduly burdensome, any substantial divestment of U.S. securities could impact U.S. funds as investors in the U.S. capital markets. For these reasons, and others, we have a strong interest in supporting your effort to develop administrable rules.

The ICI recognizes that Treasury and the IRS have been charged with implementing a statute that may well not provide all of the flexibility that commentators desire. The two Notices issued by your offices, in our view, reflect a growing understanding of industry concerns with the statute’s commercial impact. We look forward to continuing our discussions with you to address the fund industry’s administrative concerns without diluting FATCA’s impact on U.S. persons seeking to evade tax through offshore investments. The time that you already have spent with us and others on these issues is appreciated greatly.

We urge in this letter that proposed regulations address issues of particular interest to U.S. funds (but also, in some cases, of interest to non-U.S. funds) by:

- providing a U.S. fund with an option to determine the amount of a withholdable payment or the passthru payment percentage (for FATCA withholding purposes) based upon the portion of its assets treated as having a U.S. source (rather than being required to treat the payment as 100 percent U.S.-source simply because the fund is organized in the U.S.);
- permitting all funds to calculate a passthru payment percentage for distributions based upon the source of the income being distributed (rather than based upon the assets of the fund, which might overstate the portion of the distribution attributable to U.S. sources); and

³ 15 U.S.C. §§ 80a-1 *et seq.*

- providing administrable rules for treating retirement accounts – employer-sponsored defined benefit plans, employer-sponsored defined contribution plans, and individual retirement accounts – and charities as “low-risk investors.”

In addition, we urge in this letter that proposed regulations address issues of particular interest to non-U.S. funds by:

- crafting an administrable system for “deemed compliant funds” by:
 - permitting FFIs that do not enter into FFI agreements and are not treated as deemed compliant (nonparticipating FFIs or “NPFFIs”) to distribute shares of deemed compliant funds so long as various conditions (including adhering to distribution agreement obligations not to sell to U.S. persons and certain others) are met; and
 - allowing NPFFIs either to:
 - close the accounts of U.S. persons and recalcitrant account holders who either are preexisting account holders or inappropriately acquire shares of deemed compliant funds after FATCA’s effective date; or
 - report these investors to the IRS (and, subsequently, withhold on them);
- crafting an administrable system for distributor networks by providing deemed compliant FFI treatment for local distributors;
- providing administrable timing, calculation, and reporting rules for passthru payments;
- providing administrable procedures for identifying U.S. accounts among all preexisting accounts of both individuals and NFFEs;
- clarifying how the private banking rules will be applied to money managers;
- applying FATCA to umbrella funds at the sub-fund level;
- requiring a fund to consent affirmatively to an election made by an FFI that enters into an FFI agreement (a participating FFI or “PFFI”) to be withheld on;
- providing funds with a centralized compliance option; and
- providing necessary and appropriate transition relief.

II. RIC Withholdable Payments

A. Background

1. 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 Code⁴ 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.

2. 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.⁵ 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.

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

⁴ 26 U.S.C. §§ 851 *et seq.*

⁵ 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.

(“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.

3. 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 852⁶ and 4982.⁷

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 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.

⁶ 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.

⁷ 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.

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.

B. Determining a RIC's Withholdable Payment

The main RIC-specific FATCA issue identified by the ICI's members involves the portion of the distributions and disposition proceeds received by a recalcitrant account holder that would be treated as U.S. source for withholdable payment and passthru payment percentage purposes. Concerns have been raised that RICs and, indeed, all funds (both U.S. and foreign) offered by U.S. managers will suffer competitive disadvantages if RICs are treated as generating 100 percent U.S.-source payments irrespective of their underlying portfolio investments.⁸

One concern is that participating FFIs 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 FFI offers two funds investing exclusively in Asia, the FFI may advise foreign investors to invest in the non-U.S. fund (for which the passthru payment percentage will be zero) rather than 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.

A second concern is that FFIs seeking to reduce their own passthru payment percentage will use non-U.S. money market funds holding dollar-denominated foreign securities, rather than U.S. money market funds holding the same dollar-denominated foreign securities, for their own cash management purposes. Because the non-U.S. fund would be treated as a foreign asset, an FFI holding shares of the non-U.S. fund would not take those shares into account in calculating its own passthru payment percentage. In contrast, the shares of the U.S. fund with an identical portfolio would be treated as a U.S. asset, thereby increasing the FFI's passthru payment percentage.

⁸ Because RICs are U.S. corporations for federal income tax purposes, it would appear that a RIC dividend would be "from sources within the United States" under Code section 1473's definition of withholdable payment. This result appears supported by Notice 2011-34, which provides that an FFI will treat an equity interest in a domestic corporation solely as a U.S. asset in calculating the FFI's passthru payment percentage.

We would note, however, that Subchapter M does not treat RICs as "pure" corporations. For example, U.S. investors in a RIC treat a RIC's income from foreign sources as foreign source income for foreign tax credit purposes if the RIC elects Code section 853 treatment and thereby provides its shareholders with the ability to claim credits for the foreign taxes paid by the RIC itself.

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 same rules applicable to determining passthru payment percentages.⁹ 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 substantial non-U.S. investments *and* significant FFI investment, 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.

III. Passthru Payment Rules for CIVs

Administrable passthru payment rules are critically important for all funds, often referred to as collective investment vehicles ("CIVs").¹⁰ Our proposals, below, will allow a CIV to distribute shares through multiple intermediaries, and chains of intermediaries, without one NPFFI tainting the entire distribution chain and potentially causing the compliant clients of the PFFIs to incur any FATCA withholding. In essence, the passthru payment rules we suggest will allow FATCA withholding to be imposed only on NPFFIs and recalcitrant account holders.

We make the following detailed suggestions for applying the passthru payment rules to CIVs¹¹ because of some uncertainty regarding precisely how the Notice's passthru payment rules are intended

⁹ Our proposals for determining passthru payment percentages for investor dispositions of CIV interests and for CIV distributions are discussed in Part III, below.

¹⁰ The most common forms of CIVs are RICs, in the U.S., and the UCITS ("Undertaking for Collective Investment in Transferable Securities"), in Europe. UCITS also are marketed outside of Europe.

¹¹ "CIV" could be defined for FATCA purposes by reference to paragraph 4 of the Organization for Economic Cooperation and Development's ("OECD's") report – "The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles" – that was adopted by the OECD's Committee on Fiscal Affairs on April 23, 2010. <http://www.oecd.org/dataoecd/59/7/45359261.pdf>. Our proposals also might be applicable to other investment pools, whether or not they were treated as CIVs.

to apply. These suggestions, we submit, will be administrable for CIVs and their distributors without any negative impact on tax compliance.

A. Timing of FATCA Withholding

FATCA's application to CIVs raises some rather unique questions because CIVs are investment pools and therefore generally are unlike other financial institutions. Although a CIV investor essentially has an undivided interest in the CIV's assets, the CIV investor does not own the CIV's assets and almost never, if ever, is treated as in receipt of the CIV's income until the investor receives a distribution from the CIV or the investor disposes of his or her CIV interest. Thus, a CIV itself is not a custodial account.

Applying FATCA withholding to RICs is relatively straightforward because either the RIC, its transfer agent, or the U.S. custodians and brokers holding RIC shares for their customers are U.S. withholding agents rather than foreign institutions. One of these entities must impose FATCA withholding when it makes a withholdable payment. This payment will arise either when the dividend is paid to, or shares are disposed of by, an NPFPI or an FFI that has elected (with the CIV's consent, as we propose below) to be withheld on. Transactions involving the RIC's assets (*e.g.*, receipt of interest or dividends on the RIC's investments) are not allocated directly to the RIC shareholders' accounts. Instead, they are aggregated in calculating the RIC's NAV.

We submit that the same timing rules for FATCA withholding should apply to foreign CIVs. Indeed, FATCA withholding cannot be applied to recalcitrant account holders upon the receipt by a CIV, that is a PFFI, of a dividend from a U.S. company.

First, the foreign CIV knows few, if any, of the individual shareholders who might be recalcitrant. That information is known only to the intermediary that has the direct relationship with the client. Thus, the CIV does not have the information necessary to apply FATCA withholding at that point. Indeed, because of the highly intermediated nature of the CIV business, this information could not be gathered efficiently from the CIV's distributors on any basis, timely or otherwise.

Second, even if any recalcitrant account holders were known to the CIV, the U.S.-source payment is not allocated directly to the investors. Hence, no shareholder-specific cash is generated on which withholding can be imposed. Forced redemptions to generate the cash to satisfy FATCA withholding obligations would create innumerable other difficulties (*e.g.*, creating a taxable event for investors, raising legal issues in some jurisdictions, etc.).

Moreover, and most importantly, FATCA withholding need *not* be imposed at the time a CIV receives a U.S.-source payment for FATCA to be implemented effectively. FATCA's objectives will be achieved fully if FATCA withholding is imposed, by the FFI with the direct customer relationship, at

the time the investment is reduced to cash, *i.e.*, when there is a liquid amount on which withholding can be applied.¹²

Thus, we submit, FATCA withholding should be imposed on recalcitrant account holders only at the time that the accountholder receives a distribution from, or disposes of an interest in, the CIV. The most administrable way for calculating the passthru payment percentage varies by the type of income received (distribution or disposition). Each of these calculations is discussed below.

B. Passthru Payments – In General

We understand and support the view that FATCA is a reporting regime and that success will be achieved when all relevant information is reported to the IRS and no withholding is collected. We also understand that an effective withholding regime will encourage FFIs to enter into FFI agreements and meet their contractual responsibilities under those agreements. Finally, we understand that FATCA withholding is not designed as a “final tax” and therefore need not be applied on precise U.S. tax law concepts of “income.”

The Notice’s rules for calculating a passthru payment percentage may work very well for many FFIs. We have certain concerns, discussed below, about how those rules would work when the FFI is a CIV (1) with thousands (or hundreds of thousands) of investors who may purchase and sell CIV interests every day through chains of intermediaries, (2) that may receive income on its portfolio investments each day, and (3) that may distribute income to investors on a periodic basis. The suggestions we make herein are intended to make the passthru payment rules more administrable for CIVs and their distributors.

C. Calculating the Passthru Payment Percentage for Dispositions of CIV Interests

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

We also support the use of average portfolio composition to determine a CIV’s passthru payment percentage. By requiring portfolio composition averaging, the Notice reduces potentially

¹² We suggest that an investment be treated as reduced to cash when a recalcitrant account holder investor elects to reinvest a CIV distribution in additional CIV shares. At this point, 30 percent of the distribution would be remitted to the IRS and the remaining 70 percent would be reinvested. This same procedure is applied today under Code section 1441 to foreign investors in RICs.

significant swings in a CIV's passthru payment percentage (if a CIV 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 CIV's last four fiscal quarters, regardless of the time period over which a CIV investor held CIV interests, also is appropriate.¹³ As noted above, 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 CIV investor would be astronomical and reduce substantially (if not eliminate entirely) FFI participation by CIVs and their distributors.

The Notice's approach would be far more administrable for CIVs and their distributors, however, if the disposition percentage applied to all CIVs for a longer, and more uniform, period. As noted above, FFI distributors may hold shares in thousands of different CIVs¹⁴ for their customers, all of whom will retain the right to redeem or sell those interests every day. 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.

Consequently, we suggest that the passthru payment percentage for dispositions of a CIV's interests be based upon the CIV'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 CIV with a calendar-year-end. This CIV's last fiscal quarter before December 31, 2014 is September 30. Thus, the passthru payment percentage for this CIV 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 CIV with a November 30 year-end. This CIV's last fiscal quarter before December 31, 2014 is November 30. Thus, the passthru payment percentage for this CIV 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.

¹³ We would not oppose using more quarters, such as the last twelve, if regulators determined that a longer measurement period was necessary.

¹⁴ If the deemed compliant status rules we suggest for CIVs are adopted, the number of CIVs with investors potentially subject to FATCA withholding will be reduced. These CIVs nevertheless presumably would need to calculate a passthru payment percentage in case a recalcitrant account holder nevertheless acquired an interest in the CIV.

This proposal, we submit, would have three substantial benefits. First, it would allow the percentage to be determined before it becomes applicable,¹⁵ so that the percentage could be disseminated throughout the CIV'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 CIVs 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 thousands of CIVs would need to be updated. This reduction in the number of changes also would assist funds of funds and other FFIs in calculating their own passthru payment percentages.

The benefits of an annual passthru payment percentage for dispositions of CIV interests, 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.

D. Calculating the Passthru Payment Percentage for Distributions

Calculating a passthru payment percentage for distributions based upon the CIV's assets, as proposed by the Notice, creates two concerns for CIVs. These concerns, as discussed below, would be addressed by a percentage based upon "tracing" the sources of the income distributed.

Our first concern is that the Notice's approach does not provide CIV investors with treatment comparable to that received by direct investors in the same underlying securities. Comparable treatment is important, as noted above, because it allows CIVs to demonstrate to their customers that the CIV structure is not in any way disadvantaging the CIV investor vis-à-vis the direct investor.

Second, the Notice's approach could disincent CIVs to maintain cash positions in U.S. securities (including U.S. money market funds) because these cash positions would have a larger impact on the passthru payment percentage for distributions than their (generally far-lower) contribution to the CIV's income. While precision is not the ultimate goal of FATCA withholding,

¹⁵ 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 a CIV's distributors for dispositions occurring early (or perhaps even late) in the next quarter.

the guidance should reject any less precise approach that creates incentives for foreign investors to avoid U.S. securities.

We suggest that FATCA regulations address these concerns by permitting a CIV to elect¹⁶ to determine its passthru payment percentage for distributions made to its investors based upon the sources of the income that is distributed.¹⁷ This approach, in effect, would allow an electing CIV to trace the source of the income being distributed for FATCA purposes. Any CIV 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 CIV distributions should be based upon a proportionate allocation between gross income from U.S. and foreign sources of income received by the CIV during the period in which the CIV earned the income it is distributing.¹⁸ 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 CIV that distributes its income annually, in December. Further assume that the CIV 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 CIV's gross income (*e.g.*, dividends, interest, and net gains from securities sales) is from U.S. sources and the remaining 60 percent is from non-U.S. sources. Thus, 40 percent of the CIV's 2014 distribution would be a passthru payment.

Example 4. Assume a CIV that distributes its income quarterly – in March, June, September, and December. Further assume that the CIV bases its quarterly distributions on its net income received through the end of the preceding month (February, May, August, and

¹⁶ 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.

¹⁷ 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.

¹⁸ 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).

November). For the period December 1, 2013 through February 28, 2014, 15 percent of the CIV'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 CIV's March 2014 quarterly distribution would be a passthru payment.

E. 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 CIV be permitted to elect to treat its passthru payment percentage as the maximum U.S. investment permitted by the CIV's prospectus. If the CIV 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 CIV 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 CIV 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 CIV as having a passthru payment percentage of zero would reduce the burden of implementing FATCA.

F. Disseminating Passthru Payment Percentages

1. Dispositions

We do not believe that any specific regulatory guidance is needed, other than a general obligation to provide information to investors, regarding the mechanism for disseminating passthru payment percentages for dispositions. CIVs, as a practical matter, will provide this information to distributors, just as other information is provided, pursuant to the ordinary course of business. Any specific regulatory requirements merely will create potential compliance traps. The industry, we submit, will develop standardized processes for transmitting disposition passthru payment percentages.¹⁹ If any concern exists that CIV distribution agreements might not in all cases be modified to ensure transmission of passthru payment percentages, consideration could be given to imposing an obligation to transmit passthru payment percentage information in the FFI agreement.

¹⁹ The U.S. industry, for example, has developed standardized (and largely automated) systems for transmitting tax information between RICs and their distributors.

2. Distributions

Similarly, we do not believe that any specific regulatory guidance is needed, other than a general obligation to provide information to investors, regarding the mechanism for disseminating passthru payment percentages for distributions. Any CIV making the tracing election that we propose, as a practical matter, would include the distribution's passthru payment percentage with other information regarding the distribution itself (*e.g.*, per share dividend amount, record date, etc.).

3. IRS Website

We suggest that the IRS consider maintaining a database (similar to the OID database) for passthru payment percentages. CIVs would have the option to post information (particularly annual percentages for share dispositions) to the website.

IV. **Crafting an Effective System for Distributor Networks and Deemed Compliant Funds**

A. Background

CIVs are organized and distributed in virtually every country in the world. CIVs generally are organized either for domestic distribution (*i.e.*, only to residents of the country in which the CIV is organized) or for distribution more broadly (*i.e.*, either regionally, such as within Europe, or globally).

CIV distribution networks can be both different and yet quite similar. Differences may arise because of differences in: (1) the types of CIVs (*e.g.*, retail vs. institutional); (2) the way in which investors purchase and sell their CIV interests (*e.g.*, directly with the CIV, indirectly via one of its distributors, or on a stock exchange); and (3) the distribution markets (domestic vs. regional or global). The similarities, we submit, are more significant. Specifically, most CIVs are sold through a very large number of distributors, many distributors operate only locally, and many of these local distributors are quite small. ICI members frequently have distribution agreements with several thousand different distributors.

B. Summary of Proposals

The two specific proposals we advance in this section are designed to address the industry's concern that FATCA's application to foreign distributors, without appropriate additional relief, will have a very deleterious impact on CIVs. We suggest first that deemed compliant FFI status be provided to CIVs that preclude U.S. investors and that require *all* FFIs that distribute their shares (other than those that are treated as deemed compliant under another provision, *e.g.*, as an eligible

local bank) to agree with this restriction.²⁰ The procedures we suggest for ensuring distributor compliance with this restriction are designed to track FATCA's requirements with effective contractual enforcement and appropriate remedies for non-compliance. Second, we suggest that the local bank exception be expanded to cover other distributors of CIV interests, such as brokers and financial planners, that are subject to comparable regulatory restrictions and supervision.

These proposals, taken together, would reduce the number of FFIs effectively required to enter into FFI agreements without enhancing the opportunities for U.S. persons to evade their U.S. tax obligations. Our proposals, we believe, would have no effect on the very substantial portion of CIV distributors that still would enter into FFI agreements because of their global focus, their other activities, and/or their client base. Our proposals are intended only for those distributors without U.S. clients that, absent additional regulatory relief, simply would cease to distribute CIVs.

C. CIVs that Make Every Effort to Exclude U.S. Investors Must be Effectively Exempt

The Notice, quite appropriately, recognizes the need to treat as deemed compliant FFIs those CIVs that exclude U.S. investors. Deemed compliant status, appropriately provided, is essential to ensuring that the costs of implementing FATCA by these FFIs is commensurate with the benefits of enhanced compliance. We appreciate Treasury's and the IRS' interest in working with industry to develop guidance that both protects the Government's interests and is administrable for industry.

1. Concerns with Limited Scope of Deemed Compliant Status Under Notice

The guidance provided by the Notice for treating a CIV as deemed compliant, in our view, is too limited. Our three specific concerns are that a CIV cannot qualify for deemed compliant status: (1) unless all distributors are PFFIs; (2) if the CIV has any direct investors who are individuals; or (3) if a U.S. fund manager (or U.S. affiliate of non-U.S. fund manager) has provided "seed capital" necessary for the CIV to begin operations.

First, the Notice's requirement that every one of a CIV's distributors be a PFFI (or be deemed compliant with the participating FFI rules) before a CIV can be deemed compliant is a major concern for the industry. We recognize and appreciate the Notice's attempt to address FFI's FATCA concerns by reducing substantially the burdens of identifying U.S. accounts among preexisting individual accounts. This change is quite helpful. Unfortunately, this change is not sufficient to ensure full participation by a CIV's hundreds or thousands of distributors. Moreover, the change does not even begin to address the concerns of small distributors, such as financial advisers, that would be treated as FFIs.

²⁰ A CIV that limited its investors to low-risk investors (such as retirement plans and/or charities), we submit, likewise should be treated as deemed compliant (or as low-risk) so long as its prospectus and distribution agreements provided restrictions comparable to those discussed for deemed compliant CIVs.

The basic difficulty with requiring every FFI to enter into an FFI agreement with the IRS for a CIV to be deemed compliant is that some *foreign* institutions (particularly very small ones) never will be comfortable entering into an agreement with the *U.S.* Government. Nothing can be done by the Treasury and the IRS, we understand from our members, to address the fundamental resistance that some institutions will have to entering into an agreement with the IRS. These institutions will be less resistant, we submit, to entering distribution agreements with the CIV or the CIV's sponsor that provide sufficient assurances that U.S. persons are not investing through them. We support fully the goal of preventing NPFIs from acting as FATCA blockers.

Second, the Notice's requirement that a CIV cannot qualify if it has any direct investors who are individuals also is quite problematic and is not necessary to fulfill FATCA's objectives. As discussed above, while the vast majority of a CIV's investors will hold their interests through another FFI, it also is quite common for a CIV to have some investors who are direct customers of the CIV manager.

Unlike the first concern, however, a relatively straight-forward remedy would appear to exist for this second concern. Specifically, the interests of these direct-registration investors presumably (although perhaps only with investor consent) could be placed in a nominee account with the CIV manager as the investor of record. We are uncertain, however, why CIVs should be forced to re-register the interests of their direct customers. If these interests remain on the CIV's books and the CIV takes all steps necessary to ensure that these investors are not U.S. persons, the CIV should be able to qualify for deemed compliant status. If the Government's concern is that a deemed compliant FFI does not have "an agreement" with the IRS, we would be pleased to work with you to develop a "deemed compliant FFI" application that effectively results in the deemed compliant FFI agreeing to apply all of FATCA's requirements to any direct-registration investors to ensure that none of them are U.S. persons.

Finally, the strict prohibition on U.S. investors in a deemed compliant fund is problematic in one *very* narrow context involving a CIV's formation. Specifically, to form a CIV, the manager or an affiliate may "seed" the CIV by investing an initial capital amount; the "seed capital" usually is an amount required by regulation, although business circumstances may necessitate a higher amount.²¹ Situations will arise in which the seed capital today is provided by a U.S. fund manager or a U.S. affiliate of a non-U.S. fund manager. It *might* be possible to resolve this third concern by having the seed capital provided instead by a non-U.S. affiliate of the fund manager. The non-U.S. seed capital source route, however, might be impractical, unnecessarily expensive, or simply unavailable. We submit that, in no event, should capital provided by the CIV's manager or an affiliate of the manager cause a CIV to fail deemed compliant status.

²¹ Seed capital generally must remain in the CIV for a specified minimum time period although the manager may keep the seed capital invested for longer if the CIV has not grown enough to function effectively without the seed capital remaining in the CIV.

2. Deemed Compliant CIV Proposal

To address these concerns, we propose that a CIV be treated as deemed compliant under Code section 1471(b)(2) so long as:

1. the CIV's prospectus expressly limits investment to non-U.S. persons;²²
2. each of the CIV's distribution agreements:
 - a. prohibits the contracting distributor,²³ and every lower-tier FFI distributor with which the distributor does business, from allowing U.S. persons²⁴ to invest;
 - b. prohibits the distributor from allowing any lower-tier FFI to invest (on behalf of the lower-tier FFI's clients) unless the lower-tier FFI also agrees to follow the prospectus and exclude U.S. persons (and any other categories of impermissible investors);
 - c. requires the distributor to take appropriate steps to identify preexisting U.S. accounts;
 - d. requires the distributor to receive appropriate documentation when an account is opened to ensure that the investor is not a U.S. person (or other impermissible investor);
 - e. requires the distributor to permit an examination (*e.g.*, third-party audit, following procedures announced by the IRS) of

²² A U.S. person would be defined using the U.S. tax law definition, with a transition period (discussed in Part VIII.C.2., below) to allow CIVs currently defining U.S. person by reference to the U.S. securities laws to come into compliance. In addition, as discussed above, an exception would be provided for seed capital provided by the U.S. manager or a U.S. affiliate of the foreign manager.

²³ For this purpose, the term distributor includes every distributor of the CIV's interests, including those for which the requirements described herein are inapplicable because the distributor is a participating FFI or deemed compliant, such as under the Notice's local bank exception or the local distributor exception we propose.

²⁴ Consistent with the FATCA guidance issued to date, investments also should not be permitted from NFFEs other than excepted NFFEs, and NPFIs holding for their own account. We suggest that simpler terminology be developed for including these persons within a distribution agreement's definition of prohibited investors.

their relevant compliance procedures, and the application thereof;

- f. requires the distributor, with respect to every U.S. person and recalcitrant account holder identified during the examination of preexisting accounts, either to:
 - (i) close the account; or
 - (ii) provide reports regarding the U.S. person and/or recalcitrant account holder directly to the IRS (or to a PFFI or the CIV) and, after some grace period for receiving appropriate documentation for preexisting accounts, to:
 - impose FATCA withholding on all recalcitrant account holders (and transmit that withholding directly to the IRS or indirectly through a PFFI or the CIV), and
 - follow any otherwise-applicable rules provided for closing accounts of recalcitrant account holders; and
 - g. requires the distributor to provide information directly to the IRS (or to a PFFI or the CIV) regarding the identity of any NPFFI distributors, of which they have knowledge, that hold interests in the CIV for their customers;
3. the CIV provides information about these NPFFI distributors to the IRS in such form and manner as the IRS requires; and
 4. an officer of the CIV certifies each applicable period that it has complied with its obligations as a deemed compliant CIV (including the calculation of a passthru payment percentage, which would be relevant only if an investor is determined to be, or becomes, recalcitrant).

3. The Restrictions Provided by the ICI's Proposal Will Ensure Compliance

The restrictions contained in our proposal, we submit, are more than sufficient to ensure that NPFFIs distributing CIVs that are closed to U.S. investors will not become FATCA blockers. The distribution agreements for deemed compliant CIVs will impose on NPFFIs essentially the same responsibilities for identifying U.S. persons that are imposed on PFFIs. We also propose withholding and reporting rules comparable to those imposed on PFFIs. One difference is that the NPFFI could report any relevant information about investors and remit any applicable withholding either to the IRS or to a PFFI that would correspond with the IRS. We suggest this alternative of reporting to another PFFI (either the CIV or a distributor between the CIV and the NPFFI) because of concerns that some distributors (particularly small local distributors) will not agree to direct communications with the IRS. The CIV will be responsible for ensuring that all distributors have entered into distribution agreements; the CIV, upon notification from the IRS, will be required to sever the distribution agreement of any distributor that fails to comply with any audit/review procedures that the IRS requires for NPFFI distributors of CIVs claiming deemed compliant FFI status.

D. Deemed Compliant FFI Treatment for "Local Distributors"

1. Background

Many CIVs are distributed through small FFIs (banks, brokers, and financial planners) with local clients. As stated above, we are concerned that many of these distributors will be extremely disinclined to enter into FFI agreements with the IRS.

The Notice's provision of deemed compliant FFI status to local banks recognizes the disinclination of local distributors to sign FFI agreements. We support strongly this important first step in addressing our concerns about small local distributors. Banks are appropriate FFIs for deemed compliant status so long as they are organized and operate only within the country in which they are licensed and regulated and implement policies and procedures to ensure that accounts are not opened or maintained by U.S. persons.

Many local distributors that distribute CIV interests, despite having client bases comparable to local banks, will not qualify for the Notice's deemed compliant FFI treatment because they are not licensed and regulated as banks. Instead, these local distributors are organized as brokers or financial planners. The extensive licensing and regulation to which these FFIs are subject is provided by securities regulators. To the extent the securities regulators provide comparable supervision of brokers and financial planners, deemed compliant FFI status should be provided to these FFIs that likewise implement policies and procedures to ensure that accounts of U.S. persons are not opened or maintained. Moreover, absent a change, one comparably regulated distributor (*i.e.*, a bank) would have a competitive advantage over another comparatively regulated distributor (*e.g.*, a securities firm).

In one respect, the need for deemed compliant status is stronger for local financial planners than it is for local banks when both are operating only within a single country. Specifically, the burdens of entering into an FFI agreement will be infinitely more burdensome for local financial planners (which tend to be relatively small) than it will be for banks (which most likely will be larger and more sophisticated).

2. Local Distributor Proposal

The ICI proposes that deemed compliant FFI status (similar to treatment to be provided to “local banks”) be provided for local distributors under Code section 1471(b)(2)(A). A “local distributor” would be deemed compliant, under our proposal, so long as:

- a. it is licensed and regulated as a securities broker/dealer or as a financial planner/adviser under the laws of the country in which it is organized and operated,²⁵ and that is not described in Code section 1471(d)(5)(C) (*e.g.*, is not a firm investing, reinvesting or trading for its own account);
- b. all FFIs in the expanded affiliated group are organized in the same country;
- c. no FFI in the expanded affiliated group maintains operations outside the country of organization;
- d. no FFI in the expanded affiliated group solicits U.S. persons²⁶ as account holders; and

²⁵ In the United Kingdom, these persons generally are described as “dealing in investments as principals” or “as agents.” The EU Directive 2004/39/EC on markets in financial instruments (“MiFID”) treats the following as investment services and activities: (1) reception and transmission of orders in relation to one or more financial instruments; (2) execution of orders on behalf of clients; (3) dealing on own account; (4) portfolio management; (5) investment advice; (6) underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis; (7) placing of financial instruments without a firm commitment basis; and (8) operation of multilateral trading facilities. See, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2004L0039:20070921:EN:PDF>, Annex 1.

²⁶ We suggest that the solicitation prohibition apply only to U.S. persons because the requirement in the Notice’s local bank exception that prohibits soliciting account holders outside its country of organization is problematic. Well over half of the work force in Luxembourg City, for example, lives in France, Germany, or Belgium. French, German, and Belgian residents working in Luxembourg City may well have financial accounts for their convenience both in their home countries and in Luxembourg.

- e. each FFI in the expanded affiliated group implements policies and procedures to ensure that it does not open or maintain accounts for U.S. persons.

3. The Restrictions Provided by the ICI's Proposal Will Ensure Compliance

FFIs covered by our proposal would be required to implement the same policies and procedures that must be implemented by local banks covered by the Notice's provision. Local distributors, whether banks, brokers, or financial planners, already are subject to know-your-customer and anti-money-laundering rules enforced by their local regulator. These enforced rules should provide the IRS with further confidence that U.S. persons would be identified by, and prevented from investing in, these FFIs. Thus, these FFIs would not provide any enhanced opportunity for tax evasion by U.S. persons.

V. **Procedures for Identifying U.S. Accounts**

A. In General

The Notice modifies the procedures for identifying U.S. accounts to focus an FFI's efforts on accounts of greater interest to the IRS. We support targeted and more administrable procedures for identifying these accounts. Our suggested modifications would make these procedures more administrable for CIVs and their distributors.

B. Preexisting Account Rules

1. Individuals

The Notice's procedures for identifying U.S. accounts among all preexisting individual accounts will make FATCA more administrable and reduce the costs of reviewing existing accounts. We appreciate that the Notice acknowledges the reliability of documentation collected by FFIs regarding their customers and allows FFIs to rely upon that documentation absent knowledge that the documentation is unreliable.

CIVs are particularly supportive of the change made by the Notice whereby all accounts (rather than just depository accounts) with less than \$50,000 will be treated as non-U.S. accounts. Administrability also is enhanced by the change allowing an FFI not to perform additional diligence on an account (beyond reviewing electronically searchable information) until the account value exceeds \$500,000.

The Notice's requirement that an FFI utilize its existing computerized recordkeeping systems to identify all accounts of the same person, for purposes of determining account balances or values, is appropriate. So long as this obligation is limited to systems that are integrated, as appears to be the

Notice's intent, FFIs will be relieved of enormous burdens of manually aggregating data, or creating new systems to aggregate data, from diverse business units.

2. Non-Financial Foreign Entities ("NFFEs")

The Notices' procedures for identifying those NFFE accounts that should be treated as U.S. accounts are not yet sufficiently administrable. Looking through NFFEs to their substantial owners, while necessary in certain contexts to prevent obvious tax evasion opportunities, presents severe challenges for FFIs. Those FFIs, such as CIVs and their distributors, that operate in a retail environment will be particularly challenged by burdensome look-through rules.

We appreciate that many FFEs effectively have been exempted by Notice 2010-60 from FATCA's scope. Our two suggestions are intended to improve on these procedures.

First, we suggest that *de minimis* account balance rules comparable to those provided by Notice 2011-34 for preexisting individual accounts be provided as well for preexisting NFFE accounts. So long as an FFI need not inquire further about the identity of an individual account owner's status if the account has less than \$50,000 (and may treat this account as non-U.S. even if the FFI knows the account is owned by a U.S. person), it is unclear why such inquiries should be required when the account is owned by an NFFE that might have multiple owners. If the concern is that a U.S. person will set up multiple NFFEs and have each NFFE invest less than \$50,000 with a single FFI, the U.S. person can achieve the same result simply by setting up accounts with multiple FFIs and investing less than \$50,000 with each.

Second, we suggest that IRS provide "exempt NFFE numbers" to NFFEs excepted by Notice 2010-60. To the extent that excepted NFFEs receive these identification numbers, distributors will be relieved from inquiring about an NFFE's owners.

C. Application of Private Banking Rules to Fund Distributors

The additional diligence required by the Notice's new procedures for private banking accounts is appropriate when the banker has ready access to the additional information. The difficult issue is defining the activity that provides the depth of relationship for which additional diligence is necessary. The Notice's definitions of "private banking account" and "private banking department" are important first steps in distinguishing private banking from retail activity.

One concern we have with the "private banking department" definition is the treatment of any department referred to by the FFI as a "private banking, wealth management or similar department." This definition, we submit, is over-inclusive of the type of relationship for which this additional diligence should be required.

Businesses of all kinds often seek to improve their customers' loyalty by offering "preferred-customer" experiences. One such experience is being serviced by a "special" department. In the investment context, however, all customers seek assistance in managing their "wealth" (however large or modest). Many firms utilize the term "wealth management department" to cover clients for whom the depth of relationship sought by the Notice is lacking.

We suggest that an FFI's label on a department as "wealth management" should be only one small (and non-determinative) indicator that a department should be treated as a "private banking department" for FATCA purposes. This status, and the additional diligence required, should not turn on labels alone. The other three factors identified in the Notice should be sufficient to establish a private banking relationship.

In the CIV context, merely providing investment advice cannot establish the requisite depth of relationship, even within a "wealth management" group. For example, if an FFI's client is being advised more generally by an unrelated wealth manager (who typically accompanies the client to meetings with the FFI), merely providing investment advice through the "wealth management" group should not be sufficient to establish the necessary relationship. The key to private banking is the responsibility for the relationship. So long as an unrelated person has the primary relationship with the client, the account should not be treated as a private banking account.

The breadth of the private banking concept also could be addressed in part by adding a minimum account size to the definition of a private banking account. This modification would take some pressure off of the definition of private banking department because smaller accounts would not be treated as private banking accounts, under this proposal, even if some indicia of a private banking relationship were present. If the account size is over \$500,000, additional diligence will be required by Step 5. We suggest that accounts with balances below \$500,000 not be treated as private banking accounts.

VI. Retirement Plans and Accounts

A. Introduction

RICs and other CIVs are popular investment vehicles for both employer-sponsored and individual-directed retirement plans and accounts.²⁷ These plans and accounts are important sources of capital for RICs and other CIVs and for the U.S. capital markets.

²⁷ Other tax-deferred and tax-exempt entities (such as charities) also invest in RICs and other CIVs. Although this letter does not include specific suggestions for treating charities and comparable investors as low-risk investors, we support such treatment for them.

Administrable rules are necessary so that retirement accounts (which provide important social benefits) can qualify as persons posing a low risk of tax evasion (“low-risk investors”).²⁸ Indeed, Notice 2010-60 identifies certain foreign retirement plans that should be treated as low-risk investors. Unfortunately, the vast majority of retirement plans and accounts would not qualify under Notice 2010-60.

Foreign retirement plans and accounts provide U.S. persons with little, if any, opportunity for hiding assets and evading taxes. Contributions to these plans and accounts generally are limited both by amount and as a percentage of compensation. If a U.S. person working overseas and participating in a foreign retirement plan could not contribute from his or her compensation more than \$25,000 or \$50,000 per year or more than 20 to 25 percent of compensation to a retirement plan or account, for example, the risk of tax evasion would seem quite low. Concerns would be higher if very highly-compensated employees could contribute an unusually large percentage of compensation to a plan. Moreover, these plans and accounts generally impose substantial penalties on early withdrawals. This lack of liquidity makes them unattractive places to hide assets.

The primary FATCA concern with retirement plans and accounts, we submit, should relate to a plan participant’s ability to “park” assets the income on which has not been reported to the IRS. Such assets would include proceeds from unreported remunerative activities (legal or illegal). Contributions based upon employment are neither this type of “parkable” asset nor generally of sufficient size to be of concern. The only amounts that would seem large enough to be of concern, from a low-risk-of-tax-evasion perspective, would be those “rolled over” from another source.

The amount rolled over into a retirement plan or account should not be a concern, however, so long as the amount is rolled over from a retirement plan or account that is regulated and subject to appropriate contribution limits. Even an account subject to modest contribution limits (*e.g.*, \$5,000) can grow to a large account over an extended time period, particularly when market appreciation is considered. So long as rollovers are permitted only from other retirement plans or accounts that meet the restrictions we propose below, they should not create tax evasion concerns.

The concern that a U.S. tax evader might seek to “wash” unreported income by saving through a retirement plan or account and meet living expenses through the unreported assets hidden in an undisclosed account, we submit, should not lead to a narrow definition of a low-risk-of-tax-evasion retirement plan or account. First, a narrow definition presumably will require retirement plans (treated under the Notices as FFIs) and FFIs with retirement accounts to secure detailed information regarding all participants and beneficiaries in the plans or accounts; some plans have hundreds or thousands of employees and beneficiaries. The burdens of this narrow definition would appear to fall first on CIVs and their distributors and perhaps secondarily on the U.S. capital markets. Second, this “washing” possibility already exists with retirement accounts covered by the low-risk investor

²⁸ CIVs limited to such retirement plans and accounts, charities, and other tax-deferred and tax-exempt investors likewise should be treated as low-risk investors.

standard announced in Notice 2010-60; a plan does not become more likely to generate “washing” simply because the plan covers all of the employees of a business with operations in more than one country. Third, a U.S. tax evader could use his or her compensation to meet living expenses and continue to hide offshore the unreported and untaxed amounts. Finally, the “hidden” assets being “washed” through their use to meet living expenses are the express target of FATCA. Because retirement plans and accounts seek to ensure retirement security for workers worldwide, detailed compliance responsibilities should be imposed on them only when the responsibilities are administrable and the need is compelling.

We suggest below guidelines for retirement plans and accounts that should be treated as low-risk investors. In general, these plans would (1) be regulated in the country of organization, (2) be subject to contribution limits that include, as one factor, a percentage of compensation, and (3) limit rollovers to amounts coming from plans or accounts subject to contribution limits.

B. Employer-Sponsored Defined Benefit Plans

A retirement plan organized and operated by a single employer or a group of employers (hereafter “employer”)²⁹ to provide a defined benefit (a “DB plan”) to a group of employees would appear to provide no possibility of tax evasion so long as the employee cannot contribute to the plan. The benefit provided to any employee or beneficiary is based on the employee’s years of service and compensation. Neither the DB plan participant nor any beneficiary of such a plan would have any control over the plan or its assets.

We propose that an employer-sponsored DB plan be treated as a low-risk investor so long as the plan (1) qualifies as a retirement plan under the law of the country in which it is established, (2) is subject to effective regulation by the country of establishment, and (3) prohibits employee contributions. Any plan that permitted employee contributions would be eligible to meet the low-risk investor standard for employer-sponsored defined contribution plans (“DC plans”).

C. Employer-Sponsored Defined Contribution Plans

An employer-sponsored DC plan likewise, in general, would appear to provide little if any possibility of tax evasion. The only significant difference between DB and DC plans, from a FATCA perspective, relates to the possibility of employee contributions.

We propose that an employer-sponsored DC plan be treated as a low-risk investor so long as the plan (1) qualifies as a retirement plan under the law of the country in which it is established, (2) is subject to effective regulation by the country of establishment, and (3) places appropriate limits or restrictions on employee contributions and rollovers. Because of national differences, it is difficult to

²⁹ Our proposals for employer-sponsored plans also would apply to plans organized under collective bargaining arrangements; these plans technically might not be “sponsored” by the employer.

provide specific recommendations for appropriate contribution limits. As the amounts that may be contributed or rolled over are based upon compensation and subject to contribution limits, we submit that the limits on contributions should be high. Rollovers should not be subject to any amount limit, so long as they are permitted only from retirement plans or accounts that meet the restrictions identified above.

D. Non-Employer-Sponsored Retirement Accounts (e.g., plans similar to IRAs)

The other general type of retirement account – one not organized and operated by an employer – presents the most (albeit minimal) opportunity for tax evasion. These accounts are similar to individual retirement accounts (“IRAs”) in the U.S.

We propose that a non-employer-sponsored retirement account be treated as a low-risk investor so long as the plan (1) qualifies as a retirement plan under the law of the country in which it is established, (2) is subject to effective regulation by the country of establishment, and (3) places appropriate limits or restrictions on contributions and rollovers.

Importantly, these retirement accounts often serve as the vehicles into which an employee, at retirement or upon a change in employment, rolls over savings from one or more qualified DB and/or DC plans. Because of national differences, it is difficult to provide specific recommendations for appropriate contribution limits. As the amounts that may be contributed or rolled over are based upon compensation and subject to contribution limits, we submit that the limits on contributions should be high. Rollovers should not be subject to any limit, so long as they are permitted only from retirement plans or accounts that meet the restrictions identified above.

VII. Treatment of Umbrella Funds

CIVs often are organized in an umbrella fund structure, which consist of multiple “sub-funds” in a single fund structure. Each sub-fund is a separate investment vehicle (although it may not be a separate legal entity). Investors acquire interests in one or more sub-funds based upon their desire for the investment objective of each such sub-fund.

The umbrella structure is used widely because of the many organizational and operational conveniences that reduce costs and benefit investors. Indeed, many RICs are organized as part of a “series fund” which is similar to the umbrella fund structure. Each RIC is a separate person for U.S. tax purposes.

The umbrella fund structure would create innumerable compliance concerns, with potential ramifications for the U.S. capital markets, if a sub-fund without U.S. investments were subject to the same FATCA rules as a sub-fund with U.S. investments. Because each sub-fund operates effectively as a distinct investment vehicle, each should be treated as a separate FFI.

Consequently, we propose that all FFI rules be applied at the sub-fund level. One aspect of this proposal is that determinations about PFFI or deemed compliant FFI status would be made on a sub-fund-by-sub-fund basis. The common investment manager of the umbrella structure would retain the ability to serve as the administrative point of contact for all or a group of the sub-funds.

VIII. Other Issues

A. CIV Consent to Participating FFIs Electing to be Withhold Upon

The option provided to a PFFI by Code section 1471(b)(3) to elect to be withheld upon, rather than to withhold on payments it makes to recalcitrant account holders or NPFFIs, is extremely problematic for many CIVs. These CIVs intend to take all reasonable steps to exclude U.S. investors so that they qualify for deemed compliant status. One benefit of deemed compliance is that these CIVs will not need to incur the substantial costs of building, testing, integrating, and maintaining withholding systems. If a PFFI could elect to force the CIV to impose FATCA withholding on the PFFI (that otherwise would have the responsibility under its FFI agreement to impose the withholding itself), the CIV could be forced to build the withholding system even though the PFFI never may have a client for which FATCA withholding will be imposed.

We urge that this PFFI election be subject to affirmative consent by the CIV. This affirmative consent feature will protect CIVs from incurring substantial costs that appropriately should be imposed on the PFFI dealing directly with recalcitrant account holders.

B. Centralized Compliance Option

The Notice recognizes the benefit of providing affiliates with the option of centralizing their FATCA point-of-compliance responsibilities. CIVs, in many respects, would benefit more from a centralized compliance option than would corporate affiliates. Unlike corporate affiliates, CIVs typically do not have employees; instead, the administrative services provided to all CIVs with a common asset manager or other agent (hereafter “manager”) are performed by the manager’s employees (or third-party service providers hired by the manager). This manager may have responsibilities for many hundreds (or more) of CIVs.

We support strongly providing the manager with the option to take centralized compliance responsibilities for its CIVs. The manager could execute a single FFI agreement, or secure deemed compliance status through a single filing, for all CIVs that are subject to FATCA. The manager would serve an administrative function only; it would not incur any liability arising from the CIV’s FATCA obligations. All liability (other than that imposed on the manager pursuant to its contract with a CIV) would rest with the CIVs that had entered into the FFI agreement or secured deemed compliant status.

C. Transition Issues

CIVs and other FFIs will need sufficient time, after final FATCA regulations are issued, to comply with the new and detailed obligations that will be imposed on them. A CIV's "FATCA team" will 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 effort will be diligent and undertaken in good faith. The final regulations will need to be studied closely and implemented carefully. January 1, 2013, however, is less than nineteen months away.

We appreciate your understanding of these concerns and the diligent efforts being made by you and your staffs to provide administrative guidance on all relevant matters. The many impediments to delaying FATCA's statutory effective date are obvious.

1. In General

The tasks facing a CIV's FATCA team after final regulations are issued will include (but are not limited to):

- determining whether the CIV can comply with the final rules for becoming a deemed compliant FFI;
- updating its prospectus (assuming the CIV will continue to hold U.S. securities);
- receiving any necessary regulatory approvals for changes that impact current investors;
- determining which of its distributors are deemed compliant (*e.g.*, because they meet a "local distributor" exception);
- communicating with distributors regarding their FATCA obligations to the CIV (regardless of whether the CIV seeks deemed compliant status);
- determining what changes must be made to its distribution agreements;
- negotiating these changes with (up to) several thousand distributors (which must agree to costly new contractual responsibilities);
- determining if service providers, such as third party administrators and custodians, can comply;
- modifying existing processes and systems with service providers;
- modifying investor intake and documentation requirements;
- modifying procedures to identify *all* types of entities;
- modifying, or possibly building, withholding systems;
- advising investors of FATCA's impact; and
- (finally) seeking deemed compliant, low-risk investor³⁰ or PFFI status from the IRS.

³⁰ A CIV that accepts as shareholders only low-risk investors, as noted above (*see, e.g.*, footnote 20) should be treated as a low-risk investor.

While a CIV should be able to decide by December 31, 2012 whether to seek PFFI, deemed compliant or low-risk investor status, additional time surely will be needed after entering into an FFI agreement or securing deemed compliant or low-risk investor status to meet the many compliance requirements imposed on the CIV. The Notice recognizes these concerns and provides PFFIs with time after entering into FFI agreements to become fully compliant with various FATCA requirements.

We support fully providing the necessary transition relief, including penalty relief, only to FFIs that have committed to becoming FATCA compliant. This approach provides FFIs seeking to assist in preventing tax evasion by U.S. persons with the time needed to achieve that objective. Moreover, by providing transition relief only to FFIs that agree to assist in this effort, pressure will be placed on all FFIs to enter into FFI agreements or secure deemed compliant or low-risk investor status. The more widespread FATCA's acceptance, the less resistance PFFIs and deemed compliant FFIs will face from distributors less than enamored with their new responsibilities under FATCA.

2. U.S. Person Definition

One specific transition issue relates to the definition of U.S. person. Specifically, those CIVs that have been closed to U.S. persons have relied upon the U.S. securities law definition of U.S. person. This reliance has been appropriate as the legal concern has been with making a public offering in the U.S.

CIVs closed to U.S. persons clearly will need to change their prospectuses and other offering documents, their distribution agreements, and their procedures to apply the U.S. tax law definition. The transition relief requested above should accommodate a CIV's transition from the securities law, to the tax law, definition of U.S. person. Express guidance regarding the date by which this transition must be completed would be appreciated.

* * *

We would like to discuss this letter's proposals with you so that we can refine them, as necessary, to achieve FATCA's objectives in the most administrable manner. 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,

/s/ Keith Lawson

Keith Lawson

Senior Counsel – Tax Law

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