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Summer's Last Gasp: Notice 2010-60 — Preliminary Guidance Under FATCA

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INTRODUCTION

Issued during the afternoon of the last Friday in August, Notice 2010-60 [1] (the Notice) was soon emailed around the world even though it was evening in Europe and the middle of the night in Asia. Eagerly awaited by financial institutions and their advisors, the Notice provides the first guidance under the Foreign Account Tax Compliance Act (FATCA) provisions, contained in new Chapter 4 of the Internal Revenue Code of 1986, as amended (''the Code'').[2] The Notice specifically provides ''preliminary'' guidance concerning grandfathered obligations, the scope of Chapter 4, and the due diligence procedures that will be required for Foreign Financial Institutions (FFIs) and U.S. Financial Institutions (USFIs). In addition to providing preliminary guidance, the Notice also requests comments on a wide range of issues.[3] In this first tranche of guidance, the U.S. Department of the Treasury (''Treasury'') and the Internal Revenue Service (IRS) reflect the statutory compliance requirements but also attempt to reduce to the extent possible the burden on withholding agents, FFIs, and other foreign entities.

SUMMARY OVERVIEW OF FATCA

Under the FATCA rules, if certain certification and reporting requirements are not met, withholding of 30% is required on a ''withholdable payment'' made to a foreign entity. The term ''withholdable payment'' means: (1) U.S.-source fixed or determinable annual or periodical income, commonly referred to as ''FDAP,'' which is currently subject to U.S. withholding tax when paid to a foreign person; and (2) the gross proceeds from the sale of property that produces FDAP income. With respect to the latter category, which is generally not otherwise subject to U.S. tax when paid to a foreign person, FATCA imposes withholding tax (assuming the certification and reporting requirements are not met) on the gross proceeds with no basis offset, thereby potentially subjecting return of capital to withholding tax.

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[1] 2010-37 I.R.B. 329.

[2] Chapter 4 includes new §§1471–1474. (Except as otherwise specified, all section (''§'') references are to the Code and to the regulations promulgated thereunder.) Chapter 4 was enacted by §501 of the Hiring Incentives to Restore Employment Act (HIRE Act), P.L. 111-147, 124 Stat. 71 (H.R. 2847).

[3] *See* Appendix 3 for a list of requested comments.

ISSN 0090-4600

The FATCA provisions divide foreign entities into two categories: FFIs and Non-Financial Foreign Entities (NFFEs). FFIs include depository and investment banks, mutual funds, and any other entities specified in regulations. In order to avoid the new withholding regime, FFIs must enter into an agreement with the IRS under which they obligate themselves to determine which of their account holders are U.S. persons and to provide the IRS identifying information about the U.S. account holders and the accounts. An NFFE is not required to enter into an agreement with the IRS, but, instead, in order to avoid the new withholding regime, must provide the U.S. payor with a certificate that either certifies that the NFFE has no U.S. owners or identifies its U.S. owners.

COMPREHENSIVE GUIDANCE ANTICIPATED IN PROPOSED REGULATIONS

The Notice states that it provides ''preliminary'' guidance and clearly does not provide a complete, comprehensive set of rules. Most of the guidance provided by the Notice merely suggests a direction or a tentative conclusion, but does not provide specific legal definitions, limitations, or rules, with the exception of the due diligence procedures in Section III of the Notice. The Notice also does not address many important issues, such as how the ''passthru payment'' rule will be applied or even how it will be defined and what its scope will be.

Treasury officials have suggested that a proposed set of comprehensive regulations will be issued in early January 2011. The comment period for Notice 2010-60 was relatively brief, with comments requested by November 1, 2010, to comply with the looming deadline of FATCA's effective date, January 1, 2013. In addition to proposed regulations, other guidance, such as a draft FFI agreement and new forms, including an enhanced Form W-8BEN, is anticipated. It is important that final regulations be promulgated well before FATCA becomes effective, so that software programs and operating procedures may be designed and implemented. Because the effective date is statutory, unlike the regulatory effective date for the §1441 withholding regulations, the FATCA effective date presumably may not be postponed by regulations. However, Treasury has already softened the statutory effective date by providing grace periods in the documentation procedures. It remains to be seen whether such grace periods will be sufficient.

PRIVACY LAW CONCERNS

While the United States has enacted limited privacy legislation applicable to the private sector, other countries have enacted much broader privacy laws.[4] In the European Union, the EU Data Protection Directive (the ''Directive''), while not binding on the EU Member States, encourages each state to enact legislation consistent with the Directive. The principles of the Directive govern the collection and the disclosure of personal data. Under the Directive, it is not clear whether data such as whether an account holder is a U.S. citizen or resident would be permitted to be collected currently. It is also not clear whether such data (if it could be legally collected) could be disclosed to the IRS as required under an FFI agreement.

Until privacy act concerns are addressed, it is not clear how FATCA reporting can take place. An FFI that is subject to legislation enacted under the EU Data Protection Directive may be violating that legislation if it collects or discloses information to the IRS. If an FFI does not collect or disclose data to the IRS, the FFI will be subject to 30% withholding. An FFI cannot please two masters at once unless the masters coordinate and agree on what is required.

The potential conflict of privacy laws and FATCA is not an issue that may be resolved by the private sector, but rather should be resolved between governments before the FATCA provisions become effective. The fact that Treasury and the IRS have announced in the Notice that they will coordinate with the governments of U.S. possessions demonstrates recognition that coordination is needed with other governments. Such consultations should be extended to governments of countries that have privacy laws in effect. While the Notice requests comments concerning whether treaty exchange-of-information provisions may be a less burdensome avenue of disclosure, it is clear that discussions are needed with foreign governments concerning how data protection laws may be reconciled with disclosure procedures under FATCA.

The silence in the Notice with respect to privacy laws does not necessarily mean that Treasury officials are not considering how to address this issue and are not talking with their counterparts in other countries. However, it would be reassuring if they would indicate that such conversations are, or will be, ongoing. Resolving how foreign law privacy act restrictions on collection and disclosure are reconciled with the FATCA provisions will require government-to-government discussions.

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[4] For example, in the United Kingdom, personal information is protected under not only the Data Protection Act of 1998, but also case law — which recognizes a contractual duty of confidentiality — and the Banking Code. In Canada, the Personal Information Protection and Electronic Documents Act limits collection and disclosure of personal information.

ISSN 0090-4600

DETAILED DESCRIPTION OF NOTICE 2010-60

Grandfathered Obligations

Section 501(d) of the HIRE Act provides for grandfathered treatment of obligations outstanding on March 18, 2012. The obvious purpose of the rule is to prevent the disruption of ordinary business transactions and to provide a transition period during which tax provisions may be amended in new agreements. Under the grandfather rule, payments and gross proceeds from a disposition of an obligation in existence on March 18, 2012, will not be subject to withholding under FATCA.

Section I of the Notice provides guidance on the scope of the term ''obligation,'' which will include any legal agreement that: (1) produces or could produce certain types of U.S.-source FDAP income; and (2) has a definitive expiration or term. Excluded from the definition of ''obligation'' are savings deposits, demand deposits, and other similar accounts because they do not have a definitive expiration or term. A debt obligation that undergoes a ''material modification'' as defined under Regs. §1.1001-3 will be treated as newly issued as of the date of the modification. For obligations other than debt obligations, whether a material modification occurs will be determined under a facts-and-circumstances test. Note that the scope of the rule, while eliminating equity, applies to many types of transactions in addition to loans, including licenses, leases, and service agreements as long as they have a definite term. While the term ''obligation'' may also encompass a notional principal contract, because under Regs. §1.446-3(c)(1)(i) each confirmation under a master agreement is treated as a separate notional principal contract, such new contracts may be treated as a new contract for Chapter 4 purposes. To the extent such a new contract is deemed to be executed after March 18, 2012, that new contract may not be grandfathered even though the master agreement was entered into prior to March 18, 2012.

Important to note is that the language of the Notice does not extend the grandfather rule to reporting requirements, which is consistent with the statute. However, the general effective date of the FATCA provisions is for payments made on or after January 1, 2013. Thus, a payor of a ''withholdable payment'' under a grandfathered obligation will nonetheless need to obtain the appropriate certifications from the payee for payments or gross proceeds paid after December 31, 2012. However, there is apparently no sanction if the payee does not provide the required certification or documentation because withholding is not permitted on payments made under a grandfathered obligation.

Treatment of Revolver Loan Provisions Unclear

An important outstanding question is the treatment of revolver provisions in commercial loans. Under such provisions, typically a lender provides a stated amount that will be subject to reoccurring cycles of lending and repayment, thus the term ''revolver.'' The borrower usually draws down on the revolver to meet cyclical cash needs and then repays the borrowed amount when able to do so. Credit cards and overdrafts are a common type of consumer revolver loan, but revolver loans are also commonly included in commercial loans as well.

Logically, a drawdown on a revolver that does not exceed the agreed commitment amount should not be treated as a material modification and, thus, should not be treated as a newly issued obligation. Similarly, it would seem that a repayment of a revolver executed on or prior to March 18, 2012, should also be eligible for the grandfather provision. An *increase* in an amount of a revolver loan commitment, however, may constitute a material modification that would not enjoy grandfather status for purposes of Chapter 4 if executed after March 18, 2012.

In public comments, a government official seemingly agreed with the foregoing analysis by stating that he did not believe that it would be appropriate to go back and taint a prior tranche that was issued prior to the grandfathering date. However, this statement raises the question of what is an ''issuance'' and an ''issuance date.'' The government official noted that these questions are currently being considered; concepts in the original issue discount regulations, which provide specific rules about what is considered an issuance and how to deal with separate tranches, may provide some guidance. Without guidance, however, it is not clear how revolvers will be treated for purposes of ''material modification.''

Should a drawdown or a repayment of a revolver constitute a ''material modification,'' it is not clear whether only the additional loan amount or the entire loan amount (including the pre-existing loan commitment) would become subject to withholding under FATCA. As the IRS intends to issue further guidance, this issue presumably will be addressed in that future guidance.

Scope of Definition of ''Financial Institution''

Section 1471(d)(5) provides three categories of entities that will be treated as ''financial entities'' for purposes of the FATCA provisions, in addition to providing regulatory authority to modify the definition. Those categories are: (A) entities that accept deposits

ISSN 0090-4600

in the ordinary course of a banking or similar business; (B) entities that, as a substantial portion of their business, hold financial assets for the accounts of others; and (C) a broad category of entities that engage primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or other interests such as futures or forward contracts or options. Additionally, §1471(b)(2) provides a category of ''deemed-compliant'' FFIs, while §1471(f) provides a category of foreign entities that pose a low risk of tax evasion and therefore are not subject to withholding under §1471(a). Section II of the Notice provides preliminary guidance as to each of these categories of entities as well as with respect to the status of financial institutions organized in U.S. Territories, U.S. branches of FFIs, and controlled foreign corporations (CFCs).

A ''financial institution'' may be organized either within or outside of the United States. The term ''foreign financial institution'' is defined under §1471(d)(4) as a financial institution that is a foreign entity. Furthermore, the term does not include any financial institution organized under the laws of a U.S. possession except as provided in regulations. A definition of a USFI is not included either in the statutory provisions or in the Notice, although the Notice (at III.C) provides specific due diligence requirements for USFIs. In informal discussions, Treasury officials have suggested that the term ''U.S. financial institution'' will include institutions similar to FFIs.

The Notice describes the various *statutory* categories of FFIs and introduces new categories of FFIs and NFFEs, which include participating FFIs, non-participating FFIs, deemed-compliant FFIs, excluded FFIs, Territory-Organized FFIs, U.S. Branch FFIs, Excepted NFFEs, and NFFEs. If this is not confusing enough, although not addressed by the Notice, there is another category of U.S. entities that are not subject to reporting because they are excepted from the definition of ''specified U.S. persons'' under §1473(3). Those U.S. entities include publicly traded corporations and members of their affiliated groups; tax-exempt entities and individual retirement plans; the U.S. government and its agencies and instrumentalities; states, the District of Columbia, U.S. possessions, and any political subdivisions; any bank as defined under §581; any REIT or RIC; any common trust fund; and any trust that is exempt under §664(c) or that is described in §4947(a)(1). As a result of these rules, there are significant categories of entities that are not subject to reporting. However, an FFI or NFFE must still identify each account owner or entity owner in order to apply these exceptions.

Participating and Non-Participating FFIs

Although a definition of the term ''participating FFI'' is not provided, the Notice refers to participating FFIs in the context of an FFI that has entered into an agreement with the IRS that it will comply with the Chapter 4 reporting requirements as required under §1471(b). A ''non-participating FFI'' then is an FFI that has not entered into such an agreement. FFIs that enter into an agreement with the IRS will receive a special FFI EIN. If an FFI provides an invalid FFI EIN to a withholding agent, the IRS is contemplating that information about that FFI must be reported to the IRS.

Controlled Foreign Corporations

Although many commentators had requested that CFCs be treated as deemed-compliant FFIs because of the existing reporting requirements for CFCs (at II.D.2) the Notice makes clear that CFCs that are FFIs will be required to enter into an FFI agreement. Notwithstanding that under Regs. §1.6049-5(c)(5(i) CFCs are U.S. middlemen (and therefore U.S. payors) that are required to comply with Chapter 61 reporting and backup withholding requirements, the Notice describes the many differences between the U.S. payor reporting requirements and those required under FATCA, concluding that there is limited overlap in addition to important disparities in those reporting requirements.

The two major disparities cited by the Notice are that, under current Chapter 61 reporting, corporations generally are ''exempt recipients, '' and that U.S. payors do not have an obligation to report on U.S. owners of foreign corporations. Although §6041 was recently amended to override the reporting exemption for corporations effective for payments made after December 31, 2011,[5] this provision has been very controversial and likely will be repealed. At press time, the Senate was scheduled to vote on two amendments to repeal the provision, on Nov. 29, 2010. A bill to repeal the §6041 amendment was introduced on Nov. 15, 2010 by Sen. Baucus, a key supporter of the original amendment.[6] Furthermore, even if the §6041 amendment were not repealed, the requirement to report on U.S. owners of foreign corporations would not be imposed on CFC FFIs if they were deemed to be compliant. Based upon the history of the FATCA provisions and the recent Congressional concerns about U.S. tax avoidance through the use of foreign corporations and trusts, it is not surprising that the Notice rejects the treatment of a CFC FFI as a deemed-compliant FFI.

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[5] P.L. 111-148, Patient Protection and Affordable Care Act §9006 (Mar. 23, 2010).

[6] S. 3946. See also Finance Committee News Release of Nov. 12, 2010, announcing Sen. Baucus' intent to repeal the amendment. Sen. Baucus amended his proposal, which is now contained in Amendment 4713 to the FDA Food Safety Modernization Act (S. 510).

ISSN 0090-4600

Some commentators have suggested that the §6038 reporting requirements (Form 5471) are sufficient to bestow deemed-compliant treatment on CFCs. However, under §6038, reporting is required on the transactions between a U.S. shareholder and its CFC, which is dissimilar to the reporting required by FATCA on its U.S. account holders.

Statutory Categories: Section 1471(d)(5)(A), (B), and (C)

The Notice (at II.A.1) amplifies the meaning of a depository bank under §1471(d)(5)(A) by including those entities that under §585(a)(2) would qualify as a bank including a bank as defined in §581 and any corporation to which §581 would apply (disregarding the fact that it is a foreign corporation), savings bank, commercial bank, savings and loan association, thrift, credit union, building society or other cooperative banking institution. However, the type of institution covered by this statutory category is not limited to the above list. Furthermore, the Notice provides that the fact that an entity is subject to the banking laws of the United States, a state, or a foreign country ''is relevant to but not necessarily determinative of whether that entity qualifies as a financial institution under section 1471(d)(5)(A).''

What this last statement means is not clear. Presumably, it is meant to broaden the scope of the entities treated as FFIs under the depository bank category, but the language might be read to imply that the opposite is the case. Likely, Treasury wants to maintain its ability to designate a particular entity as a depository bank for purposes of §1471(d)(5)(A) even if the entity is not subject to the banking laws of a particular jurisdiction.

The second statutory category under §1471(d)(5)(B), which includes entities that hold financial assets for others, also is amplified by the Notice (at II.A.2). Included within this category are broker-dealers, clearing houses, trust companies, custodial banks, and entities acting as custodians for the assets of employee benefit plans. Again, the fact that an entity is subject to governmental oversight and examination is relevant but not determinative of whether an entity is a financial institution for purposes of §1471(d)(5)(B).

The third statutory category under §1471(d)(5)(C) is the broadest category and is intended to cover various investment funds such as mutual funds, funds of funds, exchange-traded funds, hedge funds, private equity and venture capital funds, other managed funds, commodity pools, and other investment vehicles. Because, as a threshold issue, an entity described in this category must be engaged in ''business,'' the meaning of the term ''business'' is pivotal. The Notice (at II.A.3) states that the concept as used in §1471(d)(5)(C) is different from that used elsewhere in the Code where the concept of a ''trade or business'' implies more than one or two isolated transactions. In contrast, for Chapter 4 purposes, the concept may mean that an isolated transaction *will* result in a ''business'' depending on the magnitude and importance of the transaction compared to the entity's other activities.

While the Notice does not provide an example of what this concept of ''business'' might mean as a practical matter, Treasury officials in public remarks have connected this low threshold with the deemed-compliant FFIs, which (as discussed below) will necessarily be closely held and involved in investment activities of some type. The regulations to be provided under §1471(d)(5)(C) will determine — on the basis of all relevant facts and circumstances — whether an entity is engaged in the business of investing, reinvesting, and trading in securities. In other words, the status of each entity must be determined on an individual basis. The regulations will provide guidelines for determining what types of activity will constitute ''business'' for purposes of §1471(d)(5)(C) and when an entity is so engaged.

Apparently, possible tests suggested to Treasury and the IRS to determine whether an entity is engaged in ''business'' include an income/asset test similar to that applied by the passive foreign investment company rules under §1297 or a subjective intent test. These potential tests seem problematic from the perspective of a U.S. withholding agent, particularly the intent test, unless an FFI could self-certify. Other suggestions might include guidance under §864(b) or even case law under §212 that distinguishes between investors and traders.

Deemed-Compliant FFIs

Section 1471(b)(2) deems certain financial institutions as meeting the reporting requirements if the financial institution complies with regulatory procedures to ensure that U.S. accounts are not maintained and other prescribed regulatory requirements. The Joint Committee Technical Explanation to FATCA (''Technical Explanation'') suggests that certain widely held collective investment vehicles may be included in this category.[7] In addition, affiliates of FFIs that enter into an agreement with the IRS and do not maintain U.S. accounts may also be eligible to be treated as a deemed-compliant FFI. It is possible that Treasury and the IRS are considering whether FFIs with U.S. accounts could be ''ring-fenced,'' i.e.,

[7] Joint Committee on Taxation, *Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3310, the ''Hiring Incentives to Restore Employment Act*,'' Under Consideration by the Senate (JCX-4-10) (Feb. 23, 2010) at 41.

ISSN 0090-4600

whether a separate entity within an affiliated group could be established to hold all of an affiliated group's U.S. accounts.

Interestingly, the Technical Explanation suggests that deemed-compliant institutions may include CFCs owned by USFIs and U.S. branches of FFIs that are treated as U.S. payors currently.[8] For the reasons discussed above, the Notice declined to treat CFCs as deemed-compliant FFIs and, as discussed below, does not appear to treat U.S. branches as deemed-compliant FFIs.

Small FFIs

The Notice (at II.B.3) provides that regulations will be issued applicable to an FFI that is described only in §1471(d)(5)(C) (and not in §1471(d)(5)(A) or (B)), which will be treated as a ''deemed-compliant'' FFI. A withholding agent must be able to: (1) specifically identify each individual, specified U.S. person, or excepted NFFE that has an interest in the entity; (2) obtain from each person the necessary required documentation under the new account procedures provided by the Notice; and (3) report to the IRS any specified U.S. person that is identified as a direct or indirect interest holder in the entity. All of those account holders are either individuals or NFFEs that will not be subject to withholding or reporting under §1471 or 1472 or future regulations. The treatment of certain entities as deemed-compliant FFIs appears to be an exercise of regulatory authority granted to Treasury under §1471(b)(2).

While the reporting obligation in this case is shifted to the withholding agent from the FFI, as a practical matter the entity seeking ''deemed-compliant'' FFI status obviously will have to provide the required information to the withholding agent, who in turn will be required to report such information to the IRS.

The Notice provides one example of a small deemed-compliant FFI, that of a small family trust settled and funded by a single person for the benefit of that person's children. The Notice recognizes that entering into an FFI agreement may be an administrative burden disproportionate to the amount of U.S. investments of such a small entity.

Because of the anticipated broad definition of the term ''business,'' many small investment trusts and similar entities will be covered under the §1471(d)(5)(C) FFI definition. The category of deemed-compliant FFI is an attempt to address the treatment of those smaller entities and decrease the burden that otherwise would be imposed on them under FATCA.

Foreign Collective Investment Vehicles

In addition to the small FFIs that will be treated as deemed-compliant FFIs, the Notice discusses the possibility that foreign collective investment vehicles subject to laws prohibiting the sale of their interests to U.S. persons also may be treated as deemed-compliant. The Notice is interested in comments concerning such laws, what entities are covered, whether the prohibitions are legally binding, the extent to which anti-money-laundering (''AML'')/know-your-customer (''KYC'') laws enhance enforcement of such prohibitions, whether sales to nonparticipating FFIs would be treated as unsuitable investments, and what verification procedures might be implemented to enforce the prohibitions.

Although foreign funds do restrict sales to U.S. persons for a variety of reasons (including most notably regulatory concerns, but also PFIC concerns as well), once an interest is purchased by a non-U.S. person, that person may become a U.S. person or the interest may be included in the person's estate, which may have or acquire a U.S. beneficiary. All of these issues need to be addressed.

Excluded FFIs

This category consists of foreign entities that satisfy the statutory definition of a financial institution solely because they are primarily engaged in investing or trading in securities. An entity in this category will not be treated as an FFI, but will be treated as an NFFE that is exempted from withholding under §1472(a). The Notice (at II.B.1) specifically requests comments regarding how to specifically define the classes included within the category, how withholding agents may identify such excluded FFIs (including self-identification), and any other classes of entities that should also be included in the category. For treasury centers, because they are within an affiliated group and may not provide services to non-affiliates, no identification, not even self-certification, should be required. This is a very helpful category that will permit many non-financial affiliated corporate groups to be largely exempted from the application of FATCA.

Excluded FFIs include the following classes of entities:

- *Holding companies.* This class includes a holding company of a group of operating entities not engaged in the financial business of a financial institution under §1471(d)(5). The class will not include investment funds such as a private equity fund, venture capital fund, leveraged buyout fund or any investment vehicle that funds or acquires start-up companies and holds that interest only for a limited time.
- *Start-up companies.* This class includes a foreign entity that has not begun to operate its business but is investing capital in assets. The class will not include a foreign start-up company that in-

[8] *Id.*

ISSN 0090-4600

tends to engage in a financial business or a venture fund or other investment fund that invests in start-up companies. The exemption will apply only for the first 24 months after an entity's organization.[9]

- *Non-financial entities in liquidation, reorganization, or bankruptcy.* This class includes a foreign entity in the process of liquidating its assets or reorganizing with the intent to continue or recommence operations as a non-financial institution.
- *Treasury centers of a non-financial group.* This class includes a foreign entity that primarily engages in financing and hedging transactions with, or for, members of its expanded affiliated group that are not FFIs and does not provide such services to non-affiliates. The expanded affiliated group (as defined in §1471(e)(2)) must be primarily engaged in a non-financial institution business. Presumably, borrowing from unrelated outside lenders would not disqualify an entity from qualifying for the exclusion.

U.S. Branches

Although the definition of FFI does not exclude an FFI with a U.S. branch, the definition of a withholdable payment does exclude payments that will be included in U.S. gross income under §871(b)(1) or 882(a)(1) as income effectively connected with the conduct of a U.S. trade or business (''ECI''). The Notice (at II.D.1) discusses the treatment of U.S. branches of FFIs. The Notice accurately points out that this ECI exclusion applies not to all payments made to a U.S. branch, but only to those payments made for the FFI's own account that are reported on a U.S. tax return. A payment a U.S. branch receives on behalf of its account holders or one that is not effectively connected is not eligible for the ECI exclusion.

The Notice appears to provide contradictory statements about the FFI agreement requirement. First, the Notice states that an FFI will not be exempted from having to enter into an FFI agreement even if the only payments the FFI receives are withholdable payments solely through its U.S. branch. The next sentence, however, states that ''thus, where a U.S. branch of an FFI receives withholdable payments that are not eligible for the ECI exception, the FFI will be required to execute an FFI agreement to avoid being subject to withholding under section 1471(a).'' One could infer that the second sentence refers only to those payments that are not subject to the ECI exception. Thus, if that inference is correct, it would appear that an FFI whose only U.S.-source payments are eligible for the ECI exception should not be required to enter into an FFI agreement because the only payments the FFI receives are not withholdable payments under the §1473(1)(B) ECI exception to the definition of withholdable payment. Further guidance could help to make clear when an FFI agreement is required.

A U.S. branch of an FFI may receive a withholdable payment on behalf of its account holders. In such case, the Notice announces that consideration is being given to permit the U.S. branch to apply U.S. financial institution due diligence requirements, which (as discussed below) are somewhat simpler than those imposed on FFIs. Treating a U.S. branch as a U.S. financial institution for limited Chapter 4 purposes would parallel the rule provided by Regs. §1.1441-1(b)(2)(iv), where a U.S. branch may elect to be treated as a U.S. person for Chapter 3 purposes. A U.S. branch that is eligible for the election under Chapter 3 is either a U.S. branch of a foreign bank subject to Federal Reserve regulatory control or a U.S. branch of a foreign insurance company that files a National Association of Insurance Commissioners (NAIC)-approved annual statement with its U.S. local regulatory body. Presumably a similar rule would apply for Chapter 4 purposes. However, the Notice is clear that the special presumption under Regs. §1.1441-4(a)(2)(ii), which treats a payment made to such a U.S. branch as an ECI payment without documentation, will not be applicable in the Chapter 4 context. That would indicate that an ECI branch will need to provide a certificate.

Territory-Organized Financial Institutions

Section 1471(d)(4) excludes from the definition of an FFI a financial institution organized in a U.S. territory, which the Notice (at II.B.4) terms a ''Territory-Organized FI,'' unless regulatory authority provides otherwise. The Notice confirms that Treasury does not intend to treat a Territory-Organized FI as an FFI.

The FATCA provisions do not provide any further guidance as to how payments made to a Territory-Organized FI (for the account of the FFI or others) will be treated. The Notice notes that, for §1441 purposes, certain Territory-Organized FIs are permitted to assume the withholding and reporting responsibilities applicable to U.S. withholding agents. Under Regs. §1.1441-1(b)(2)(iv), a Territory-Organized FI is treated as a U.S. branch for Chapter 3 withholding purposes. As explained above, a U.S. branch may elect to be treated as a U.S. person. As the Notice further notes, §§1471 and 1472 do not apply this treatment for Chapter 4 purposes; however, future guidance is intended to permit a Territory-Organized FI that receives payments as an intermediary to provide

[9] Note that the FATCA two-year start-up period is more generous than the one-year start-up period allowed for a PFIC under §1298(b)(2).

ISSN 0090-4600

a certification to a U.S. withholding agent that it is assuming U.S. withholding agent responsibility for purposes of Chapter 4, thus providing a parallel rule to that provided by the Chapter 3 regulations.

For a Territory-Organized FI that is described only in §1471(d)(5)(C), i.e., mutual funds and similar investment vehicles, the Notice announces that with respect to withholdable or passthru payments made to such an entity for its own account, the Territory-Organized FI will be treated as an NFFE. This treatment would permit such a Territory-Organized FI to qualify for the exception under §1472(c)(1)(C), which exempts such payments when the entity is wholly owned solely by bona fide residents of the territory in which the entity is organized.

Although the Notice does not explicitly discuss withholdable payments made to a Territory-Organized FI that is a bank or holds financial assets for others, i.e., institutions described in §1471(d)(5)(A) and (B), by implication, it would appear that such payments would be treated as paid to an FFI. Such treatment would parallel that of a U.S. branch that receives non-ECI withholdable payments. Later guidance should clarify this point.

The Notice further announces Treasury's intention to consult with Territory governments about withholding and compliance issues concerning Territory-Organized FIs, as well as about enhancing existing information exchange agreements to reduce the burden on Territory-Organized FIs. As the U.S. government's relationship with the governments of the U.S. Territories is different from those with the governments of foreign countries (as discussed above), it would be useful to expand such discussions to other foreign governments.

Foreign Entities with a Low Risk of Tax Evasion

Section 1471(f) provides an exception from withholding for payments made to a beneficial owner who is a member of a class that poses a low risk of tax evasion. Statutory exemptions are provided for foreign governments, including political subdivisions or wholly owned entities, international organizations, foreign central banks, and any class identified by regulations as having a low risk of tax evasion. In remarks made in the *Congressional Record*, Rep. Sander Levin, House Ways and Means Committee Chairman, instructed that this regulatory authority be exercised ''narrowly'' and consistent with the purposes of the FATCA provisions.[10]

The Notice (at II.C) provides only one example of such a class having a low risk of tax evasion — a foreign retirement plan — which is qualified as a retirement plan in the country in which it is organized, is sponsored by a foreign employer, and does not allow U.S. participants or beneficiaries other than employees who were employed in that country where the plan is organized during the period benefits were accrued.

While this may be an obvious case for exemption under §1471(f), the requirements outlined are very limited. For example, a U.S. employee may work for the foreign employer in a country other than in the country under which the plan is organized. Furthermore, a beneficiary may not be the same person as the employee and the rule also does not appear to cover death benefits that would be paid to a non-employee beneficiary. Moreover, the Notice does not address foreign individual retirement accounts that may be similar to U.S. IRAs, which have annual contribution limits and are subject to local law reporting requirements. However, such accounts presumably will be addressed in responses to the Notice's request for comments on how a foreign retirement plan may be defined and the treatment of deferred compensation plans. It is likely that other retirement plans will be added to this category by regulations.

Insurance Companies

While insurance companies would appear not to be treated as FFIs under §1471(d)(5), the Notice (at II.B.2) states that the definition in §1471(d)(5) is broad enough to cover certain insurance companies, noting the broad grant of regulatory authority to determine what is an FFI. The Notice indicates that insurance policies without cash value do not implicate Chapter 4 concerns and specifically identifies property and casualty insurance contracts, reinsurance contracts, and term life insurance policies as examples of such policies. Accordingly, insurance companies that issue only such policies will be treated as NFFEs for Chapter 4 purposes. Insurance products identified by the Notice that raise concerns include whole life insurance contracts and annuity contracts because of their typical investment component.

The key is the definition of ''cash value.'' Presumably, the regulations will provide a definition that will eliminate policies that have no investment feature that could be accessed by a policy holder. The Notice requests comments on how ''cash value'' should be defined.

Several Code provisions provide definitions of terms that may be of some help, but may need modification to address tax avoidance concerns. Section 264(f)(3) defines ''unborrowed policy cash value,'' while §805(a)(4)(F)(ii) defines ''adjusted cash value.'' Prop. Regs. §1.7702-2(b) does provide a definition of ''cash value,'' but that definition is designed to determine what portion of a life insurance payment quali-

[10] 156 *Cong. Rec.* S1745 (3/18/10).

ISSN 0090-4600

fies as true insurance. Whether this definition would really work for FATCA purposes is not clear because there is a question of whether it would exclude property or term life insurance contracts.

A second source, although not a tax definition, is contained in the Title 31 regulations regarding suspicious activity reporting (''SAR'').[11] Those regulations identify life insurance policies that have a ''cash value or investment element'' as subject to SAR provisions. Group life insurance policies and group annuity contracts, however, are exempted from reporting under those regulations. Property and casualty and reinsurance contracts would appear to be excluded as they are not addressed by those regulations. Because Title 31 addresses money laundering concerns while FATCA addresses reporting of income, it is not clear how directly applicable the Title 31 definitions would be for FATCA purposes. However, together all of these sources may be helpful.

Foreign Charitable Organizations and Other Tax-Exempt Organizations

Neither the statutory provisions nor the Notice provides any guidance as to how a withholdable payment made to a foreign charitable organization will be treated. Because foreign charitable organizations are not specifically exempted, such organizations may be FFIs. The Notice (at II.E) requests comments on how such entities may be identified and defined for possible exception from the definition of an FFI and whether such entities could be treated as exempt because there are no U.S. account holders. While the answer might be clear for large public charities, it is less clear what criteria should be applied to identify smaller, less-known foreign charitable organizations.

For Chapter 3 purposes, to be exempt from withholding, a foreign charitable organization must have either a §501(c)(3) determination letter or a written opinion from U.S. counsel that the foreign charitable organization is described in §501(c)(3).[12] A similar rule could be applied for FATCA purposes.

Collection of Information and Identification of Persons by FFIs

Introduction

The most significant portion of the Notice — Section III — contains a detailed description of the procedures to be applied by an FFI and by a USFI in collecting information on account holders in order to identify U.S. persons. Separate procedures are provided for FFIs and USFIs, for individual and entity accounts, and for pre-existing and new accounts. Appendices 1 and 2 provide a detailed description of those due diligence procedures. Under those procedures, individuals must be classified as either U.S. or non-U.S. individuals and foreign entities must be classified as participating FFIs, deemed-compliant FFIs, non-participating FFIs, exempt FFIs, excepted NFFEs, or NFFEs.

For an FFI, a new account is defined as one in existence prior to the effective date of the FFI's agreement with the IRS. For a USFI, a new account is an account opened on or after January 1, 2013.

The procedures for pre-existing accounts are less rigorous and permit an FFI to rely on its searchable electronic files, while for new accounts all files must be searched. For new entity accounts, an FFI must examine all information with respect to such accounts, not limited to information available in electronic files. This includes account opening information, correspondence information, and AML/KYC information. Additionally, new account procedures require the identification of the beneficial owner, which was not required for pre-existing accounts.

Moreover, pre-existing account procedures permit grace periods for obtaining documentation, while new account procedures do not. Although special procedures are provided for pre-existing individual accounts, the Notice requires that pre-existing accounts of greater than $1,000,000 conform to the new account documentation requirements within two years and all other pre-existing accounts within five years. While this phase-in is designed to provide a grace period during which the FFI may obtain required documentation, even with the additional extension of time it may be difficult to obtain the information from existing account holders.

Special Exception from Reporting for Active Businesses

For entities that conduct an active trade or business, Section III.B.3 (step 4a) of the Notice provides an important exception that should exclude a large number of accounts from the reporting requirements. Under that provision, an account owned by an entity that is confirmed through third-party data as engaged in an active trade or business (other than a financial business) is treated as an ''excepted NFFE,'' the account of which is treated as a non-U.S. account. Importantly, a non-U.S. account is not subject to reporting under Chapter 4.

This special rule is not contained in the statutory provisions, but is suggested by the Technical Expla-

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[11] Under 31 CFR §103.10(a)(4) and (a)(10), the term ''permanent life insurance policy'' and an insurance product with features of cash value or investment element are covered. A ''permanent life insurance policy'' is defined as ''an agreement that contains a cash value or investment element and that obligates the insurer to indemnify or to confer a benefit upon the insured or beneficiary to the agreement contingent upon the death of the insured.''

[12] Regs. §1.1441-9(b)(2).

ISSN 0090-4600

nation, which anticipates an exclusion for payments made in the ordinary course of business for goods, services, and the use of property.[13] This exclusion for payments made to an entity engaged in an active trade or business is, of course, broader than that suggested by the Joint Committee on Taxation. However, it is a practical response to the need to reduce the burdens associated with the identification of account holders.

Presumed FFIs

Under the participating FFI due diligence requirements for pre-existing entity accounts (step 3a), an ''eyeball'' test is provided where electronic records show a name clearly indicating that the account holder entity is an FFI. In such case, an account holder entity may be tentatively classified as an FFI. However, the presumed FFI must be asked for its FFI EIN and certification of FFI status, which must be provided within nine months of the effective date of the participating FFI's FFI agreement. If this documentation is not provided within one year of the effective date of the participating FFI's FFI agreement, the FFI must request from the presumed FFI documentation of the entity's status. In the interim period, the account holder entity is treated as an excepted NFFE unless it is identified on an IRS list as a non-participating FFI. If within one year of the request for documentation the documentation has not been provided, the entity will be treated as a non-participating FFI, subject to 30% withholding.

USFI Due Diligence Procedures

Section III.C of the Notice provides for USFIs due diligence procedures similar to those required for FFIs. However, there are some differences. For example, a USFI only has to identify foreign entity payees because a withholdable payment made directly to an individual is not subject to FATCA.[14] Furthermore, a USFI that makes a withholdable payment to a U.S. person is not required to determine whether that U.S. person is a ''specified U.S. person'' except in the case of NFFE owners or to search electronic files for ''U.S. indicia.'' Finally, a USFI may not rely solely on electronic files for the identification of pre-existing account holders as may FFIs. A USFI must use all the information it has collected, including AML/KYC data, to identify account holders.

Sanctions for Long-Term Recalcitrant Account Holders and Their FFIs

The major compliance issue concerns pre-existing account holders who either ignore requests for documentation or choose not to waive their privacy rights under their home country law. When an FFI's account holders do not permit it to identify them, the FFI potentially will be subject to 30% withholding on amounts attributable to those accounts. The potential sanction with respect to pre-existing accounts is draconian given the difficulty in obtaining privacy law waivers and documentation from existing account holders. Treasury and the IRS are contemplating how to address this issue and has asked for comments on sanctions with respect to long-term recalcitrant account holders. (The Notice does not provide any guidance as to what period of time would constitute ''long-term.'')

Consequently, despite its attempts to obtain the required documentation to the extent possible under local country law, an FFI likely will have a large number of recalcitrant pre-existing account holders. Furthermore, the sanctions likely will fall on the FFI that is unable to obtain the documentation, while the account holder may not suffer any sanctions if contractually or legally the FFI may not withhold on the recalcitrant account holder.

One possible sanction suggested by the Notice is the termination of the FFI's agreement when an FFI has a number of recalcitrant account holders remaining after a reasonable period of time. This harsh sanction would result in 30% withholding on all payments made to the sanctioned FFI.

The Notice is silent with regard to a possible requirement that accounts of recalcitrant account holders be closed, which is suggested by the Technical Explanation.[15] Such requirement may not be legally possible under the laws of some countries requiring that bank accounts be offered to all residents. Consequently, closing an account may not be a legal option for some FFIs.

As discussed below, the Notice states that regulations will require reporting on recalcitrant account holders. If the IRS is able to obtain information about such account holders through income tax treaty exchange-of-information provisions, this should be taken into account in determining whether the IRS will apply sanctions to the FFI.

Participating FFI Reporting Requirements on U.S. Accounts and Recalcitrant Accounts

Statutory Reporting Requirements

Section 1471(c)(1) provides very specific reporting requirements including the name, address, and tax-

[13] Technical Explanation at 46.

[14] FFIs must identify individual account holders because a withholdable payment made to an FFI is obviously made to a foreign entity and FATCA is designed to identify both individuals who hold an FFI account and those who own an interest in a foreign entity. Payments made directly to a U.S. citizen or resident by a USFI are reported under Chapter 61.

[15] Technical Explanation at 40.

ISSN 0090-4600

payer identification number of each U.S. person subject to reporting, the account number, the annual account balance or value, and any deposits of gross receipts or withdrawals that occurred during the year. Alternatively, an FFI may elect to assume the reporting requirements of a U.S. payor, which requires issuing Forms 1099 that do not require reporting of account balances, deposits, or withdrawals.

Recalcitrant Account Reporting

In addition, the Notice (at IV.F) indicates that regulations will require information reporting with respect to recalcitrant accounts. An FFI will be required to provide the number and aggregate value of all recalcitrant accounts and the number and aggregate value of related and unrelated non-participating FFIs. Moreover, reporting as to the number and aggregate value of financial accounts of recalcitrant account holders with U.S. indicia will also be required.

Electronic Filing

The Notice announces that all FFIs will be required to report under both Chapters 3 and 4 by electronic filing, notwithstanding the current exception under §6011(e)(2) requiring electronic filing only for filers with 250 or more returns for a calendar year. This is not a surprising requirement, and most FFIs likely would do so in any case. This requirement would be effective for returns for years ending after December 31, 2012. Amid concerns about the cost and burden the electronic filing requirement would impose on smaller FFIs, it is helpful that small family trusts will be exempted from FATCA reporting.

Coordination with Chapter 3

To avoid duplicate withholding and reporting, coordination with the Chapter 3 requirements will be a necessary aspect of the implementation of the FATCA provisions. Also, financial institutions that currently are Qualified Intermediaries likely will also enter into a Chapter 4 agreement with the IRS and will need an FFI-EIN in addition to a QI-EIN. Likely, one EIN will be coded to signify what designations a financial institution has rather than actually issuing two EINs. Having two EINs for U.S. withholding purposes easily could lead to confusion.

Issues Not Addressed — Comments Requested

Many questions remain unanswered, as Notice 2010-60 was meant to address only the most important issues, as determined by commentators and such groups as the Information Reporting Public Advisory Committee (IRPAC).[16] Two additional important issues for which comments are sought are the due diligence requirements of non-financial withholding agents and the treatment of passthru payments. Appendix 3 provides a list of the issues for which comments are specifically requested.

Another significant issue not addressed by the Notice is refunds. Interestingly, the Notice does not request comments on this issue, presumably because refunds will not arise until after the January 1, 2013 effective date. A foreign FATCA refund claimant likely will be required to provide more robust documentation than currently required. It also would not be surprising for similar requirements to apply to Chapter 3 refund claimants.

As of Nov. 21, 2010, Treasury has received more than 50 separate comment letters, most of which provide detailed, thoughtful comments. These comment letters, from various types of institutions, should be very helpful to Treasury in crafting proposed regulations.

CONCLUSION

The Notice is the beginning of the implementation of the FATCA provisions. It provides some key guidance, notably the scope of the definition of a ''foreign financial institution'' and specific due diligence procedures. Much more guidance is needed, and hopefully will be forthcoming in the next few months. The FATCA provisions are far-reaching and, for that reason, FFIs need to continue to consider how this will impact them and to provide comments to Treasury and the IRS on the practical application of the provisions.

APPENDIX 1

Pre-Existing Individual Accounts

- ≥$50k individual depository accounts (aggregate) identified
- Treat previously identified U.S. persons for Chapters 3/61 purposes as specified U.S. persons for Chapter 4
- Search records for U.S. indicia:
  1. Identification as U.S. resident/citizen
  2. U.S. address
  3. U.S. place of birth
  4. Address is ''in care of,'' ''hold mail,'' or sole address is P.O. Box

[16] The 2010 IRPAC Public Report: Emerging Compliance Issues Subgroup (Oct. 18, 2010), which may be found on the IRS website at www.irs.gov.

ISSN 0090-4600

5. POA or person with signatory authority has U.S. address
6. Standing instructions to transfer funds to U.S. account or directions received from a U.S. address

- Obtain documentation from U.S. indicia accounts
  - If indicia 1, obtain W-9
  - If indicia 2 or 3, must obtain W-9 or, if non-U.S., a W-8BEN and a non-U.S. passport or other evidence of non-U.S. citizenship
  - If indicia 4-6, obtain a W-9 or documentary evidence of non-U.S. status: W-8BEN not required but may be relied upon by FFI
- Documents not already held must be obtained within one year of the effective date of the participating FFI agreement or the account holder is treated as a recalcitrant account holder subject to 30% withholding
- Pre-existing accounts will need to conform to new account due diligence requirements unless documentation sufficient to establish status of accounts exists
  - For accounts >$1M, must conform within 2 years
  - All other accounts must conform within 5 years

New Individual Accounts

- Documentation must be obtained from beneficial owners of new accounts to establish U.S. or non-U.S. status
  - Note that an FFI must now also identify *beneficial* owners of accounts, which was not required for pre-existing accounts
  - All records must be reviewed and an FFI is charged with the knowledge contained in those records
  - No one-year grace period: if no documentation, the account holder is treated as a recalcitrant account holder

APPENDIX 2

Pre-Existing Entity Accounts

- Pre-identified U.S. person allowed one-year grace period to provide documentation that it is not a specified U.S. person
  - After one year and no documents, treated as a specified U.S. person
- Search electronic files for U.S. indicia
  - Such entities may show that either not a U.S. entity or not a specified U.S. person
  - One-year grace period applies but at end, if no documents, treated as a specified U.S. person that is a recalcitrant account holder subject to 30% withholding
- *Presumed FFI*
  - Electronic file search permits "eyeball" test for FFI, i.e., name indicates entity is FFI
  - Must ask for FFI-EIN and certification of FFI status, which must be provided within nine months of effective date of the participating FFI's agreement
  - If not provided, within one year of effective date of the participating FFI's agreement, must request documentation of entity's status; in interim period treated as an excepted NFFE unless identified on an IRS list as a nonparticipating FFI
  - Within one year of request, if no compliance, entity treated as a nonparticipating FFI subject to 30% withholding
- *Active trade or business exception*
  - Search electronic files for indication of active business
  - Evidence of active business
    - Statements of business activities
    - Physical assets used in business
    - Persons employed in business
    - Audited financial statements or other business records
    - Third-party credit databases?
    - Other?
  - If any of above, entity treated as an excepted NFFE
- If no business indicia or documentation, must request documentation of status or

ISSN 0090-4600

rely on account files if existing documentary evidence

- If none, FFI must request documentation of status within one year after FFI's agreement enters into effect; otherwise, entity treated as a non-participating FFI from one year from the date of request

New Entity Accounts

- Similar procedures as for pre-existing accounts, but must use all information collected by the FFI, including information obtained through:
  - Account opening and maintenance
  - Correspondence with account holder
  - Complying with regulatory requirements (AML/KYC)

APPENDIX 3

Comments Requested by Notice 2010-60

I. FFIs and NFFEs

- **Entities Excluded from Definition of Financial Institution and/or Otherwise Exempt from Some or All of the Obligations Imposed by Chapter 4**
  - **Entities That Will Be Exempt from Withholding Under §§1471 and 1472**
    - Treasury and the IRS have requested comments on: (1) how certain classes of entities that are excluded from the definitions of the terms "financial institution" and FFI (e.g., certain holding companies, start-up companies) may be more specifically defined in the regulations; (2) what mechanisms withholding agents could use to properly identify such entities (including self-certification, as appropriate); and (3) whether other classes of entities should be similarly excluded.
  - **Insurance Companies**
    - Treasury and the IRS have requested comments with respect to the appropriate treatment under Chapter 4 of entities that issue cash value insurance contracts, annuity contracts, or similar arrangements, and with respect to the appropriate definition of cash value insurance contracts, annuity contracts and similar arrangements for the purpose of determining whether an insurance company that issues such products qualifies as a "financial institution" as defined by §1471(d)(5).
  - **Entities with Certain Identified Owners**
    - Treasury and the IRS have requested comments as to whether certain small FFIs should be required, for purposes of applying Chapter 4, to be treated as NFFEs, regardless of whether withholding agents currently determine the direct and indirect owners of such entities for purposes of complying with local law or regulatory obligations.
- **Classes of Persons Posing a Low Risk of Tax Evasion Under §1471(f)(4) — Retirement Plans**
  - Treasury and the IRS have requested comments on the definition of a retirement plan to determine if such a plan poses a low risk of tax evasion, thereby exempting payments beneficially owned by said plan from withholding, and on how such a plan could appropriately identify or document itself to a withholding agent to verify its compliance with any such definitional requirements. In addition, Treasury and the IRS have requested comments as to whether other categories of foreign employee benefit or deferred compensation plans should be subject to the same treatment as foreign retirement plans for Chapter 4 purposes.
- **Treatment of Certain Other Classes of Entities**
  - U.S. Branches of FFIs
    - Treasury and the IRS have requested comments as to other possible rules or methods that

ISSN 0090-4600

withholding agents could use to determine the application of the effectively connected income exclusion (the ECI exclusion), which excludes from the definition of a withholdable payment income taken into account under §871(b)(1) or §882(a)(1).

- **Comments Requested (General)**
  - Treasury and the IRS have requested comments concerning the treatment under §1471 of FFIs and NFFEs, as well as the treatment of other foreign entities including, for example, any foreign charitable organizations that may fall within the definition of an FFI.
  - In particular, Treasury and the IRS have requested comments providing specific suggestions for defining and identifying specific classes of foreign entities that should be: (1) excluded from the definition of FFI; (2) deemed to meet the requirements of §1471(b) pursuant to §1471(b)(2); or (3) identified as posing a low risk of tax evasion pursuant to §1471(f).

II. Collection of Information and Identification of Persons by Financial Institutions Under §§1471 and 1472

- **Participating FFIs**
  - **Financial Accounts Held by Entities – Identification by Participating FFIs**
    - Treasury and the IRS have requested comments regarding the development of presumptions on which a participating FFI could rely to determine whether a U.S. person is a specified U.S. person for purposes of §1471.
    - Treasury and the IRS have also requested comments about the level of evidence that should be sufficient to establish that an FFI or an entity account holder that is not treated as a U.S. person for purposes of §1471 is engaged in an active trade or business, as well as about ways that this analysis can be structured to ensure that it is not subject to abuse.
- **USFIs**
  - **Identification of New Foreign Entity Accounts**
    - Treasury and the IRS have requested comments regarding appropriate procedures for USFIs to identify participating FFIs, deemed-compliant FFIs, non-participating FFIs, entities described in §1471(f), excepted NFFEs, and other NFFEs among the new account holders of USFIs that are held by persons other than individuals.

III. Reporting on U.S. Accounts

- **Account Balance or Value**
  - Treasury and the IRS have requested comments regarding approaches discussed in this section that would require a participating FFI to report information with respect to each of its U.S. accounts (e.g., requiring a participating FFI to report the highest of its month-end balances during the year and additional account-related information).
  - Comments have also been requested regarding other potential approaches that may provide adequate information in a manner that will be administrable by participating FFIs without being subject to manipulation by U.S. account holders.
  - Comments on possible currency translation conventions have been requested.
  - Finally, comments on specific situations in which foreign laws may prevent the reporting of the information discussed above have been requested, along with descriptions of the steps that would be required of a participating FFI (and account holders of U.S. accounts maintained by the FFI) in order to overcome or waive any such restriction.
- **Gross Receipts and Withdrawals**
  - Treasury and the IRS have requested comments as to how to minimize bur-

ISSN 0090-4600

dens on participating FFIs with respect to the reporting of gross receipts and gross withdrawals and payments.

- **Section 1471(c)(2) Election**
  - Treasury and the IRS have requested comments regarding whether and in what circumstances a participating FFI should be permitted to make a §1471(c)(2) election, which permits an FFI to report under §§6041, 6042, 6045, and 6049, as if it were a U.S. person and each holder of a U.S. account that is a specified U.S. person or U.S.-owned foreign entity were an individual and citizen of the United States.
  - Specifically, comments have been requested regarding the situation where a §1471(c)(2) election would be permissible with respect to a subset of an FFI's accounts without making the election for all of its accounts (for example, whether a participating FFI should be permitted to make the election with respect to accounts held by individuals without requiring that the FFI make the election with respect to accounts held by entities).

IV. Request for Specific Comments

- **Verification Requirements Applicable to Participating FFIs**
  - Treasury and the IRS have requested comments about the procedures performed by public accountants or other external auditors when conducting an AML/KYC audit or similar engagement, including information about the objectives of such engagements, the types of procedures performed, and the types of reports issued as part of such engagements.
  - In addition, Treasury and the IRS have requested comments on: (1) the possibility of the IRS relying on written certifications completed by high-level management employees of participating FFIs to ensure compliance with Chapter 4; (2) what particular representations should be included in such certifications; and (3) the extent to which public accountants or other external auditors rely on written certifications of compliance provided by officers or other responsible management employees of the applicable financial institution in the course of AML/KYC audits or similar engagements.
  - Treasury and the IRS have also requested comments concerning the extent to which the format of reports associated with such engagements could be appropriately modified to ensure further compliance with Chapter 4.
  - Finally, Treasury and the IRS have requested comments as to the extent to which public accountants would be able to perform, consistent with their attestation or other accounting standards, verification procedures (which participating FFIs agree to comply with once entering into FFI agreements), and reporting with respect to FFIs under engagements that are not agreed-upon procedures.
- **Treatment of Passthru Payments**
  - Treasury and the IRS have requested comments as to methods that a participating FFI could use to determine whether passthru payments it makes are attributable to withholdable payments, including any associated information reporting that may be necessary, and which take into account the administrative burden imposed by any such approach.
- **Election to Be Withheld Upon**
  - Treasury and the IRS have requested comments as to the appropriate scope of a §1471(b)(3) election, which permits a participating FFI to elect to have a withholding agent withhold on withholdable payments or passthru payments made to it, rather than act as a withholding agent for passthru payments it makes to its account holders.
  - In particular, Treasury and the IRS have requested comments as to the types of financial accounts for which a §1471(b)(3) election should be made available.
  - Finally, Treasury and the IRS have requested comments as to the type of

ISSN 0090-4600

information reporting an electing FFI would need to provide to a withholding agent so that the appropriate amount of tax could be deducted and withheld from any withholdable payments or other passthru payments made to the electing FFI.

- **Sanctions with Respect to Recalcitrant Account Holders**
  - Treasury and the IRS have requested comments on what measures should be taken to address long-term recalcitrant accounts, including whether, and in what circumstances, Treasury and the IRS should consider terminating FFI agreements due to the number of recalcitrant account holders remaining after a reasonable period of time.
- **FFIs Subject to Restrictions Prohibiting U.S. Account Holders**
  - Treasury and the IRS have requested comments regarding whether particular arrangements created by foreign collective investment vehicles (e.g., including language in their prospectuses and application documents indicating they are prohibited from selling their interests to U.S. account holders) are sufficient to satisfy the requirement of §1471(b), which generally calls for an FFI to agree to undertake certain due diligence, reporting, and withholding responsibilities.
  - Specifically, Treasury and the IRS have requested comments on the following:
    - Specific information about the applicable laws and regulations that may result in an investment vehicle's determination to prohibit sales of its interests to U.S. persons;
    - Categories of investment vehicles that may be covered by such laws and regulations;
    - Examples of the distribution or similar agreements that prohibit sales of interests to U.S. persons;
    - Information regarding the legally binding nature of such prohibitions and the penalties applicable to a violation of such prohibitions;
    - Extent to which the AML/KYC laws used to enforce such a prohibition would apply in identifying U.S. persons (as defined for U.S. tax purposes) that may invest in such vehicles, directly or through ownership in one or more other entities;
    - Extent to which purchases of interests by non-participating FFIs would be treated as unsuitable investments and the extent to which and mechanisms by which non-participating FFIs could be prohibited from purchasing such interests; and
    - Approaches that would allow Treasury and the IRS to verify or otherwise ensure compliance with such prohibitions.
- **Electronic Filing Requirements for Financial Institutions**
  - Treasury and the IRS have requested comments on the possibility of financial institutions being required to provide electronic filings in lieu of paper filings when reporting pursuant to Chapter 4.
- **Application of Chapter 4 by U.S. Withholding Agents Other Than USFIs**
  - Treasury and the IRS have requested comments on: (1) the form of certifications made as to the classifications of foreign entities for Chapter 4 purposes; (2) their renewal provisions; and (3) circumstances under which a withholding agent should not be required to solicit such certifications from certain classes of persons or with respect to certain classes of payments, such as arm's-length payments made for goods or services in the ordinary course of the withholding agent's trade or business.
  - In addition, Treasury and the IRS have requested comments regarding: (1) the appropriateness of an excep-

ISSN 0090-4600

tion to the withholding required under §1472 for payments made to an NFFE engaged in an active trade or business by withholding agents other than financial institutions; (2) how a withholding agent may determine whether an NFFE is engaged in an active trade or business; and (3) other exceptions to withholding under §1472 that may be appropriate.

- **Potential Modifications to Chapter 4 Requirements Based on Availability of Information From Other Sources**

  - Treasury and the IRS have requested comments on possible approaches to reduce the burden imposed on participating FFIs by Chapter 4 (e.g., permitting the IRS to obtain information about the identities of the recalcitrant account holders of a participating FFI through an information exchange request to a foreign jurisdiction).

ISSN 0090-4600