FOREIGN BANK ACCOUNT REPORTING AND TAX COMPLIANCE

HEARING

BEFORE THE

SUBCOMMITTEE ON SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

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FOREIGN BANK ACCOUNT REPORTING AND TAX COMPLIANCE

THURSDAY, NOVEMBER 5, 2009

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON SELECT REVENUE MEASURES,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:05 a.m., in Room B–318, Rayburn House Office Building, the Honorable Richard E. Neal [chairman of the subcommittee] presiding.

[The advisory of the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON SELECT REVENUE MEASURES

November 5, 2009
By (202)225–5522

Neal Announces Hearing on Foreign Bank Account Reporting and Tax Compliance

House Ways and Means Select Revenue Measures Subcommittee Chairman Richard E. Neal (D–M(A) announced today that the Subcommittee on Select Revenue Measures will hold a hearing on foreign bank account reporting and related tax compliance issues. **The hearing will take place on Thursday, November 5, 2009, in the main Committee hearing room, B-318 Rayburn House Office Building, beginning at 10:00 a.m.**

Oral testimony at this hearing will be limited to invited witnesses. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

FOCUS OF THE HEARING:

The hearing will focus on non-compliance by U.S. taxpayers with foreign bank accounts, rules regarding foreign trusts with U.S. beneficiaries, and certain U.S. dividend equivalent payments to foreign persons to avoid U.S. taxes. The hearing will also focus on recently introduced legislation, HR 3933, the Foreign Account Tax Compliance Act of 2009.

BACKGROUND:

According to the most recent tax year data available (2003), more than $293 billion in U.S. source income was sent to individuals and businesses residing abroad. The United States imposes withholding taxes when U.S. source investment earnings are paid to a foreign person. Those withholding taxes were largely designed to collect tax on income earned in the United States even though the income is earned by a foreign person not subject to the jurisdiction of our laws. Those withholding taxes also play a role in preventing non-compliance by U.S. persons holding investment assets in accounts overseas.

The Internal Revenue Service (IRS) has established the Qualified Intermediary (QI) program that authorizes foreign financial institutions to collect withholding taxes on behalf of the U.S. government. The program was implemented to improve compliance for tax withholding and reporting on U.S. source income that flows offshore through foreign financial institutions. The recent UBS case revealed problems with the QI program that permitted tax evasion by U.S. persons. Further, even with jurisdictions in which the United States has a tax treaty, effective information exchange used by tax enforcement agencies may sometimes be undermined by local laws providing for banking secrecy that conflict with U.S. law.

In March of this year, this Subcommittee held a hearing on bank secrecy and tax evasion at which the Commissioner of the Internal Revenue Service testified (Ways and Means Committee Hearing Print, Serial 111-12, Hearing on Banking Secrecy Practices and Wealthy American Taxpayers). In May, the President released a fiscal 2010 budget proposal including a number of new requirements on taxpayers with foreign bank accounts and foreign financial institutions holding those accounts. Last week, Representative Charles B. Rangel filed HR 3933, the Foreign Account Tax Compliance Act of 2009 containing, among other proposals, many of the proposals from the Administration's budget, including a mandatory 30 percent withholding on payments to foreign financial institutions unless they disclose information to the IRS on accounts owned by U.S. individuals or close the accounts, and a requirement on individuals and entities to report offshore accounts with values of $50,000 or more on their tax returns (see Joint Committee on Taxation Technical Explanation, JCX-42-09).

In announcing the hearing, Chairman Neal stated, "For many years, I have sought to crackdown on individuals and corporations that are abusing overseas tax havens. With billions of dollars in revenue being lost each year, strengthening our tax compliance efforts is essential. I strongly believe the Foreign Account Tax Compliance Act of 2009, introduced this week in the House by Chairman Rangel and myself, gives the Treasury Department the necessary tools it needs to get tough with those Americans hiding their assets overseas. I welcome the support for this bill offered by President Obama and Treasury Secretary Geithner, and look forward to working with them to turn this proposal into law. It is my hope that this hearing marks the beginning of a vigorous campaign by Congress and the Obama administration to end the practice of offshore tax avoidance by U.S. citizens."

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, http://democrats.waysandmeans.house.gov, select "*Committee Hearings*." Select the hearing for which you would like to submit, and click on the link entitled, "*Click here to provide a submission for the record*." Once you have followed the online instructions, complete all informational forms and click "submit" on the final page. ATTACH your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business November 19, 2009. Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721.

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1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone, and fax numbers of each witness.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Note: All Committee advisories and news releases are available on the World Wide Web at http://democrats.waysandmeans.house.gov.

Chairman NEAL. Let me call this hearing to order. I apologize for just being a couple of minutes late. Governor Patrick was here, and the mass delegation had breakfast with him this morning. And based on the attendance, I won't be calling the question on any——

[Laughter.]

Chairman NEAL. Let me welcome everyone to this hearing of the Select Revenue Measures Subcommittee on tax avoidance in foreign bank account reporting.

When we last met on this issue, in March of this year, we were seeking legislative options to handle the weaknesses exposed by the UBS case. The IRS and the Justice Department were struggling to get the names of U.S. account holders from a bank that had already admitted complicity in a tax avoidance scheme for which they agreed to pay $780 million, in terms of a fine.

The treaty would only provide tax enforcement information if it was a crime under local law, and if you had a name. Negotiations, however, produced a break-through, and more than 4,500 names were to be divulged.

The IRS announced an amnesty program which has thus far netted 7,500 taxpayers with previously hidden overseas accounts seeking to avoid the worst penalties. I congratulate the IRS and the Department of Justice on this hard-fought victory.

Of course, the story does not end there. We never knew that the tax information exchange would be virtually meaningless because we didn't have the names. We didn't know bank secrecy would prove such an effective shield for evaders, even when we knew a crime had been committed.

Following our March hearing, President Obama announced a number of new enforcement provisions as part of his budget proposal. Under the leadership of Chairman Rangel, we have spent months sorting through these issues. And last week Mr. Rangel and I filed the Foreign Account Tax Compliance Act of 2009.

This bill creates a new reporting regime for foreign financial institutions with U.S. account holders, whether they are participants in the existing qualified intermediary program or not. This legislation casts a wide net in search of undisclosed accounts and hidden income. It is carefully balanced. And, as we will hear from one foreign bank today, it is actually supported by one who will bear the brunt of this new disclosure.

The boxer, Joe Lewis, once told an opponent who proceeded to outrun him for 12 rounds, "You can run, but you can't hide." Lewis knocked him out in the 13th round. And I believe we are entering that 13th round, and it will not be long before those individuals seeking to hide money overseas will be caught. This bill could be enacted by the year-end.

And just before I recognize Mr. Tiberi, it has become a priority issue for the G20, as well as the G7. And I think that, in terms of the economic confrontation that America currently is experiencing, that it makes good sense, before we talk about raising revenue elsewhere, that we begin talking about closing down these tax havens and these loopholes that the American people have justly come to see being patently unfair.

And with that, I would like to recognize my friend, Mr. Tiberi, for his opening statement.

Mr. TIBERI. Thank you, Mr. Chairman. Early this year the subcommittee met to examine issues surrounding banking secrecy and illegal tax evasion. At that hearing we all agreed that criminal tax evasion should be aggressively pursued and punished.

I also said that I hoped our efforts in the area would remain focused on compliance, that the line between illegal tax evasion and legal tax practices used by U.S. taxpayers around the world is distinct. And to blur that line may only make our compliance efforts more difficult.

I am pleased, Mr. Chairman, that you have called this hearing to discuss legislation recently introduced by Chairman Rangel and you that seeks to address the issue of illegal tax evasion. During this—these challenging economic times, honest, hardworking taxpayers who play by the rules expect others to do the same.

I am anxious to hear from our witnesses about some of the details of the bill, and certainly hope it is a workable solution to the problem of offshore tax evasion that avoids unintended consequences.

I will note, however, that I am very pleased the bill does not blur the issues of tax evasion and legal tax practices, and does not include the most controversial international tax policy changes proposed by the Administration. We have heard a lot of rhetoric in recent months from the Administration and others designed to confuse the issues, and characterize them as one and the same. I am pleased to see, Mr. Chairman, that you have cut through that, and drawn a bright line separating the two.

I look forward to continued work with you on all these issues in the days and weeks and months ahead. Thank you to our witnesses. I look forward to your testimony today.

With that, Mr. Chairman, I will yield back.

Chairman NEAL. Thank you, Mr. Tiberi. Let me welcome our witnesses today. On our first panel, we will hear from Stephen Shay, the Deputy Assistant Secretary for International Tax Affairs at the Treasury Department. We were fortunate to have Mr. Shay as a private sector expert in our March hearing, but even more pleased to have him today in his official capacity.

We will next hear from William Wilkins, the chief counsel for the Internal Revenue Service. The legislation we are discussing today could not have been possible without the thoughtful commentary from both Treasury and IRS. And we are very appreciative of your contribution.

Our second panel will allow us to hear from Mr. Thomas Prevost, a managing director and America's head of tax for Credit Suisse. In his position, he is responsible for all tax matters in the Americas for the Swiss-owned bank.

Next we will hear from Professor Charles Kingson, from New York University.

And, finally, we will hear from Dick Suringa, a partner at Covington & Burling, specializing in international tax matters.

I will note for the record that all of these witnesses have put in their time, either at Treasury or IRS. And we look forward to their unique perspectives.

Without any objection, any other Members wishing to insert statements as part of the record may do so. All written statements offered by our witnesses will be inserted into the record, as well. With that, let me recognize Mr. Shay for his opening statement.

STATEMENT OF STEPHEN E. SHAY, DEPUTY ASSISTANT SECRETARY FOR INTERNATIONAL TAX AFFAIRS, UNITED STATES DEPARTMENT OF THE TREASURY

Mr. SHAY. Thank you, Mr. Chairman. Chairman Neal, Ranking Member Tiberi, and Members of the Subcommittee, I appreciate the opportunity to testify today about foreign bank account reporting and tax compliance. With the permission of the chairman, I will ask that my statement be put in the record, and just summarize a few remarks.

Chairman NEAL. Without objection.

Mr. SHAY. For too long, some Americans have taken advantage of the system by hiding unreported income in a foreign financial account, trust, or corporation. When Americans evade their tax-paying responsibilities, the millions of workers and businesses who do pay their taxes are forced to pay the price.

The Foreign Account Tax Compliance Act of 2009—I will refer to it on occasion as H.R. 3933—and its companion bill in the Senate, S. 1934, represents an important step toward reducing the amount of taxes lost through illegal use of hidden accounts, and making sure that everyone pays their fair share.

Before talking about the act itself, I would like to discuss more broadly how the Administration is addressing the problem of offshore tax evasion. Because offshore evasion has many facets, the Treasury Department has developed a multi-pronged approach to it. This comprehensive approach includes legislative proposals, a focus on bilateral information exchange agreements, multilateral initiatives to improve transparency and information exchange in tax matters, and IRS enforcement actions.

This approach is intended to provide the IRS with the information from taxpayers, third parties, and other countries, and the tools needed to tackle offshore evasion. The Administration's fiscal year 2010 budget includes a series of legislative proposals to curb the abuse of offshore accounts and entities. The proposals are directed at enhancing information reporting, strengthening penalties, and making it harder for foreign account holders to evade U.S. taxes.

Some information that the IRS needs to enforce U.S. tax law can be obtained only through foreign countries. Accordingly, the Administration has placed a high priority on concluding tax information exchange agreements. In the last year alone, we have signed agreements to exchange tax information with Switzerland, Luxembourg, Liechtenstein, Gibraltar, and Monaco.

The Administration also seeks to improve international tax cooperation. Thus, we are working on a multi-lateral basis to make sure that countries meet international standards on tax transparency and information exchange. We are committed to preventing the facilitation of offshore tax evasion.

To further the IRS's enforcement capacity, the President's budget proposes new enforcement tools to crack down on evasion through offshore accounts and entities, and provides funds to add nearly 800 new IRS employees to combat offshore evasion, and to improve compliance with U.S. international tax laws by businesses and wealthy individuals.

The Foreign Account Tax Compliance Act represents an important step forward in correcting problems within U.S. tax law that have allowed taxpayers to shirk their responsibilities.

Like the Administration's proposals, H.R. 3933 would make it more difficult for U.S. persons to hide assets abroad in foreign financial accounts by: Enhancing information reporting; increasing withholding taxes for foreign financial institutions that do not engage in information reporting; and strengthening the penalties for taxpayers who do not adequately report their income.

It will also make it more difficult for taxpayers to hide behind foreign trusts. And it will prevent taxpayers who receive the benefit of U.S.-sourced dividend payments from avoiding U.S. withholding taxes.

Mr. Chairman, we applaud the leadership role taken by you and Chairman Rangel in the House, and by Chairman Baucus and Senator Kerry in the Senate, in introducing this legislation. And, additionally, the work of Senator Levin and Congressman Doggett, in supporting a strong international tax enforcement agenda.

Mr. Chairman, Ranking Member Tiberi, and Members of the Subcommittee, the Foreign Tax Compliance Act fits well into the Administration's multi-pronged strategy of improving our domestic tax laws, while increasing global cooperation on tax information exchange to help narrow the tax gap, and create the fairer tax system we need.

We look forward to working with you and Members of this Subcommittee on this important subject. I would be pleased to answer questions when the time is appropriate.

Thank you.

[The statement of Mr. Shay follows:]

EMBARGOED UNTIL DELIVERY
Remarks as Prepared for Delivery

Opening Statement of Stephen E. Shay
Deputy Assistant Secretary of the Treasury (International Tax Affairs)
House Committee on Ways and Means
Subcommittee on Select Revenue Measures
November 5, 2009

Chairman Neal, Ranking Member Tiberi, and members of the Committee, I appreciate the opportunity to testify today about foreign bank account reporting and tax compliance.

For too long, some Americans have taken advantage of the system by hiding unreported income in a foreign financial account, trust or corporation. When Americans evade their taxpaying responsibilities, the millions of workers and businesses who do pay their taxes are forced to pay the price. The Foreign Account Tax Compliance Act of 2009 (H.R. 3933 and S. 1934), represents an important step toward reducing the amount of taxes lost through illegal use of hidden accounts and making sure that everyone pays their fair share.

Before talking about the Foreign Account Tax Compliance Act, I would like to discuss more broadly how the Administration is addressing the problem of offshore tax evasion.

A Multi-Pronged Approach to International Tax Compliance

Because offshore tax evasion has many facets, the Treasury Department has developed a multi-pronged approach to combat it. This comprehensive approach includes legislative proposals, a focus on bilateral tax information exchange agreements, multilateral initiatives to improve transparency and information exchange in tax matters, and IRS enforcement actions. This approach is intended to provide the IRS with the information (from taxpayers, third parties, and other countries) and the tools needed to tackle offshore tax evasion.

The Administration's FY 2010 budget includes a series of legislative proposals to curb the abuse of offshore accounts and entities. The proposals are directed at enhancing information reporting, strengthening penalties, and making it harder for foreign accountholders to evade U.S.

Some information that IRS needs to enforce U.S. tax law can be obtained only through foreign countries. Accordingly, the Administration has placed a high priority on concluding tax information exchange agreements. In the past year alone, we have signed agreements to exchange tax information with Switzerland, Luxembourg, Liechtenstein, Gibraltar and Monaco. The Administration also seeks to improve international tax cooperation. Thus, we are working on a multilateral basis to make sure that countries meet international standards on tax transparency and information exchange and are committed to preventing the facilitation of offshore tax evasion.

Finally, to further enhance the IRS' enforcement capacity, the President's budget proposes new enforcement tools to crack down on evasion through offshore accounts and entities and provides funds to add nearly 800 new IRS employees to combat offshore tax evasion and improve compliance with U.S. international tax laws by businesses and wealthy individuals.

The Foreign Account Tax Compliance Act

The Foreign Account Tax Compliance Act represents an important step forward in correcting problems within U.S. tax law that have allowed taxpayers to shirk their tax responsibilities. Like the Administration's proposals, H.R. 3933 would make it more difficult for U.S. persons to hide assets abroad in foreign financial accounts, by enhancing information reporting, increasing withholding taxes for noncompliant foreign financial institutions, and strengthening penalties for taxpayers who do not adequately report their income. It will also make it more difficult for taxpayers to hide behind foreign trusts and it will prevent taxpayers who receive the benefit of U.S.-source dividend payments from avoiding U.S. withholding taxes.

New Reporting Regime for Foreign Financial Institutions

Under the current U.S. Qualified Intermediary (QI) program, financial institutions may sign an agreement with the IRS to share certain information about their U.S. customers with the IRS, in exchange for simplified rules with respect to their foreign customers, including non-customer-specific reporting and the ability to claim more easily any applicable exemption or lower U.S. withholding tax. While this regime has been effective in improving compliance with

U.S. tax laws in relation to collecting withholding taxes on foreign persons, its provisions relating to U.S. account holders have been subject to abuse by some foreign banks.

Moreover, not all foreign financial institutions choose to participate in the QI program. In that case, U.S. persons making payments to accounts held at non-QI foreign financial institutions must determine whether the accountholder is eligible for a reduced rate of tax based on self-certification by the payee. Current law, however, imposes only limited obligations on either the payor or the foreign financial institution to check the accuracy of the self-certification. As a result, U.S. persons have been able to use accounts at such foreign financial institutions to hide assets from the IRS.

H.R. 3933 addresses these gaps in the current information reporting rules by introducing a new withholding tax on payments to foreign financial institutions of U.S.-source income or gross proceeds from the sale of certain assets producing U.S.-source income. To avoid being subject to the withholding tax, a foreign financial institution must enter into an agreement with the IRS to report the identity of its U.S. accountholders, along with information about their account balances, gross receipts and withdrawals. The withholding tax also generally applies to payments to a nonfinancial foreign entity that fails to provide information with respect to its substantial U.S. owners.

Consistent with the Administration's budget proposals, this provision will improve information reporting with respect to U.S. accountholders by creating a powerful incentive for foreign financial institutions to provide the IRS with the information it needs to identify persons seeking to evade U.S. tax.

Foreign Financial Asset and Other Reporting Provisions

Under current law, U.S. investors are required to file reports disclosing ownership of foreign financial accounts with balances greater than $10,000. However, when accounts are hidden offshore, it is difficult to identify taxpayers who are supposed to file the Report of Foreign Bank and Financial Accounts (FBAR) but do not. In addition, even when the IRS has evidence that a taxpayer has a foreign account, it may be difficult, time-consuming, and costly for the IRS to prove that the account has a large enough balance to require the FBAR to be filed and to assess applicable penalties. To ensure that the IRS gets the information it needs regarding foreign financial accounts, H.R. 3933 introduces new reporting obligations for U.S. individuals holding substantial foreign financial assets, and imposes adverse consequences on U.S. individuals who fail to comply with new or existing disclosure rules regarding foreign assets or income. H.R. 3933 would also require reporting by U.S. advisers who assist U.S. individuals in forming or acquiring foreign entities. These reporting and penalty provisions, which are similar in approach to proposals in the Administration's budget, build upon the disclosure rules and penalties found in current law and should deter taxpayers from using foreign financial accounts to attempt to evade taxes. For those taxpayers who persist in attempting to evade taxes through offshore accounts, the bill's new enforcement tools would greatly assist the IRS in identifying those taxpayers and collecting the taxes they owe.

Foreign Trust Provisions

H.R. 3933's trust provisions would enhance the ability of the IRS to identify cases in which U.S. persons are hiding behind foreign trusts, and would ensure that any U.S. person that can benefit from trust property is treated as a beneficiary for U.S. tax purposes. The bill also includes an Administration proposal enhancing the penalties applied to persons who fail to adequately report information about interests in offshore trusts. Together, these provisions will help prevent U.S. persons from using foreign trusts to hide income and assets from the IRS.

Repeal of Favorable Treatment of Foreign-Targeted Bearer Bonds

Certain adverse tax consequences apply to holders and issuers of "bearer bonds," unless the bonds are marketed under procedures designed to ensure their sale only to foreign investors. By eliminating this exception to those "bearer bond" sanctions, H.R. 3933 will require non-U.S. holders to certify their status as a non-U.S. person on a Form W-8. This change will improve transparency and ensure that investors are not able to use bonds issued by U.S. issuers to keep their identities concealed.

Dividend Equivalent Payments

Payments of U.S.-source dividends to foreign investors are generally subject to U.S. withholding tax. However, foreign investors seeking to receive the economic benefit of U.S.-

source dividends without paying U.S. tax may enter into transactions such as equity swaps without being subject to the dividend withholding tax. As evidenced by the work of the Permanent Subcommittee on Investigations, under the leadership of Senator Levin, this loophole has been abused by foreign investors, often with the help of financial institutions, to escape tax on U.S.-source dividends.

Consistent with the Administration's budget proposal, H.R. 3933 would treat amounts that are attributable to U.S.-source dividends under equity swaps or similar transactions as dividends for U.S. withholding tax purposes and provide the Secretary with authority to exclude from dividend treatment transactions that present a low risk of tax avoidance. Under this provision, foreign investors engaging in transactions that are intended to avoid withholding taxes on dividends will have to pay tax on those dividends.

Conclusion

Mr. Chairman, we applaud the leadership role taken by you and Chairman Rangel in the House and by Chairman Baucus and Senator Kerry in the Senate in introducing this legislation, and, additionally, the work of Senator Levin and Congressman Doggett in supporting a strong international tax enforcement agenda.

Mr. Chairman, Ranking Member Tiberi, and members of the Subcommittee, the Foreign Tax Compliance Act fits well into the Administration's multi-pronged strategy of improving our domestic tax laws while increasing global cooperation on tax information exchange to help narrow the tax gap and create the fairer tax system we need.

We look forward to working with you and members of the Subcommittee on this important subject.

Chairman NEAL. Thank you, Mr. Shay.

Let me recognize Mr. Wilkins to offer testimony.

STATEMENT OF STATEMENT OF WILLIAM J. WILKINS, CHIEF COUNSEL, INTERNAL REVENUE SERVICE

Mr. WILKINS. Thank you, Chairman Neal, Ranking Member Tiberi, Members of the Subcommittee. I the opportunity to present the Internal Revenue Service's views on H.R. 3933. Like Mr. Shay, I would like to summarize the key points of my written testimony.

The IRS does support this legislation, because we feel it will provide significant new tools for our international tax compliance strategy. Our strategy is a multi-year effort. It is tailored for both individual and corporate taxpayers. For the strategy to be successful, it requires guidance for taxpayers and their advisors, legislative support, adequate resources, more enforcement activities, more and better information reporting, and stronger international cooperation.

We believe that this strategy is already producing results. Part of our approach was the initiative that ended October 15th to provide clear rules for imposing severe civil penalties, back taxes, and interest, but not imposing criminal penalties on qualifying taxpayers who came forward to disclose previously undisclosed offshore accounts.

The successes of the IRS and the Department of Justice in their investigation of UBS created a setting under which this kind of initiative could succeed. Just before the October 15th closing date of that program, the IRS announced that it expected at least 7,500 people to come forward. I have been told that the final numbers will be well over that initial estimate. The IRS hopes to be able to provide additional data later in November.

There will be significant taxes and penalties paid as a direct result of these disclosures. But just as importantly, these taxpayers are now back in the U.S. tax system, and will be paying taxes on their offshore income in the years to come.

In addition, publicity regarding the obligations of U.S. citizens and residents to report worldwide income and assets has, for a practical matter, made it impossible for U.S. taxpayers to ignore the clear mandate of our tax laws, even if they may reside abroad, or even if they may have derived their wealth from foreign sources.

The IRS will also develop leads that we obtain from voluntary disclosures. We will be scouring this information to identify financial institutions, advisors, and others who promoted or otherwise helped U.S. taxpayers hide assets and income offshore, and skirt their tax responsibilities at home.

Some weakness in our reporting systems have come to light, as a result of this enforcement activity, and the valuable investigative work carried out by Congress. H.R. 3933 would repair these weaknesses.

The particular problem being addressed here is the deliberate and illegal hiding of assets and income from the IRS by U.S. citizens and residents. It is true that such law breakers now face significant civil and criminal penalties. H.R. 3933, however, is still needed to help the U.S. government detect such activities, and to enforce applicable penalties.

The problems being addressed fall into certain categories. One category is the limited scope of current requirements, whether for qualified or non-qualified foreign intermediaries to report on their U.S. customers' investments. There is a limitation on reporting on investment and foreign securities, because of source rules.

Another category of problem is that intermediaries may be able to avoid reporting their U.S. customers' indirect investments that are made through foreign entities.

Another category of problem is the lack of diligence required for non-qualified intermediaries to detect a U.S. customer's false certification of foreign status, even when investing in U.S. securities.

Another category of problems involves features of the FBAR rules that create obstacles to enforce penalties for failures and violations.

Finally, the bill would tighten certain existing rules involving trust, bearer bonds, and dividend withholding, and would require certain advisors to become part of the diligence and reporting system when they assist a U.S. person to avail himself of a foreign legal entity.

On the topic of qualified intermediaries, most international financial institutions have entered into agreements with the IRS to be qualified intermediaries, because that status helps them to more efficiently serve their non-U.S. clients who want to invest in U.S. securities.

However, the obligations of qualified intermediaries to provide the IRS with reports on their U.S. customers is currently inadequate in two important respects. First, as I mentioned, there is generally no obligation to report the non-U.S. source income of a U.S. customer that's not paid within the United States, or to report the gross disposition proceeds of a U.S. customer who does not communicate with the institution from within the United States.

Second, a foreign corporation or other foreign entity is normally not subject to Form 1099 and back-up reporting and withholding rules that apply to U.S. persons, even if that foreign entity is owned by a U.S. taxpayer who does have the obligation to pay tax on the entity's income.

H.R. 3933 would repair both of these inadequacies, and would require a qualified intermediary to provide reporting to the IRS and to the customer broadly on financial activities through foreign financial accounts, including non-U.S. securities activities, and including activity of foreign entities owned by U.S. persons.

In the area of non-qualified intermediaries, another problem that we have faced is that a U.S. person who invests in U.S. securities through a non-QI can falsely claim to be a non-U.S. person. And there is probably too little that the payer of the securities income must do to check the certification, and too little that the intermediary must do.

Further, we do not have the ability to verify the information provided by the non-QI. And this increases the risk that false claims will remain undetected. To address this problem, the bill would generally apply a new U.S. withholding tax to U.S. securities proceeds, dividends, and interest that are paid to a non-qualified intermediary, unless the intermediary agrees to due diligence and reporting obligations on its U.S. customers' worldwide investments, including indirect U.S. customers who invest through foreign entities.

A customer who is subject to withholding could apply to the IRS for a refund of withholding that was in excess of its U.S. tax obligation.

It is our expectation that most, if not all, significant international institutions would undertake the due diligence and reporting obligations necessary to avoid U.S. withholding on U.S. securities proceeds of their customers and on their own proprietary U.S. securities activity.

On the FBAR topic, under current law the penalties applicable to persons who fail to file an FBAR, a foreign bank account report, are not imposed through the Internal Revenue Code. They are, instead, imposed through the Bank Secrecy Act, which is in Title 31 of the U.S. Code.

If an individual fails to report income held in a foreign financial account, on the one hand, the IRS could use traditional tools such as assessments, liens, and garnishments to collect the taxes and the tax penalties. However, the traditional IRS enforcement tools may not be used to collect the Title 31 FBAR penalties that apply if the foreign account is not reported. The FBAR penalty must instead be referred to the Justice Department for separate prosecution and collection.

H.R. 3933 amends the Internal Revenue Code to create an FBAR-like reporting obligation as part of the filing of a tax return, and a separate penalty regime for failure to report the foreign financial account. This would allow the IRS to enforce the new Internal Revenue Code penalty by applying traditional IRS enforcement tools.

There would be a new 40 percent penalty that would apply to income tax deficiencies attributable to unreported assets. And this would apply not only to unreported foreign investment income, but also to business and other income that was hidden through the use of foreign accounts.

The bill would address an important detection issue by amending the statute of limitations in the case of income admissions attributable to foreign assets, importantly including a suspension of the statute, until the asset was properly reported.

Other provisions of the bill—clarifying foreign trust rules would be helpful in addressing some forms of tax avoidance involving those entities. There are also provisions affecting use of derivatives to avoid dividend withholding. And, finally, the withholding exception for foreign targeted bearer bonds should eliminate the kind of investment that may have been used for tax avoidance in the past.

To conclude, we believe this bill will be of significant assistance to the IRS in assuring greater compliance with U.S. tax rules. The deliberate and illegal hiding of income and assets from the IRS should not be tolerated, and we believe the bill will help make this activity easier to detect and punish, and will help deter future such illegal activity. Thank you.

[The statement of Mr. Wilkins follows:]

Statement of William J. Wilkins, Chief Counsel
Internal Revenue Service

Chairman Neal, Ranking Member Tiberi and Members of the Subcommittee, thank you for this opportunity to testify on H.R. 3933, the "Foreign Account Tax Compliance Act of 2009."

We strongly support this important legislation that, if enacted, would provide the IRS with additional tools to address offshore tax evasion by U.S. persons who hide unreported income and assets in offshore accounts. The Foreign Account Tax Compliance Act would aid the IRS in its mission to ensure that all businesses and individuals are playing by the rules and paying their fair share of taxes.

H.R. 3933 is a far-reaching and comprehensive bill that brings together most of the strong international reporting and disclosure proposals outlined earlier by President Obama—and subsequently incorporated in the FY 2010 Budget—and those contained in other proposed legislation designed to combat offshore tax evasion.

In this regard, we applaud not only Chairmen Baucus and Rangel and you, Mr. Chairman, but also Senator Levin and Representative Doggett for their significant and important contributions to the "Foreign Account Tax Compliance Act of 2009."

IRS International Compliance Program

To meet the broad array of challenges that we face in the international arena, the IRS has focused its efforts on a multi-year international tax compliance strategy that is tailored for both individual and corporate taxpayers. For this strategy to be successful it requires guidance for taxpayers and their advisors, legislative support, adequate resources, more enforcement activities, more and better information reporting, and stronger international cooperation.

So far, we believe that this strategy is already producing results. The IRS recently announced that over 7,500 people came forward under its special offshore voluntary compliance program that ended in mid-October. It is too early to say how much tax will be collected from this effort. However, I can tell you that account sizes ranged from just over $10,000 to more than $100 million. Just as importantly, these taxpayers are now back in the U.S. tax system and will be paying taxes on their offshore income in the years to come.

A key aspect of our future international offshore work will be mining the voluntary disclosure information from people who have come forward. We will be scouring this information to identify financial institutions, advisors, and others who promoted or otherwise helped U.S. taxpayers hide assets and income offshore and skirt their tax responsibilities at home.

In addition, we are increasing our scrutiny of annual foreign bank and financial account reports (Treasury Department Form TD F90–22.1, "Report of Foreign Bank and Financial Accounts," or "FBAR"). Current law requires that U.S. taxpayers file an FBAR if their foreign financial accounts total more than $10,000. But current rules make it difficult to catch taxpayers who do not file a required FBAR.

Our focus today is on ending offshore noncompliance by U.S. individuals. The bill will provide the IRS welcome tools toward that goal.

The Problem: Secret Offshore Accounts

Recent experience has provided a wake up call for the United States, and tax administrations worldwide, on the problem of taxpayers hiding assets and income in offshore financial institutions. We have more insight about the manner in which U.S. persons hide their income offshore and conceal their identities from the IRS. The use of secret offshore accounts, often in the name of offshore entities, like trusts or corporations—sometimes with the assistance of advisors—makes it increasingly difficult for the IRS to gather the information it needs to enforce our tax laws.

Strengthening the QI System

The bill will build upon the network of foreign financial institutions the IRS has established as the foundation for its nonresident withholding tax system for U.S. portfolio investments, known as the Qualified Intermediary (QI) system. A QI's main task has been to check the qualification of nonresident investors in U.S. securities, and report their income entitled to reduced withholding rates under treaties or the Code. The system has managed this job well, and regularly processes billions of dollars in U.S. portfolio investment income flows and associated withholding taxes. QIs also directly report to the IRS information on the U.S. source income and certain gross proceeds of their U.S. individual account holders. We know that some U.S. taxpayers have exploited this framework by failing to report income associated with 1) non-U.S. securities held in QIs or affiliates, or even 2) U.S. securities with a shell foreign entity interposed as the technical account owner. The bill would prevent this kind of exploitation of today's rules for reporting and withholding.

The potential for U.S. taxpayers to evade U.S. tax through the use of offshore accounts maintained by nonqualified foreign intermediaries (NQIs) also poses a serious problem. Because NQIs have little incentive to report information to the IRS, the IRS is at a disadvantage in verifying compliance by these financial intermediaries. Under the bill, an NQI would be subject to withholding unless it enters into an agreement with IRS and complies with the associated reporting, due diligence, and verification obligations with regard to its direct and indirect U.S. customers. The bill would, therefore, create a strong incentive for global foreign financial institutions to provide the IRS with the information it needs to ensure that U.S. account holders are complying with U.S. tax laws.

Similar provisions are included in the FY2010 Budget.

Repeal of Bearer Bond Eligibility for Portfolio Interest Exemption

Along similar transparency lines, the bill would repeal the remaining exceptions to the ability to issue bearer bonds eligible for the portfolio interest exemption.

This provision is not included in the FY2010 Budget.

Assisting the Examination of Individual Offshore Accounts

The bill would fill gaps in the current reporting requirements with regard to the foreign financial assets and income of U.S. individual taxpayers or their domestic entities formed to hold foreign financial assets. Individuals or entities that have an interest in foreign financial assets or accounts with an aggregate value over $50,000 during the taxable year must disclose their holdings of foreign financial assets or accounts with their income tax return.

Regular penalties in increments of $10,000, up to a maximum penalty of $50,000 for one taxable period, apply for failures to comply with this new information reporting obligation, as well as an elevated 40% accuracy-related penalty for understatements attributable to a transaction involving a foreign financial asset.

Individuals also would face an extended 6-year statute of limitations in the event of significant omissions of income attributable to foreign financial assets.

In addition to enhanced reporting of foreign financial interests by taxpayers and an extended statute of limitations, material advisors also would be required to report assistance they provide to U.S. persons acquiring or forming a foreign entity.

Similar provisions are included in the FY2010 Budget.

Transactions with Foreign Trusts

U.S. grantors of foreign trusts have taken aggressive positions by failing to report income of foreign trusts that afford a U.S. person with effective enjoyment of the trust assets and income. The bill would clarify and enhance the grantor trust rules in regards to when a foreign trust may have a U.S. beneficiary. The bill would treat uncompensated use of foreign trust property as a distribution equal to the value of the use. The foreign trust reporting provisions and applicable penalty are also strengthened to help prevent U.S. persons from concealing income or assets offshore in foreign trusts.

A similar foreign trust penalty provision is included in the FY2010 Budget.

Avoidance of the Dividend Withholding Tax

Foreign persons seek to avoid the 30% withholding tax imposed on U.S. source dividends by temporarily converting U.S. stock into an economically equivalent derivative investments such as total return swaps. The IRS is actively pursuing these schemes under existing law.

The bill would prevent this abuse by treating dividend equivalent amounts as generally U.S. source, thereby subjecting them to the withholding tax.

Regulation authority is provided to provide exceptions in cases where the contract or other arrangement does not have the potential for avoidance of tax.

A similar provision is included in the FY2010 Budget.

International Consistency and Cooperation

As I noted at the outset, IRS is not alone in facing the enforcement challenge posed by secret offshore accounts. Other tax administrations across the globe share a similarly problematic experience. The bill will help, but international cooperation and coordination is also key. It is fundamentally important to achieve consistent international standards of transparency that support compliance without overly burdening the efficiency of cross border portfolio investment flows. Financial institutions obviously also have a strong interest in international consistency in this area. There is an obvious link to the ongoing efforts to promote better mechanisms for exchange of information under treaties, TIEAS, and other international agreements. The IRS will continue to seek a consensus on transparency with its counterpart tax administrations in bilateral competent authority discussions, as well as in multilateral forums such as JITSIC and OECD. The Commissioner and I are committed to this effort.

Conclusion

In conclusion, the "Foreign Account Tax Compliance Act of 2009" would provide the IRS with enhanced tools it needs to continue its expansion of international tax enforcement and make it even more difficult for U.S. taxpayers to avoid paying their faire share of taxes by unlawfully hiding money overseas.

Thank you Mr. Chairman. The Internal Revenue Service looks forward to working with the Subcommittee on this important legislative initiative.

Chairman NEAL. Thank you, Mr. Wilkins. Mr. Shay, we will hear testimony today that some are concerned that if this bill becomes law, that other countries could use it as a model for reporting, as well. Great Britain, perhaps, the most notable example.

How would Treasury treat such an international effort for greater information exchange, even if it meant greater reporting for our financial institutions?

Mr. SHAY. Thank you, Mr. Chairman. We can't—I can't anticipate what other countries will do. Countries that operate in the markets of another country are going to have to be responsible to the—for the compliance with the laws of that country.

Let me comment a little bit about this bill in relation to other countries and, you know, multi-lateral activity. This bill is intended to increase reporting.

And so, what it does is uses the incentive of not having to suffer a withholding tax to provide for a foreign financial institution to assist the IRS with respect to providing information to the IRS regarding U.S. accounts. If other countries were to do the same, it would be a legitimate action on their part, as I think it's legitimate on our part.

What this approach reflects is an effort to use the tools that are available outside of a multi-lateral context. If at some point in the future there is an ability to reach multi-lateral agreements to achieve the same thing, then you would have the potential to calibrate the nature of the incentive that's involved.

Chairman NEAL. Okay. Mr. Wilkins, we will hear suggestions today that the effective date under this bill is too soon, that the amount of the work that the IRS will need to do in renegotiating with QIs in establishing relationships with non-QIs will simply take too much time.

How ready, or how prepared is the IRS for something as bold as this proposal?

Mr. WILKINS. Well, we are prepared to devote the resources necessary to implement the legislation. I do think it will be important for us to continue to work with you on being sure that there is—the flexibility is there to not impose withholding taxes because a reporting system is not ready to go yet.

As Mr. Shay said, the idea here is to collect the information, more than to collect the withholding tax. The withholding tax is really an incentive to collect the information. So, I do think we need the flexibility to face—you know, to face realities that may occur, given the—what's going to be imposed.

That may be partly recalibrating parts of the effective dates. It may be providing flexibility for us to address important issues first, and have the flexibility to address the secondary and tertiary issues after the—you know, the primary issues of the major international financial institutions are first addressed.

Chairman NEAL. And let me ask you, Mr. Wilkins. Your amnesty program sounds as though it's been quite successful. And I must tell you I have not received one letter from one constituent opposing my position on this issue.

And I wonder if the threat of disclosure by UBS made taxpayers more nervous and more willing to come forward voluntarily. And can you tell me how this initiative fared, compared to prior amnesties?

Mr. WILKINS. Well, thank you for that opportunity, and including for the opportunity to point out that it's really not an amnesty. There are severe penalties involved. It does provide relief from criminal prosecution for qualifying applicants.

There is no question that the enforcement activity surrounding UBS was an extremely important part of the atmosphere that made this initiative work. We have—there has been a voluntary disclosure policy within IRS for a very long time. It typically only produces a handful of disclosures each year. Getting disclosures in the thousands, like we were getting with this one, is really something new and different. And I don't think there is any question, but that the enforcement activity and the surrounding publicity was really responsible for making that happen.

Chairman NEAL. Thank you. And, Mr. Shay, some of the criticism that we will hear today is that this initiative is too bold, and that we should rely on multi-lateral negotiations for our information exchange. Might you comment on that?

Mr. SHAY. Well, I don't think this initiative is too bold. I think there are great responsibilities, if it's adopted, on the administration and on the Internal Revenue Service, to be sure it's implemented in a way that the United States gets the information it wants, that we only have withholding on any circumstances where there are essentially non-compliant financial institutions—or, if not, withholding final tax, because there is the ability to reclaim the tax—and that we do it in a manner that is as respectful of the burdens on the financial institutions and—but still gets us the information as we can make it.

We want this to work, and hopefully a win-win for good tax administration and good, efficient capital markets. It simply is doing something that cannot be done through a multi-lateral arrangement. And it certainly reflects, I think, the urgency of this issue and—by bringing this powerful incentive to move forward. And I think that actually will probably advance the time when there are multi-lateral arrangements—get to this and process it.

But as I think we all know, that's a very, very long process, and I think this legislation will increase the likelihood of it, but will assure that information is provided to the IRS before that ultimately happens.

Chairman NEAL. Thank you. With that, I would like to recognize Mr. Tiberi to inquire.

Mr. TIBERI. Thank you, Mr. Chairman. Mr. Wilkins, can you assure us and the hard-working, law-abiding taxpayers that we all represent that the IRS is doing everything in its power to collect and aggressively go after tax cheats?

Mr. WILKINS. Yes, this is a priority for the commissioner, and it's a priority for the whole IRS. There is particular focus on international tax compliance, which is the subject matter of this bill. And we are focused on it. That is where our deployment of additional resources is focused, and we need to balance service and enforcement.

But there is no question that enforcement is key, and bringing taxpayers into compliance is important. We will likely need assistance of the congress from time to time in those efforts, such as the current example.

Mr. TIBERI. Thank you. To further go on, with respect to international tax, would you agree that there is a distinction between individuals and corporations who are deliberately avoiding taxation, deliberately hiding assets, not following the Internal Revenue Code, and a distinction between American, U.S.-worldwide companies who are doing business internationally, who are working every day with the Internal Revenue Service on issues of deferral, and check the box, and other legal measures within the Internal Revenue Code?

Mr. WILKINS. Yes. I definitely agree with that statement. What we are dealing with in this bill is deliberate and illegal hiding of income and assets, and non-compliance with what the law is today.

Issues of tax policy surrounding multi-national corporations whose returns are audited every year is a different question, and requires different strategies.

Mr. TIBERI. And there are IRS officials that are working with U.S. companies, literally, every day on those issues, correct?

Mr. WILKINS. Yes, that is correct. Most large, multi-national corporations are constantly under audit, and they frequently have IRS auditors on site.

Mr. TIBERI. To continuing questioning on just a slightly different issue, most people seem to agree that international exchanges of information in particular are key elements of our ongoing effort to fight tax evasion.

Do you agree that excluding black-listing from the legislation that Chairman Rangel and Chairman Neal have introduced makes countries around the world more willing to continue providing the Internal Revenue Service the critical information needed to combat tax evasion effectively?

Mr. WILKINS. Well, Mr. Shay may want to comment on this, too.

Mr. TIBERI. I was going to ask him next.

Mr. WILKINS. I think the approach in this bill was focused more on institutions than countries. I think the institutions is really where the activity is, and where the money is, and I think that was a good choice.

I think, obviously, you need to have the flexibility to go around country by country and work on information exchange. And that kind of negotiation and treaty activity is an important part of an overall strategy. But, as Mr. Shay says, that doesn't get you all the way there. I think using this kind of approach to obtain information directly from institutions is an important part of it, too.

Mr. TIBERI. Mr. Shay.

Mr. SHAY. I think Bill said it all. No, I think we certainly like the approach in this legislation. It has—it reflects—it is in common with the approach that was taken by the administration's budget proposals, and we're very hopeful that it, combined with information exchange together, will be successful.

I want to add one comment, and that is in—during the course of the—the legislation includes a possibility that the foreign financial institution will provide not just information on the U.S. person's account, but information in the form that's traditional for a U.S. bank, what's called 1099 reporting.

And my understanding is that was actually requested by a financial institution that had had conversations with relevant staffs, so that not only does this legislation have the potential to help or address the evader, help us—help the IRS find the evader, but it also has the potential, frankly, to make compliance easier and more effective by the U.S. person with a foreign account that wants to comply with their tax.

And, frankly, I think for most of us, getting a 1099 from a bank is a huge help. And we do know, on the compliance side, that we have the highest rates of compliance where we have 1099 reporting. Thank you, sir.

Mr. TIBERI. Thank you. Mr. Chairman, on a final note, I think Congresswoman Schwartz would agree Saturday is a big day in Happy Valley, where my Ohio State Buckeyes are taking on the Penn State and Nittany Lions.

I just want to thank—I understand, and I wasn't going to bring up the World Series. But, Mr. Shay, I just want to thank you. I don't know if it's subliminal or not, but you are wearing scarlet and gray. That tie is very nice. I want to thank you for that. I yield back.

Mr. BLUMENAUER. He needs a bow tie.

Chairman NEAL. It was part of our strategy to disarm you.

Let me recognize the gentleman from Georgia, Mr. Linder, to inquire.

Mr. LINDER. Thank you, Mr. Chairman. I would ask each of you, how many dollars are offshore in dollar denominated deposits?

Mr. WILKINS. I don't have that data.

Mr. LINDER. Why don't you have that data?

Mr. WILKINS. I wasn't prepared to answer that question. I apologize.

Mr. LINDER. Mr. Shay, do you have any idea?

Mr. SHAY. I also don't have that data. I think just to fine tune it, I assume that the question would be not just dollar accounts, but dollar accounts by U.S. persons with respect to accounts held outside the United States.

Mr. LINDER. The answer is $13 trillion. Three groups, including McKinsey & Company, did studies in early 2005, and came up with $10 trillion, growing by about $800 billion a year in dollar denominated deposits.

Can you give me any idea how much of that is legitimately there for reasons other than hiding it?

Mr. SHAY. Thank you for that. And I would be very interested in seeing those studies.

Mr. LINDER. I'm surprised you haven't.

Mr. SHAY. I'm not sure we're—I would have to make sure we are talking about the same—you know, I haven't seen what you are referring to, but I would be very interested in it.

And I am not in a position to answer today the question of how much of whatever that denominator is would be reported or not. I think it would be—I think we will know a lot more, and have a lot more confidence in our ability to answer that question, if this legislation is adopted. I——

Mr. LINDER. The number is available. This legislation is simply not going to change it.

Mr. SHAY. Was your question whether it was reported, or whether—I am sorry. Maybe I misunderstood your question.

Mr. LINDER. There are about $13 trillion in offshore financial centers in dollar denominated deposits. My question is, do you have any idea how much of that is there legitimately for purposes other than evasion?

Mr. SHAY. It seems to me the answer to that question would depend on whether the—not the account itself, but the income from the account that is owned by U.S. taxpayers has been fully and adequately reported on the U.S. tax returns. And I—if people know the answer to that today, I would be very interested in the data source for that. Thank you.

Mr. LINDER. Mr. Chairman, I have no further questions.

Chairman NEAL. Thank you, Mr. Linder. Let me recognize the gentleman from Illinois, Mr. Roskam, to inquire.

Let me recognize—it looks like we're going to recognize the gentleman from Nevada, Mr. Heller, to inquire.

Mr. HELLER. Thank you, Mr. Chairman. And I apologize for running a little late. I had another hearing, testifying on another bill in another committee, so I didn't get to hear all the testimony, and I apologize. So if my questions overlap a little bit, please bear with me.

But based on the comments of Mr. Linder, and the amount of money that we're talking about, a large number of accounts that obviously are at stake here, Mr. Shays, can you give us or explain to us what your specific methodology is to determine U.S. ownership of these accounts?

Mr. SHAY. Under the legislation, there are—there is a provision that the foreign financial institution would identify U.S. owners of accounts, and substantial U.S. owners of foreign entities that have accounts. And there is a great—there is leeway given to the Treasury Department and to the IRS to specify further.

But there is provision in there to look to certifications from the account owners, and then such additional requirements as may be required by regulations, I believe, is the approach.

Mr. HELLER. Are these known as know-your-customer rules?

Mr. SHAY. Well, if there is a certification that is in addition to a know-your-customer rule—the know-your-customer rule refers to banking practices which vary in different jurisdictions, which are the standards by which the banks in those jurisdictions are expected to obtain information about their account holders. And that, of course, is very helpful and important as a base on which to identify whether there would be an account holder by a U.S. person.

But this legislation would seek that information in particular, and would—as I said, there is some regulatory authority to further elucidate what the requirements would be. And there is a provision in circumstances for self-certification.

Mr. HELLER. Okay. So I understand you're prepared to allow KYC rules in—for this purpose?

Mr. SHAY. I think when the legislation is passed, that would be part of the analysis. As I said earlier, I think it's in everybody's interest to try and come up with rules that are—work as well as possible with existing financial institution practices.

So, I think that while that's a determination that should be made after we see the final legislation, that certainly is an objective to get the information, but to do it in a way that is as least burdensome, but that that achieves the task, as is possible.

Mr. HELLER. Thank you, Mr. Shay. Mr. Wilkins, your time frame for implementing the FFI agreements, what do they call for in this particular bill?

Mr. WILKINS. Under this bill, the effective date is at the beginning of 2011. I think, as I mentioned in response to an earlier question, we would devote resources needed to at least address the most important aspects of these rules dealing with major financial institutions.

We will continue to work with the committee, and we would continue to work in the regulatory process, to try to roll this out in such a way that it—if certain pieces of it couldn't be fully implemented by the beginning of 2011, we would hope to have the flexibility to have preliminary measures that maybe were not full implementation, but didn't impose withholding taxes in areas where we really didn't want to get the withholding tax; what we really want to get is the information.

Mr. HELLER. Will these side agreements be made public?

Mr. WILKINS. Typically not, but they are—they would, if they follow current practices in the QI area, they would follow a particular form that is a public document.

Mr. HELLER. Okay. Thank you. Thank both of you for being here. Thank you, Mr. Chairman.

Chairman NEAL. Thank you, Mr. Heller. Let me recognize the gentleman from Oregon, Mr. Blumenauer, to inquire.

Mr. BLUMENAUER. Thank you, Mr. Chairman. And I deeply appreciate both the work you're doing and the course of this hearing, the thrust and direction. It seems to me, for years, Congress—and sadly, this committee—has been less interested in actually moving forward aggressively with compliance. And, at times, it almost seemed like it was tying your hands, denying resources. And I love the fact that we are now making it a legitimate force of activity to help you do your job.

I want to say that I too am interested in the answer to Mr. Linder's question. I didn't quite fully understand the grasp—or grasp, I guess, the nature of it. 2005 data on, for example, volume of money might have changed pretty radically in the course of the last——

Mr. LINDER. Would the gentleman yield?

Mr. BLUMENAUER. I would be happy to yield.

Mr. LINDER. Three companies, including McKinsey & Company, and a Boston group, and a third one I don't recall now, studied MasterCard and Visa transactions, and extrapolated that into a $9 trillion to $11 trillion figure, and they said it was growing by about $800 billion a year, probably growing more than that right now.

The question that it seems to me these gentlemen should have thought about is how much is there. But a significant part of that is there for legitimate reasons, and not evasive reasons. And that's the number we really ought to know about. Thank you.

Mr. BLUMENAUER. I appreciate the clarification. My point is I think there has been a—you mentioned the year 2005 for the study. I think in the last four years there has been a wild roller coaster, in terms of activity overseas. I know some of us had 401(k)'s that are now 201(k)'s. There have been changes, in terms of the value of currency and the velocity of it. So I am guessing that finding current data, I think we would all be interested in.

The notion of what's there for legitimate or illegitimate purposes is also curious. I mean, how much of United States deposits are there for legitimate business purposes, or to help facilitate meth lab activity? I think there is an issue of intent and activity that is curious. And I would look forward to finding out how those studies determined intent, and what you would do to determine intent.

I think the purpose of our hearing is one of compliance with the law. I would put, I guess, two questions before you—I see my time is rapidly getting away.

One is whether or not we, in Congress, are doing enough to give you the tools to actually implement this and other elements of compliance. Because, in times past, we have talked one story and then cut back on your resources while we have done things that make it difficult to do your job.

And I am very interested at getting a sense from you—not necessarily at this point, but getting a sense of whether or not Congress is on your side, in terms of things in the budget, and if there are items that we could employ that would make it easier to more directly use the resources that you might uncover to make sure that it's self-financing.

I hear from tax professionals that there are certain audit functions where the people earn $5,000 or $10,000 an hour for their undertakings, in terms of what specific things they do. And not that I am suggesting that we put them on commission, but if there is a way to make sure that areas that are generating more money because it is dealing with compliance, if there is a way to target money back to that, to be—make sure that we are doing it adequately. And your help from—to help me think that through would be appreciated.

The second piece I would put on the table seeking your guidance is whether or not we are doing enough in terms of the actual penalties against businesses and professionals who are in the business of, frankly, aiding and abetting evasion. I am just as interested in the reporting. I am interested in making sure we understand what the appropriate penalties and sanctions are for people who are engaging in the facilitation.

I think the evidence is that there are lots of people who can't do this alone. And, in some cases, they have been counseled to do this. And having an assessment from you about the adequacy of those provisions, and where they might be enhanced, both for individuals and for organizations, would be of great interest to me.

Thank you very much, Mr. Chairman.

Chairman NEAL. Thank you, Mr. Blumenauer. Let me recognize the gentleman from Kentucky, Mr. Yarmuth, to inquire.

Mr. YARMUTH. Thank you. I want to expand a little bit on the questions that Mr. Linder raised. And I recall the statement made by a former Secretary of Defense who said, “There are things we know, things we don't know, things we know that we don't know,” and all of that continuum.

How much of what—the question that Mr. Linder phrased, how much of this—these amounts do we know that we know—know that we don't know, and how much do we don't know that we don't know?

Mr. WILKINS. Well, you are putting your finger on an issue, in terms of assessing levels of tax evasion and the tax gap, and so forth. And part of the problem is that, for example, many, if not most, of the previously undisclosed foreign accounts that are coming in through our voluntary disclosure initiative we did not know about before.

And so, part of the issue is because of the efforts to hide offshore assets, we don't know what the total number of hidden offshore assets is.

Mr. YARMUTH. Has the voluntary program given you clues as to how you might detect things that you don't know that you didn't know?

Mr. WILKINS. The data is still quite fresh. And I am not sure we are ready to answer that question yet.

Mr. YARMUTH. So you don't know?

Mr. WILKINS. We will be looking at it to see what it teaches us, and to see if—first, for enforcement reasons—to see—to go out and detect additional accounts that didn't come in voluntarily. But it is possible that it will be helpful to us for data analysis and projection reasons, as well.

Mr. YARMUTH. Mr. Shay, a question about the relevance of tax rates to this whole problem.

I suspect that if the corporate tax rate in the United States or income tax rate were zero, we wouldn't have this problem. People would be happy disclosing everything they made.

Have you done an analysis of how tax rates, relative tax rates in this country, have affected the non-disclosure rate? Is that something that would be valuable? I mean, it's an intuitive response to it, but I don't know whether it is a practical response.

Mr. SHAY. Well, actually, I think one needs to be cautious about the intuitive response, in that, you know, if one viewed tax evaders as rational, then you would correlate it very closely to how much you're making by evading taxes, which would correlate to the size of the rate.

The literature on non-compliance is still, I think, in my judgement, fairly weak. In other words, there has not been as much resource devoted to it academically and otherwise as we would like, sitting here today, in order to be addressing all the questions we're hearing. But I do think there is some evidence in the literature that non-compliance is not directly correlated to tax rates.

And that may be counter-intuitive, but there are a lot of emotional and other aspects that go into non-compliance. Now, that is an anecdotal response. So I think we would all like to have more work done in that area. And maybe, Bill, if you want to comment?

Mr. WILKINS. I guess the only thing I would add is the anecdotal observation that many of the most aggressively promoted individual tax shelters in the tax shelter heyday were devised to shelter 15 percent capital gains income. So it's—the rate at which the incentive stops, at least for some people, has got to be lower than that.

Mr. YARMUTH. I yield back, Mr. Chairman. Thank you.

Chairman NEAL. Thank you, Mr. Yarmuth. Let me recognize the gentleman from California, Mr. Thompson, to inquire.

Mr. THOMPSON. Thank you, Mr. Chairman, and thank you for holding this hearing. I would be interested, Mr. Shay, in hearing if you believe that we are doing enough in this bill to get at the issue of evasion. And I want to—I guess we have already established the fact that—the difference between evasion and avoidance.

But on the evasion part, are we doing enough? Are there other proposals that are out there that we should be including in this to be able to get a better handle on it?

Mr. SHAY. Thank you. One way to approach that question is to observe that this bill adopts in a legislative form—in substance, not in every respect the same way—substantially all of the anti-evasion proposals that were in this administration's budget.

I would note there is one proposal in our budget that is not in the legislation, and that we have been working on, the Internal Revenue Service, and the Treasury, to develop further. And we think it does need further work before we bring it back as a proposal. And that involves reporting on cross-border transfers of cash. And the reason——

Mr. THOMPSON. Cross-border transfers——

Mr. SHAY. Transfers of cash, cross-border wire transfers from bank to bank. And the reason for that, and the work we are trying to do, is the volume is extremely high.

And one of the things that we are working toward is trying to identify a way that we could take that volume of information and sort of—if you think of it as a sieve, whittle it down to the information that will not overburden the Internal Revenue Service, and allow us to target it to enforcement, so that our use of resources is efficient and focused.

Do you want to comment any further on that?

Mr. WILKINS. I think that is——

Mr. THOMPSON. Before you do, how long before you have this thing run out, or able to make a proposal as to what it should look like?

Mr. SHAY. We've been working—we've actually been working on it very actively. I can't give you a precise answer to that. But one part of our next step is we also—we do want to be talking to the elements of the business community that would be the companion to the IRS in having it implement something.

So, I can't give you a precise answer, but we are working on it very actively.

Mr. THOMPSON. Mr. Wilkins, anything to add?

Mr. WILKINS. I think Mr. Shay said it. I mean, the shaping that needs to be done is one to identify that kind of information to tax obligations and taxpayers, and that's where the work is being done, to try to shape it that way.

Mr. THOMPSON. Thank you. I yield back.

Chairman NEAL. I thank the gentleman. The gentlelady from Pennsylvania, Ms. Schwartz, is recognized to inquire.

Ms. SCHWARTZ. Thank you, Mr. Chairman, and thank you for your efforts in taking action on, you know, the legislation you've introduced to be able to move forward on what I think all of us are outraged about.

I guess we all might have imagined that, you know, there is tax evasion. And the amount of money that is overseas, I think, actually—whether the amounts we know about—almost $1 trillion, I guess, is something that has been talked about, now maybe much more than that. It's outrageous that it's actually out there and we're not collecting taxes on it.

So, I actually appreciate the work the legislation would do, and the work you have already done in trying to get these dollars back for the taxpayers and for the Treasury. We could use it, as you know.

So, I really—you made a couple of comments about ways you're moving forward. And I think, Mr. Wilkins, you even used the word "urgency," in your sense of what needs to be done. So—and I think we share that.

So, while we want to see movement on this legislation, I did want to ask what else you could be doing, or are doing now, in two ways. One is in making sure that other banks, other institutions—you were sort of suggesting that this is country-to-country and it's, you know, the issue of these kind of agreements between nations. It's really also getting to the banks.

I mean, UBS, that agreement settlement really did change the atmosphere. And I am assuming that—a question for Mr. Shay—how many other banks have—are you—or institutions are you engaging with, in terms of having similar agreements about reporting voluntarily? And how much do you think is out there? Do you have any sense of that?

And, secondly, Mr. Wilkins, whether—you talked about the amnesty, or people coming through voluntarily now. What else do you need to be doing, or are you doing, to actually make sure that taxpayers know that this is no longer acceptable, that we're going to go after folks and we have legislation coming down the pike, but in the meantime we have—we know the money is there, we know that there are—you say thousands and thousands of accounts? Tens of thousands of accounts? I mean what kind of volume are we talking about? And what kind of dollars are we talking about? And how quickly can you move without additional tools, is sort of my question.

So, Mr. Shay, if you could, speak to how aggressively you are moving to engage other financial institutions to give us voluntary agreements, as we move—so we can move forward more quickly. Similar reporting to what UBS is doing.

And, Mr. Wilkins, if you could, speak to the kind of volume and urgency of what you can do, given the information—given the tools that you will have before we give you extra tools.

Mr. SHAY. The activities of the Treasury that involve expanding agreements are largely with other countries. And I am going to turn it back to Bill for the——

Ms. SCHWARTZ. Okay. And I apologize if I'm not asking the right people the right questions. You can decide who answers them this time.

Mr. SHAY. Yes, I will give that piece to Bill. But let me—as I mentioned in my testimony, we have recently expanded the range of countries with whom we have agreements. But I think, as Secretary Geithner has observed in connection with this broader effort at the G20 more generally, the number of information exchange agreements that have been signed internationally in the last 12 months exceeds the number of agreements that was signed in the prior decade.

And I was in the Treasury Department in the 1980s. I can tell you that the atmosphere internationally—I was the international tax counsel—the atmosphere internationally has been transformed, and a great deal of credit for that goes to the Liechtenstein bank case and, very importantly, the case that the IRS and the Justice Department have brought with UBS. It has had, I think, a transformative effect. Bill, do you want——

Mr. WILKINS. In terms of going forward, investigations are continuing. I can't comment on ongoing investigations, but they are ongoing. I would not be surprised to see additional investigations be generated from the information that we are collecting this year.

Characterizing the agreement with UBS as voluntary needs to be—you need to think about how voluntary it was.

Ms. SCHWARTZ. Right.

Mr. WILKINS. It was under pain of indictment.

Ms. SCHWARTZ. Yes.

Mr. WILKINS. That is how these agreements get obtained.

Ms. SCHWARTZ. Yes, right.

Mr. WILKINS. And so we are continuing——

Ms. SCHWARTZ. You're pursuing that——

Mr. WILKINS. We are pursuing that in other cases.

Ms. SCHWARTZ. Okay. In terms of the—just to follow up on the international agreements, that's good to know how many more are happening.

One of the concerns I suppose we would have is that new countries that have not engaged in this behavior who have been off sort of the radar screen now may actually become new tax havens. Do you have any sense of how you anticipate—maybe sort of the opportunity to actually anticipate where else we might go?

And this is not actually—rather than—there are some obvious countries, I assume, but then there might be some less obvious that might actually promote this. Is there more that we're doing in that regard, too?

Mr. SHAY. The international process that is currently undergoing has actually targeted, or looking for or monitoring new countries attempting to become offshore financial centers. That is one of the very hopeful aspects of the multi-lateral work that is going on under the overall oversight of the G20.

And recalling that G20 includes, really, not just European—I mean the major countries of the world. And the work that's being done in what's called the global forum on tax transparency and information exchange includes somewhere between 80 and 90 countries. There are very few jurisdictions left. And they have all agreed back in this last fall in Mexico, one of their—to monitor and look for jurisdictions that attempt to become tax havens.

Ms. SCHWARTZ. Thank you. Thank you, Mr. Chairman.

Chairman NEAL. Thank you, Ms. Schwartz. The gentleman from New York, Mr. Crowley, is recognized to inquire.

Mr. CROWLEY. Thank you, Mr. Chairman. I did arrive a little late. So, a couple of questions that may have been answered before, and so you can just say that and I can get the record.

In terms of the number of potential accounts that we're looking at, we're looking at possibly millions of accounts overseas. Is that correct?

Mr. WILKINS. We don't have that kind of data. As I said, the voluntary disclosure program was projected at around October 14th to bring in about 7,500 new accounts. I have been told that the number is significantly in excess of that. But, again, that is that range of numbers. And for the voluntary disclosures the millions number would not be right.

Mr. CROWLEY. There are some measurements in place, for instance a customer—an anti-money laundering legislation in place already. Are those the tools by which—or the methodologies by which we use to account for these particular accounts? Or are you looking at other methodologies to do that?

Mr. WILKINS. I think the answer is both, and Mr. Shay discussed it earlier. Certainly for banks that are subject to robust know-your-customer regimes, that information would produce the data that is needed for them to provide the reports that the legislation seeks on U.S. investors.

For banks that did not have as robust KYC regimes, they would need to adopt, you know, additional measures to be sure that they complied with their diligence obligations for being either a qualified intermediary or a foreign financial institution that entered into one of these disclosure agreements.

Mr. CROWLEY. Mr. Shay, do you want to comment, or—it's covered.

How many FFI agreements do you anticipate you will have to enter into agreement here?

Mr. WILKINS. I am not sure we know a number to expect. We do expect the existing qualified intermediaries to, for the most part, amend their agreements in the ways that are contemplated here.

Mr. CROWLEY. Prior to having to formally enter into, you mean, or——

Mr. WILKINS. Well, no. I mean there are existing qualified intermediary agreements with a number of foreign financial institutions. Really, most of the major international ones.

This legislation would seek to impose some new obligations on QI's, with respect to U.S. account holders. And we would expect, for the most part, those existing agreements to be amended, and we would look to efficient ways to accomplishing those amendments, rather than, you know, retail level, one-by-one negotiations.

Mr. CROWLEY. Is it the intent to publicize those—the—when those agreements are entered into? I guess following a little bit on Ms. Schwartz's question before.

Mr. WILKINS. I think individual agreements typically have not been the subject of press releases, unless the banks decide to do that on their own, for their own——

Mr. CROWLEY. So the government itself will not——

Mr. SHAY. But the fact that a bank is a party to an agreement will be public, because it will be necessary information for the U.S. withholding agent that is dealing with that bank to know that they have an agreement, and therefore, they will not withhold on payments to that institution.

Mr. CROWLEY. Okay. The U.S. is the world's largest market for foreign portfolio investment. And foreign investment in the U.S. is good for our economy. I think, Chairman, you would agree with that.

I have some concerns that the real cost of investment in the U.S. for non-U.S. investors has increased significantly, as foreign financial firms complied with the IRC Section 1441, the QI regs. While I welcome the IRS and Treasury's goal of identifying U.S. persons, there is concern in the financial services community that the U.S. has and could further create an invasive administrative burden that applies to all recipients of the U.S. income, not just Americans, by discouraging our shared goal of increased U.S. investment.

Could you just comment on this issue, on the complexity, the cost of implementing this program, and do you believe it is easier and less costly than the current system we have in place?

Mr. SHAY. Let me comment, if I may, first. We share the view that foreign portfolio investment in the United States is important, and we want to be sure that it is—it continues unabated.

And, as I said in my earlier remarks, part of our objective—and a very important objective of ours in implementing legislation, should this legislation be passed—will be to do—work closely with the affected financial institutions, business community, and to come out with rules that will balance and achieve the information reporting that we seek, but at the least burden and cost as possible to the affected intermediaries.

I—our view is it is going to be possible to do this, to allow Americans to comply with their tax obligations, and not interfere in an inappropriate way with cross-border investment, which we view as very important.

Mr. CROWLEY. Thank you. I agree with the intent of the legislation. With that, I yield back, Mr. Chairman.

Chairman NEAL. Thank you very much, Mr. Crowley. Let me recognize the gentleman from Texas. While not a member of the subcommittee, he has certainly demonstrated a consistent interest in this issue. Mr. Doggett.

Mr. DOGGETT. Thank you, Mr. Chairman, and thank you for your efforts in this area, those addressed through your most recent legislation with Chairman Rangel, and those in this general area. I thank both of you for your testimony and your public service.

Mr. Shay, you have—or Secretary Shay—you have testified before us over the years on a number of occasions. And I realize that the views you express now in this new position are not necessarily those that you have written about in the past. But I would just say, as a general matter, that I think a good place for Treasury to start on many of these problems, particularly with reference to international corporate tax avoidance, would be to go back and read what you have written in the past, and adopt it as policy in the main.

My interest today in this, as you know, stems from my having filed with Senator Carl Levin—and I appreciate your reference to it—the Stop Tax Haven Abuse Act. I appreciate the fact that Secretary Geithner, when he was before the full committee in March, indicated that the administration fully supports that legislation.

And while the primary focus of the hearing today, and the sole focus of the recent legislation that's been introduced is tax evasion by individuals, I believe that much more costly tax evasion is occurring from corporate individuals, and that that must also be considered.

As I noted when this subcommittee convened on March the 31st considering these matters, the use of international tax games by corporations in these offshore tax havens is widespread, and it drains billions of dollars from the treasury.

I don't believe that there is any justification for having one standard for individual taxpayers and another, more permissive approach, to corporate individual taxpayers. One rule for Wall Street corporations and one rule for individuals? I think that's indefensible.

And after years, if not decades of delay in this committee, there is also no justification for failing to address international tax abuse, or insisting that this has to be done in a two-step approach, one for individuals now, and another for corporations some day. We need a comprehensive approach, not just a vague promise that corporate evasion will eventually be addressed.

In fact, while some may try to draw a distinction, as has occurred here today, between illegal tax evasion and tax avoidance, the real difference primarily is—between individuals illegally hiding their cash overseas and corporations manipulating the tax does—the main difference is that the corporations have better lobbyists to obtain the—legitimacy for some of these questionable transactions than do some of the individuals.

With reference to some of the ideas that are advanced here by Professor Kingson today, I hope you will review those. I understand you can't take a position on them formally this morning, but I think he advances a number of ideas about how to handle those.

The whole idea of the stock tax haven approach was to prompt other legislative response and discussion. And I am pleased that it has prompted what I think are some improvements on our approach as it relates to individuals, but a concern that it does not address the issue of corporate tax abuse.

Let me ask you specifically about one matter, just as an example of these problems. As you know, we finally, a while back, addressed this issue of corporate inversions, of companies that are American but claim, by putting up a post office box somewhere, that they are no longer American, except to receive all the benefits, and not pay for them.

In addition to the companies that have done that, and the law that was passed to try to discourage that in the future, does the current law cover corporations that are formed here in the United States, or that choose not to be formed here initially in the United States, to be formed abroad, even though all their management, most of their operations in the United States—can they simply incorporate in a tax haven and develop their intangibles from this foreign corporation, even though doing so may cause them to yield other tax benefits? And is that occurring with some corporations?

Mr. SHAY. It is permissible under current law to establish a foreign corporation at the outset. Section 7874, which is the anti-inversion proposal you were referring to, does not address corporate formation at the outset.

As you observed, if one is then going to be investing in R&D, then assuming that they're not carrying on business in the United States such that they would be taxed currently, then they would be losing or deferring the benefit of those deductions. And so that is one pretty significant drag on doing that from the outset.

Mr. DOGGETT. But there are—that has occurred. And the current inversion law does not cover that, does it?

Mr. SHAY. That is correct. The current inversion law does not cover corporate formations.

Mr. DOGGETT. Is there any justification for an American corporation with a foreign subsidiary retaining passive assets in that foreign subsidiary that exceed the resources that it needs to compete abroad?

Mr. SHAY. There——

Mr. DOGGETT. Any competitive justification. I'm not talking about tax dodging as justification——

Mr. SHAY. Well, I think without the—certainly a foreign corporation that, under today's law, is permitted to accumulate earnings and retains it in passive form, there are some limits on that. But they are not very great.

But certainly one would, I think, think that an amount that would permit what—normal working capital amounts would be acceptable. To the extent that amounts are accumulated beyond that, then that's a question—that's really a policy question that I think you're alluding to. And current law would permit that.

Mr. DOGGETT. Right. Well, I believe that the chairman, Mr. Neal, got it right at the outset, that we shouldn't be looking to raise taxes, to seek revenue from people that are playing by the rules here at home, working hard, if there are others who are engaged in tax avoidance, through manipulating international rules and the Tax Code, and that he also got it right with the famous Joe Lewis, "You can run, but you can't hide."

Unfortunately, even if we adopted, just as it has been proposed, the legislation that he and Mr. Rangel and Chairman Baucus have introduced, corporate tax avoidance will still be hiding, and some Americans will be asked to pay more because those multi-nationals are not paying their fair share. Thank you very much.

Chairman NEAL. Thank you, Mr. Doggett. The gentleman from Louisiana, Dr. Boustany, is recognized to inquire.

Mr. BOUSTANY. I thank the chairman for this courtesy. I think the ranking member, at the outset, made the—I think the clear distinction between tax evasion and legitimate tax planning on the part of corporations, based on current policy and law. And, gentlemen, I believe you acknowledged that there is that clear distinction. Am I correct in——

Mr. WILKINS. Yes, that's right.

Mr. BOUSTANY. Thank you. I want to focus on a couple of issues in the bill that's proposed. Very important to ensure that dividend withholding rules are not abused. But equally important is clarity with this.

And the scope of the bill's proposal on this issue seems to me to be unclear, because it applies to a broad range of payments that may be economically similar to a dividend, but excludes any payment pursuant to any contract which the Secretary determines does not have the potential for tax avoidance. The statute then lays out several general factors to use in determining whether a payment has the potential for tax avoidance.

So, can you explain what types of payments Treasury regards as having the potential for tax avoidance, or what types of payments Treasury regards as not having that potential? We need a little clarity on where you are going with this.

Mr. SHAY. Thank you for that question. This is an important and highly technical area. And the work of the permanent subcommittee on investigations clearly brought out that there were transactions being entered into where—I don't think there would be much disagreement—inappropriately avoided dividend withholding tax.

Our task, should this legislation be adopted—and it was—it is a provision that we also had in the administration's budget, a very comparable provision, I should say—will be to identify that dividing line between the transactions which are dividend avoidance, and the transactions which do not have that—are part of everyday commercial activity, which we do not want to interfere with.

I don't think it—today, particularly before—that will be our objective during the regulation-writing process, to achieve that. And we will work with the industry participants, to learn what they are doing. And then we will make a judgement as to how to draw that line. It's not something I think we can do in testimony. Thank you.

Mr. BOUSTANY. I hope we can explore this further as time goes on, because it is a critically important issue.

My other question pertains to the QI program. And current law already provides for QI agreements between foreign banks and the IRS. Can you elaborate on the overlap, if any, between the QI program and the bill's proposal to require banks to enter into certain agreements with the IRS to avoid a 30 percent withholding tax?

Mr. WILKINS. Well, I think there would be two alternative ways for a bank to avoid that. One would be to enter into a full-blown QI agreement. The other would be to enter into sort of a QI light, or a modified agreement with the IRS which would impose information sharing obligations on the bank, but not imposing the obligation on the bank to do the work for non-U.S. investors investing in U.S. securities market that happens with a QI.

Mr. BOUSTANY. Are you looking at a streamlining process?

Mr. WILKINS. Yes. We will be interested in coming up with processes that are efficient, and are not sort of onesies, if——

Mr. BOUSTANY. Okay. And for banks already part of the QI regime, might there be a way of bootstrapping into the new regime, by using practices they have already developed for the QI program?

Mr. WILKINS. Yes. I mean, we do hope to work with the industry, and learn from our QI experience, in order to make this transition as effective as possible.

Mr. BOUSTANY. Thank you. I yield back, Mr. Chairman.

Chairman NEAL. Thank you, Doctor. And let me thank our witnesses. I thought it was most helpful. Always impressed with the caliber of witnesses that are sent here by Treasury and IRS. And I must say left, right, or center, I think it's always well informed information that they pass on to us.

And, with that, let me call up our second panel. Thank you.

Mr. SHAY. Thank you, Mr. Chairman.

Mr. WILKINS. Thank you.

Chairman NEAL. We are anticipating a vote in the next few minutes, and I believe that there will be two additional votes after that.

So—but I would like to proceed with the witness testimony. And I think that it would be helpful, as we go along, just anticipating that we might be interrupted.

With that, let me recognize Mr. Prevost.

STATEMENT OF THOMAS PREVOST, AMERICAS' TAX DIRECTOR, CREDIT SUISSE, NEW YORK, NEW YORK

Mr. PREVOST. Thank you, Chairman Neal. Good morning. My name is Tom Prevost, and I am an Americas tax director for Credit Suisse. I would like to thank you for allowing us to offer testimony today.

Credit Suisse has always been an active participant in the qualified intermediary program. The bill makes broad changes that will have implications for the QI regime, and impact how financial institutions will deal with both U.S. and non-U.S. customers with foreign accounts.

Our comments are not intended to be unique to Credit Suisse, and will be relevant to tax reporting for all non-U.S. financial institutions, with the majority of the comments also being relevant to U.S. financial institutions.

We would like to make three basic points today. First, Credit Suisse supports the proposed framework for simplified reporting of accounts under control by U.S. taxpayers. The measure is very comprehensive, and represents a meaningful improvement over the administration's initial greenbook proposal, and previously proposed measures, which would have been considerably more difficult to implement, from an operational basis.

We appreciate the committee's diligence in working through these issues in its effort to eliminate problematic requirements.

Second, while we support the framework proposed in the bill, we have concerns about some of the specific details related to FFI tax reporting, and in certain areas we would like to work with the committee to garner greater clarity. We express these concerns in an attempt to ensure that the stated aims of the legislation are met, rather than falling short due to complications associated with unintended consequences.

In considering operational details, we believe that the current QI program has been a success in allowing U.S. securities to be held by both U.S. and non-U.S. taxpayers overseas, and suggest that as new requirements are put in place to deal with U.S. taxpayers, there needs to be a careful balance struck between the amount of information that the IRS would like to collect, and the compliance burden placed on institutions so that the qualified intermediary program remains attractive to institutions participating outside of the U.S.

Rightly or wrongly, there are significant fears in the international banking community that being a QI may lose its appeal and simply carry too much compliance burden, which could have negative ramifications for foreign investment into the U.S. We recommend a practical focus in the implementation stage to ensure the legislation fulfills its worthy aims.

Finally, Credit Suisse has some concerns and comments relating to two other provisions of the bills, bearer bonds and equity swaps, and we would like to offer constructive ideas to ensure the responsible participants in these markets are not unnecessarily penalized.

With respect to the simplified information reporting approach in the bill, it is a meaningful improvement over the greenbook and other proposals, because it eliminates the requirements for foreign financial institutions to do full 1099 reporting, and a requirement that all related foreign financial institutions be qualified intermediaries.

We appreciate the tremendous effort made by the committee and the Treasury Department to thoughtfully address the concerns raised by financial institutions with respect to the previous proposals.

Regarding the technical issues on reporting, in the interest of time I will not fully detail the technical implementation issues we have with the bill, but instead, summarize our concerns. We have provided considerably more detail in our written testimony.

First, there are effective date issues with a number of provisions in the bill. The rules have to be fully known and foreign financial institution agreements have to be executed before systems and procedures can be established. And it takes time to implement after the rules are established—probably 18 to 24 months, depending on the specific provision.

Second, the method of determining U.S. status of financial accounts is critical. We believe that most foreign financial institutions will not choose to obtain customer certifications from their entire customer base, as permitted by the bill. So, the bill should clarify that foreign financial institutions may, as an alternative, rely on their existing know-your-customer, anti-money laundering procedures.

Third, the verification process should not be so burdensome that it dissuades foreign financial institutions from signing an agreement with the IRS. The concern is that you're dealing with the FFI's entire customer base, versus their much smaller QI customer base, so the cost could be prohibitively expensive.

Fourth, in an effort to ensure that reporting will always occur, the bill has created a number of situations where reporting of the same information happens more than once. We should strive to eliminate these redundant reporting situations.

With respect to the bearer bond provisions, there is an economic issue, in that the bill limits access to certain capital markets for U.S. issuers. For example, the Swiss market and the Japanese retail market.

With regard to equity swaps, we appreciate the committee's efforts to recognize that equity swaps are primarily used for legitimate business purposes, by having the bill only target abusive equity swaps. We welcome the opportunity to assist the Treasury Department in defining non-abusive equity swaps.

Besides an effective date concern, there is also a double-withholding issue for internal hedging swaps, which is described in our written testimony.

To close my testimony, I would like to restate our three primary points. First, Credit Suisse supports the new framework for foreign account reporting as a thoughtful improvement on earlier proposals. Second, we would like to see consideration given to certain technical and implementation issues. Third, we would like to ensure that responsible parties are not unnecessarily harmed by restrictions on bearer bonds and equity swaps.

Thank you for the opportunity to appear today, and I will be happy to answer any questions you may have.

[The statement of Mr. Prevost follows:]

CREDIT SUISSE

Foreign Account Tax Compliance Act of 2009

TESTIMONY OF TOM PREVOST

on behalf of Credit Suisse

Ways & Means Committee
Subcommittee on Select Revenue Measures
November 5, 2009

Testimony of Tom Prevost
Hearing on the Foreign Account Tax Compliance Act of 2009
Ways & Means Committee
Subcommittee on Select Revenue Measures
November 5, 2009

Introduction

Good Morning. My name is Tom Prevost and I am the Americas Tax Director for Credit Suisse[1]. I would like to thank you for allowing us to offer testimony today.

Credit Suisse, as a member of the Swiss delegation, was actively involved in helping the IRS set up the existing US Qualified Intermediary ("QI") program for information reporting and withholding on US securities, and has since its inception been an active participant in the QI program. The newly proposed Foreign Account Tax Compliance Act of 2009 (the "Bill") makes broad changes that will have implications for the QI regime and impact how non-US (and certain US) financial institutions will deal with both US and non-US customers with foreign accounts. With this backdrop, we would like to make three basic points today. First, Credit Suisse supports the new proposed framework for simplified reporting on accounts owned or controlled by US taxpayers. It is a meaningful improvement over the Administration's initial Green Book proposal and previously proposed measures, which would have been considerably more difficult to implement from an operational basis. We appreciate the Committee's

[1] As one of the world's leading banks, Credit Suisse provides its clients with private banking, investment banking and asset management services worldwide. Credit Suisse offers advisory services, comprehensive solutions and innovative products to companies, institutional clients and high-net-worth private clients globally, as well as retail clients in Switzerland. Credit Suisse is active in over 50 countries and employs approximately 47,400 people. Credit Suisse is comprised of a number of legal entities around the world and is headquartered in Zurich. The registered shares (CSGN) of Credit Suisse's parent company, Credit Suisse Group AG, are listed in Switzerland and, in the form of American Depositary Shares (CS), in New York. Further information about Credit Suisse can be found at www.credit-suisse.com.

diligence in working through these issues and its effort to eliminate problematic requirements that could have undermined global tax compliance efforts.

Second, while we support the framework proposed in the Bill, we have concerns about some of the specific details related to foreign financial institution ("FFI") tax reporting and in certain areas would like to work with the Committee to garner greater clarity. We express these concerns in an attempt to ensure that the stated aims of the legislation are met, rather than fall short due to complications associated with unintended consequences. In considering operational details, we suggest that the current QI program has been a success in allowing US securities to be held by both US and non-US taxpayers overseas and that as new requirements are put in place to deal with US taxpayers, there needs to be a careful balance struck so that the modified QI program remains attractive to institutions participating outside of the US. Rightly or wrongly there are significant fears in the international banking community that being a QI may lose its appeal and simply carry too much compliance burden which could have negative ramifications for foreign investment into the US. Above all, we would recommend a "practical" focus in the implementation stage to ensure that complexities are resolved. We look forward to working with the Committee and the Administration on these items as the Bill makes its way through the legislative process.

Finally, Credit Suisse has some concerns / comments relating to two other provisions of the Bill, bearer bonds and equity swaps, and we would like to offer constructive ideas to ensure that responsible participants in these markets are not unnecessarily penalized.

Again, we appreciate the Committee's invitation to be here today. My discussion will be divided into three parts. They are: (1) the new framework for reporting on foreign accounts owned by US taxpayers, (2) technical issues involved in the new reporting regime, and (3) issues surrounding bearer bonds and equity swaps. It should be noted that our comments are not intended to be unique to Credit Suisse and will be relevant to tax reporting for all non-US financial institutions, with a majority of comments also relevant to the overseas operations of US financial institutions.

Reporting on Foreign Accounts

Before getting into the details of our discussion points, I would like to again acknowledge the tremendous effort made by the Committee and the Treasury Department to thoughtfully address the concerns raised by financial institutions with respect to previously proposed measures aimed at modifying the QI regime. I would like to re-emphasize that we very much look forward to working with the Committee and the Administration to ensure that this new proposal meets its stated goals and minimizes unintended consequences.

The simplified information reporting approach in the Bill is a meaningful improvement over the Green Book and other proposals to require full Form 1099 reporting. The new approach recognizes the fact that it would be extremely difficult for FFIs to provide information reporting under a full US 1099 tax analysis, given the lack of US tax compliance knowledge and systems in foreign financial institutions ("FFIs") and custodians servicing these firms.

In addition, the Bill also eliminates the requirement that every FFI in an affiliated group be a QI & fully satisfy QI requirements, thereby also reducing the compliance burden for the Non-QI FFIs.

The simplified reporting structure proposed should permit FFIs to utilize basic account information and not force the FFI to be responsible for complex tax calculations based on US tax law. We expect that this simplified reporting structure -- if the details are properly implemented -- can successfully meet the goal of improved tax reporting for US taxpayers with foreign accounts and preserve the current advantages of the QI program as well as support inbound capital investment into the US economy.

Technical Issues & Issues for Clarification Under the New FFI Reporting Regime

Our comments surrounding the details of the simplified reporting proposal will center around the following issues: 1) the effective date of the Bill; 2) standards for determining the status of financial accounts; 3) verification/audit issues; 4) avoidance of redundant reporting; and 5) withholding on non-financial entities.

Effective Date of the Bill

Under the Bill, FFIs will have to enter into an agreement ("FFI Agreement") with the IRS to avoid 30% withholding on certain payments. In order for any information reporting and withholding regime to work consistently for such a large volume of transactions, it is critical that an institution develop an automated systemic process that can handle the transaction volume without errors. The Bill would apply to payments made on or after January 1, 2011, but given that FFIs will need time to establish new systems and procedures to comply with the FFI Agreement, the details of which remain to be seen, the Committee may want to consider whether this effective date is too soon.[2] For example, before FFIs can comply with the new requirements, at a minimum, the following will need to be addressed:

- Release by the IRS of the standard FFI Agreement, new and revised certification forms and new FFI information reporting forms. In revising existing certification forms such as IRS Form W-8s, it would be very helpful if the IRS could simplify the current form requirements to ease the confusion and potential for errors caused by their complexity. We would be happy to provide the IRS with a list of concerns relating to the existing Form W-8s to be considered by the IRS when designing new forms.

- Whether FFI information reporting must be done on aggregate basis for each account, or with respect to each substantial US owner's share thereof. We believe the Bill requires reporting to be done on an aggregate account basis, rather than based on each US owner's share of the account. As there are a number of additional complexities with significant additional costs that arise if FFIs are required to do the reporting on a segregated basis, confirmation of the aggregate approach would be helpful.

- Due diligence procedures. Not only in the case of US owners of foreign entities, but for all accountholders, whether FFIs will be required to do any additional due diligence beyond their existing Know Your Customer / Anti-Money Laundering procedures.

- Changes in status. In the case of US owners of foreign entities, how changes in the status of US persons as substantial US owners (both year to year and within each year) are handled, and the frequency with which such information is to be updated by the FFI.[3]

We note that the 2011 effective date coincides with the effective date for cost basis reporting, the implementation of which financial institutions will have had over three years to prepare for. While it is difficult to predict without knowing what the final rules

[2] This Bill would create implementation challenges and risks that should not be underestimated. Because of the expansive definition of FFI in the Bill, there are a large number of entities that will have to comply with these provisions that have very little existing information reporting expertise and systems, and thus will be starting from the very beginning in implementing these systems. Also, the potential withholding tax amounts at risk and the volume of transactions covered are large. In order to achieve the desire of the Bill (i.e., to achieve better compliance based on the alternative of an additional withholding tax), it is critical that everyone has fundamental clarity about the requirements and that their systems are fully operational before the withholding tax is effective.

[3] If FFIs are allowed to use their anti money laundering ("AML") / know-your-customer ("KYC") procedures for determining US owners of foreign entities as we have suggested, changes in ownership should also be determined based on the FFIs AML/KYC procedures.

will be, our current best guess is that it will take up to 24 months to properly implement these new requirements after all of the relevant rules and forms have been finalized.

Standards for Determining US Status of Financial Accounts

An FFI that enters into an FFI Agreement must determine whether each account is held by a US person or a US-owned foreign entity ("US Account"). We strongly believe that guidance is needed on how an FFI may determine that an account is or is not a US Account. The Bill provides that an FFI may rely on a certification from each account holder that it is not US person or a US-controlled foreign entity. However, it is not fully clear how this certification will be made and the Bill should clearly indicate that this would not be the only means of establishing non-US Account status.

For example, it may be possible to obtain certifications upon new account opening for future accounts[4] or to obtain certifications for existing QI accounts that are already providing a Form W-8 when the old form expires. However, it may not be feasible for an FFI to obtain a certification from its entire existing client base.[5] In fact, it is difficult to understand why a foreign account holder with no US securities or even minimal connection with the US, must provide a US tax certification form. Given the huge volume of existing accounts that a global bank has worldwide, it could be extremely costly, burdensome and impractical to obtain certifications from all global

[4]. New account opening is the logical point to obtain any type of new certifications required by the bill. However, customers with no connection to the US or US securities in their account may resist providing the form even during a new account opening process.

[5] The Securities Industry and Financial Markets Association ("SIFMA") suggested a certification process in its letter dated August 31, 2009. However, as SIFMA noted in the letter, it is not feasible for an FFI to obtain a certification from its entire existing client base. Their expectation was that the certification process would only apply to QI accounts where customers had already been providing a Form W-8. The rationale was that if customers were already willing to give the QI a Form W-8 to avoid US withholding on their US securities, these same customers would likely be willing to provide the new certification (most likely a revised Form W-8) when it came time to renew the form currently on file.

account holders. Beyond direct customer certification, to remedy this situation the Bill should clarify that an FFI may also rely on documentary evidence obtained pursuant to the FFI's existing AML and/or KYC procedures for customer and account identification of non-US taxpayers.[6] Use of these procedures would properly balance the government's objective of minimizing US tax evasion without unduly increasing the tax compliance burdens and costs of financial institutions.

Apart from individual account holders, certain exceptions should be considered where an FFI must determine whether an entity is a US-owned foreign entity. The Bill currently contains no exception for publicly-traded foreign corporations in this context. In contrast, an exception is provided in the Bill for publicly traded corporations in the case of the withholding tax on payments to non-financial foreign corporations -- due to lower risk of tax evasion by publicly-traded corporations than for other entities. For the same reason, an FFI should not be required to obtain a certification or other information to establish that any publicly-traded corporation (or affiliate) is not a US-owned foreign entity. Similarly, any foreign entity that is an operating entity (for example, entities actively engaged in business activities that are not engaged primarily in investing, reinvesting or trading in securities, commodities and derivatives thereon) should also be exempted due to the lower risk of tax evasion associated with such operating entities.[7] If operating entities are not exempted, FFIs will need detailed guidance on when the

[6] For these purposes, the term FFI should not include affiliated legal entities.
[7] Under the exempt-recipient rules, the IRS currently does not require information reporting for payments that are beneficially owned by US corporate entities (for example, operating entities) nor is there any requirement for looking through such corporate entities for purposes of information reporting. Under the same rationale, there should be no requirement to look through foreign operating entities to determine the existence of substantial US ownership.

10% ownership determination must be made and what the requirements are for redetermining the ownership of the operating entity.

It should be noted that generally KYC / AML customer identification procedures do not "look through" operating entities to determine the underlying owners thereof. Consequently, it would be a major undertaking, which may not even be possible as a practical matter, for FFIs to have to get certifications from all of the operating entities that are customers.

Verification and Audit Issues

FFIs that enter into an FFI Agreement would also be required to comply with verification and due diligence procedures as Treasury or the IRS may require. The Joint Committee Explanation of the Bill indicates that verification could include independent review procedures to ensure compliance with an FFI's obligations under its FFI Agreement. It is unclear whether such an independent review may be analogous to the external audit procedures currently applicable in the case of QIs. However, in determining the scope of any external audit procedures, it is important to note that applying current QI audit procedures to FFIs could result in costs that are many times greater than in the QI context. QI agreements only apply to a limited subset of designated accounts of a financial institution that are chosen for inclusion in the QI arrangement. On the other hand, if, under the FFI Agreement, all accounts of the FFI, as well as all accounts of its affiliates, are potentially subject to examination, this would be a major concern to the FFI community. Given the vast number of accounts that may be at issue, it is important that the verification procedures not be so burdensome as to dissuade FFIs from entering into a new FFI Agreement.

Avoidance of Redundant Reporting

The Bill requires a party to an FFI Agreement to file annual information reports with respect to US persons who are account holders or substantial owners of US-owned foreign entities. In our view, as currently drafted, the Bill could result in redundant reporting by multiple FFIs.

In the situation where there are tiered FFIs (such as a fund of hedge funds or hedge fund accounts at an FFI), the Bill appears to require multiple layers of information reporting for the same information. To avoid this duplicate reporting, an FFI should be exempt from the information reporting with respect to substantial US owners of any foreign entity that is itself a party to an FFI Agreement. This would conform to the exception to withholding in the case of payments made to an FFI that has an FFI Agreement.

Similarly, the Bill should provide certain investment entities an election to be excluded from the definition of an FFI. Such an election would be available to any entity that is engaged primarily in the business of investing, reinvesting or trading in securities, commodities and derivatives thereon and who has 20 or fewer investors, providing that the entity is already being reported on by an FFI. Such small foreign investment vehicles may not have the resources to fulfill the obligations imposed by an FFI Agreement. Yet, if they do not enter into an FFI Agreement, such investment vehicles would be subject to 30% US withholding with no opportunity for refund if they are not residents of a treaty jurisdiction. Such electing small foreign investment vehicles would be treated the same as any other foreign entity and only be required to provide a payor with information indicating whether they have US owners, and the identity of such US owners. [8]

Another example of redundant information reporting arises in the case of an FFI that is a foreign investment partnership that is already required to file detailed tax statements on IRS Schedule K-1 to its US taxable investors and the IRS. More detailed information than an FFI would be required to information report under an FFI Agreement is already included on a Schedule K-1, so any additional reporting burden would not likely result in a corresponding tax compliance benefit to the US government.

Furthermore, the Bill defines financial account to include any debt interest in an FFI that is not regularly traded on an established securities market. Many FFIs issue debt that is not regularly traded (for example, structured notes). Thus, the FFI would have to determine whether the purchasers of the notes, as account holders, are US persons or US-owned foreign entities. However, it is common for note issuers to sell their notes to investors through other US or foreign broker-dealers, with no contact with the investors. In this situation, the issuing FFI has no information about such investors and therefore can neither make determinations as to their status, nor information report. Even if the issuing FFI had information about each investor, information reporting by the

[8] We also note that while the Bill provides an exception for accounts of individuals with low balances, the exception is not likely to be relied upon by most large financial institutions because the exception treats all affiliates as a single institution for purposes of determining whether the account exceeds the threshold ($10,000 for new accounts and $50,000 for accounts in existence on the date of enactment of the Bill). To be sure that the exception applies to an account, each branch and affiliate of a financial institution would have to be able to readily determine the aggregate balances of each individual at all other branches and affiliates. However, bank secrecy laws may prohibit sharing of account information with other entities and jurisdictions. In addition, even where no legal impediment exists, a financial institution's computer systems may not provide ready, non-manual aggregation of account balances for a particular individual across various jurisdictions and affiliates. Finally, the Bill does not indicate how and when threshold is measured. For example, must the account balance be below the threshold for each day during the calendar year to qualify, or is it determined only as of the reporting date, or as of some other period, such as an average of the closing balances for each month?

FFI would be redundant because the broker-dealer through whom the investor holds the note would also information report on such note. This issue could be addressed by excluding from the definition of financial account any debt interest in an FFI that is held in a financial account with a US financial intermediary or an FFI that has signed an FFI Agreement.

Withholding on Non-Financial Foreign Entities

Under the Bill, a withholding agent is required to withhold 30% from any withholdable payment made to a non-financial foreign entity that fails to either, certify that it does not have any substantial US owners, or provide the withholding agent with information relating to each substantial US owner. Exceptions are provided in the case of certain types of foreign entities, including publicly traded corporations that present a lower risk of tax evasion. Treasury has been granted authority to issue guidance on other types of entities that pose a low risk of tax evasion. However, as currently drafted, withholding agents will have to put in place additional tax compliance processes for situations that Treasury may subsequently say are not required. To alleviate this concern, this provision should also not be effective up to 24 months after rules are issued clarifying which situations do not require this additional withholding or reporting.

We also believe an exception is appropriate in the case of payments made to foreign payees for services provided to the US payor (vendor payments), as these types of payments are made in the ordinary course of business to bona fide foreign service providers who should present little risk of tax evasion by US persons.

Bearer Bonds

Since 1982, pursuant to the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), issuers have been prohibited from issuing bonds that are not in registered form ("Bearer Bonds"), except for Bearer Bonds that meet the requirements of the foreign targeted bearer bond provisions. These provisions have historically allowed US issuers to issue Bearer Bonds outside the US in capital markets where Bearer Bonds are either customary or required, while implementing procedures reasonably designed to ensure their sale to non-US persons. The current proposal will eliminate such provisions, thus requiring users to either issue all obligations in registered form or lose the benefit of the portfolio interest exception from US withholding tax. This may shut US issuers out of certain debt markets around the world where the obligation cannot be structured to be considered registered for US income tax purposes, or the issuer cannot obtain from holders the required documentation to be able to apply the portfolio interest exception.[9]

Additionally, the proposed change has the potential to disrupt foreign capital markets where both the issuer and the investor base are all non-US persons. By taking away the TEFRA exception for foreign targeted bearer bonds, this Bill also has the likely unintended consequence of making all foreign issuers of bearer bonds subject to US excise tax.[10] In addition, any foreign debt that uses a US middleman (e.g., a London branch of a US financial institution) would result in US information reporting requirements even though the issuer and investors are all non-US persons. We

[9] For example, we understand that Bearer Bonds are still typically issued to Japanese retail investors.

[10] The issuer sanctions in §4701 are technically not limited to US issuers.

welcome the opportunity to work with Congress and the Treasury department to resolve these technical issues which we believe may be unintended.

Equity Swaps

With respect to the equity swap provisions, I would first like to thank the Committee for its efforts to recognize that equity swaps are primarily used for legitimate business purposes by having the Bill only target abusive equity swaps. We welcome the opportunity to assist the Treasury Department in their efforts to define non-abusive equity swaps. One concern we have with the Bill is the effective date. As a practical matter, the swap dealer community cannot begin to implement information reporting and withholding procedures until after there is clear guidance on which equity swaps or other contracts will be subject to withholding tax. Once we know the rules, our best guess is that it will take up to 18 months to implement, depending on what the rules ultimately say. Another issue has to do with potential for double withholding because of the way the equity swap business is executed at a number of firms. Firms will often centralize their swap trading in one legal entity to achieve netting benefits for credit and balance sheet purposes. However, the risk from the positions may be managed in a different legal entity so there is a mirror internal swap for each client swap. This mirror swap creates the potential for double withholding. Consideration should be given to providing an exemption from the second withholding tax where dealers can demonstrate that an internal mirror swap situation exists and withholding tax was actually imposed on the first (client) swap.

Conclusion

To close my testimony, I would like to restate our three primary points --

1. Credit Suisse supports the new framework for foreign account reporting. It is a thoughtful improvement on earlier proposals.

2. We would like to see consideration given to certain technical issues as well as further clarity related to certain implementation issues. We would like to ensure that the system works smoothly for all interested parties, including our customers and the government in a manner that ensures that the incentives related to the existing QI system are maintained. We feel that the maintenance of a robust QI regime is in the long term interest of the government and important to the ultimate success of the stated goals of the proposed legislation.

3. We would like to ensure that responsible parties are not unnecessarily harmed by restrictions on bearer bonds and equity swaps.

Thank you for the opportunity to appear today and I will be happy to answer any questions that you may have.

Chairman NEAL. Thank you, Mr. Prevost.

Professor Kingson is recognized to offer testimony.

STATEMENT OF CHARLES I. KINGSON, ADJUNCT PROFESSOR, NEW YORK UNIVERSITY LAW SCHOOL, NEW YORK, NEW YORK

Mr. KINGSON. I've been invited here to discuss avoidance of U.S. tax by using companies and by—incorporated in tax havens. And, of course, you know, tax—they are called tax havens, but they are only tax havens to the extent that we let them be tax havens. And my comments really concentrate on publicly held companies where the money is.

And they avoid U.S. tax in two ways. One, they transfer intangibles to their foreign subsidiaries, and the foreign subsidiaries make them, and they're not taxable until the money is brought back into the U.S. And in the case of U.S. parents that become subs of foreign parents, the foreign parents are not taxed on any non-U.S. income ever, and including interest on capital gains.

Now, this can be countered by reasonably effective measures. One would repeal an obscure provision that was enacted in 1997 in the name of alleviating complexity. And the second would be, really, Representative Doggett's suggestion that we say that a company that is managed, controlled in the United States is a resident of the United States, and fully subject to U.S. tax.

The—although the former has—the subsidiaries have more revenue loss, I am going to take up the parent's technique first, because it's more visible and it's more resented, and also because it's the only thing on the table because of Representative Doggett's bill.

Now, the use of—for both parents and subsidiaries, what is important is intangibles. We have changed from a world of steel where Andrew Carnegie was the richest man to a world where Bill Gates is the richest man, and the wealth is intangibles.

And the United States, too, has intangibles. It has a government—I mean a great government—it has shared ideals, it has sacrifices. And we have commercial intangibles. We have great educational institutions, a skilled workforce, and we have maybe the best scientific community that ever was. And these U.S. corporations take advantage of these to make their fortunes, and they then want to really say, "Well, you know, I have made mine, and now I don't have any more obligations."

And as for the parents, they very often want to incorporate abroad and still live here, and we don't allow individuals to do that. If you live here and you want the benefits of civilization, I mean, you have to pay what Justice Holmes called the price of civilization. I mean taxes.

And the stuff to deter inversions, I mean, that's very long and complex, and I don't know how well it works. It certainly doesn't work, as Mr. Shay said, in the case of start-ups.

But even if you have a U.S. sub of a foreign parent, they can take the intangibles out of the U.S., and have them forever outside U.S. tax jurisdiction. Now, you can't do that with something that's legal, because you know, a patent you have to transfer out, and that's a realization event. The corporation gets taxes on its value, and so does the foreign parent on the dividend.

But other things are easier to get out of U.S. tax jurisdiction, and that's stuff like know-how, and goodwill, and the workforce. You can't put your hand on them. And that's why—and that gives an incentive to get these—this stuff that has been done forever.

Now, I would like to say about the foreign subs, they transfer these intangibles to the foreign subs, and they build up incredible, incredible amounts of money. The table prepared by the Democratic House Ways and Means Committee staff said that in 2003 alone, 9 pharmaceutical companies reinvested $26 billion abroad, and this was in low-tax jurisdictions. And they did it because they syphoned the intangibles off to their subsidiaries, and so they had $26 billion, mostly in passive assets they didn't need in the business.

And if you—the way to combat this really is to, I think, to repeal an exemption they had, they got in 1997. It said, basically, if you're an investment company you have to—a foreign investment company—you have to economically repatriate all your earnings. And these companies were going to become investment companies because more than 50 percent of their assets became—they didn't know what to do with them. They had no business reason. And they were stocks and bonds and bank deposits.

So, the—they got an exemption in 1997 from foreign subsidiaries of U.S. companies being called investment companies, and characterized as investment companies. And then, in 1997, the real accumulation began, because there were no tax penalties.

And then, starting in 2002, they said, "Well, you know, we really have to get this stuff back, because this stuff we siphoned abroad, we have to bring it back tax-free, so we can recreate U.S. jobs." And they got it back. And, you know, to show what happens, a company like Intel, which brought back $6 billion, as soon as—you're supposed to have a plan to create more jobs—and the next year they cut 10,500 jobs. And Pfizer, which had $38 billion abroad, the next year they fired 10 percent of their domestic sales force.

And so, I characterize this as really one of the most brilliant, farsighted, and ingenious rip-offs of the U.S. tax base ever accomplished. And to counter this, Congressman Rangel's bill would say, "Well, you can't just bring back your high-tax earnings and use them to wipe out tax on your exports. You have to allocate part of that against the income that you keep abroad in low-tax earnings."

But I think that what would be much more effective would be to repeal the exemption that these companies got from foreign investment companies. It wouldn't hurt their competitive position at all. Because, by definition, you only count as passive assets, assets that you don't need in the business as working capital. So there is no real justification for this.

And, you know, you have legitimate reasons for doing business in a foreign country, and a tax haven. Avis can't rent cars in Florida and send them—I mean, can't send them to the Bahamas every time somebody wants to rent a car, so you have to have a business there. And if it's untaxed, it's untaxed. But that doesn't mean that Avis should be—Avis Bahamas should be able to get a huge mutual fund there going with untaxed income.

And this would—my second thing would be—because, I mean, I have had experience with what companies do, and they value earnings much more than they do saving taxes. And if you required that published income statements couldn't say that there is no U.S. tax on these accumulated earnings because you're never going to bring it back, that would deter them very substantially. Instead of showing $100 of income on their balance sheet in Bermuda, they would show $65 of income. And without earnings per share being increased, which is the, you know, the summum bonum, I mean, you don't really have any—you don't have that much of an incentive. It doesn't show up in your performance to do these tax havens.

And the final thing is really just—I think you—I think one of the things—although these foreign information things are, I think, valuable. I haven't had much experience in the area, but I think it should be—I think the focus of my testimony has been that you concentrate on the U.S. activities. If a company has U.S. activities, and you measure it by where the executives live—because they're not going to live in the Cayman Islands, and you don't do it by their officers, because they can fool around with titles, you just say, "Who are the highest paid people," and that's it.

And when you focus on U.S. activities, and focus on the consequences to the U.S. parents when they're—with their foreign subsidiaries, I think you will—it will do very well.

And, as a coda, I just want to say that I would do the same thing for—focus on U.S. people with respect to tax evasion. I mean, if a person—instead of chasing the crooks and the tax evaders, I would also go after their beneficiaries, because in my experience everybody who wanted to give up a citizenship, he would never have his children give up their citizenship.

And so, if you just said if everybody who got more than $10 million in gifts and bequests had to show that it had been reported in the Internal Revenue Service—and with $10 billion or some 8-figure number, you couldn't say, "Well, we just forgot to keep records"—I mean, if you said that that was income and subject to an excise tax, you would make law-abiding people—you would—people would lose the incentive to give money—to take tax evasion, if they couldn't give money to the next generation. And that wouldn't be involving chasing foreigners.

[The statement of Mr. Kingson follows:]

Statement of Charles I. Kingson, Adjunct Professor
New York University Law School, New York, New York

Testimony

My name is Charles Kingson. The subcommittee has invited me here to discuss avoidance of United States tax by using companies set up in low-tax foreign jurisdictions. These countries are often called tax havens, but of course they are only tax havens to the extent we let them be. My comments and suggestions concentrate on publicly held U.S. companies, which is where the real money is.[1]

U.S. corporations use tax-haven companies in two ways. One is by U.S. parent corporations establishing a tax-haven subsidiary, to which is allocated income not taxed by the United States (or anyone else) until assets representing that income are brought back as dividends. The other is by the top U.S. company reincorporating as a tax-haven parent in, say, Bermuda. This removes foreign operations, and the income they produce, from the United States ability to tax them now *or* later.[2]

[1] The views expressed are personal.

[2] A former tax chief of Intel Corp. suggested to the Senate Finance Committee that had he known at Intel's founding in 1968 about the present international tax rules, he would have suggested incorporating in a lower-tax jurisdiction. Senator Moynihan then asked the tax officer

Continued

The first, use of tax-haven subsidiaries to deflect United States tax, can be countered by repealing an unpublicized provision enacted in 1997 in the name of alleviating complexity. The second, reincorporating as a foreign parent, can be countered by doing what almost all other industrialized nations do: treating a corporation managed and controlled in their country as a resident subject to full tax.[3] Although the former problem involves more revenue loss, I will begin with the latter, because it is more visible (and resented); and because it is the only one on the table owing to Representative Doggett's bill.

A. *The Use of Tax Haven Parents*

United States corporations benefit from perhaps the greatest intangibles that have ever existed; a system of government, a fairness of law, and a defense made possible by sacrifice. As a commercial matter, they benefit from other U.S. intangibles as well: great educational institutions; a skilled workforce; perhaps the best scientific community ever; the most universal language; and a culture—or several cultures—that are both inclusive and admired.

Having benefited from those intangibles in making their fortunes, some want to escape tax on them while retaining the benefits. We do not allow individuals to do this; we consider those who live here "residents" of the United States and tax them on all their income. Accordingly, a person cannot avoid U.S. taxation by giving up citizenship. If you get the benefits of our intangibles, you pay what Justice Holmes called the price of civilization.

By contrast, we consider a corporation to be resident in the country in which it is incorporated—say, Bermuda. This has led some United States parent companies to reincorporate in jurisdictions like Bermuda. The procedure, known as corporate inversion, involves the domestic parent of a multinational corporation becoming the subsidiary of a tax-haven foreign parent with the same stockholders. The United States continues to tax all earnings of the domestic company, now a subsidiary; but earnings from foreign operations that can be shifted to or started by the tax-haven parent, as well as interest and capital gain, will fall outside what we define as our residence jurisdiction.

Section 7874, intended by the 2004 Jobs Act to deter inversions occupies over two pages of the Internal Revenue Code of 1986, as amended (the "Code"). But these complex provisions, although often a deterrent, do not deal with the fact that our definition of resident is wrong; a corporation, like an individual, lives where it is present. Therefore, once the price of Section 7874 is paid (and for a loss or startup corporation it might be small), there is a substantial incentive for the new foreign parent to transfer the valuable U.S. intangibles of its U.S. subsidiary to foreign companies—that is, outside what we define as residence jurisdiction. This is easy to monitor and tax with items such as patents: their transfer will be treated as a taxable sale by the U.S. corporation followed by a taxable dividend to its foreign parent. But a transfer is harder to ascertain with items like goodwill, workforce and know-how: opportunities to make money can be funneled elsewhere. (A colleague refers to this as a "slurp" reorganization.)

A report by the Joint Committee on Taxation, contemporaneous with the original enactment of Section 7874, suggested a residency test similar to that used by most other countries. The report suggests that a company incorporated abroad should be considered a U.S. corporation if its day-to-day management is located here. As the report says, that factor "is more difficult to manipulate. Moving the management of a company generally requires the physical relocation of top executives and their families to an office in a foreign jurisdiction." The United States in fact has adopted this standard through tax treaties. A treaty often grants a corporation that is a "resident" of the other country either reduction of or exemption from U.S. source tax.[4] The definition of resident includes a corporation that is managed and controlled, or has its effective place of management, in the other country.[5] In deciding whether a foreign corporation is entitled to treaty benefits, the United States is—perhaps unknowingly—determining what those terms mean under its own law. Since domestic law does not use those concepts, an opinion that a foreign corpora-

"if he expected the Marines to show up in the Caymans in case of trouble." Hal Lux, Nationalities of Convenience, Inst. Investor, Feb. 2002 (paraphrasing Moynihan's question).

[3] Tax commentary by the Organization for Economic Cooperation and Development (OECD) states that in determining the residence of a company, "It would not be an adequate solution to attack importance to a purely formal criterion like registration. Therefore, paragraph 3 attaches importance to the place where the company, etc. is actually managed." Paragraph 22 of the Commentary on Article 3 of the OECD Model Tax Convention.

[4] See Model Treaty, art. 23(2).

[5] Id., art. 4(1).

tion is a resident on the basis of its place of management is resting on foreign rather than domestic concepts.[6]

The landmark British case on management and control, involving De Beers Consolidated Mines Ltd., was fairly straightforward: the directors met primarily in London. Since then, as a subsequent British case noted, communications allow meetings to be held without physical presence. Moreover, management and control of public companies resides substantially with their executives. Representative Doggett's provision treats certain foreign corporations as domestic corporations for U.S. federal income tax purposes if the management and control of the corporation occurs primarily within the United States. That concept gets it right, and I would suggest that it be made more specific by using a criterion of where the most highly compensated employees live. They will be reluctant to give up the intangibles this country offers, as well as their personal ties. Where a company is incorporated might determine its taxes, but where an executive has to live determines his life.

In addition to U.S.-based start-up corporations incorporated in tax havens, a corporate residence test based on management and control would affect previously expatriated corporations. These would become domestic companies, bringing earnings from their foreign operations back into U.S. corporate tax jurisdiction. This puts the companies in the same position as if they had not inverted, yet allows them to pay U.S. tax later. Any complaint can be met by paraphrasing John F. Kennedy: Ask not what your country can do to you: ask what you did to your country.

B. *The Use of Tax-Haven Subsidiaries*

1. Avoidance of U.S. Tax: The Transfer of Intangibles and Portfolio Investment Abroad

Wealth has changed from physical to intangible, from Andrew Carnegie to Bill Gates. Therefore, although companies will not replicate U.S. Steel mills in the Caymans, they find it relatively easy to transfer intangible assets to a tax-haven subsidiary.[7] Congress' response, the statutory commensurate-with-income test, works; but only if you get caught.

A table prepared by the Democratic staff of the Ways and Means Committee[8] shows that during 2003 the foreign reinvested earnings of nine pharmaceutical companies totaled more than $26 billion. Like Intel, these companies have intangibles of immense value; and their foreign subsidiaries' income is attributable to those intangibles. When the 2004 Jobs Act permitted low-taxed foreign earnings to be repatriated to United States parent corporations with virtually no U.S. tax, companies that took most advantage of this were those in high-tech industries.

In a sense, then, the high-tech industries have pulled off a hat trick. First, they beat the intercompany pricing rules. They have been able, despite all the work on 482 and 367, to transfer intangibles to Ireland and Singapore. Next, those companies beat back the passive foreign investment company (PFIC) rules, which would have stopped them investing the income from those intangibles abroad in non-productive portfolio assets without incurring U.S. tax. Before 1998, once more than 50% of a foreign subsidiary's assets were bank deposits and bonds, all the income of that subsidiary would therefore in effect be taxed currently in the U.S. But in 1997, the PFIC rules were changed to exempt a foreign subsidiary. Subsidiaries of high-tech companies could therefore keep their intangibles profits abroad in passive assets. They did not use them to compete, which is the justification for encouraging low-taxed profits abroad.

By 2002, the high-tech companies were beginning to say, although not in these words, that "We need this money that we siphoned abroad to recreate U.S. jobs." Under that rationale, the 2004 American Jobs Creation Act allowed them to replace

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[6] Concern exists that a managed-and-controlled test might sweep legitimately foreign corporations—for example, Swiss pharmaceutical companies with substantial U.S. research and marketing activities—into full U.S. jurisdiction. But the scope can be mostly limited to tax-haven companies. For countries with which the United States has an income tax treaty (such as with Switzerland, see Income Tax Treaty, U.S.-Switz. Art. IV, Oct. 2, 1996, 4 Tax Treaties (CCH) ¶9101.04, but not Bermuda), the United States could cede residence jurisdiction to the country in which an entity is incorporated. Special consideration might apply to low-tax treaty partners such as Ireland and Barbados.

[7] Those assets are listed in Code section 936(h), part of a section intended to prevent their value (and the resulting income) from being shifted to subsidiaries exempt from U.S. tax because they operate in Puerto Rico. Two significant assets not listed are goodwill (reputation) and going concern value (skilled workforce).

[8] The table is reproduced on page 358, Summer 2005 issue of the *Tax Law Review*, vol. 58, number 4.

the money they had paid out in dividends by bringing their foreign bank deposits back to the U.S. tax-free.[9]

In short, by taking advantage of the U.S. tax system: outfoxing intercompany pricing rules; justifying the accumulation of bank deposits abroad in the name of tax simplicity; and claiming that those bank deposits would replace lost jobs, companies have succeeded in exempting U.S. profits from U.S. tax.

I think this has been one of the most brilliant, farsighted and ingenious rip-offs of the U.S. tax base ever accomplished. To counter this, Chairman Rangel's tax reform bill rightly proposes that foreign tax credits be allocated fungibly among high-taxed repatriated earnings and unrepatriated low-taxed earnings. The stiffness of the opposition implies how effective it would be.

Perhaps even more effective would be repeal of Code section 1297(d), which exempts tax-haven subsidiaries from PFIC status. Its repeal would force the distribution of tax-haven earnings not needed in the business, and thus should not hurt their competitive position. Companies do have legitimate reasons for doing business in tax havens. Avis, for example, cannot rent cars in the Bahamas by shuttling them back and forth from Florida. But that should not mean that Avis Bahamas Ltd. can become a giant mutual fund, making portfolio investments with untaxed income.

Two related recommendations to deter the use of tax havens:

- Require that, on their published income statements, companies reflect United States tax on foreign earnings even if considered permanently reinvested. Corporations value earnings even more than saving taxes; and taking away the earnings incentive would lessen the attraction of tax havens.
- Require companies whose foreign subsidiaries show more than, say, a 25 percent return on tangible assets to describe (consistent with keeping trade secrets) the intangibles of the subsidiary and how it obtained them. This would reinforce the intercompany pricing rules of sections 367 and 482 and show if the parent was materially assisting the subsidiary in earning amounts that could be subpart F income.

2. Avoidance of Non-U.S. Tax Repatriation of Business Profits from High-Taxed to Low-Taxed Foreign Subsidiaries

The proper U.S. response to the avoidance of non-U.S. taxes is not the topic of this testimony. Because it is related, Appendix I discusses the issue with respect to U.S. multinationals.

CODA

A theme of this testimony is to deter avoidance by focus on the United States. A similar focus might be applied to deter individual evasion, even though evasion—unlike avoidance—is criminal. In addition to the anti-abuse measures proposed in Congressman Doggett's bill and the Rangel-Baucus bill, I would add an additional suggestion. As a complement to the foreign information, tax law might elicit compliance by enlisting beneficiaries. Gifts and bequests to Americans in excess of, say $10 million—or some other eight figure number—could be characterized as income and subjected to an excise tax unless it could be shown that the assets and income from which they were derived had been reported on tax returns.[10]

APPENDIX I:

Avoidance of Non U.S. Tax: Repatriation of Business Profits from High-Taxed to Low-Taxed Foreign Subsidiaries

A. *Dividends, Interest and Royalties*

For 70 years the United States has considered there to be no legitimate reason for its taxpayers to earn passive portfolio income—dividends, interest and royalties—outside its immediate taxing jurisdiction. When the investment was not part of an active business (like banking or insurance), taxing the income immediately was considered not to affect the ability of U.S. persons to compete abroad.

The Revenue Act of 1962 extended the scope of that principle to undistributed passive investment income earned by foreign subsidiaries (controlled foreign corporations) of U.S. widely held multinationals. Foreign personal holding company in-

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[9] Intel, which repatriated $6.2 billion under the Jobs Act, shortly thereafter announced that it was cutting 10,000 jobs, about 10 percent of its workforce. (Editorial, "Cashing their Chips," N.Y. Times. Sept. 8, 2006, p. A28.) Pfizer, which had $38 billion indefinitely reinvested abroad at the end of 2003, drastically cut its domestic sales force in 2006.

[10] This was prompted by a call to me from a Swiss lawyer, concerned about what would happen to his U.S. client's large secret Swiss account when he died. "Money grows faster when you don't pay tax," he explained.

come became a type of subpart F income taxed as if earned directly by its United States shareholders.

For subpart F purposes, passive income includes not only portfolio investment like bank deposits but also what is essentially the distribution of business profits from one foreign subsidiary to another. Those distributions could take the form of low-taxed dividends, interest or royalties paid by one foreign subsidiary to another; or in the most complete realization of business profits, it would take the form of gain from sale of all the stock owned in one foreign subsidiary by another. Unlike interest from liquid bank deposits, which a foreign subsidiary rather than the U.S. parent had little reason to receive except to defer U.S. tax, realization of one foreign subsidiary's business profits by another generally was intended to save *foreign* tax.

The inclusion of business profits distributed from one foreign subsidiary to another as subpart F income, despite the motivation to save foreign rather than U.S. tax, has provoked fierce attack since (and during) its original enactment in 1962. Yet, however correct that position was, circumstances have changed. Once, after World War II, the United States had all the money there was; and now it does not.

The Tax Reform Act of 1986 reflected this sea change. For purposes of the foreign tax credit, the act treated deductible payments of interest and royalties from foreign subsidiaries to U.S. parents—which eroded foreign tax bases—in the same way as dividends. Legislative background described this as an incentive for U.S. multinationals to reduce their foreign taxes.[11] The 2006 enactment of section 954(c)(6) was therefore extending that logic when it exempted foreign-to-foreign interest and royalties from subpart F. Although such logic may not have motivated the provision, it remains valid. Distributing business profits with the least foreign tax cost should not be considered avoidance for *U.S.* tax purposes.[12]

Accordingly, section 954(c)(6) should be continued and be extended to include gain from sales of stock in foreign subsidiaries. There would be no income for U.S. tax purposes—and thus no subpart F income—if instead the transferred foreign subsidiary sold its assets and distributed the cash to its foreign parent in liquidation. It is foreign rather than U.S. tax that generally makes an asset sale prohibitive.

B. *Artificial Intercompany pricing: Sales and Services Income*

Section 482 gives the IRS authority to prevent erosion of the U.S. income tax base by artificial intercompany pricing. To illustrate, a domestic corporation may charge too little for goods sold to, or services performed for, a foreign subsidiary. This inflates the subsidiary's profit (which the United States does not tax) while decreasing that of the parent (which the United States does tax).

But enforcement of intercompany pricing requires enormous effort. To combat what President Kennedy termed "the shifting of management fees and similar practices which maximize the accumulation of profits in a tax haven," subpart F income included profit from sales and services between foreign subsidiaries and related corporations. In significant part, this was intended to make Section 482 attribution of subsidiary sales and services income to a U.S. parent corporation unnecessary. Whether the transaction resulted in the parent earning $20 and the subsidiary $80, or the parent $80 and the subsidiary $20, the entire $100 would be taxed to the parent.

Again, however, subpart F income includes sales and services income intended to erode a foreign as well as a U.S. tax base; and the same considerations that should exclude from subpart F income the distribution of business profits among related foreign companies should likewise exclude income from sales and services transactions among them. We are not the world's tax policeman of intercompany pricing: we can hardly police our own.[13]

Without too much detail, some suggestions follow:

- In view of encouragement of U.S. multinationals to reduce their foreign taxes, restrict subpart F to transactions that erode the U.S. tax base. This would entail at least repeal of the section 954(d)(2) branch rule, and might well go further and limit subpart F sales and services income to transactions that reduce U.S. taxable income.
- Concomitant with having subpart F sales and services income limited to the U.S. tax base, ensure preservation of that base in two ways: ending the avoidance of subpart F sales income by contract manufacturing with its complex and vague rules; and stopping the avoidance of subpart F services income

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[11] The 1986 Blue Book description of section 904(d)(3) at p. 866.

[12] We try to prevent United States subsidiaries of foreign companies from distributing profits with the least U.S. tax cost, even when it entails discrimination, Code 163(j), aimed at what is called earnings stripping. By contrast, U.S. private equity funds depend on this technique.

[13] One subpart F provision, known as the branch rule, even polices *alternative* ways of avoiding foreign tax. Code section 954(d)(2).

> when foreign subsidiaries perform services with substantial assistance from a United States parent in the form of *sub rosa* expatriated intangibles.

The central issue of the U.S. international tax system has become the expatriation of U.S. intangibles abroad. In the case of services income, the proposals intend to mitigate the result of that expatriation. Repeal of the passive foreign investment company exception for foreign subsidiaries (proposed in the testimony above) also intends to mitigate the effect of those intangibles.

Chairman NEAL. Thank you. Mr. Suringa, it's up to you. Do you want to offer testimony in the next five minutes, or do you wish to have us reconvene here at approximately noon time, and then it would give you a better chance? I want to make sure we're fair.

Mr. SURINGA. Whatever the committee would like. I am happy to stay within the five minutes, or——

Chairman NEAL. Then do it.

Mr. SURINGA. Okay.

Chairman NEAL. So are we.

Mr. SURINGA. Thank you, sir.

STATEMENT OF DIRK J.J. SURINGA, PARTNER, COVINGTON & BURLING LLP, WASHINGTON, D.C.

Mr. SURINGA. Chairman Neal, Ranking Member Tiberi, and Members of the Committee, my name is Dirk Suringa. I am a partner with the law firm of Covington & Burling. From 2000 to 2003, I was an attorney advisor in the office of international tax counsel at the Treasury Department. I appreciate very much the opportunity to testify before the committee today.

Although I regularly advise clients on how best to comply with U.S. information reporting requirements, my testimony today is on my own behalf, and not on behalf of any of my clients.

I would like to make, briefly, three basic points summarizing my written testimony. First, offshore tax evasion remains a significant problem, and the committee is right to be concerned about it, and focused on efforts to stop it.

Although it's difficult to establish with precision the extent of offshore tax evasion, it clearly represents a substantial cost to the U.S., and undermines the basic fairness of our tax system. Put simply, the IRS needs effective enforcement tools to ferret out and stop U.S. tax evasion abroad.

Second, the conceptual approach effect, in my view, increased information reporting and disclosure, gives the IRS exactly the right type of tool to deal with offshore tax evasion. Disclosure enables the IRS to bring cases to recover revenue otherwise lost to tax evasion, and it discourages evasion in the first place, by raising the risk of detection.

Equally as important, properly structured information disclosure need not interfere with legitimate business transactions, which is as essential to our economic recovery as it is to generating tax revenue for our government.

While the objectives and overall approach of the bill, FATCA, are clearly correct, my third point is that the legislation may give rise to certain unintended consequences, largely because it's a unilateral measure.

The sanction that FATCA uses to obtain foreign bank account information is a withholding tax imposed on U.S. source investment income. So, a foreign financial institution or foreign entity can avoid the sting of FATCA simply by divesting from the United States. This type of a divestment would be troubling, not only because it would deprive the IRS of the opportunity to obtain actionable information, but also because of its potential harmful effect on the U.S. dollar and on in-bound U.S. investment, and the ability of U.S. companies to raise capital.

FATCA also could encourage foreign countries to impose a withholding tax on payments to U.S. financial institutions and U.S. entities, unless they disclose ownership by those countries' citizens and residents. A proliferation of country-by-country reporting and requirements of withholding taxes would raise, in my view, barriers to trade that should be avoided.

Last point is that FATCA, as drafted, may have the unintended consequence of overriding existing U.S. tax treaties. U.S. tax treaties typically require, as a condition for obtaining benefits, that the foreign person provide—demonstrate ownership, or demonstrate qualified treaty residence. In other words, they have to show that they are a good foreign country resident. Under existing treaties, that does not depend on whether they demonstrate that they have a U.S. ownership or now.

Thus, even if a foreign entity satisfies all the requirements of a treaty, FATCA could deny it the reduced rate of withholding tax provided by the treaty. In my view, a multi-lateral agreement on the sharing of taxpayer financial information would better serve the enforcement objectives of FATCA without these unintended consequences.

The more jurisdictions that would join such an agreement, the less of an incentive foreign financial institutions and foreign investors would have to divest from the United States, because they would know that wherever they invest their money in major markets, they would face the same problem.

At the same time, the less likely foreign governments would be to adopt conflicting unilateral measures that could end up putting information about taxpayers in the hands of governments that do not protect it to the same degree that we protect it under Code Section 6103.

Finally, an agreement among our major treaty partners would reduce the risk of the treaty override effect of the bill.

My written testimony has a couple of technical points on other aspects of the bill. I am happy to answer questions about that. Thank you very much for the opportunity.

[The statement of Mr. Suringa follows:]

STATEMENT OF DIRK J.J. SURINGA
BEFORE THE SUBCOMMITTEE ON SELECT REVENUE MEASURES
OF THE
COMMITTEE ON WAYS & MEANS
OF THE
U.S. HOUSE OF REPRESENTATIVES
ON THE SUBJECT OF
FOREIGN BANK ACCOUNT REPORTING AND
TAX COMPLIANCE

NOVEMBER 5, 2009

Chairman Neal, Ranking Member Tiberi, and Members of the Committee:

My name is Dirk Suringa. I am a partner with the law firm of Covington and Burling LLP. From 2000 to 2003, I was an Attorney-Advisor in the Office of International Tax Counsel at the Treasury Department. I appreciate very much the opportunity to testify today before the Committee. I appear before you today on my own behalf and not on behalf of my firm or any firm client.[1]

The topic of foreign bank account reporting and tax compliance is broad and complex. I will not attempt to cover the topic in a comprehensive way. Instead, I would like to make some general observations regarding the Foreign Account Tax Compliance Act of 2009 ("FATCA"), and then offer a few comments, from a practitioner's perspective, on two specific provisions.

I. Objectives and Overall Approach of FATCA

The Committee's efforts to stop offshore tax evasion by U.S. citizens and residents are both timely and essential. The revenue losses associated with offshore tax evasion are significant.[2] Tax evasion of any magnitude cannot help but erode the public's sense of equity in our tax system, and it unfairly shifts the cost of public services to law-abiding citizens. It is critical for the IRS to have the right tools at its disposal to investigate and prosecute U.S. tax evasion through foreign financial accounts.

At a conceptual level, FATCA gives the IRS the right type of tool for dealing with this problem. By creating several new information-reporting requirements, backed up by financial and other penalties, FATCA would provide the IRS with significant amounts of actionable information and likely would deter some types of criminal tax evasion before they

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[1] Covington & Burling has represented Liechtenstein during the period in which it has agreed to enter into Tax Information Exchange Agreements with the United States and eleven other countries. My involvement in that representation has been limited to providing the client with a summary description of the U.S. Qualified Intermediary ("QI") program and FATCA.

[2] According to Internal Revenue Service estimates, the "tax gap" for the 2001 tax year was $345 billion. Internal Revenue Service, *IRS Updates Tax Gap Estimates,* IR-2006-28 (February 14, 2006). Part of this tax gap is attributable to tax evasion by individuals.

begin. As noted by Supreme Court Justice Louis Brandeis, "[s]unlight is said to be the best of disinfectants; electric light the most efficient policeman."[3] Properly crafted information reporting requirements would bring to bear the disinfectant power of IRS disclosure to the problem of tax evasion without disturbing legitimate cross-border business activity.

II. Addressing Potential Unintended Consequences

While the objectives and overall approach of FATCA are clearly correct, the legislation may give rise to certain unintended consequences. As discussed further below, a multilateral approach to the sharing of tax information on financial assets may better achieve the tax enforcement objectives of FATCA without those unintended consequences.

First, FATCA may make it more difficult for U.S. taxpayers to raise foreign capital. Recent press reports have focused attention on the rejection by certain foreign banks of legitimate U.S. customers residing abroad.[4] In my view, this phenomenon has nothing to do with the prospect of FATCA's enactment for the simple reason that foreign banks will not be able to avoid the proposed 30-percent withholding tax under new section 1471 merely by refusing to accept U.S. customers. To avoid that withholding tax, they must enter into an agreement with the IRS, elect to report information like a U.S. bank, or cease making investments that would produce U.S. source income. It is not inconceivable, however, that some foreign financial institutions (and individual foreign investors) will choose the last alternative rather than comply with FATCA. This would undermine not only the effectiveness of FATCA, which relies on a withholding tax for its sanction, but also past efforts by Congress to attract mobile capital to U.S. markets and strengthen the value of the U.S. dollar, including through the reduction of U.S. withholding taxes on portfolio interest.[5]

Second, FATCA may lead foreign governments to impose a reciprocal withholding tax on U.S. financial institutions and U.S. entities that do not report account information regarding those countries' own citizens and residents. Foreign governments often follow the United States in adopting tax enforcement measures, and they may do so in this case as well.[6] A few instances of reciprocal legislation would not be cause for concern, but a

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3 Louis Brandeis, Other People's Money – and How the Bankers Use It (1914).

4 *See, e.g.*, Warren Giles, *Swiss Banks Shun Americans as U.S. Compels Disclosure*, Bloomberg.com (June 29, 2009), *available at* http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a8VwpO5m0WQ; Louise Armitstead, *Lloyds Bank Hit by Obama Tax Purge*, Telegraph.co.uk (June 15, 2009), *available at* http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/5526129/Lloyds-Bank-hit-by-Obama-tax-purge.html.

5 *See* I.R.C. § 871(h), 881(c); Joint Comm. on Tax'n, *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984*, at 391-92 (1984).

6 For example, the IRS in recent years has stepped up enforcement of transfer pricing penalties unless taxpayers produce contemporaneous documentation of their transfer pricing policies. Foreign governments have responded by adopting their own contemporaneous documentation requirements. As a consequence, U.S. taxpayers now may find that they must prepare separate sets of contemporaneous documentation, subject to different local requirements, for each jurisdiction in which they do business. *See, e.g.*, Daily Tax Report, *G.E. Counsel Details Transfer Pricing Burden, Suggests Consensus Databases for Big Four* (March 23, 2007) (reporting that General

significant proliferation could impose an undue burden on foreign commerce. Moreover, jurisdictions that enact reciprocal legislation may not protect against the misuse of confidential taxpayer information that they receive from our banks and securities dealers to the same extent as the IRS protects such information under section 6103 of the Code.

Third, FATCA as drafted may unintentionally override the reduced rates of withholding tax provided under U.S. tax treaties. U.S. tax treaties typically contain various objective tests to determine whether a foreign person is a "qualified resident" of a treaty jurisdiction and therefore entitled to treaty benefits. FATCA would add in certain cases a new information-reporting test not found in our treaties.[7] Where this requirement conflicts with the treaty, FATCA as the later-enacted provision would prevail and override it.[8] Treaty overrides adversely affect the treaty-making process and historically have been avoided unless essential to the ends sought by the legislation. In fact, Congress in the past has gone so far as to suspend for a period of years the effective date of a treaty override, in order to give Treasury the opportunity to add the domestic-law requirements to its treaty network.[9]

Whether or not FATCA is enacted in its current form, the potential unintended consequences described above could be mitigated through a multilateral agreement, entered into with our major treaty partners, providing for direct or inter-governmental exchange of taxpayer information.[10] The more jurisdictions that join such an agreement, the less of an incentive foreign financial institutions would have to divest from the United States, and the less likely foreign governments would be to adopt conflicting, unilateral measures. An agreement among our major treaty partners also would reduce the practical effect of any potential treaty override.

III. Additional Technical Comments

The scope of the material advisor reporting requirement (new section 6116) should be revised to provide the IRS with information more directly relevant to targeting

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Electric "has gone from producing 10 documentation studies per year in the early 1990s to having to provide 2,000 separate transfer pricing studies each year").

7 The Joint Committee's Technical Explanation of FACTA indicates that FACTA is "consistent with U.S. obligations under existing income tax treaties" because it allows foreign entities subject to withholding under FATCA to apply for a refund of the tax withheld. *See* Joint Comm. on Tax'n, *Technical Explanation of the "Foreign Account Tax Compliance Act of 2009*," at 22 (2009). The text of the statute remains ambiguous, however. Since most treaties do not condition benefits on the absence (or disclosure) of U.S. ownership interests, a refund claim that merely proves an entitlement to treaty benefits (*e.g.*, qualification under the active trade or business test) may not defeat the new withholding tax any more than the original treaty-based withholding certificate.

8 *See* U.S. Const. Art. VI; *Breard v. Greene*, 523 U.S. 371, 376 (1998); *Reid v. Covert*, 354 U.S. 1, 18 (1957); *Whitney v. Robertson*, 124 U.S. 190, 194 (1888); I.R.C. § 7852(d).

9 *See* Pub. L. No. 96-499, §1125(c), 94 Stat. 2599, 2690 (1980); *see generally* H.R. Conf. Rep. No. 96-1479, at 193 (1980) ("Until January 1, 1985, gain would not be taxed to the extent required by the treaty obligations of the U.S. On and after that date, the provision would prevail over any conflicting treaty provisions remaining in effect.").

10 The OECD is pursuing this type of approach in its Global Forum. *See* Meeting of the Global Forum on Transparency and Exchange of Information, *Moving Forward on Global Standards of Transparency and Exchange of Information for Tax Purposes*, at 7 (Sept. 2009), *available at* http://www.oecd.org/dataoecd/43/57/43775637.pdf

offshore tax evasion.[11] Despite its use of the term "material advisor," new section 6116 would require reporting with respect to all types of services, not merely advisory services. For example, it could cover the service provided by an information technology firm that connects the computer systems of a U.S. corporation to those of a newly acquired foreign group. The statute also would appear to apply to any category of person, including for example the officers and employees of the acquiring company itself (or the target), such as an in-house lawyer who works in a corporate mergers and acquisitions department.

The statute also covers any "interest" in the foreign entity, which could extend to any public debt offering (as well as any IPO) of a U.S. company with foreign affiliates. The statute also could apply to deemed acquisitions and constructive transfers, from the deemed asset sale that occurs when a section 338(g) election is made, to certain types of recapitalizations, to the deemed purchase of parent stock under section 1032 for compensating employees of a foreign subsidiary. Information returns filed in such cases may be of little enforcement value to the IRS, particularly because the fee threshold of $100,000 is more likely to be triggered in connection with public transactions than in individual tax evasion, however widespread.

The requirement in new section 1298(f) that shareholders of a passive foreign investment company ("PFIC") file an information return should include a minimum ownership threshold to account for the practical inability of PFIC shareholders with minimal ownership interests to obtain information from the PFIC. Section 1297 defines a PFIC based solely on its assets and income, and not based on whether it has any U.S. owners.[12] Thus, a U.S. person with a fractional stock ownership interest in a PFIC could be required to report, under section 6116, corporate information as to which he or she has no practical access. Information reporting is currently required with respect to PFICs that make qualified electing fund ("QEF") elections and from PFIC shareholders that elect mark-to-market treatment for their PFIC stock or that obtain a taxable excess distribution from the PFIC. In those cases, the reporting U.S. person has access to reportable information because the PFIC has affirmatively agreed to be treated as a QEF; the PFIC's stock is publicly traded; or the U.S. person has received an excess distribution or taxable gain amount. These reporting requirements thus do not present the same practical concern as new section 1248(f).

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[11] The Joint Committee Technical Explanation confirms that the provision is meant to apply broadly to any "advice incident or related in any way to the acquisition of an interest in a foreign entity." *See* Joint Comm. on Tax'n, *Technical Explanation of the "Foreign Account Tax Compliance Act of 2009,"* at 43 (2009). As noted in the text below, the statute applies beyond advice to other "material aid" and "assistance."

[12] New section 1298(f) technically would require shareholders of a PFIC with no U.S. ownership or any other relevance to the U.S. tax system to file a U.S. information return. Under FATCA, the failure of such foreign persons to file a return, which likely would be a common occurrence, would be of little practical consequence unless they (or their spouse, in community property jurisdictions) were to become a U.S. citizen or resident. At that point, the extended statute of limitations provided by new section 6501(e) would appear to apply retroactively to extend their statute of limitations indefinitely until the required information returns are filed. It is unclear whether this result was intended, but a minimum ownership threshold would reduce the scope of this potential trap for the unwary.

Chairman NEAL. Thank you, Mr. Suringa. We have three votes on the floor. So we will recess until after the last vote. I anticipate being back here right after noon time. And then we will have an opportunity to not only resume testimony, but have some questions answered. The committee stands in recess.

[Recess.]

Chairman NEAL. Let me call this meeting back to order. And we have finished testimony from the witnesses, so there will be now an opportunity to raise questions with our very good panelists.

Mr. Prevost, let me congratulate you, first of all, on your willingness to come and testify today. I know it was not an easy decision, given the strong objections that we have heard to this bill from some in the international banking community. But you seem to think, overall, it is a responsible approach to the enforcement problem.

You mentioned that this bill is an improvement over the budget submission from earlier this year. Would you be specific?

Mr. PREVOST. Sure, Chairman Neal. You know, there were a couple very fundamental concerns with the greenbook proposal that this bill fixed, and I think this is going to be helpful to the banking community.

The first is the elimination of the requirement to do full 1099 reporting. That was a major concern by a number of foreign financial institutions. And the other was the requirement that every qualified intermediary—all of their affiliates had to be qualified intermediaries, as well. It's a very big sort of compliance issue to be a qualified intermediary. So, to have to make every entity be forced to be one was a concern that a lot of people had.

Chairman NEAL. I was also interested in your comments about potential duplicative reporting. Maybe you can suggest some ways for us that Treasury and the IRS limit the potential for this use?

Mr. PREVOST. Sure. I mean, some of this is described in our written testimony, but you know, there is fundamental things.

Like, if a hedge fund is already providing K1s to the Internal Revenue Service, to ask them to do this reporting as well, which actually doesn't even give you as much information that's already on the K1, that seems to us to be unnecessary.

If you have got a bank that has a hedge fund account and the hedge fund has also got the FFI agreement to have the bank do the reporting and then have the hedge fund do the reporting as well, you—basically you're giving the same information to the IRS twice. And, if anything, it has the potential to confuse them, because they're getting more information than actually what's really out there in dollar terms, because they get the same information more than once.

So, it is things like that that they need to work on.

Chairman NEAL. And, Professor Kingson, I was interested in your suggestion that companies be required to disclose the U.S. tax on their foreign earnings that are permanently reinvested. Can you explain why that would make tax havens less attractive?

Mr. KINGSON. It would not result in their increasing earnings per share.

I can give two examples of this. I went to a conference at Merrill Lynch years ago where the Internal Revenue Service had offered to say that they would give a bigger—an interest factor on convertible bonds, increasing your deductions, if the companies did the same thing for book purposes. And there were tax lawyers and investment bankers there, and the tax lawyers said, "This is great, you will save a lot of taxes," and the bankers said, "It will hurt earnings," and they did not agree.

And you take something like the HealthSouth Corporation. To support their billion dollars of earnings, they overpaid $300,000 of taxes. And when they went bankrupt, the trustee got it back. They were willing to pay taxes in order to really inflate their earning.

Chairman NEAL. And Mr. Suringa, I appreciate the fact that, in your testimony, you acknowledged that this was a legitimate problem that we are examining here, and I thought that was very helpful.

Mr. SURINGA. Yes.

Chairman NEAL. You would note that there is very little rancor here on the subcommittee today. I think much of it has to do with the fact that this is a serious issue——

Mr. SURINGA. Yes.

Chairman Neal.—and that the American people are focused on it.

Mr. SURINGA. I agree completely. I think it is an important issue. Individual tax evasion has a corrosive effect on the willingness of law-abiding taxpayers to pay their fair share. So I think it's a very important problem.

Chairman NEAL. Thank you. And let me yield to Mr. Tiberi.

Mr. TIBERI. Thank you. Thank you, Mr. Chairman. First, Mr. Prevost, thank you for being here. Question to you.

You mentioned the issue of bearer bonds. If I can ask you a question related to that, I understand that bearer bonds have sometimes enabled dishonest people to cheat on their taxes. And it's important to address that problem. On the other hand, I think that it's also important that these—in these troubled economic times, to broaden the U.S.—the access to U.S. companies and the Treasury to sources of capital, not to restrict such access, in this particular case.

Wouldn't the bill's bearer bond provision make it harder for the Treasury Department and American companies to raise capital in some markets around the world, and wouldn't the resulting implications—and what would the resulting implications be for the economy right now, the U.S. economy right now?

Mr. PREVOST. Oh, you know, I am not an expert on bearer bonds, but yes, I am aware of the fact that there are some markets where U.S. companies can only raise money through bearer bond activity.

For example, in Switzerland, we understand that, you know, $40 billion was raised in the 2004 through 2007 period by U.S. companies. And, you know, if they wanted to tap that market, if they couldn't do bearer bonds they wouldn't be able to raise the money. So I don't know what the alternative would be. But there is an issue that needs to be thought about.

Mr. TIBERI. Mr. Suringa, have you thought about the issue at all?

Mr. SURINGA. I have. I mean, I think in terms of—we would be in sort of uncharted territory, if we were to repeal the ability of issuers to include the TEFRA disclaimer language, and the reason is that the issuer sanctions, for example, apply, in essence, to all issuances of debt. So it's sort of drafted in a way that is an extra-territorial application of U.S. law.

And the way that foreign issuers, as well as U.S. issuers, deal with that problem or that potential problem is to include the TEFRA disclaimer language in all debt issuances. So they basically can avoid the issue by just putting the foreign targeting requirements into their issuances of debt. And so we don't have to encounter the problem about whether or not, if that language weren't in there, if it weren't effective, that issuance would be subject to a one percent excise tax, multiplied by the number of years of the issuance.

If we take away the ability of companies to be able to do that, then I think we have to confront the extra-territorial application of the bill—of the law, as it stands now. And that could have a negative effect on the ability of U.S. companies to raise capital, and on foreign companies, as well.

Mr. TIBERI. Taking a step further, as I understand it—and please correct me if I'm wrong—the legislation would not prevent a foreign company, my understanding, from using bearer bonds, which then would put U.S. companies, potentially, at a competitive disadvantage, while not meeting the objective, I believe, the objective of removing bearer bonds from the markets entirely.

So, instead of unilaterally—a unilateral U.S. action on the issue, wouldn't it maybe be more effective, if we're trying to get this more—at it from a global perspective, attempt to address the bearer bond issues cooperatively, through multi-lateral negotiations with other countries?

Mr. SURINGA. Well, I do think—I mean, the tenor of my testimony is that I think a multi-lateral approach is the best way to avoid the issues that kind of rise——

Mr. TIBERI. If we don't do that, wouldn't it put us at a disadvantage, our folks at a disadvantage?

Mr. SURINGA. Oh, I think that's right, in terms of where can we raise capital, where can our companies raise capital——

Mr. TIBERI. Right.

Mr. Suringa [continuing]. If we have this disincentive, or this sanction. I mean, other companies are going to be able to raise capital without having to deal with that sanction, I mean, assuming that they can work out the extra-territorial application——

Mr. TIBERI. Mr. Kingson, you agree?

[No response.]

Mr. TIBERI. Do you agree?

Mr. KINGSON. I'm sorry, I am not—really not qualified to——

Mr. TIBERI. Okay. Mr. Prevost?

Mr. PREVOST. I do agree that that is an issue that has to be addressed.

Mr. TIBERI. Want to take a stab at it, Mr. Kingson, even though you're not—we're not experts, either.

No? All right. Mr. Chairman, I will yield back.

Chairman NEAL. Thanks for giving up the disguise.

Let me yield to Mr. Doggett to inquire.

Mr. DOGGETT. Thank you very much, and thanks to each of our witnesses. I will have some questions for Mr. Kingson.

Doesn't the revenue loss from corporate manipulation of the Tax Code far exceed even the very substantial revenue loss from individual tax evasion?

Mr. KINGSON. I think it does.

Mr. DOGGETT. And, given the magnitude of that problem, and the loss to the treasury from international tax misconduct, do you agree that a comprehensive approach to international tax abuse should include proposals that you have advanced, along with managed and controlled provisions of the stock tax havens, in order to really deal with the whole problem?

Mr. KINGSON. Yes.

Mr. DOGGETT. And as far as this whole term "managed and controlled," I know you talk about it in your testimony. But all we're really saying is if you look like an American corporation, you sound like an American corporation, you're here as—physically, as an American corporation with your directors and your management, maybe you ought to pay taxes like an American corporation?

Mr. KINGSON. That's—what an individual does, a corporation should do, too.

Mr. DOGGETT. As I discussed with Mr. Shay, one category of corporate entities that would be affected by this provision for management and control are newly formed corporations that start out by filing a piece of paper somewhere in the Caribbean entitling them under current law to be treated as a foreign corporation, even though the company is being run here, from America.

Is it correct that our current inversion provisions do not reach those companies?

Mr. KINGSON. I think they don't, no.

Mr. DOGGETT. And is there a substantial problem in that area that needs to be corrected, legislatively?

Mr. KINGSON. It depends on how good the idea is. I mean, if they're going to be successful, obviously they would get a lot of stuff offshore.

Mr. DOGGETT. All right. And I will take that as a yes, is that right?

Mr. KINGSON. Yes.

Mr. DOGGETT. Some have argued that a managed and controlled provision would conflict with our tax treaties. Because, under the treaty, the corporation is considered a resident of the contracting state, and liable for tax there. Is there any legitimacy to the argument that the managed and controlled provision from Stop Tax Havens would lead to double taxation for some corporations?

Mr. KINGSON. I don't think there should be—title of every tax treaty says it is a convention for the prevention—for the avoidance of double taxation. And almost all of our treaty partners use the management and control test.

And, what's more, the OECD commentary said it would not be proper to use the function of just registration. You should use a management and control test. And that's the OECD commentary on their model treaty.

Mr. DOGGETT. And the management and control provision, I believe, has been used in the Netherlands tax treaty in a little different form, and it is a factor in the conduct of many other countries, that we're just asking the same standard apply here.

Mr. KINGSON. Yes.

Mr. DOGGETT. I will pose one more question to you, and that is that corporate tax avoidance, as substantial as it is, is usually defended as just being essential to maintaining American competitiveness.

In fact, don't these avoidance provisions that are usually available only to a multi-national with a fleet of lobbyists and CPAs, aren't those provisions actually providing a competitive advantage over small businesses across America who don't have those opportunities?

Mr. KINGSON. Yes. I think the competitiveness cry is really sort of the second-to-last refuge of a scoundrel. I mean, I think there is very little basis in it. I usually don't believe it. You cannot ascertain effective rates very, very precisely.

And, for example, years ago, if we exempted real estate from income tax, there would have been a revenue gain.

Mr. DOGGETT. And as multi-national shenanigans that aren't available on Main Street, but are available on Wall Street, I know you feel they need to be addressed in this legislation, and that they are not.

But let me ask you whether, if we address and try to provide a level playing field and real competitiveness for all businesses here within the United States, if we will be—based on your experience, having worked as international tax counsel for the Treasury, and having taught this at a number—the whole question of international tax law—at a number of prestigious law schools—if there will be any adverse effect, versus foreign companies that we compete with that are real foreign companies, rather than just made-to-look-like a foreign company to dodge our tax burden?

Mr. KINGSON. Well, if companies have no tax at all, I think, obviously, they are getting a free ride. And I think that you raise a very important issue, that when they're talking about competitiveness, there is some significant competitiveness of people who keep jobs in the United States and who export, from those who say, "Well, we need to compete abroad by not having any tax."

Mr. DOGGETT. Thank you. Thank you, Mr. Chairman.

Chairman NEAL. Thank you, Mr. Doggett. And I want to thank our panelists today for their informed testimony. You may receive some written follow-up questions from Members, and I hope that you will respond promptly, so that we might include your comments in the record.

Being no further business before the subcommittee, then the hearing is adjourned.

[Whereupon, at 12:49 p.m., the subcommittee was adjourned.]

[Submissions for the Record follow:]

American Citizens Abroad, statement

American Citizens Abroad

The Voice of Americans Overseas

To: The Honorable Charles Rangel, Chair, W & M Committee: FAX: 202-225-0816
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The Honorable Richard E. Neal, Chair, Select Revenue Measures Sub-committee of the Ways and Means Committee: FAX: 202-225-8112
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November 3, 2009

Concerns: **Foreign Account Tax Compliance Act – HR 3933**

Dear Sirs:

American Citizens Abroad (ACA), the voice of Americans overseas, is a non-profit, non-partisan all-volunteer organization that represents the interests of Americans living and working outside the U.S. to the Executive Branch of the U.S. Government, the U.S. Congress, and the U.S. Federal Judiciary to insure that Americans overseas are treated with equality and fairness. ACA keeps Americans overseas informed and supports their role as informal representatives of the United States. More can be learned about ACA through our website, www.americansabroad.org.

We are submitting this written comment to the hearings on HR 3933 which will take place on November 5, 2009 and request that this submission be included in the record. These comments are addressed to the four members of Congress who jointly issued the Congressional press release of October 27, 2009 supporting HR 3933, as the close coordination between the Senate Finance Committee and the Ways and Means Committee on this issue is apparent.

American Citizens Abroad is dismayed to see the contents of the proposed ***Foreign Account Tax Compliance Act*** which, if passed, will create a backlash from foreign governments in response to what is openly referred to overseas as the financial imperialism of the United States. This legislation aims to significantly expand the reach of the Qualified Intermediary (QI) regulations. Whereas the current QI regulations are concerned principally with investment accounts, the ***Foreign Account Tax Compliance Act*** would apparently cover all bank activity, including current accounts. As stated in the joint press release, "The ***Foreign Account Tax Compliance Act*** would force foreign financial institutions, foreign trusts, and foreign corporations to provide information about their U.S. accountholders, grantors, and owners, respectively. The nonpartisan Joint Committee on Taxation has estimated the provisions of the ***Foreign Account Tax Compliance Act*** would prevent U.S. individuals from evading $8.5 billion in U.S. tax over the next ten years." This legislation would significantly enhance the authority of the Treasury in imposing the QI regulations and, in fact, requires foreign financial institutions to become policemen for the IRS. The administrative burden and costs associated with compliance will be significant for foreign financial institutions. And the associated legal risk is perceived as high.

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As stated by Chairman Rangel in the Congressional press release, "This bill offers foreign banks a simple choice – if you wish to access our capital markets, you have to report on U.S. account holders. I am confident that most banks will do the right thing and help to make bank secrecy practices a thing of the past." In the same press release, Ways and Means Select Revenue Subcommittee Chairman Neal stated: "I believe this bill provides the Treasury Department with the tools it needs to crack down on those Americans hiding assets overseas."

This legislation assumes that banks will submit passively to the U.S. rules and that business will go on as usual. But this will not be the case. UBS in Switzerland has already announced that it will no longer accept as a client any American person residing in the United States. Many other foreign banks are adopting the same policy in a more discrete way.

With regard to American citizens residing abroad, a group of major UK banks has already stated that they will close accounts of American citizens if the proposed QI regulations of January 1, 2010 become effective. We know for a fact that Swiss, Dutch and Spanish banks are refusing American citizens residing in their countries as clients and are closing accounts. Do not forget that there are over 5 million American citizens residing abroad. These people need to maintain foreign bank accounts in the country where they reside to make current payments receive salaries and hold their investments. The proposed legislation and reinforced QI regulations will make it all the more difficult for overseas Americans to maintain a bank account where they reside.

Although ACA understands and sympathizes with the efforts of the U.S. Congress to close the door to tax cheats, you must remember that most Americans working and living overseas are not tax cheats but are performing significant services for the United States in representing American companies and products. The proposed legislation specifically discriminates against one category of U.S. citizens – those residing overseas. Imagine the uproar if Congress passed a law that all residents of New York would have their bank accounts submitted to special investigation, including the total of debits and credits in a year and the maximum balance in the account.

Closing accounts is just one reaction to the U.S. overreach. The United States imposing its laws on foreign countries is creating a poisoned atmosphere which will hinder the positive development of international trade and finance. One Swiss bank has already publicly announced that it will no longer invest in any American securities for any of its clients. Since that announcement, which received substantial press coverage, and the explanation of US tax legislation behind that statement, foreigners are already beginning to divest of U.S. stocks. The U.S. tax code states that if a foreigner owns more than $60,000 of U.S. securities at the time of his death, his estate becomes subject to U.S. inheritance laws. At a time when the United States should aim to attract foreign capital, its legislation will discourage investment in the United States. As the United States government depends on foreign investors to purchase a large share of Treasury bills, the threat of a significant divestment out of the United States is not to be taken lightly.

While there is no doubt that the United States remains a financial powerhouse, it is no longer the only option for investment purposes. With the U.S. dollar devaluing against other currencies, many individuals are focusing investments in currencies other than the U.S. dollar. The United States risks losing investment flows into the country and compromising free flow of trade if people located outside of the United States view compliance as administratively too burdensome. Furthermore, the probable restriction on access to bank accounts overseas by American citizens and corporations will put a restrainer on the free development of trade. The new movement away from the U.S. stock market is just one form of backlash on American policies, and all of the publicity linked to the bank secrecy issue has made foreigners sensitive to the implications of any relationship with the United States.

The United States also risks facing measures of reciprocity from foreign governments. In fact, the perspective of the United States on bank secrecy and fiscal paradises is very hypocritical. On November 2, 2009, a Financial Secrecy Index was been published for the first time by the

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International network for fiscal justice, co-founded by the South Alliance and the Declaration of Bern. Ranking number one in the overall index of secrecy is Delaware in the United States with a heavy weight in international transactions. In terms of secrecy, Delaware ranks on a par with the Cayman Islands, Bermuda and Dubai.

The U.S. one way approach has also been illustrated by the fact that when Mexico asked for United States assistance in providing the names of Mexican citizens with money hidden in the United States, the United States refused to collaborate. The OECD countries are also building up forces to obtain transparency of their nationals. This movement will extend to money held in the United States as well as to other foreign banks.

American Citizens Abroad fears that the current Congressional approach to stop the few thousand American citizens that evade taxes by imposing its laws on other nations risks to open up Pandora's box, to create suspicion and friction with many other governments and to have a long-term negative impact on U.S. trade and commerce in general. The costs to the United States could far exceed the $850 million annual revenue projected to be collected by the Joint Committee on Taxation due to the proposed HR 3933. Right now the United States should be encouraging more foreign trade to increase the nation's exports, not develop legislation reaching beyond its borders, which will hinder that free movement of trade.

American Citizens Abroad supports Congress in its efforts to eliminate tax evasion, but asks that the current legislation be revised and rewritten so as not to discriminate against Americans living and working abroad and not to negatively impact continued foreign investment in the US. ACA feels it imperative to warn Congress of the serious risks for the United States related to the current drafting of the ***Foreign Account Tax Compliance Act***.

We thank you for your attention.

Sincerely yours,

Marylouise Serrato	Jacqueline Bugnion
Executive Director	Director

cc: Americans Abroad Caucus
The Honorable Timothy F. Geithner, Secretary of the Treasury
The Honorable Paul Volcker, Chairman, Presidential Task Force on Tax-Code Review

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Chamber of Commerce of the United States of America, statement

CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

R. BRUCE JOSTEN
EXECUTIVE VICE PRESIDENT
GOVERNMENT AFFAIRS

1615 H STREET, N.W.
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November 24, 2009

The Honorable Max Baucus Chairman Committee on Finance United States Senate Washington, DC 20510	The Honorable Charles Rangel Chairman Committee on Ways & Means U.S. House of Representatives Washington, DC 20515
The Honorable Charles Grassley Ranking Member Committee on Finance United States Senate Washington, DC 20510	The Honorable Dave Camp Ranking Member Committee on Ways & Means U.S. House of Representatives Washington, DC 20515

Dear Chairmen Baucus and Rangel and Ranking Members Grassley and Camp:

The U.S. Chamber of Commerce, the world's largest business federation representing more than three million businesses and organizations of every size, sector, and region, appreciates the opportunity to provide comments on H.R. 3933/S. 1934, the "Foreign Account Tax Compliance Act of 2009."

While the Chamber applauds measures to improve taxpayer compliance and to curb tax evasion, we are concerned that certain provisions in this legislation would limit the flow of foreign capital into the United States and cause disruptions to the international capital markets. The Chamber believes access to credit is crucial to economic recovery.

Section 101, Increased Reporting and Withholding Obligations on Foreign Financial Institutions

Effective for payments made after December 31, 2010, §101 of this legislation would impose extensive new reporting and tax withholding requirements on foreign financial institutions (FFIs) that could potentially hold the accounts of U.S. persons. Despite the existing obligation of U.S. persons to report and pay U.S. tax on income earned through both domestic and foreign financial accounts, this provision would create a second layer of reporting on these transactions. To enforce these new requirements, a 30 percent U.S. withholding tax would be imposed on certain U.S. payments to FFIs that do not, or that simply could not, satisfy these reporting obligations. Further, this tax would apply broadly regardless of whether these payments relate to a U.S. customer's account, a foreign customer's account, or the institution's own account.

Many FFIs already participate in the Qualified Intermediary (QI) program. Under the QI program, participating FFIs are responsible for withholding U.S. tax with respect to foreign persons that hold accounts with the FFI. These new reporting and withholding requirements would add another layer of responsibility to FFIs who already comply with requirements under the QI program. Further, these proposed new requirements would extend to much smaller institutions which are generally excluded from the QI program.

The Chamber is concerned that these new requirements are unnecessarily onerous and broad and thus could result in foreign persons, including certain FFIs, divesting themselves of their current U.S. investments and avoiding future U.S. investment entirely. This would be severely detrimental to the U.S. financial markets and the U.S. economy, currently struggling to get on the road to economic recovery.

To ensure that this new reporting and withholding regime is administrable but also is not unduly burdensome and does not discourage U.S. investment, the Chamber recommends:

1. That the effective date of this provision be delayed both to give the Treasury Department the appropriate time to develop and implement regulations to create a workable compliance system, and to allow FFIs and their withholding agents the time to develop systems to comply with their duties under this provision. Further, the Chamber recommends this provision be modified to authorize the Treasury Department to further delay the effective date of this provision if necessary to avoid disruptions to financial markets.

2. That this provision be modified to better coordinate with the existing QI regime so as to avoid conflicts with that regime and to ensure these new requirements meet their objectives in the least onerous manner possible.

3. That this provision be modified to avoid duplicative reporting by multiple FFIs.

Section 102, Repeal of the Foreign-Targeted Bearer Bond Exception

Since 1982, the "TEFRA" rules have generally allowed U.S. issuers to issue debt obligations in bearer (i.e., nonregistered) form and still receive an interest deduction, as long as these obligations are not offered or sold to U.S. persons (the "foreign-targeted bearer bond exception"). Applicable to debt obligations issued more than 180 days after the date of enactment, §102 of this legislation would repeal the foreign-targeted bearer bond exception.

The Chamber is concerned that repeal of this exception could limit, if not potentially eliminate, U.S. issuer's access to funds in certain foreign markets. In many foreign markets, issuance of securities in bearer form is currently the international norm where as registered securities, as would be required under this provision, are unusual or unknown. In these markets, it would be unworkable to issue securities in registered form; U.S. issuers would be precluded from issuing bearer bonds in these markets as a financing mechanism and, thus, effectively precluded from raising funds in these jurisdictions.

To prevent a disruption of the financial markets and to prevent unnecessary limits on access to capital, the Chamber recommends that the Committees and Congress direct the Treasury Department to study and report on the potential consequences of the repeal of the foreign-targeted bearer bond exception before any such repeal is undertaken.

Section 501, Dividend Equivalent Payments Received by Foreign Persons Treated as Dividends

Under current law, payments to foreign persons pursuant to equity swap transactions are not subject to U.S. withholding. Applicable to payments made 90 days or more after the date of enactment, §501 of this legislation would provide that "dividend equivalent payments" on such equity swap transactions would be subject to a 30 percent U.S. withholding tax.

The Chamber is concerned that this proposal would cause market disruptions as a result of the fact that the provision is not clear on which transactions could be subject to this new withholding requirement. Without further clarification, the Chamber is concerned that this provision could wind up governing transactions not intended to be targeted by this proposal, such as where equity swap transactions are structured to comport with the practices of foreign markets. Further, the Chamber is concerned that this provision could result in outstanding transactions being terminated and future transactions not being entered into.

The Chamber recommends that the enactment of this proposal or its effective date be delayed until clear specific guidance can be provided by the Treasury Department. Such guidance should set forth the transactions and payments governed by this provision and allow interested parties sufficient time to implement systems which ensure proper compliance with this provision.

The Chamber appreciates the opportunity to offer comments on this proposed legislation and looks forward to working with Congress to improve it so that it achieves its objective of curbing tax evasion while avoiding unnecessary limits on access to capital and minimizing capital market disruptions.

Sincerely,

R. Bruce Josten

Cc: The Members of the House Committee on Ways & Means
The Members of the Senate Committee on Finance

Managed Funds Association, statement

MANAGED FUNDS ASSOCIATION

WRITTEN STATEMENT
OF

RICHARD H. BAKER
PRESIDENT AND CHIEF EXECUTIVE OFFICER

MANAGED FUNDS ASSOCIATION

For the Hearing on

Foreign Bank Account Reporting and Tax Compliance

BEFORE THE

SUBCOMMITTEE ON SELECT REVENUE MEASURES
COMMITTEE ON WAYS & MEANS
U.S. HOUSE OF REPRESENTATIVES

NOVEMBER 5, 2009

WRITTEN STATEMENT OF MANAGED FUNDS ASSOCIATION

Foreign Bank Account Reporting and Tax Compliance
November 5, 2009

Managed Funds Association ("MFA") is pleased to submit this written statement in connection with the House Ways & Means Subcommittee on Select Revenue Measures' hearing, "Foreign Bank Account Reporting and Tax Compliance" held on November 5, 2009. MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $1.5 trillion invested in absolute return strategies.

MFA appreciates the opportunity to express its views on U.S. tax policy and specifically on foreign bank account reporting and related tax compliance issues. MFA strongly supports the efforts in Congress and the Obama administration to provide regulators with the authority needed to detect and prevent tax evasion and non-compliance with U.S. tax laws by U.S. persons holding investment assets in offshore accounts. We note that there are several legislative proposals that seek to address the issue of tax compliance, including the Obama administration's fiscal year 2010 budget proposal, the *Stop Tax Haven Abuse Act* (H.R. 1265) and more recently the *Foreign Account Tax Compliance Act of 2009* (H.R. 3933), which is the focus of today's hearing.

MFA believes that any legislative proposal that seeks to expand regulatory authority in this area and to establish a new tax compliance framework should be designed to uncover and stamp-out those activities that are intended to evade taxes. We strongly support regulators having the tools necessary to combat tax evasion. It is equally important, however, for U.S. businesses that manage offshore investment funds or otherwise engage in legitimate overseas investment activities to be able to continue to do so without excessive administrative burdens or adverse tax treatment that threatens the global competitiveness of U.S. businesses and markets. Legislation that does not carefully consider such activities may unduly impair investment in funds managed by U.S. advisers and place U.S. advisers at a competitive disadvantage to their foreign counterparts, particularly during this critical period in our nation's economic recovery.

LEGITIMATE OFFSHORE ACTIVITIES

Hedge funds are among the most sophisticated institutional investors and play an important role in our financial system. They provide liquidity and price discovery to capital markets, capital to companies to allow them to grow or improve their businesses, and sophisticated risk management to investors such as pension funds, to allow those pensions to meet their future obligations to plan beneficiaries. The growth and diversification of hedge funds have strengthened U.S. capital markets and provided their investors with the means to diversify their investments, thereby reducing overall portfolio investment risk. Hedge funds engage in a variety of investment strategies across many different asset classes. As investors, hedge funds help dampen market volatility by providing liquidity and pricing efficiency across many markets. Each of these functions is critical to the orderly operation of our capital markets and our financial system as a whole.

U.S. hedge fund managers engage in offshore investment activities for a number of business reasons, including to broaden their investor base internationally and to be able to raise capital from U.S. tax exempt investors. Current U.S. tax law deters pension funds and other U.S. tax exempt investors as well as non-U.S. investors from investing in domestic funds.[1] U.S. based managers need to manage offshore funds to meet the demands of these investors and to remain competitive with non-U.S. advisers. Thus, these transactions are quite legitimately conducted offshore and generally are not motivated by a desire to avoid disclosure or evade U.S. federal income tax.

MFA'S PERSPECTIVE ON THE LEGISLATIVE PROPOSALS

MFA generally supports the objectives of those measures in the legislative proposals that seek to improve the quality of foreign information reporting. MFA believes that a more efficient reporting regime—which supplants the existing rules for Reports of Foreign Banks and Financial Accounts (TD F 90-22.1, commonly referred to as "FBAR")—would assist hedge funds and other private investment funds in complying with regulators' requests for information regarding offshore accounts, while reducing duplication and the costs associated with compliance.

In contrast, MFA believes that Congress should further examine and amend certain measures in the legislative proposals in order to avoid unintended and detrimental consequences for U.S. hedge fund and other private investment fund managers. For example, we believe that any measure that would treat substantially all offshore funds managed and controlled primarily in the United States as domestic corporations would impair the ability of U.S. investment managers to successfully compete with their non-

[1] Section 501(a) of the Internal Revenue Code of 1986, as amended (the "Code") provides that U.S. tax-exempt entities generally are not subject to U.S. income tax. Nonetheless, section 511 of the Code requires that these entities declare and pay taxes on "Unrelated Business Taxable Income" or "UBTI". This section defines UBTI as any money earned from conduct unrelated to the entity's tax-exempt purpose. This section, however, also excludes from the definition of UBTI investment income (*i.e.*, dividends, royalties, rents, capital gains and interest income) unless such income is derived from debt-financed property. Many hedge funds use some amount of debt (leverage) in connection with their trading strategies. As a result, a U.S. tax-exempt investor that invests in a domestic hedge fund would be required to treat the debt-financed income flowing through the hedge fund partnership as UBTI.

Section 864 of the Code does not subject non-U.S. investors to U.S. income tax unless such investor conducts a trade or business within the United States. In that case, section 864 of the Code requires that non-U.S. investors file a U.S. tax return and pay taxes on the same terms as a U.S. individual or corporation. If a foreign investor invests in a domestic hedge fund, he or she is typically treated as engaged in a U.S. trade or business.

U.S. counterparts in attracting investments from U.S. tax exempt investors and non-U.S. investors. By treating offshore funds as domestic corporations, these funds would be subject to U.S. corporate tax at rates up to 35 percent (39.6 percent in 2010), regardless of the source, character (*i.e.,* ordinary or capital gain) or nature (*i.e.*, related to a business or mere investment) of the income they generate. These taxes would significantly reduce the return on investment for pension funds and other fund investors. The lower return on investment ultimately would drive pension funds (which have a fiduciary duty to their pensioners) and non-U.S. investors (who generally are not currently subject to U.S. federal income taxes to the extent they invest in a non-U.S. fund, even when that fund invests in U.S. securities) to invest in funds managed by non-U.S. investment managers (*e.g.*, Canadian, European and Asian fund managers). In effect, this type of measure would only penalize U.S. private investment fund managers who lawfully manage funds for U.S. tax exempt investors and non-U.S. investors. It is questionable whether such a provision would even raise revenue, as most affected investors would likely invest in funds managed by non-U.S. advisers.

It is noteworthy that, if such measures were to be enacted into law, U.S. investment managers might relocate their management companies outside of the United States in order to successfully compete with their non-U.S. counterparts. Additionally, the relocation of an entire industry could cause many more U.S. jobs to be lost. At a time when the U.S. economy and job market are struggling, tax measures that seek to domesticate offshore funds for U.S. federal income tax purposes appear to establish an unnecessary impediment to investment activities and job creation in the United States. Given these harmful and unintended consequences, we commend House Ways & Means Committee Chairman Charles Rangel for introducing a legislative proposal that addresses the concerns of tax evasion by U.S. persons without including such a measure. Indeed, such a provision could result in U.S. job losses as a consequence of investors migrating to non-U.S. advisers.

Other measures in the legislative proposals appear overly broad and, in attempting to halt the use of a specific financial product, would inadvertently constrain the use of a much broader range of financial products. In particular, some of the legislative proposals seek to expand the definition of the term "dividend" for U.S. withholding and sourcing purposes to include dividend equivalents (*i.e.*, payments pursuant to notional principal contracts contingent upon or reference to the payment of a dividend) and other similar payments. It is our understanding that these measures are intended to target investors who enter into certain equity derivative products solely to avoid U.S. withholding tax. While we agree that such equity derivatives entered solely for tax avoidance purposes should be the subject of withholding, it is our view that the language in the legislative proposals is written too broadly and would also cover equity derivatives that are entered into for legitimate business reasons. As a consequence, we believe these proposals would unnecessarily require an intermediary to withhold funds in connection with all equity derivative transactions. One significant business reason why market participants enter into equity derivatives is for hedging purposes, including hedging positions taken in U.S. equity markets. In effect, these legislative proposals could reduce the cost benefit of equity derivatives and ultimately the liquidity in U.S. and non-U.S. equity markets as a result of investors not having access to financial products that allow them to hedge their risks. We look forward to working with Chairman Rangel, the Subcommittee and other policy makers to target abusive equity swaps while permitting market participants to continue trading legitimate equity swaps. MFA plans to submit substantive comments to this measure and other aspects of the Chairman's proposal that are consistent with the purposes of the legislation.

CONCLUSION

MFA strongly supports legislation that seeks to provide regulators with the necessary tools to detect and prevent tax evasion by U.S. persons engaged in offshore activities. MFA members are willing to comply with any new compliance framework that provides regulators with the appropriate amount of information to enforce U.S federal tax law. However, it is important that such framework does not impose excessive or duplicative administrative burdens on hedge funds and other private investment funds. As stated above, MFA looks forward to being a constructive participant in working with the Subcommittee and other policy makers to achieve the intended objectives of the legislation.

MFA appreciates the opportunity to submit this statement to the Subcommittee. We would welcome the opportunity to elaborate on these points, or answer any questions that Subcommittee members or staff may have regarding our views.

Prepared Statement of American Bankers Association

Chairman Neal, Ranking Member Tiberi, and Members of the Subcommittee, the American Bankers Association ("ABA") appreciates having this opportunity to submit a written statement for the record of the Subcommittee on Select Revenue Measures' November 5, 2009 hearing on H.R. 3933—the Foreign Account Tax Compliance Act of 2009 (the "H.R. 3933").

The American Bankers Association brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members—the majority of which are banks with less than $125 million in assets—represent over 95 percent of the industry's $13.3 trillion in assets and employ over 2 million men and women.

The ABA commends the government's efforts to combat offshore tax evasion and ensure that all U.S citizens, whether at home or abroad, are in compliance with the U.S. tax rules. We would be glad to work with the Committee on Ways & Means (the "Committee") in its efforts to achieve these goals through clear and targeted rules that do not unintentionally place undue and unnecessary burdens on any particular sector(s).

The ABA supports legislation that will ensure that all U.S. citizens and residents pay their fair share of taxes, and thus, prevent loss of millions of dollars by the U.S. because of taxpayers that engage in illegal use of offshore accounts to hide taxable income. It is important that the IRS has the tools necessary to investigate and prosecute U.S. taxpayers that take advantage of the system to evade their tax obligations, thereby shifting the cost of their actions to law-abiding taxpayers who pay their taxes. On its face, H.R. 3933 appears to give the government the necessary tools for improving compliance and achieving the stated goal of ensuring that U.S taxpayers are not able to hide income abroad. However, as drafted, the legislation raises a number of issues that must be addressed in order to avoid unintended negative consequences, and we strongly urge the Committee to focus on those negative consequences as it continues to examine the issue of offshore tax evasion. With respect to H.R. 3933, we specifically urge the Committee to focus on the following:

- the effective date of the legislation is very unrealistic, both from an industry compliance perspective and an IRS enforcement perspective;
- the legislation is so broad in scope and application that it pulls in entities and activities that are not the intended target of the legislation; and,
- IRS/Treasury should be given significant latitude and flexibility in the administration of these rules, especially with respect to clarification of terms and definitions included in H.R. 3933 and the imposition or waiver of penalties under certain circumstances.

It is important to point out that this statement does not attempt to cover H.R 3933 or the topic of offshore tax evasion in a comprehensive manner. Instead, we are providing very broad and general comments on the logistics of the legislation from an industry perspective.

Effective Date is Unrealistic

Payments made to a foreign financial institution or foreign nonfinancial entity after December 31, 2010 will be subject to these rules. The rules relating to offshore bank account tax reporting and compliance are already very broad and complex. H.R. 3933 would add significant complexity to existing rules that U.S. withholding agents would be expected to be able to implement within an insufficient period of time. In addition to the fact that U.S. withholding agents cannot realistically be expected to fully comply on such short notice with rules that would need to be further clarified and fine-tuned, there is no question that the proposed effective date does not provide sufficient time for the IRS to issue the required regulations, forms, or guidance that would be necessary for implementing the rules and for withholding agents to understand and implement them by the effective date.

The legislation would require foreign payees to enter into agreements with the IRS and, presumably, a list of foreign payees that have entered into such agreements would be made available to U.S. payors in advance of the effective date. For many foreign financial institutions, much of the information that may be needed to comply with the proposal may not currently be collected or retained in their customer files—for instance, some institutions do not ask (because they are not required to ask) the questions necessary to determine whether a customer is a U.S. citizen. Thus, an entity that has decided to participate in the program would have to set up a process for collecting such information, and there is no assurance that it will be able to obtain all the information (for maybe hundreds or thousands of customers) and have systems and controls ready in order to enter into an agreement with the IRS by December 31, 2010. Nevertheless, according to the legislation, payors would be obligated to withhold on every payment that is made to a foreign financial institution after the effective date in order to avoid penalties, without regard to whether the IRS list is completed within sufficient time for the payors to work with the information from the IRS. This would create a significant amount of confusion, including the possibility of a huge interruption in services and activities, particularly when payees that should not have been subject to withholding challenge the U.S withholding agent on numerous transactions.

Further, H.R. 3933 would require U.S. withholding agents to engage in operational and technological overhauls, because their current systems do not collect all of the information needed to comply with the proposal. For instance, U.S. withholding agents do not currently track gross proceeds payments or payments of portfolio interests on foreign-targeted bearer instruments made to foreign financial institutions or foreign nonfinancial entities. Since this legislation would require that they track and withhold on such payments, they would need sufficient lead time to update their systems. Hence, the proposed effective date is not realistic. In fact, an effective date cannot be realistically set until Treasury has promulgated the necessary rules or other guidance that would clearly be needed for the implementation of the Legislation.

Scope and Application Too Broad—Results in Unintended Consequences

The scope and application of H.R. 3933 is overly broad and will lead to certain unintended consequences. Clearly, the U.S. does not intend to enact legislation that would disturb legitimate cross-border business activities, impair liquidity and access to vital capital, or interfere with existing treaty provisions. The permissible goal of enhancing information reporting that will help identify tax cheats can be attained without undesirable results that will negatively impact the U.S. economy. This could be done through legislation that clearly targets the areas of concern rather than broadly scoping in so many unrelated activities and taxpayers, thereby creating unworkable rules that result in significant costs to the industry and the economy as a whole. For instance, the legislation defines “withholdable payment” to include U.S. source short-term interest, which is treated as original issue discount under current law and not subject to withholding. Requiring foreign payees to enter into an agreement with the IRS or provide additional documentation may limit the sources of short-term funding, which banks and other U.S. companies depend on to conduct their business. ABA recommends that any final legislation include a provision exempting U.S. source short-term interests from the definition of withholdable payments.

The legislation would impose unnecessary burdens on foreign affiliates of U.S. withholding agents. Such entities should be exempt from the application of the rules if they are already subject to the 1099 filing requirements. The legislation would require a foreign financial institution to enter into an agreement with the Treasury to provide certain information on U.S. account holders. Such an entity may also elect to be subject to the same information reporting requirements as a U.S financial institution (i.e., the 1099 reporting rules). Thus, a foreign financial institution that is already subject to the 1099 reporting rules (because it is a Qualified Intermediary or a subsidiary of a U.S. financial institution) and files information returns for its U.S. customers would still be required to go through this onerous exercise.

In addition, the scope of the material advisor reporting requirement is so broad that it tends to capture all types of services, rather than just advisory services. For instance, would a U.S. withholding agent that provides a prospectus at a client’s request be considered a “material advisor?” Unless the rules are clear and specifically targeted, they would extend beyond the scope of the problem and pull in unintended activities that have no direct relationship with the goal of combating offshore tax evasion.

Furthermore, H.R. 3933 would repeal current law foreign-targeted bearer bond provision. This provision, which allows U.S. issuers to issue debt obligations in bearer form as long as they are foreign-targeted, will negatively impact U.S borrowers because it will cause serious disruptions in their access to non-U.S. bond markets. The ABA suggests that the impact of this provision be given a lot of scrutiny and any reasonable alternatives be seriously explored before it is enacted in order to avoid unnecessary disruptions in the business activities of U.S. bond issuers.

The legislation would also require the U.S. withholding agent to pierce the corporate veil, i.e., look through a foreign corporation to its underlying owners. Thus, a foreign corporation (except for a publicly traded corporation) that provides a W–8BEN would be withheld on (at the 30% rate) until and unless the corporation certifies that it has no substantial U.S. beneficial owners. Clear guidance needs to be provided addressing, among other things, rules on how the U.S. withholding agent should go about verifying this certification or how often this certification would have to be made. For example, would the verification be based on a form provided by the foreign company on which the U.S. withholding agent would be allowed to rely without further investigation? If ownership changed, or the percentage of ownership changed, is the full responsibility on the company to provide an updated form to the U.S withholding agent, or will this provision require re-solicitation similar to the current W–8 rules? In addition to the fact that current systems will have to be changed significantly in order to apply withholding based on more than one criterion (foreign status based on a W–8) as required under current law, obtaining this information will initially be very difficult for U.S withholding agents. The information that is required by the legislation is not information that is used or needed by financial institutions. Thus, Congress must allow sufficient time for the industry to understand the implications, the staffing resources needed, the systems changes needed, the data to be collected, the internal controls to be implemented, etc., so that the burdens on withholding agents to identify U.S. ownership in foreign companies can reasonably be accomplished within a reasonable time frame at reasonable costs.

Treasury/IRS Should be Given Flexibility in Administering the Rules

As noted above, H.R. 3933 is too broad and does not clearly define some terms. Furthermore, the effective date of the Legislation would be incredibly difficult for the industry to accomplish. As the Treasury and IRS are aware, it took a significant amount of time for the current Qualified Intermediary rules to be developed and put in place by the IRS. We believe that it will take a significant amount of time for the Treasury to get this program in place, and because many issues and terms still have to be further addressed and clarified, it is important that Treasury be given a significant amount of flexibility in the administration of the new rules. For instance, as mentioned above, the requirement that payments made to a foreign corporation (that is not publicly traded) be subject to the 30% withholding unless such entity provides information on its U.S. owners requires clarifying guidance from the Treasury—which could include the development of a new form for this withholding provision. As the details are developed, Treasury may uncover problems that it will need to resolve, and additional flexibility will be important.

Conclusion

Mr. Chairman and Members of the Subcommittee, the ABA supports the purpose and goal of H.R. 3933. However, unless it is properly and correctly administered, the intended purpose and goal may not be achieved without undue burdens, significant costs, unnecessary confusion and possible interruptions or impairment of some of the business activities of U.S. financial institutions and their foreign counterparties. The ABA applauds the Committee's efforts to combat offshore tax evasion and looks forward to working with the Committee on this important issue through rules that are targeted and specifically geared toward achieving the stated purpose and goal without undue burdens and costs to the industry.

Letter of the American Citizens Abroad (ACA)

Dear Sirs:

American Citizens Abroad (ACA), the voice of Americans overseas, is a non-profit, non-partisan all-volunteer organization that represents the interests of Americans living and working outside the U.S. to the Executive Branch of the U.S. Government, the U.S. Congress, and the U.S. Federal Judiciary to insure that Americans overseas are treated with equality and fairness. ACA keeps Americans overseas informed and supports their role as informal representatives of the United States. More can be learned about ACA through our Web site, *www.americansabroad.org*.

We are submitting this written comment to the hearings on HR 3933 which will take place on November 5, 2009 and request that this submission be included in the record. These comments are addressed to the four members of Congress who jointly issued the Congressional press release of October 27, 2009 supporting HR 3933, as the close coordination between the Senate Finance Committee and the Ways and Means Committee on this issue is apparent.

American Citizens Abroad is dismayed to see the contents of the proposed ***Foreign Account Tax Compliance Act*** which, if passed, will create a backlash from foreign governments in response to what is openly referred to overseas as the financial imperialism of the United States. This legislation aims to significantly expand the reach of the Qualified Intermediary (QI) regulations. Whereas the current QI regulations are concerned principally with investment accounts, the ***Foreign Account Tax Compliance Act*** would apparently cover all bank activity, including current accounts. As stated in the joint press release, "The ***Foreign Account Tax Compliance Act*** would force foreign financial institutions, foreign trusts, and foreign corporations to provide information about their U.S. accountholders, grantors, and owners, respectively. The nonpartisan Joint Committee on Taxation has estimated the provisions of the ***Foreign Account Tax Compliance Act*** would prevent U.S. individuals from evading $8.5 billion in U.S. tax over the next ten years." This legislation would significantly enhance the authority of the Treasury in imposing the QI regulations and, in fact, requires foreign financial institutions to become policemen for the IRS. The administrative burden and costs associated with compliance will be significant for foreign financial institutions. And the associated legal risk is perceived as high.

As stated by Chairman Rangel in the Congressional press release, "This bill offers foreign banks a simple choice—if you wish to access our capital markets, you have to report on U.S. account holders. I am confident that most banks will do the right thing and help to make bank secrecy practices a thing of the past." In the same press release, Ways and Means Select Revenue Subcommittee Chairman Neal stated: "I believe this bill provides the Treasury Department with the tools it needs to crack down on those Americans hiding assets overseas."

This legislation assumes that banks will submit passively to the U.S. rules and that business will go on as usual. But this will not be the case. UBS in Switzerland has already announced that it will no longer accept as a client any American person residing in the United States. Many other foreign banks are adopting the same policy in a more discrete way.

With regard to American citizens residing abroad, a group of major UK banks has already stated that they will close accounts of American citizens if the proposed QI regulations of January 1, 2010 become effective. We know for a fact that Swiss, Dutch and Spanish banks are refusing American citizens residing in their countries as clients and are closing accounts. Do not forget that there are over 5 million American citizens residing abroad. These people need to maintain foreign bank accounts in the country where they reside to make current payments receive salaries and hold their investments. The proposed legislation and reinforced QI regulations will make it all the more difficult for overseas Americans to maintain a bank account where they reside.

Although ACA understands and sympathizes with the efforts of the U.S. Congress to close the door to tax cheats, you must remember that most Americans working and living overseas are not tax cheats but are performing significant services for the United States in representing American companies and products. The proposed legislation specifically discriminates against one category of U.S. citizens—those residing overseas. Imagine the uproar if Congress passed a law that all residents of New York would have their bank accounts submitted to special investigation, including the total of debits and credits in a year and the maximum balance in the account.

Closing accounts is just one reaction to the U.S. overreach. The United States imposing its laws on foreign countries is creating a poisoned atmosphere which will hinder the positive development of international trade and finance. One Swiss bank has already publicly announced that it will *no longer invest in any American securities for any of its clients*. Since that announcement, which received substantial press coverage, and the explanation of U.S. tax legislation behind that statement, foreigners are already beginning to divest of U.S. stocks. The U.S. Tax Code states that if a foreigner owns more than $60,000 of U.S. securities at the time of his death, his estate becomes subject to U.S. inheritance laws. At a time when the United States should aim to attract foreign capital, its legislation will discourage investment in the United States. As the United States government depends on foreign investors to purchase a large share of Treasury bills, the threat of a significant divestment out of the United States is not to be taken lightly.

While there is no doubt that the United States remains a financial powerhouse, it is no longer the only option for investment purposes. With the U.S. dollar devaluing against other currencies, many individuals are focusing investments in currencies other than the U.S. dollar. The United States risks losing investment flows into the country and compromising free flow of trade if people located outside of the United States view compliance as administratively too burdensome. Furthermore, the probable restriction on access to bank accounts overseas by American citizens and corporations will put a restrainer on the free development of trade. The new movement away from the U.S. stock market is just one form of backlash on American policies, and all of the publicity linked to the bank secrecy issue has made foreigners sensitive to the implications of any relationship with the United States.

The United States also risks facing measures of reciprocity from foreign governments. In fact, the perspective of the United States on bank secrecy and fiscal paradises is very hypocritical. On November 2, 2009, a Financial Secrecy Index was been published for the first time by the International network for fiscal justice, co-founded by the South Alliance and the Declaration of Bern. Ranking number one in the overall index of secrecy is Delaware in the United States with a heavy weight in international transactions. In terms of secrecy, Delaware ranks on a par with the Cayman Islands, Bermuda and Dubai.

The U.S. one way approach has also been illustrated by the fact that when Mexico asked for United States assistance in providing the names of Mexican citizens with money hidden in the United States, the United States refused to collaborate. The OECD countries are also building up forces to obtain transparency of their nationals. This movement will extend to money held in the United States as well as to other foreign banks.

American Citizens Abroad fears that the current Congressional approach to stop the few thousand American citizens that evade taxes by imposing its laws on other nations risks to open up Pandora's box, to create suspicion and friction with many other governments and to have a long-term negative impact on U.S. trade and commerce in general. The costs to the United States could far exceed the $850 million annual revenue projected to be collected by the Joint Committee on Taxation due to the proposed HR 3933. Right now the United States should be encouraging more foreign trade to increase the nation's exports, not develop legislation reaching beyond its borders, which will hinder that free movement of trade.

American Citizens Abroad supports Congress in its efforts to eliminate tax evasion, but asks that the current legislation be revised and rewritten so as not to discriminate against Americans living and working abroad and not to negatively impact continued foreign investment in the US. ACA feels it imperative to warn Congress of the serious risks for the United States related to the current drafting of the ***Foreign Account Tax Compliance Act.***

We thank you for your attention.

Sincerely yours,

Marylouise Serrato	Jacqueline Bugnion
Executive Director	*Director*

cc: Americans Abroad Caucus

The Honorable Timothy F. Geithner, Secretary of the Treasury

The Honorable Paul Volcker, Chairman, Presidential Task Force on Tax-Code Review

Statement of the American Institute of Certified Public Accountants

The American Institute of Certified Public Accountants thanks the House Ways and Means Committee for the opportunity to submit this statement for the hearing on November 5, 2009, on foreign bank account (Form *TD F 90–22.1,* Report of Foreign Bank and Financial Accounts (FBAR)) reporting and related tax compliance issues.

The AICPA is the national professional organization of certified public accountants comprised of approximately 360,000 members. Our members advise clients of federal, state and international tax matters, and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized business, as well as America's largest businesses.

General Comments

We thank the Internal Revenue Service (IRS) and the Department of Treasury (Treasury) for the various announcements [1] this year, providing FBAR form filing relief and extending the 2008 (and prior years) FBAR form due date for certain persons. We also appreciate the continuing dialogue we have had over the past several

[1] Announcement 2009–51 and IR–2009–58, released June 5, 2009; Notice 2009–62, released August 7, 2009; IR–2009–84, released September 21, 2009; "Frequently Asked Questions" (FAQs) on the Voluntary Disclosure Initiative, posted on the IRS website May 6, 2009, and modified July 31, 2009; additional FAQs added June 24, 2009, and August 25, 2009, FAQs on the FBAR form, posted on the IRS website March 13, 2009, and modified July 1, 2009; and the Voluntary Disclosure Initiative, announced March 26, 2009.

years with various government officials responsible for the FBAR form and the Voluntary Disclosure Initiative.

However, many of our members remain concerned about the potential breadth of the newly revised form, effective for the 2008 calendar year (i.e., filed starting on January 1, 2009), and are confused as to the specific application of the filing requirements to their clients' circumstances. Because of the substantial penalties potentially applicable to taxpayers who do not comply with the FBAR form filing requirements and the lack of regulations and written guidance (other than the form instructions), we request written guidance addressing the issues discussed below.

Specific Comments

Based on member feedback on the FBAR form over the past few years, the AICPA suggests the following (elaborations on each are contained later in the letter):

1. Taxpayers should be assured that until definitive FBAR regulations and rulings are issued, they can rely upon information on the IRS website, including FAQs and similar information, and Internal Revenue Code (IRC) definitions in complying with the FBAR form requirements.
2. The FBAR form should be considered timely filed when timely mailed (or e-filed), rather than when timely "received," similar to the "mailbox" rule for filing all tax and information returns.
3. The FBAR form due date should be changed from June 30 to October 15, or an automatic extension should be available for October 15 filing.
4. The FBAR form should continue to apply only to U.S. persons, but if it is decided that non-U.S. persons must file FBAR forms, such requirement should be adopted prospectively and with clear definitions.
5. An FBAR form filing requirement with respect to foreign accounts held by a trust should be imposed only on U.S. settlors/transferors and U.S. trustees of the trust. Also, any U.S. person who is considered to have control of the trust as a grantor under IRC Section 679 should be required to file an FBAR form if the trust has a foreign account. If it is nonetheless decided that additional reporting is required by foreign trust beneficiaries, only trust beneficiaries who receive a distribution from a foreign trust should be required to file an FBAR form, reporting the receipt of the distribution.
6. When Treasury and IRS clarify the rules regarding a comingled account for FBAR form filing purposes, we recommend the FBAR form filing requirement, if any, be limited to the current year and applied prospectively, rather than retroactively, and that no FBAR form reporting be required for foreign financial accounts owned by any comingled account that is itself an entity and a reportable financial account.
7. When Treasury and IRS clarify the rules regarding which taxpayers are considered to have signature authority over a foreign bank or financial account for FBAR form filing purposes, we recommend that the FBAR form filing requirement, if any, be limited to the current year and applied prospectively, rather than retroactively.
8. Regarding delinquent FBAR forms, Treasury and IRS should provide guidance and relief regarding their filing, including reasonable cause for waiver of penalties. Guidance and relief are needed (consistent with FAQ# 9, posted on the IRS website on May 6, 2009) for those who reported all their income and paid all their taxes on the foreign accounts, but did not file FBAR forms, as well as for those with unreported income and taxes due who also did not file FBAR forms.
9. The IRS Office of Professional Responsibility (OPR) should work with the tax practitioner community in formulating more comprehensive guidance for FBAR form purposes before the practitioner due diligence guidance under Circular 230 goes into effect.

Each of the above comments is explained in further detail below.

1. *Taxpayers should be assured that, until definitive FBAR regulations and rulings are issued, they can rely upon information on the IRS website, including FAQs and similar information, and IRC definitions in complying with the FBAR form requirements.*

If information on the IRS website is deleted or superseded prior to the issuance of more formal guidance, taxpayers should not be penalized for relying on information on the IRS website at the time they, or their advisors, access it.

IRS and Treasury should establish a clear procedure for requesting FBAR form rulings (authorized by 31 C.F.R. Section 103.56(g)) that is similar to the existing ruling process/procedures for requesting tax private letter rulings (PLRs) from the

IRS, and the IRS should release sanitized FBAR form rulings similar to what is done with tax PLRs.

Also, IRS and Treasury should use terms and definitions from the IRC with which taxpayers and practitioners already are familiar rather than developing a new set of definitions for FBAR form purposes.

2. *The FBAR form should be considered timely filed when timely mailed (or e-filed), rather than when timely "received," similar to the "mailbox" rule for filing all tax and information returns.*

If the "mailbox" rule is not adopted for FBAR form purposes, all IRS websites (and websites of U.S. embassies and consulates), publications, instructions, responses, and references to the filing of an FBAR form should be clarified to say "received by" rather than "filed by" or "mailed by." The "received by" rule, as it currently stands, is a trap for the unwary since it differs from the filing requirements that apply to all tax and information return filing rules.

IRS and Treasury should allow and encourage taxpayers to efile the FBAR form.

A grace period of at least 10 days should continue to apply for FBAR form filings because there is no tax due.

We recommend proof of timely filing include: (1) hand-delivery of the FBAR form with receipt of a date stamp at an IRS district office, and (2) use of USPS certified receipts or other proof of mailing alternatives available for tax forms.

We also suggest that a street address and phone number (rather than just the current P.O. Box) be added to the instructions to enable a taxpayer (including a non-resident of the U.S.) to use an overnight delivery service to deliver the FBAR form to the IRS.

3. *The FBAR form due date should be changed from June 30 to October 15, or an automatic extension should be available for October 15 filing*.

Taxpayers with the financial resources to purchase offshore investments or business interests are very likely to request an extension of time to file their income tax returns. Complete filing information from foreign sources is rarely available until mid-summer or later. As a result, the amount and details of offshore accounts are often not known until after June 30.

Taxpayers often do not have all the information (such as Schedules K–1 and footnotes thereto) that may be needed to complete the FBAR form by June 30. Many investors do not receive their Schedules K–1 until well after June 30 (many are received in September). Furthermore, if a taxpayer's investment advisor purchases a foreign investment, such as a hedge fund, on behalf of the taxpayer, the investor may not be aware of this except to the extent that a short entry is included on a monthly statement. People who utilize investment advisors typically have multiple accounts, and each account has a monthly statement that can run tens of pages. The investor may, therefore, have no idea of the new investment in the foreign hedge fund and the taxpayer's tax preparer may not be made aware of this until receipt of the Schedule K–1 for the initial year of investment, which will in many cases be well after June 30.

Few taxpayers understand the full scope of the phrase "foreign financial account" or the concept of indirect (constructive) ownership. Thus, they are unlikely to inform their tax preparer of their need to file the FBAR form or to provide all information necessary to file by June 30. Because the definition of a foreign financial account is a complex determination, especially if indirect ownership is involved, preparers are more likely to discover that there is indirect ownership of a foreign financial account when they are preparing the income tax return for the individual later in the year. For example, an individual may own a controlled foreign corporation (CFC) that might have a foreign bank account; however, the individual generally files the Form 1040 after June 30 because of Schedules K–1 that are not yet received or the inability to obtain the CFC information for the individual's Form 5471 by June 30. The tax practitioner might not even be aware of the CFC or be in a position to inform the client of the need to file an FBAR form until well after June 30.

No other tax form is due on June 30, so many taxpayers are not aware of, or accustomed to, the need to provide their tax preparers with information by this June 30 due date. In addition, taxpayers are not accustomed to having a filing requirement for which there is no extension. It also takes a lot of time for many taxpayers to gather the information required to prepare the FBAR form. For the above reasons, and in light of the potentially significant penalties involved, the FBAR form due date should be on or after October 15 to conform to the extended due date for the vast majority of individuals. This would also ensure that the FBAR form due date is after the extended filing deadline for calendar year-end entities, so most taxpayers will have reviewed their prior calendar year filing requirements and disclosures to ensure that complete and accurate FBAR forms are filed rather than having to file late or amended FBAR forms due to Schedules K–1 received after June 30.

4. *The FBAR form should continue to apply only to U.S. persons, but if it is decided that non-U.S. persons must file FBAR forms, such requirement should be adopted prospectively and with clear definitions*.

The policy provided in Announcement 2009–51, adopting for 2008 and prior-year FBAR form filings the definition of "in and doing business in the U.S." that was provided in the pre-October 2008 instructions for the FBAR form, should be adopted for 2009 FBAR form filings and all future years. The FBAR form should not apply to those meeting the IRC section 7701(b) definition of a non-U.S. person. Special elections to be treated as a U.S. person for non-FBAR form purposes and treaty-based return filings should not require an FBAR form filing.

Despite our urging to restrict FBAR forms to U.S. persons, if Treasury and IRS decide to require non-U.S. persons to file FBAR forms, we encourage careful thought and clear definitions, and that such treatment be adopted only prospectively.

5. *An FBAR form filing requirement with respect to foreign accounts held by a trust should be imposed only on U.S. settlors/transferors and U.S. trustees of the trust. Also, any U.S. person who is considered to have control of the trust as a grantor under IRC Section 679 should be required to file an FBAR form if the trust has a foreign account. If it is nonetheless decided that additional reporting is required by foreign trust beneficiaries, only trust beneficiaries who receive a distribution from a foreign trust should be required to file an FBAR form, reporting the receipt of the distribution.*

Beneficiaries of a foreign or domestic trust should not be required to file an FBAR form. Beneficiaries will in most cases not have access to a trust's foreign account information. Beneficiaries often are not aware of, or able to calculate, their percent interest in trust current income and assets (and the trustees may not share that information) so it is often difficult or impossible for many beneficiaries to complete an accurate, timely, and complete FBAR form. In some instances, a U.S. person may not even be aware he or she is a beneficiary of a trust until a distribution is made. Form 3520 is required to be filed by U.S. persons receiving distributions from foreign trusts. Likewise, beneficiaries who receive a distribution from a domestic trust will receive a Form 1041, Schedule K–1 and are required to include any income arising from the distribution on their individual income tax return. Therefore, beneficiaries already are required to report any distributions, and income included in such distributions, from trusts. A U.S. settlor or transferor or a U.S. trustee to a trust which owns a foreign bank account is much more likely to have access to and knowledge of the trust's assets than the beneficiary.

If it is nonetheless decided that additional reporting is required by foreign trust beneficiaries, despite our recommendation and concerns mentioned above, only beneficiaries who receive a distribution from a foreign trust should be required to file an FBAR form, reporting the receipt of the distribution. This provides reporting when there is income involved and is easier and simpler to administer and with which to comply. If there is no distribution from the trust, an FBAR form should not be required unless the person is considered to have control of the trust as a grantor under IRC Section 679.

In all cases, U.S. settlers/transferors, and trustees of trusts with a foreign account should be required to file an FBAR form.

6. *When Treasury and IRS clarify the rules regarding a comingled account for FBAR form filing purposes, we recommend the FBAR form filing requirement, if any, be limited to the current year and applied prospectively, rather than retroactively, and that no FBAR form reporting be required for foreign financial accounts owned by any comingled account that is itself an entity and a reportable financial account.*

We appreciate the IRS Notice 2009–62 delay until June 30, 2010, for the FBAR form filing for the 2008 and prior-year calendar year FBAR form filings for persons with signature authority over, but no financial interest in, a foreign financial account, and for persons with a financial interest in, or signature authority over, a foreign comingled fund. We note that both issues continue to concern our members.

It would be extremely difficult and an administrative burden for taxpayers to go back multiple years and research whether an account would have required an FBAR form filing and gather the information required. The new definitions and clarifications should apply only prospectively.

We also suggest that when taxpayers own an interest in a foreign pooled investment account that is an entity, such as a mutual fund or hedge fund that is itself a reportable financial account for FBAR form purposes, guidance clarify that FBAR form reporting is not required with respect to any financial accounts owned by the foreign pooled investment account.

7. *When Treasury and IRS clarify the rules regarding which taxpayers are considered to have signature authority over a foreign bank or financial account for FBAR form filing purposes, we recommend that the FBAR form filing requirement, if any, be limited to the current year and applied prospectively, rather than retroactively.*

The signature authority requirement has created significant uncertainty and concern for entities who have assigned various rights over customers' accounts to employees within their organizations. Guidance on this should be limited to the current year and applied prospectively, rather than retroactively.

8. *Regarding delinquent FBAR forms, Treasury and IRS should provide guidance and relief regarding their filing, including reasonable cause for waiver of penalties. Guidance and relief are needed (consistent with* FAQ# 9*, posted on the IRS website on May 6, 2009) for those who reported all their income and paid all their taxes on the foreign accounts, but did not file FBAR forms, as well as for those with unreported income and taxes due who also did not file FBAR forms.*

The Voluntary Disclosure Initiative served its purpose in bringing more taxpayers into the system. We encourage IRS and Treasury to continue that program and work with taxpayers to increase compliance in this area without unnecessarily harsh civil or criminal penalties for coming forward. We also request an extension of the relief provided by the IRS in FAQ #9 regarding delinquent FBAR forms when all income was reported and taxes paid. Finally, we urge the IRS and Treasury to provide an adjustment of the penalty when the amount of unpaid tax on the previously unreported income from the foreign bank account is less than the penalty.

9. *The IRS Office of Professional Responsibility (OPR) should work with the tax practitioner community in formulating more comprehensive guidance for FBAR form purposes before the practitioner due diligence guidance under Circular 230 goes into effect.*

Although we appreciate the importance of due diligence in preparing tax and information returns, in view of the significant open questions and lack of clear definitions in the FBAR form context, in combination with the potentially onerous penalties involved, we recommend that OPR work with the tax practitioner community in formulating more comprehensive guidance before the due diligence guidance goes into effect.

* * * * *

We welcome the opportunity to discuss our comments further with you or others at the House Ways and Means Committee Select Revenue Subcommittee.

Jo Van de Velde, letter

Dear Chairman Rangel and Chairman Neal,

We, Euroclear Bank, welcome the opportunity to comment on the proposed Foreign Account Tax Compliance Act of 2009 ("the Bill").

Euroclear Bank is an International Central Securities Depositary (ICSD), and the world's largest clearance and settlement system for internationally traded securities. We serve close to 1,500 major financial institutions located in more than 80 countries across the globe. Securities are accepted for deposit into Euroclear Bank if they are, or are expected to be, actively traded in the international markets or held in quantity by our clients. We have provided settlement and related securities services for cross-border transactions involving Eurobonds for more than 40 years. Over this time, we have acquired considerable experience in dealing with international products, financial institutions, and investors. The provision of an efficient withholding tax relief service is an important part of our extensive range of custody services: we are a therefore a Qualified Intermediary (QI) for U.S. tax purposes and have assumed primary Non-Resident Alien and backup withholding responsibility.

We have seen the representations on the proposed new reporting and withholding obligations for Foreign Financial Institutions (FFIs) and the TEFRA repeal [1] made by market associations such as the International Capital Market Association (ICMA), the International Capital Market Services Association (ICMSA), the European Banking Federation (EBF) and the Securities Industry and Financial Markets Association (SIFMA). We confirm the prevailing sentiment that the Bill addresses

[1] i.e. the repeal of the rules permitting the issuance of foreign-targeted bearer bonds in compliance with the requirements of the Tax Equity and Fiscal Responsibility Act of 1982.

valid concerns but may be overlooking both the implementation complexity and the market impacts of the proposed changes.

Section 101, Information Reporting and Withholding by Foreign Financial Institutions

The proposed new reporting and withholding regime for FFIs contemplated by Section 101 of the Bill is of some concern to us (and indeed the other entities of the Euroclear group). Our detailed formal submissions on this point are being made through the European Banking Federation, but on a high level we would ask you to take the following considerations into account:

- *Timeframe:* Implementing Section 101 will be very complex and thus very resource-consuming for industry players. We urge you to give the Treasury Department the necessary powers and time to propose a workable implementation plan. We consider that at least two years will be required from the time that definitive Treasury regulations are adopted;
- *Proportionality:* Even those already acting as QIs today will face significant additional system developments, running and compliance costs, which may discourage them from entering an FFI agreement if the Bill is not carefully implemented in order to limit the additional burden to the smallest extent necessary to capture U.S. account information. On this note we would:

(i) ask you to consider removing gross proceeds from the definition of "withholdable payment" in proposed Sec.1473(1). Most FFIs simply do not have the systems in place to withhold on such payments (even QIs are not currently required to withhold on such payments). The inclusion of "gross proceeds" thus renders the FFI agreement more onerous than the existing QI agreement. This makes it less likely that FFIs will sign an FFI agreement, which we understand to be contrary to the aim of the legislation. Moreover, under the proposed information reporting requirements the IRS/Treasury will obtain the requisite information on U.S. accounts (and persons): we consider therefore the burden created by the inclusion of gross proceeds to be disproportionate to the aim of the Bill;

and

(ii) propose that the Treasury Department be given the necessary flexibility to craft regulations which exclude certain payments and entities from the scope of the Act where there is a low risk of tax avoidance.

Section 102, Repeal of Certain Foreign Exceptions to Registered Bond Requirements

Our standpoint as ICSD gives us a unique overview of bond issuances in the international capital markets. We can see that the market has overwhelmingly adopted the bearer legal form as the preferred form for security issuance, moving from definitive bearer instruments at the market's inception to a custody structure where global bearer notes are now immobilised with ICSDs such as Euroclear Bank and settle through a book-entry system. Approximately 80% of the securities held in Euroclear Bank have been issued in global immobilised bearer form under the TEFRA D rule, regardless of the nationality of the issuer (U.S. or non-U.S.).

In the period from 2008–2009, admittedly a very difficult time for both the markets and the issuers, it may be of interest for you to note that as much as 85% of all Eurobond issues brought to the market was in immobilised bearer form.

The issuance of global immobilised bearer bonds is thus the norm in the market and represents a very important and efficient funding vehicle for all issuers, U.S. or non-U.S.

The proposed elimination of the foreign-targeted bearer bond exceptions, on which the market currently is based, would inevitably lead to wide-spread market disruption and would impose substantial costs and additional complexities on market actors in order to comply with the new requirements (different legal documentation, additional registration services, additional tax certification and tax processing procedures, etc).

Given that these bond issues are foreign-targeted, that they are only bearer in a very technical sense, that the mechanisms in place under the TEFRA rules already provide safeguards against offering to U.S. persons, and that under the proposed Section 101 regime the Treasury/IRS should obtain enhanced information on investments held by U.S. persons, we consider that the TEFRA repeal may produce marginal benefits in terms of reducing U.S. tax avoidance compared with the disruption it may cause to the €8 trillion Eurobond market.

In light of these considerations, we recommend that you reconsider the repeal of the foreign-targeted bearer bond exceptions (which exceptions appear to have helped maintain a level-playing field in terms of access to the international capital markets).

Should the repeal of these exceptions be nevertheless adopted, Euroclear Bank supports the recommendation made by other industry groups that Congress requests a report regarding the potential consequences of the repeal of the foreign-targeted bearer bond exceptions. We also recommend that the final legislative provision limits clearly the repeal to securities issued by U.S.-incorporated entities, in order to avoid uncertainty over the extra-territorial application of U.S. tax laws and to avoid extending market disruption to non-U.S. issuers. If it were felt necessary to cater for the needs of U.S. issuers (while also recognising the global immobilised form in which most bearer bonds are now held), you might consider granting the Treasury Department discretion to issue regulations to determine the circumstances in which bearer debt held in a clearing system may be considered registered for U.S. tax purposes.

We thank you for the opportunity to voice our concerns on the proposed legislation if it were to be passed in its current form. We hope the comments and the recommendations presented above will be considered and provide useful guidance in the drafting of the definitive Bill.

Yours sincerely,

Jo Van de Velde
Managing Director, Head of Product Management
Euroclear SA/NV

The Securities Industry and Financial Markets Association, letter

Dear Chairman Neal and Ranking Member Tiberi,

The Securities Industry and Financial Markets Association (SIFMA)[1] welcomes the opportunity to submit comments on the Foreign Account Tax Compliance Act of 2009, H.R. 3933 (the Bill), which was introduced on October 27, 2009, by House Ways and Means Committee Chairman Charles B. Rangel (D–NY) and House Ways and Means Select Revenue Measures Subcommittee Chairman Richard E. Neal (D–MA).[2]

SIFMA shares the objectives of the bill's sponsors, and the Obama Administration, in improving offshore tax compliance. SIFMA also welcomes the fact that the Bill is responsive to a number of important concerns that were expressed in its earlier comment letter, dated August 31, 2009, regarding the related offshore tax compliance proposals included in the *General Explanation of the Administration's Fiscal Year 2010 Revenue Proposals.*

This letter comments on several aspects of the Bill primarily relating to the expansive new information reporting and withholding regimes that it would impose. These regimes would create a broad new definition of foreign financial institution (FFI) and require that these FFIs enter into agreements with the IRS and provide annual information reporting in order to avoid a new U.S. withholding tax on U.S. source dividends, interest, and other FDAP income, as well as U.S.-related gross proceeds. They would also impose related information reporting and withholding requirements in respect of payments made to non-financial foreign entities (FEs).

In evaluating the Bill, SIFMA has proceeded on the basis of five core observations:

- The principal goal of the Bill, which SIFMA supports, is to collect tax from U.S. taxpayers who have been evading their responsibilities by investing through FFIs and FEs that have thus far been generally free of reporting obligations to the IRS.

[1] SIFMA brings together the shared interests of securities firms, banks, and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services, and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

[2] A companion bill, S. 1934, was introduced on the same day by Senate Finance Committee Chairman Max Baucus (D–MT) and Senator John Kerry (D–MA). Also on October 27, an accompanying technical explanation prepared by the Staff of the Joint Committee on Taxation (the JCT Report) was released.

- To achieve this goal, the Bill would impose the risk of a punitive withholding tax on a very broad class of U.S.-related payments (including gross proceeds) to a broad class of foreign investors, unless relevant FFIs and FEs agree to provide information to the IRS regarding their U.S. account holders and owners. Accordingly, the withholding tax would function as a hammer to encourage information reporting.
- Although the withholding tax would hopefully not need to be utilized, if it were actually collected, it could cause a decline in inbound investment that would significantly increase the global financing costs of U.S. issuers (as described in more detail below).
- Even if the Bill functioned as planned, and the withholding tax were not actually collected, the new information reporting and withholding regimes would require the development and implementation of extensive new compliance systems by FFIs, FEs, and withholding agents.
- In order to achieve the Bill's goals without causing market disruption, financial institutions and other market participants will need clear statutory rules as well as supporting legislative history that explains the rules' context and intended meaning. They will also need precise regulatory guidance that is published in advance of the time that both the information reporting and withholding requirements of the Bill would take effect.

SIFMA looks forward to working with the Congress and the Treasury Department in crafting the details of the Bill and its accompanying regulatory implementation. In the remainder of this letter, SIFMA proposes the following specific comments on the Bill, which are intended to assist the Congress and the Treasury Department in this effort:

(1) Delay the effective date of the information reporting and withholding requirements.
(2) Exclude short-term obligations from the withholding tax.
(3) Defer repeal of the foreign-targeted bearer bond exception until it can be studied further.
(4) Simplify and extend the grandfather rule for existing registered debt.
(5) Provide a grandfather rule for existing securitization vehicles.
(6) Exclude U.S. payors and Schedule K–1 filers from the FFI definition.
(7) Provide workable procedures for reliance on certifications by FFIs.
(8) Establish commercially reasonable standards for identifying U.S. accounts and foreign entities with substantial U.S. ownership.
(9) Provide a uniform 10 percent test for substantial U.S. owner status.
(10) Revise carve-outs for corporations and tax-exempt entities.
(11) Exempt separate depository accounts not exceeding $50,000.
(12) Allow simplified Form 1099 reporting by FFIs.
(13) Allow FFIs to receive refunds or credits of the withholding tax in additional cases.
(14) Coordinate with other withholding and information reporting provisions.
(15) Provide for further limits to the definition of withholdable payment.
(16) Address tiering issues.

Comment 1: ***Delay the Effective Date of the Information Reporting and Withholding Requirements.***

The Bill should provide adequate time for the development of the extensive regulatory guidance and compliance systems that will be necessary to implement the new information reporting and withholding regimes.[3]

The information reporting and withholding provisions of the Bill applicable to FFIs and FEs are proposed to be effective for payments made after December 31, 2010. SIFMA believes that this proposed effective date should be substantially delayed. These provisions of the Bill are by their nature not self-implementing, and will require the Treasury Department and the IRS to develop detailed and complex regulations, reporting agreements, certification forms, and other guidance. Based on recent experience, it is reasonable to expect that it will take more than one year for a proposed version of the implementing regulations to be produced and that substantial comments will be submitted on the proposed regulations by the affected parties.[4] In this regard, the regulatory process will need to take into account the

[3] Section 101(d) of the Bill.

[4] For example, the new basis reporting rules of sections 6045(g) & (h), 6045A, and 6045B were first proposed by the Joint Committee on Taxation in its August 3, 2006, report on *Additional Options to Improve Tax Compliance.* They were eventually enacted into law in October 2008. Thus far, the Treasury Department and the IRS have not issued proposed versions of any of

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large number of FFIs, FEs, and withholding agents who will be directly affected by the regulations (including a significant number of entities that have not previously had occasion to deal with U.S. tax compliance rules), as well as the many companies, investors, and depositors who will be indirectly affected. Moreover, once a substantial comment process has run its course and implementing regulations are finalized, it is reasonable to expect that the IRS will need a substantial amount of time to draft and then enter into the required reporting agreements with FFIs.[5] Finally, but most importantly if the goals of the Bill are to be achieved, FFIs, FEs, and withholding agents will need a substantial amount of time to develop and implement the necessary compliance systems to perform their duties under the agreements and the Bill.

The Bill will require an unprecedented level of U.S. tax information gathering and reporting by foreign entities that have not traditionally engaged in such efforts. Even for a seasoned U.S. financial institution, expanding existing U.S. tax information reporting systems to satisfy the requirements of the Bill would be time consuming and expensive. For an FFI that has no existing U.S. tax information reporting systems, complying with the requirements of the Bill will be a monumental task, which will require the hiring of numerous additional employees, the creation of extensive new information technology systems, and the training of large numbers of current workers. The ability of FFIs to engage in such efforts on a short time frame (or, indeed, at all) cannot be presumed.

SIFMA believes that the implementation of the necessary compliance systems for the information reporting and withholding regimes will take at least two years from the date that all applicable regulatory guidance is finalized (including the publication of a model reporting agreement). Therefore, SIFMA recommends that the new information reporting and withholding regimes not enter into force until at least three years after the date of enactment of the Bill. In order to plan for unforeseen issues and avoid market disruption, SIFMA also believes that it is critical that the Bill authorize the Secretary of the Treasury to postpone the effective date of the information reporting and/or withholding regimes as needed. The delay in the effective date of the withholding provisions will also benefit the IRS, which will be required to establish and implement a system to provide refunds and credits for the withholding tax.

Comment 2: *Exclude Short-Term Obligations from the Withholding Tax.*

An exception from the withholding provisions of the Bill should be provided for short-term obligations, in order not to disrupt the ability of U.S. issuers to obtain funding from foreign investors that have historically invested in the United States for short-term liquidity purposes.[6]

Many large U.S. financial institutions and other U.S. issuers derive billions of dollars of funding through the issuance of short-term debt instruments (such as commercial paper) in foreign markets, to entities that would be treated as FFIs. These funding sources are relied on, in part, to support substantial domestic lending to large and small businesses, as well as to mortgagors and credit card holders. To the extent that these foreign lenders receive little or no other U.S. source income, they will likely not be willing to enter into information reporting agreements with the IRS. It can also be expected that they will be unwilling to incur any risk of a 30 percent withholding tax on the principal amount of their investment, which the Bill would create. As a consequence, such investors could substantially decline as a funding source for U.S. financial institutions and other U.S. issuers.

SIFMA believes that the Bill should carefully balance its tax compliance objectives against the need for U.S. financial institutions and other U.S. issuers to readily finance themselves. Although many U.S. issuers may be able to replace the affected borrowings with funds from other sources (at possibly higher rates), the

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the regulations that will be necessary to implement the rules. Unless otherwise indicated, section references herein are to the Internal Revenue Code of 1986, as amended (the Code).

[5] We note, for example, that the IRS did not provide a first draft of the much needed Model Qualified Intermediary Agreement until January 1999, despite the fact that the qualified intermediary (QI) regime was first introduced in proposed regulations issued in April 1996 and that final regulations were issued in October 1997. The absence of this Model Qualified Intermediary Agreement and the fact that necessary refinements to certain critical sections of the final regulations occurred after 1997 caused the effective date of the final regulations to be postponed multiple times to, eventually, January 2001. As another example, we note that the IRS introduced temporary regulations in November 1987 that required payors to send backup withholding notices (B–Notices) to payees informing them that they had provided an incorrect taxpayer identification number and that they would be subject to backup withholding tax if this failure were not timely rectified. The IRS did not provide payors with a model B–Notice, however, until August 1989.

[6] Proposed section 1473(1).

weaker or less creditworthy U.S. issuers may suffer funding shortfalls. In the case of U.S. financial institutions, such shortfalls could significantly limit their lending into the domestic market or even challenge their viability. For this reason, SIFMA suggests that the definition of a withholdable payment contain an exclusion for interest and gross proceeds payments made in respect of obligations of U.S. issuers with a term not exceeding 183 days. Such an exclusion would be consistent with longstanding exemptions for short-term debt instruments in other provisions of the Code's exemptions which reflect a long-held belief that such instruments do not lend themselves to tax evasion.[7] In this regard, SIFMA believes that FFIs and FEs will be powerfully motivated to comply with the information reporting provisions of the Bill because the potential withholding tax would still apply to longer term obligations, Treasury securities, U.S. equity securities, and other obligations that pay U.S. source income. To allay any concerns that FFIs or FEs could abuse a short-term obligation exception by continuously rolling over short-term obligations, SIFMA would suggest that the Bill provide that a debt instrument would be considered short-term only if payments thereon would qualify under section 871(g) as exempt from nonresident gross income and withholding tax (for which the same abuse considerations apply). As an alternative, and at a minimum, SIFMA believes that the Secretary of the Treasury should be given authority to identify situations where short-term obligations may be exempted from the withholding tax because they do not create a significant opportunity for abuse.

Comment 3: ***Defer Repeal of the Foreign-Targeted Bearer Bond Exception Until It Can Be Studied Further.***

The consequences of the repeal of the foreign-targeted bearer bond exception should be subjected to further study before such exception is repealed, in order to prevent restricting U.S. issuers' access to non-U.S. markets. Additionally, the disparity between the repeal's effective date and the effective date of the new information reporting and withholding rules should be eliminated. [8]

Since 1982, the TEFRA rules generally have allowed U.S. issuers to issue debt obligations in bearer form, so long as the obligations are issued under arrangements reasonably designed to ensure their sale to non-U.S. persons (the foreign-targeted bearer bond exception). The Bill would repeal this exception to the registration requirement.

SIFMA believes that the repeal of the foreign-targeted bearer bond exception may restrict access to a number of non-U.S. markets in a manner that would adversely affect U.S. borrowers. In a number of markets, securities traditionally have been issued in bearer form. In some of those markets (e.g., Japan), it may not be feasible to issue securities in registered form, or there may not be sufficiently well developed mechanisms in place to permit the effective collection of Form W–8s. Thus, U.S. issuers would be unable to issue debt in such markets under the Bill, or would be able to do so only in a manner that causes interest on the obligations to be subject to withholding tax at a 30 percent rate, effectively precluding them from raising funds in these markets. In addition, even in markets in which it is feasible to issue securities in registered form, the transition to such issuances may create substantial market disruptions if it is not the current market norm.

In this regard, it is worth noting that most bearer bonds are currently bearer in only a very technical sense, since most beneficial interests in such bonds are held through Euroclear or other book-entry clearing systems. As a consequence, it seems unlikely that such instruments would pose any special risks of tax evasion under the Bill, since the information reporting and withholding provisions of the Bill could generally be applied to payments in respect of such securities in the same manner as for payments in respect of registered bonds (in each case for bonds issued after the applicable grandfather date).

In order to prevent unwarranted disruption to the borrowing ability of U.S. issuers in situations where the risk of U.S. tax evasion seems miniscule, SIFMA recommends that the Congress direct the Treasury Department to study the potential consequences of the repeal of the foreign-targeted bearer bond exception and prepare a report regarding such a repeal before any action is taken. In this regard, one alternative to a complete repeal that the Treasury Department might wish to consider would be a more limited prohibition that focused solely on bearer bonds in definitive form (i.e., those not held through Euroclear or other book-entry clearing systems).

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[7] For example, interest and original issue discount on an obligation with a term of 183 days or less are generally exempt from current nonresident gross income and withholding tax. *See* section 871(g)(1)(B)(i).

[8] Sections 102(d) and 101(d)(2)(A) of the Bill.

In addition to the foregoing considerations, there appears to be an inadvertent glitch in the effective date provisions of the Bill relating to the repeal of the foreign-targeted bearer bond exception. In general, the repeal of the foreign-targeted bearer bond exception would be effective for obligations issued more than 180-days after the date of the Bill's enactment. The new information reporting and withholding rules, however, would apply to any bearer-form obligation that is issued by a U.S. issuer after the date of first Committee action. As a consequence, the Bill would create two categories of U.S.-issued bearer bonds, one that is subject to the new information reporting and withholding regimes and one that is not. SIFMA believes that this result was not intended, and suggests that, if the repeal of the foreign-targeted bearer bond exception is retained, the effective date of the information reporting and withholding rules should be conformed, by grandfathering bearer-form obligations issued prior to the effective date of the repeal of the foreign-targeted bearer bond exception.

Comment 4: *Simplify and Extend the Grandfather Rule for Existing Registered Debt.*

To avoid market confusion and disruption, the grandfather rule for existing registered debt should be simplified and extended to exempt all registered debt instruments that are outstanding on the effective date of the new information reporting and withholding regimes and that contain an issuer gross-up provision. [9]

The FFI and FE information reporting and withholding regimes are proposed to be effective for all registered form debt instruments of U.S. issuers, unless the debt is outstanding on the date of first Committee action and includes a provision under which the issuer would be obligated to make gross-up payments by reason of the Bill. This grandfather provision has already led to substantial market uncertainty as to whether many instruments will or will not be eligible for its protection, and would be very difficult for withholding agents to apply. As one example, gross-up provisions frequently allow an issuer to elect either to make a required gross-up payment or to redeem a debt instrument early. In such a case, it may be questioned whether the issuer is obligated to make gross-up payments for purposes of the grandfather provision. As another example, gross-up provisions frequently contain carve-outs for withholding taxes that would not be imposed but for a failure by a holder or beneficial owner of an instrument to make a certification or comply with information reporting requirements. In such a case, because the information reporting obligations contemplated by the Bill would apply to intermediaries in a chain of ownership that may not be holders or beneficial owners for purposes of the gross-up provision, it may be questioned in some instances whether a failure to enter into an information reporting agreement with the IRS under the Bill constitutes such a failure, and whether the issuer would be required to make gross-up payments for purposes of the grandfather provision.

More generally, SIFMA notes that many large U.S. financial institutions and other U.S. issuers derive billions of dollars of funding through debt issuances to foreign investors. In some cases (e.g., debt issuances to foreign retail investors), it may be impossible to effect issuances while the application of the new information reporting and withholding provisions of the Bill remain uncertain, because the issuance structures will not tolerate the uncertainty neither as a reputational matter for the issuer and underwriters or oftentimes as a local securities law matter that an intermediary in a chain of payments could fail to comply with the information reporting provisions of the Bill with the result that a foreign investor would suffer a withholding tax through no fault of its own. If the grandfather rule for registered debt contained in the Bill continues to apply only up to the date of first Committee action, U.S. issuers may accordingly be required to cease some or all of their registered debt issuances in foreign markets after that date until uncertainties regarding the application of the information reporting and withholding provisions of the Bill are resolved.

If retained in its current form, SIFMA anticipates that the grandfather rule for existing registered debt could lead to substantial market confusion and disruption. In order to minimize such confusion and disruption, and the legal and other disputes between issuers, holders, and withholding agents that could result, SIFMA recommends that the grandfather rule for existing registered debt be simplified and extended to exempt all registered debt instruments that are outstanding on the effective date of the new information reporting and withholding regimes and that contain an issuer gross-up provision, regardless of whether that gross-up provision would in fact be triggered by the Bill. Because even this simplified grandfather rule would place substantial compliance burdens on withholding agents needing to determine the status of numerous debt instruments, SIFMA further recommends that

[9] Section 101(d)(2)(B) of the Bill.

withholding agents be permitted to presume that a registered debt instrument outstanding on the grandfather date qualifies for the grandfather rule, unless the withholding agent knows or has reason to know that it does not qualify.

Comment 5: Provide a Grandfather Rule for Existing Securitization Vehicles.

The Bill should provide a grandfather rule for existing offshore securitization vehicles, under which such vehicles would be excluded from the FFI definition and exempt from the FE information reporting and withholding regime.

A typical offshore securitization vehicle that holds U.S assets and issues its own equity and/or debt securities (such as a CDO issuer) would be considered an FFI under the Bill.[10] As a result, such a securitization vehicle would be required to enter into an information reporting agreement with the IRS and report on U.S. holders of non-publicly traded debt and equity that it had issued, or otherwise be subject to the withholding tax on its U.S. investments. Foreign securitization vehicles currently in existence have invested billions of dollars in the United States, particularly in loans and other debt instruments issued by U.S. companies.

Unfortunately, it is quite likely that many offshore securitization vehicles will simply be unable to enter into and comply with the required reporting agreement, which could lead to large scale disruptions in the markets. Offshore securitization vehicles have no employees and, in most cases, their activities are strictly controlled by a trust indenture. The trust indentures for existing securitization vehicles predate the Bill, and accordingly do not authorize or require any party on behalf of the securitization vehicle to perform the actions required of FFIs under the Bill. The trust indentures also do not provide a means of paying for such activities. Although it might in theory be possible for the trust indenture of a securitization vehicle to be amended by a vote of the investors in the vehicle to permit the vehicle to enter into an FFI information reporting agreement, no party is likely to be designated to initiate such an amendment process. In addition, different investors may have conflicting interests in permitting such an amendment. Some investors may in particular prefer for the vehicle to be prematurely wound up, which would be required in many cases if the investments of the vehicle became subject to the withholding tax imposed by the Bill. Finally, even if it were possible to amend a trust indenture to permit a securitization vehicle to enter into an information reporting agreement with the IRS and hire contractors to perform the required actions, there can be no guarantee that the vehicle would be able to force holders of its outstanding debt and equity interests to comply with applicable identification and documentation requirements that were not contemplated at the time the trust indenture was executed and the securities were issued.

Taking these considerations into account, it appears very likely that many typical offshore securitization vehicles that have invested in U.S. assets would become subject to the withholding tax imposed by the Bill, which could lead to their required liquidation. A large scale liquidation of U.S. debt instruments by offshore securitization vehicles could result in a very significant disruption of the U.S. credit markets. Therefore, SIFMA believes that the Bill should provide a grandfather rule for securitization vehicles in existence on the date of first Committee action. The grandfather rule should provide that existing securitization vehicles are (i) excluded from the FFI definition; and (ii) exempt from the FE information reporting and withholding regime in respect of their U.S. assets.[11]

Comment 6: *Exclude U.S. Payors and Schedule K–1 Filers from the FFI Definition.*

In order to avoid unnecessary duplication and confusion, the FFI definition should exclude certain foreign entities and branches that are considered U.S. payors required to file Form 1099 reports as well as certain foreign partnerships that are required to file Schedule K–1 reports.[12]

The FFI definition is extraordinarily broad, and there are a great many entities that could need to enter into information reporting agreements with the IRS under the terms of the Bill. SIFMA believes that it would be beneficial to market partici-

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[10] A typical CDO is structured as an offshore corporation that invests in loans and other debt instruments issued by U.S. companies. Such CDOs in turn issue several classes of non-publicly traded debt and equity securities themselves, which divide up the cash flows on the underlying U.S. investments. Another example of a typical securitization vehicle is a grantor trust that invests in U.S. debt or equity investments and in turn issues pass-through certificates that represent the cash flows on those investments. Pass-through interests in U.S. investments could also be structured as shares of an offshore cell company.

[11] Note that there is precedent for a targeted exception from otherwise applicable rules for securitization vehicles, including an appropriate limiting definition, in section 743(f).

[12] Proposed section 1471(d)(4).

pants and the IRS to limit the scope of the FFI definition in the case of certain foreign entities that already have robust U.S. tax information reporting responsibilities, in order to reduce the potential for a flood of information reporting agreements. For example, foreign entities and branches that are considered U.S. payors under the current information reporting rules (e.g., U.S. branches of foreign banks and controlled foreign corporations) are already required to file full Form 1099 reports with respect to income paid to U.S. persons.[13] In addition, foreign partnerships that derive gross income that is either U.S. source or effectively connected with the conduct of a U.S. trade or business are already required to file Form 1065 and accompanying Schedule K–1 reports, which include extensive information regarding both U.S. and foreign source income allocable to all partners. SIFMA believes that the Form 1099 and Schedule K–1 information reporting regimes generally provide the IRS with sufficient tax information where they apply. Keeping such foreign entities within their existing information reporting regimes would also reduce the very substantial burden that the IRS will bear as it enters into the new information reporting agreements with FFIs. As a consequence, SIFMA recommends that U.S. payors and Schedule K–1 filers be excluded from the FFI definition.

Comment 7: *Provide Workable Procedures for Reliance on Certifications by FFIs.*

The proposed standard for knowledge of an incorrect certification is unworkable in the context of global financial institutions. Instead, FFIs should be permitted to rely on certifications from account holders so long as they implement procedures reasonably designed to identify incorrect certifications. [14]

The Bill provides that, in fulfilling its information reporting obligations, an FFI may rely on a certification from an account holder only if neither the FFI nor any entity which is a member of the same expanded affiliated group knows, or has reason to know, that any information provided in such certification is incorrect. The expanded affiliated group of a large FFI may include tens of thousands of employees in hundreds of different branches, business entities, and segments, located in numerous jurisdictions. FFIs do not currently maintain systems that can monitor and compare the knowledge of these vast numbers of employees across such branches, business entities, and segments. The creation of such systems would be extremely expensive and difficult to implement and, even if the construction of such systems were practically achievable, their use may be impermissible under U.S. and non-U.S. securities, data protection, and other laws.[15]

In order to make the certification reliance provision workable in the context of global financial institutions, SIFMA recommends that the Bill provide that an FFI may rely on a certification from an account holder so long as the FFI has implemented procedures reasonably designed to identify incorrect certifications. The Treasury Department and the IRS would then be expected to craft safe harbors that are deemed to satisfy the requirements. In general, SIFMA believes that the development of these safe harbors is best left to the regulatory process, in which SIFMA would be pleased to participate. It would be helpful, however, if the Treasury Department and the IRS could be directed in legislative history to focus the safe harbor procedures on the knowledge of employees of an FFI that directly establish an account or perform direct client-facing services in respect of the account, together with any information actually contained in a universal account system,[16] and to avoid any procedures that could be in conflict with U.S. and non-U.S. securities, data protection, or other laws. Potential abuse concerns could then be addressed with a targeted anti-abuse rule to prevent an FFI from structuring an account relationship in a manner that avoids the purposes of the Bill.

Comment 8: *Establish Commercially Reasonable Standards for Identifying U.S. Accounts and Foreign Entities with Substantial U.S. Ownership.*

The Bill and its legislative history should direct the Treasury Department and the IRS to establish commercially reasonable standards for identifying U.S. accounts and foreign entities with substantial U.S. ownership, and should confirm that, until such standards are adopted, FFIs and U.S. withholding agents may rely on existing

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[13] See Treasury regulations Section 1.6049–5(c)(5) for the complete list of entities that are considered U.S. payors for Form 1099 information reporting purposes.

[14] Proposed section 1471(c)(3).

[15] For example, the sharing of relevant information may be prohibited under the so-called Chinese Walls required under U.S. securities laws. *See, e.g.,* 15 U.S.C. 78o(f) (2006) (requiring broker-dealers to adopt policies and procedures designed to prevent insider trading and tipping); 15 U.S.C. 80b–4a (2006) (requiring investment advisors to establish policies and procedures reasonable designed to prevent insider trading and tipping).

[16] *Cf.* Treasury regulations Section 1.1441–1(e)(4)(ix)(A).

documentation, account information, and KYC and AML procedures for such purposes. [17]

SIFMA understands that the Bill does not mandate any particular method or procedure to identify U.S. accounts, and welcomes the JCT Report's reference to the use of existing know-your-customer (KYC) and anti-money-laundering (AML) procedures as a method of account identification.[18] Nevertheless, it is important that the Treasury Department and the IRS be directed to adopt identification and documentation standards that are commercially feasible and utilize existing documentation and account information wherever possible. Until more complete guidance is issued, the Bill and its legislative history should also confirm that FFIs and U.S. withholding agents may rely on existing documentation, account information, and KYC and AML procedures for purposes of identifying U.S. accounts and foreign entities with substantial U.S. ownership. SIFMA believes that confirmation of this intended result will be particularly critical in the case of certain investment fund FFIs (e.g., foreign mutual funds) that hold U.S. securities and that have beneficial owners that hold their interests in the investment fund through other entities (e.g., a mutual fund distributor), where such other entities are not themselves reporting FFIs (see additional discussion of foreign mutual funds under Comment 16).[19] SIFMA also believes that, in all cases, the applicable identification and documentation standards should apply equally to FFIs (whether or not U.S. controlled) and U.S. withholding agents (e.g., for purposes of determining whether a foreign entity has substantial U.S. ownership under the FE information reporting and withholding regime), and regardless of whether the account is on-shore or offshore, in order not to put either U.S. or non-U.S. financial institutions at a competitive advantage. Furthermore, in utilizing existing documentation and account information, FFIs and U.S. withholding agents should not be required to perform due diligence that would require aggregating the knowledge of all members of their expanded affiliated groups, for the same reasons noted above with respect to aggregating knowledge that could potentially cause an FFI to question the correctness of a certification. SIFMA looks forward to assisting the Treasury Department and the IRS in adopting more complete guidance in this area during the regulatory process.

Comment 9: *Provide a Uniform 10 Percent Test for Substantial U.S. Owner Status.*

The substantial United States owner definition should apply a uniform 10 percent test.[20]

The Bill provides that an FFI must report on substantial United States owners of foreign entities that hold financial accounts with the FFI. The Bill also requires FEs to provide information regarding their own substantial United States owners to withholding agents for provision by such withholding agents to the IRS. For these purposes, the Bill defines substantial U.S. ownership to be 10 percent or more with respect to foreign corporations and foreign partnerships that are not foreign investment entities, but any U.S. ownership with respect to a foreign investment entity. SIFMA does not believe that any currently existing or contemplated KYC or AML procedures investigate entity ownership below a 10 percent level (and, indeed, only the more advanced KYC and AML procedures investigate entity ownership at that level). In addition, the proposed dual standard would be extremely difficult to implement in practice, particularly as the determination of the correct percentage test would require an FFI to study and identify the business of each such account holder to determine whether it is a foreign investment entity. SIFMA accordingly believes that the Bill should adopt a uniform 10 percent test for substantial United States ownership for all foreign entities.

Comment 10: *Revise Carve-outs for Corporations and Tax-Exempt Entities.*

The carve-out for corporations whose stock is regularly traded on established securities markets should be replaced with a carve-out for foreign entities that are per se corporations under Treasury regulations Section 301.7701–2(b)(8). In addition, certain foreign tax-exempt entities should be fully carved out from the FFI and FE information reporting and withholding regimes. [21]

The Bill provides carve-outs from the account holders that are subject to FFI information reporting and from the entities that are subject to FE information report-

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[17] Proposed section 1471(d)(1).

[18] Under the current QI program, QIs have long been able to rely on KYC documentation in lieu of obtaining certifications in appropriate cases. *See* Revenue Procedure 2000–12.

[19] Such investment fund FFIs have invested billions of dollars in the United States, and it will be very important to their decision to continue such investments that they have a clear idea from the outset as to how the new information reporting and withholding regimes will apply to them.

[20] Proposed section 1473(2).

[21] Proposed sections 1472(c)(1)(A) and 1473(3)(A) & (C).

ing and withholding in the case of corporations whose stock is regularly traded on an established securities market, presumably because the risk of tax evasion in connection with a publicly traded corporation is low. It would be extremely difficult and expensive, however, for an information reporting or withholding agent to determine whether the stock of large numbers of corporations is regularly traded. Accordingly, SIFMA recommends that the Bill instead provide a carve-out for foreign entities that are per se corporations under Treasury regulations Section 301.7701–2(b)(8), subject to such exceptions as the Secretary of the Treasury determines are necessary to prevent avoidance of the purposes of the Bill. Per se corporations (e.g., U.K. public limited companies) generally present a low risk of being used to facilitate U.S. tax evasion, because they are generally subject to tax filing requirements and/or more extensive corporate regulation, and because they are not eligible to be flow-through entities for U.S. tax purposes. Moreover, although there may be certain situations where a particular per se corporation presents greater risks, SIFMA believes that the Treasury Department and the IRS should be able to identify relevant abuse factors and provide exceptions for this purpose in regulations.

The Bill also provides a carve-out from the account holders that are subject to FFI information reporting (but not from the entities that are subject to FE information reporting and withholding) in the case of an organization that is exempt from tax under section 501(a), again presumably because such entities pose a low risk of being used to facilitate U.S. tax evasion. As such, and in order to preserve a level playing field between U.S. financial institutions dealing with foreign entities through the FE regime, on the one hand, and FFIs dealing with foreign entity account holders through the FFI regime, on the other, the exception should be expanded to apply equally to the FE information reporting and withholding regime. (Otherwise, FFIs would have a competitive advantage over U.S. withholding agents in providing account services to such entities.) This could be done by adding such entities to the list, in Proposed section 1472(c), of the entities that are exempt from the requirements of Proposed section 1472(a). In addition, however, SIFMA believes that there are many additional foreign pension funds and other tax-exempt entities that similarly pose a low risk of being used to facilitate U.S. tax evasion, but that may not meet the definition of section 501(a) (or have any idea whether they do or do not meet that definition). Accordingly, SIFMA would recommend that the carve-outs for foreign tax-exempt entities be expanded to include all foreign tax-exempt entities that are entitled to treaty benefits under a comprehensive income tax treaty with the United States.

Comment 11: ***Exempt Separate Depository Accounts Not Exceeding $50,000.***

Depository accounts that do not exceed $50,000 on a non-aggregated basis and that have not been structured to avoid the purposes of the Bill should be excluded from the definition of United States account. [22]

The Bill provides two de minimis thresholds, one at $10,000 for new accounts and one at $50,000 for existing accounts, to determine whether a depositary account held by an individual may be exempt from FFI information reporting. In applying the thresholds, all accounts throughout an FFIOs expanded affiliated group must be aggregated. SIFMA believes that it would not be practical or perhaps legal for FFIs to collect the information necessary to aggregate the value of all depositary accounts across their expanded affiliated groups for purposes of applying the de minimis test, for the same reasons noted above with respect to aggregating knowledge that could potentially cause an FFI to question the correctness of a certification. In addition, having two tests would make compliance substantially more difficult, since an FFI would have to implement two different tracking mechanisms in addition to the many other compliance systems that it would be required to develop to comply with the Bill. As a consequence, SIFMA would suggest that the de minimis threshold be revised to a uniform level of $50,000, applied on a non-aggregated basis, and that potential abuse concerns be addressed with a targeted anti-abuse rule that aggregates accounts that have been structured to avoid the purposes of the Bill.

Comment 12: ***Allow Simplified Form 1099 Reporting by FFIs.***

The alternative reporting election available to FFIs should allow simplified Form 1099 reporting, rather than full Form 1099 reporting, in order to induce more FFIs to elect this more useful reporting alternative. [23]

The Bill is responsive to many of the concerns expressed in SIFMA's prior comment letter on the Obama Administration's offshore tax compliance proposals. SIFMA in particular welcomes the Bill's simplified reporting regime for FFIs that would apply as a default matter (the default reporting regime). SIFMA also welcomes the flexibility provided by the election to opt for full Form 1099 reporting if

[22] Proposed section 1471(d)(1).
[23] Proposed section 1471(c)(2).

an FFI so desires. The latter election would be much easier for FFIs to implement, however, and thus much more likely to be adopted, if it provided for simplified Form 1099 reporting that contains more information than the default reporting regime, but less than full Form 1099 reporting would require. SIFMA would be pleased to work with the Treasury Department and the IRS to develop a process for such simplified Form 1099 reporting. In general, SIFMA contemplates that such reporting would be limited to cash payments, and would not require an FFI to, e.g., report any income on an accrual basis, deemed income, adjusted tax basis, or any supplemental information that might otherwise be required. This would mean that an FFI would report cash payments of dividends, interest, royalties, and gross proceeds from the sales of securities, but would not be required to report accruals of original issue discount on long-term obligations, foreign tax withheld, deducted investment expenses, adjusted issue price, market discount information on REMICs or CDOs, imputed income or supplemental information on a widely held fixed income trust, or similar tax information. This would obviate the need, among other things, to reclassify income paid, track holding periods, make complicated tax calculations to determine income amounts, or perform tax lot accounting for securities sold in order to prepare Form 1099s. SIFMA believes that these simplifications would not significantly impair the IRS's ability to combat offshore tax evasion, and that the simplified Form 1099 information would indeed be substantially more useful to the IRS than the information that it would receive under the default reporting regime. As a consequence, SIFMA believes that the goals of the Bill would be advanced by providing for a simplified Form 1099 reporting alternative.

Comment 13: *Allow FFIs to Receive Refunds or Credits of the Withholding Tax in Additional Cases*.

As a matter of fundamental fairness, an FFI should be allowed to receive a refund or credit with respect to amounts withheld in the same circumstances as other investors. [24]

The Bill provides that, except to the extent required by a treaty, no refund or credit of the withholding tax imposed by the Bill will be available if the beneficial owner of a withholdable payment is an FFI. This rule is punitive in nature (since other beneficial owners are permitted to receive such refunds and credits where they disclose their beneficial ownership). Its purpose is presumably to induce FFIs to enter into reporting agreements with the IRS, in order to avoid the withholding tax in the first instance. As a matter of fundamental fairness, SIFMA believes that FFIs should be allowed the same refund and credit possibilities as other investors if they disclose their beneficial ownership of a withholdable payment. At a minimum, the Treasury Department and the IRS should be authorized and directed to provide such refunds where the withholding tax results from an inadvertent or temporary disqualification of an FFI that is otherwise compliant, and where an FFI subsequently enters into or reestablishes an information reporting agreement with the IRS within a certain period after the withholding.

Comment 14: *Coordinate with Other Withholding and Information Reporting Provisions*.[25]

Although the Bill provides appropriate coordination language with respect to the existing withholding provisions of Section 1441 (withholding tax on nonresident aliens) and Section 1445 (withholding tax on dispositions of U.S. real property interests), additional coordination language should be added with respect to other sections, including but not limited to Section 1442 (withholding tax on foreign corporations), Section 1446 (withholding tax on foreign partnersÕ share of effectively connected income), Section 3402 (wage withholding), Section 3405 (withholding tax on pension, annuities, and other deferred income), Section 3406 (backup withholding tax), and Section 4371 (foreign insurance excise tax).

In addition, the Bill should provide for appropriate coordination language with respect to existing information reporting provisions, including but not limited to Section 6041 (information at the source), section 6041A (returns regarding payments of remuneration for services and direct sales), Section 6042 (returns regarding payment of dividends), Section 6045 (returns of brokers), and Section 6049 (returns regarding payment of interest).

Comment 15: Provide for Further Limits to the Definition of Withholdable Payment. [26]

The definition of withholdable payment is extremely broad, and appears to include many items that pose a very low risk of facilitating U.S. tax evasion (including, e.g., payments for services performed in the United States; adjustments required under

[24] Proposed section 1474(b).
[25] Section 101(b) of the Bill.
[26] Proposed section 1473(1).

section 482; issuances of stock in tax-free reorganizations; and intercompany payments between a U.S. company and a foreign affiliate). Although the FE information reporting and withholding regime provides a mechanism for the Secretary of the Treasury to exclude certain payments from the withholding tax, the FFI information reporting and withholding regime does not contain a similar payment-based carve-out mechanism.[27]

SIFMA recommends that the Bill authorize the Secretary of the Treasury to exclude from the entire definition of withholdable payment any payments that pose a low risk of tax evasion, and that the Treasury Department and the IRS be directed to consider the exclusion of the above-noted payments (and others) under this authority.

Comment 16: *Address Tiering Issues.*

The Bill or its legislative history should provide guidance to the Treasury Department and the IRS regarding tiered ownership issues.

In addition to the points raised in the foregoing comments, there are a number of other more mechanical issues raised by the Bill. For the most part, a discussion of these issues would be beyond the scope of this letter, and is better left to the regulatory process. One particular area of concern, however, will be the application of the new information reporting and withholding rules in the case of tiered FFIs and withholding agents. SIFMA believes that it would be helpful if the Treasury Department and the IRS could be given some direction, in either the text of the Bill or legislative history, regarding the way that certain tiered ownership situations are intended to be addressed.

One important situation that will need to be addressed concerns a payment made by one FFI to another FFI. In this case, SIFMA would suggest that primary information reporting responsibility should be placed on the recipient FFI, since that FFI will have the closer relationship to the beneficial owner (or will be the beneficial owner), and will accordingly be in the best position to provide appropriate information to the IRS. As a consequence, the payor FFI should be exempted from any information reporting or withholding requirements in respect of the payment so long as the recipient FFI confirms that it has entered into an information reporting agreement with the IRS. SIFMA believes that clarification of this intended result will be particularly critical in the case of certain investment fund FFIs (e.g., foreign mutual funds) that hold U.S. securities and that have beneficial owners that hold their interests in the investment fund FFI through other entities (e.g., a mutual fund distributor), where such other entities are themselves reporting FFIs.

Another tiering issue that will need to be addressed concerns the case where an FFI establishes an account on behalf of a customer directly with a U.S. payor that files Form 1099 reports. In that case, SIFMA would recommend that the U.S. payor be given primary information reporting responsibility with respect to the account, and that the FFI should be exempted from any information reporting or withholding requirements in respect of the account so long as the U.S. payor confirms that it will undertake that responsibility.

We appreciate the opportunity to comment on the Bill and to provide our recommendations for improving offshore tax compliance. We would welcome the opportunity to discuss our recommendations in more detail and hope to provide further comments and suggestions as the legislation progresses. If you have any questions or need more information, please do not hesitate to contact Ellen McCarthy, or Scott DeFife.

Best Regards,

Kenneth E. Bentsen, Jr.
Executive Vice President, Public Policy and Advocacy

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[27] *Compare* proposed section 1472(c)(2) *with* proposed section 1471(f)(4).

Statement of The Financial Services Roundtable

Overview

Both Congress and the Administration are focusing considerable attention on addressing the potential for U.S. tax evasion through the inappropriate exploitation of foreign financial accounts. This is part of an overall effort aimed at ensuring that the IRS has the tools needed to enforce the U.S. tax laws fully and fairly. We are committed to working with lawmakers to assist in the accomplishment of these important compliance goals.

The recent introduction of The Foreign Account Tax Compliance Act of 2009 (the "Bill") is an element of this effort. One major focus of the Bill is tax compliance by U.S. persons that have accounts with foreign financial institutions. The Bill would impose substantial new reporting and tax withholding obligations on a very broad range of foreign financial institutions that could potentially hold accounts of U.S. persons. The reporting and withholding obligations imposed on the foreign financial institutions would serve as a backstop to the existing obligations of the U.S. persons themselves, who have a duty to report and pay U.S. tax on the income they earn through any financial account, foreign or domestic. These new reporting and withholding obligations for financial institutions would be enforced through the imposition of a 30 percent U.S. withholding tax on a very broad range of U.S. payments to foreign financial institutions that do not (or cannot) satisfy the reporting obligations. This withholding tax would apply without regard to whether the payment relates to a U.S. customer's account, a foreign customer's account, or the institution's own account.

This proposed new reporting and withholding tax regime would be in addition to the vital role many foreign financial institutions currently play in contributing to U.S. tax compliance and enforcement through their participation in the Qualified Intermediary ("QI") program. Foreign financial institutions that are part of the QI program take on responsibility for ensuring the proper imposition of U.S. withholding tax with respect to the foreign persons that hold accounts with such institutions. The additional obligations under this proposed new regime would substantially increase the U.S. reporting and withholding responsibilities of those foreign financial institutions that currently participate in the QI program. Specifically, it would require the determination of the tax status of all customers in order to identify any U.S. persons and the reporting of all payments to, or activity in the accounts of, any U.S. customers. In addition, the proposed new regime would extend to thousands of foreign financial institutions, including very small institutions, which are not within the coverage of the QI program either because they do not handle the kinds of U.S. investments that are covered by the QI rules or because they have not entered into a QI agreement.

Given the high priority of this Bill for both Congress and the Administration, we are limiting our comments to the foreign financial institution provisions (and to how such provisions apply to banks and other traditional financial institutions). Within those provisions, we focus on five key areas as described in more detail below. In addition, we include two further suggestions regarding issues related to particular aspects of the operation of the proposed provisions. However, we would stress that the burden and uncertainty of obligations that would be imposed under the Bill could lead some foreign financial institutions to conclude that they have no choice but to divest themselves of all their U.S. investments, to the severe detriment of the U.S. financial markets and the U.S. economy. Therefore, we urge policymakers to work closely with the financial services industry to ensure that the proposed new regime operates in a way that is clear and workable and that will ensure that it accomplishes the objective of improving U.S. tax compliance by U.S. persons while not inappropriately discouraging U.S. investment.

Additional Time Needed for Development and Implementation of the Proposed New Reporting and Withholding Regime

The Bill provides that the new regime would take effect for payments made after December 31, 2010. However, development and implementation of the new regime will require a tremendous amount of work by the foreign financial institutions that will be subject to the regime (in terms of customer investigation and information gathering, as well as systems and process changes), by U.S. persons that make covered payments to foreign financial institutions (in terms of systems modifications and implementation of new processes), and by the Treasury Department and IRS (in terms of detailed substantive and procedural guidance, development and implementation of agreements, and development and implementation of internal review processes). Therefore, in order to give sufficient time to accomplish all the necessary preliminary work, we believe that the effective date of the new regime should be delayed by at least three years so that the regime would apply no earlier than for payments made after December 31, 2013, and then phased in as discussed in more detail below. **We also believe it is important to authorize the Secretary of the Treasury to delay the effective date to avoid unforeseen issues that may disrupt financial markets.**

The statutory provisions in the Bill delegate substantial responsibility to the Treasury Department to develop detailed rules for the operation of the regime, to establish compliance thresholds and mechanisms, and to provide exceptions and special rules for appropriate situations. Treasury and the IRS will need time to develop the required overall guidance with respect to the regime and to address the specific areas where Treasury action is explicitly contemplated in the statutory language. Treasury and the IRS should work closely with the industry in developing this guidance. Moreover, the guidance should be issued in proposed form in order to provide an opportunity for public comment.

The Bill also contemplates that Treasury and the IRS will develop an agreement to be executed by foreign financial institutions to reflect their commitment to accept information reporting responsibilities in lieu of being subjected to the U.S. 30 percent withholding tax on U.S. payments received. The government will need time to develop this agreement, the specifics of which likely will need to be coordinated with the detailed guidance developed with respect to the new regime. Again, it is important that Treasury and the IRS work with the industry in developing this agreement. In addition, once the form of agreement is finalized, the government will need to execute agreements with the many thousands of foreign financial institutions affected by the new regime. As a practical matter, this process will take time and resources for the government to complete. It should be noted that it took multiple years to introduce and implement the QI program, which involved vastly fewer foreign financial institutions.

When the detailed guidance specifying the applicable operational rules is issued and the required agreements are executed, foreign financial institutions will need to put in place numerous new systems to ensure compliance with the new reporting obligations. For those financial institutions that are part of the QI program currently, this will require a complete overhaul of existing systems to capture the new information required to be tracked and reported. For many such institutions, new systems also will need to be put in place in order to cover all the accounts that are not covered by the QI program. In all cases, the number of additional accounts to be covered will be many multiples of the number of accounts covered by the QI program. For those foreign financial institutions that are not currently part of the QI program, the required systems development and implementation work will be a new undertaking to be started from scratch.

For these reasons, we respectfully urge the further delay of the effective date of the new regime (so that the regime would not apply any earlier than payments made after December 31, 2013) and then the phase in of the new regime over time.

A Phased-In Approach Should be Used for Implementation of the New Reporting and Withholding Regime

The burdens involved in implementation of the new regime, and the processes that will be required in order to obtain the information needed to comply with the reporting requirements, will be very different for different types of financial accounts. In particular, the burdens associated with compliance with respect to deposit accounts will be disproportionately high. Therefore, a phased-in approach should be used for implementation of the new regime.

The QI program covers custodial accounts in which the foreign financial institution holds U.S. securities for its account holders and receives payments with respect to those securities. Those foreign financial institutions that are part of the QI program have processes in place for obtaining and reporting information with respect to the holders of these accounts. While the new regime would require significant additional information, existing processes potentially could be overhauled and expanded to gather this additional information. Moreover, the relationship between the financial institution and the account holder is particularly close in the case of a custodial account due to the required interaction between the institution and the account holder regarding investment instructions and other matters. Thus, even for those foreign financial institutions that are not in the QI program, the relationship and regular interaction with the account holder should help facilitate the obtaining of the required information in order to implement the new regime.

In contrast, the QI program does not cover deposit accounts held by foreign financial institutions, such as checking or savings accounts. Foreign financial institutions that are part of the QI program will not have processes in place to gather the required customer information or to report under the new regime with respect to their deposit accounts. The number of such accounts in most cases will be many multiples higher than the number of custodial accounts currently covered by the QI program. The tax status of every checking and savings account holder would need to be determined in the manner required by the Treasury Department and then would need to be input into the foreign financial institution's deposit and customer information systems. In addition, there are many foreign financial institutions that do not have custodial accounts but that do have large numbers of deposit accounts. Finally, the interactions between the financial institution and the deposit account holder are much more limited—often to ATM or on-line transactions only. Therefore, obtaining the required information would be much more difficult, particularly given the natural caution (due to concern about identity theft) about providing detailed personal information in response to unexpected inquiries that purport to be from a financial institution.

For these reasons, we respectfully urge that the new regime be phased in so that it applies initially only to custodial accounts and that the regime be extended to apply also to deposit accounts over a period of years (such as over a four year period). This will allow additional time for the necessary groundwork with respect to the huge number of deposit accounts that would be affected. It also will allow foreign financial institutions and the government to gain experience with respect to the new regime, and to make any necessary refinements in the implementation requirements, before the regime is vastly expanded in its application.

In addition, we respectfully urge that the requirements of the regime be phased in over this additional period of years so that the customer documentation requirements apply first to newly-opened accounts and then over time to pre-existing accounts so that financial institutions have additional time to obtain this documentation with respect to such accounts. Given the often limited interaction between the institution and its deposit account holders, the gathering of this information with respect to pre-existing accounts likely would require multiple mailings and repeated follow up by telephone. In contrast, in the case of new accounts, once the necessary forms, systems and processes are developed for reporting the information, the customer documentation could be requested as part of the account opening procedure.

The New Reporting and Withholding Regime Should be Coordinated with the QI Program

Under the proposed new regime, a foreign financial institution that cannot enter into an agreement with Treasury regarding compliance with the new reporting and withholding requirements would be subjected to 30 percent U.S. withholding tax on U.S. payments received, without regard to whether those payments relate to U.S. customers' accounts, foreign customers' accounts, or the financial institution's own account. Thus, a financial institution that is a participant in good standing in the QI program could be subjected to this withholding tax on payments with respect to its foreign accounts for which it properly satisfied all the required reporting obligations under the QI program. Thus, this Bill would essentially abrogate the QI program.

The QI program is critically important to ensuring that the United States collects the proper amount of withholding tax with respect to payments on U.S. investments held by foreign persons through foreign financial accounts. Thus, foreign financial institutions in the QI program serve a vital role with respect to U.S. tax compliance by foreign persons. The government should not risk sacrificing this important aspect of tax compliance in the interest of shoring up tax compliance by U.S. persons.

In order to avoid that potential conflict and to maximize the beneficial impact on tax compliance across the board, the Bill should be modified to provide for coordination between the proposed new regime and the existing QI program. Under this coordination, a foreign financial institution that is a participant in good standing in the QI program should not be subject to 30 percent U.S. withholding tax with respect to payments it receives on behalf of foreign accounts properly reported under the QI rules.

Therefore, we respectfully urge that the new regime be fully coordinated with the existing QI program.

The New Withholding Tax Rules Should Not Apply to Payments Made for the Foreign Financial Institution's Own Account

Under the proposed new regime, foreign financial institutions that cannot enter into an agreement with Treasury regarding compliance with the new reporting requirements with respect to potential U.S. accounts would be subjected to 30 percent U.S. withholding tax even on payments that are received with respect to its own account. Such payments are income of the foreign financial institution and are subject to withholding tax or reporting on a tax return as required under existing provisions of the tax law (or are excluded from income and are exempt from U.S. tax under applicable provisions).

By definition, payments received for the foreign financial institution's own account cannot relate to any possible account of a U.S. person. Therefore, there is no direct compliance goal served by subjecting these payments to this 30 percent withholding tax. Such tax serves solely as an unrelated penalty to try to force foreign financial institutions to comply with the reporting obligations with respect to any unrelated accounts of U.S. persons. Moreover, this penalty will force those foreign financial institutions that simply cannot comply with the new reporting obligations to divest all their U.S. investments.

The imposition of a 30 percent withholding tax on payments received for a foreign financial institution's own account would be confiscatory. The amount of such withholding tax would bear no relation to the amount of tax actually owed by the institution with respect to such payments. The amount of such withholding tax also would bear no relation to the amount of tax that might be owed by U.S. persons that have accounts with the institution (which accounts would be unrelated to these particular payments). The burden of this imposition of the withholding tax on payments for the foreign financial institution's own account would far outweigh any compliance benefits to be achieved through this penalty.

Therefore, we respectfully urge that payments received by a foreign financial institution for its own account not be subjected to the 30 percent U.S. withholding tax as contemplated by the Bill.

The New Withholding Tax Rules Should Not Apply to Tax-Exempt Payments

Under the proposed new regime, foreign financial institutions that cannot enter into an agreement with Treasury would be subjected to 30 percent U.S. withholding tax even on payments that are of a type that otherwise are exempt from U.S. withholding tax under long-standing substantive provisions of the U.S. tax law.

Specifically, the proposed new withholding tax would apply to payments to foreign persons that qualify as portfolio interest, short-term original issue discount, and interest on bank deposits. In addition, the proposed new withholding tax would apply to payments that are considered effectively connected with a U.S. business and that therefore would be subject to net-basis income taxation and otherwise would be exempt from withholding tax. (In each case, the foreign person is required under existing law to provide the appropriate Form W–8 to obtain the exemption.) Finally, the proposed new withholding tax would apply to payments of interest on tax-exempt bonds that otherwise would be exempt from any U.S. tax, even if the beneficial owner is a U.S. person.

Application of the withholding tax with respect to payments received for the account of a foreign person that are of a type that otherwise would be exempt from withholding tax should not be subjected to the new 30 percent withholding tax regime. Such application of the regime would impose an unnecessary burden on the foreign account holders, who would be required to file a claim for refund simply to obtain the statutory tax exemption. Similarly, application of the withholding tax with respect to any payments of tax-exempt interest would be particularly inappropriate as such amounts are never taxable regardless of the identity of the beneficial owner.

In addition, in the case of payments received by a foreign financial institution for its own account, the limited credit/refund rules contained in the Bill mean that the potential application of this 30 percent withholding tax would effectively eliminate the tax exemption provided by statute. The refund process under the Bill applies only to the extent that an applicable tax treaty gives the institution the benefit of reduction in the withholding tax and does not apply to allow the benefit of a statutory exemption. Moreover, a foreign financial institution from a country with which the United States has not concluded a tax treaty cannot obtain any refund or credit with respect to amounts withheld. At a minimum, foreign financial institutions (wherever located) should be entitled to file claims for refund or credit with respect to amounts that are over-withheld because the underlying payment is tax-exempt under applicable statutory provisions.

If the new regime continues to be structured to apply a 30 percent withholding tax to payments received by a foreign financial institution for its own account and to payments received for the accounts of foreign customers properly reported under the QI program, we respectfully urge that an exception from such withholding tax be provided for amounts that are exempt from withholding tax under other existing provision of the U.S. tax law.

Additional Suggestions Regarding the Operation of the Proposed New Reporting and Withholding Regime

In addition to the foregoing comments relating to the overall structure and implementation of the proposed new reporting and withholding regime, we would like to make suggestions with respect to two aspects of the operation of the new regime.

Compliance Under the Proposed New Reporting and Withholding Regime

The Bill would provide the Treasury Department with broad authority to establish verification and due diligence procedures with respect to a foreign financial institution's identification of any U.S. accounts (or its determination that it has no U.S. accounts). We believe it is critically important that Treasury and the IRS work with the industry in designing these requirements and in establishing the approach for assessing compliance with such requirements.

In this regard, we believe that the compliance assessment approach should focus on the establishment of proper procedures by each foreign financial institution and its implementation of such procedures on an ongoing basis. The IRS should work with foreign financial institutions to establish the agreed procedures the institution will follow on a day to day basis. Once these procedures are in place, the institution should be able to make periodic representations to the IRS that the procedures have been followed and that there have been no breaches. Moreover, it would be appropriate to establish a further streamlined representation approach in the case of a foreign financial institution that has determined it has no U.S. accounts and that has put in place procedures to prevent any U.S. accounts from being created.

Interaction of Proposed New Reporting and Withholding Regime with Proposed Changes to the Foreign Trust Rules

In addition to the foreign financial institution provisions that are the focus of this submission, the Bill includes a proposed modification to the rules with respect to foreign trusts. This section of the Bill would create a new presumption rule that could have the effect of causing a U.S. person that makes a transfer of property to a foreign trust to be deemed to be an owner of the trust if under the thrust instruments a U.S. person could ever receive a distribution from the trust. If this occurs, a foreign financial institution that holds an account for such trust could suddenly be subject to reporting and withholding obligations with respect to that trust.

As a result of the potential interaction of this provision with the new reporting and withholding regime, a foreign financial institution could be required to continuously monitor all activity with respect to the foreign trusts that are account holders to determine if any U.S. person makes any transfer to a trust and then to further analyze the trust instruments themselves to determine if that transfer would trigger the application of these presumption rules that would treat the U.S. transferor as an owner of the trust. It would be virtually impossible for a foreign financial institution, which may have thousands of trust accounts, to undertake such efforts.

Therefore, we respectfully request that the Bill be modified so that the proposed modification to the foreign trust rules does not interact with the proposed new reporting and withholding regime in a manner that would subject a foreign financial institution to this onerous and impractical additional responsibility with respect to its trust accounts.

Graham Cox, letter

Dear Mr. Buckley and Ms. Mueller,

Comments on the Foreign Account Tax Compliance Act of 2009 (H.R. 3933, S. 1934)

On behalf of the members of the International Capital Markets Services Association ("ICMSA"), we thank you for the opportunity to comment on the proposed Foreign Account Tax Compliance Act of 2009 ("the Bill").

ICMSA[1] is a London-based self regulatory organization representing international financial and non-financial institutions active in the provision of services to the International Capital Markets. Our membership includes universal banks, registrars, stock exchanges, law firms, International Central Securities Depositories ("ICSD"s) and other service providers specialised in specific product segments such as the processing of tax reclaims. The primary purpose of the association is to foster

[1] More information on the association can be found on www.capmktserv.com.

the highest standards in the practice and management of international capital market services, thereby facilitating the efficient functioning of the market. In its day-to-day activities, the ICMSA is predominantly focusing on the operation of the International Securities Market,[2] which has outstanding issuance levels exceeding U.S. Dollar (USD) 13 trillions, i.e. about half of the overall international debt securities outstanding volumes reported by the Bank for International settlements.[3]

We wish first to confirm our full support to the overall objective of the Bill which we understand is intended to prevent the avoidance of tax by U.S. persons. We however would like to express our serious concerns regarding Section 102 of the proposed Bill (Repeal of Certain Foreign Exceptions to Registered Bond Requirements) which, we fear, could result in a severe disruption of the international capital markets' current economic fundamentals and operating practices at a time when global access to cost-efficient funding is pivotal to achieve economic recovery. Please note that many of our members have also expressed serious concerns over other aspects of the Bill (for example the new "foreign financial institution" regime in Section 101, which will affect the financial community worldwide and may deter foreign investment from U.S. securities). These concerns have been and will be addressed by members either individually or through other industry groups.

The International Securities Market has overwhelmingly adopted the bearer legal form as the preferred form for security issuance, moving from definitive bearer instruments at its inception to a custody structure where global bearer notes are now immobilized with the ICSDs and settle through a book-entry system. Approximately 80% of the securities in the International Securities Market have been issued in global immobilised bearer form under the TEFRA[4] D rule, regardless of the nationality of the issuer (U.S. or non-U.S.), effectively becoming the norm in the market and representing therefore a very important and efficient funding vehicle for all issuers, U.S. or non-U.S..

An elimination of the foreign-targeted bearer bond exemptions, as we understand the current draft of the bill is proposing, on which the market is based would inevitably lead to wide-spread market disruption and would impose substantial costs and additional complexities (different legal documentation, restricted placement opportunities due to a more limited investor base, additional registration services, additional certification and tax processing procedures, etc) to those actors, across the entire chain from issuers to investors, forced or willing to comply with the new requirements. This would ultimately translate into a higher cost of borrowing for those issuers forced to adopt the registered format for their international securities issuances and thus expose them to sub-optimal funding conditions. This could therefore put U.S. issuers seeking foreign funding at a disadvantage compared to their non-U.S. peers, who chose to continue issuing in the global bearer format.[5]

U.S.-incorporated issuers represent today a significant portion of the International Securities Market. These entities mostly tap this market to raise funds in Euros and British Pounds (i.e. alternative funding to USD) with European- and Asian-based investors, thereby diversifying their funding base, and they do so very efficiently and effectively through the issuance of global bearer notes immobilized with the ICSDs. Because these transactions are foreign-targeted and that the mechanisms in place under the TEFRA rules already provide appropriate safeguards against offering to U.S. persons, we believe that the measures proposed in Section 102 will produce marginal benefits in terms of reducing U.S. tax evasion compared to the disruption they will provoke.

Moreover, we note that, in some markets, it is simply not feasible to issue obligations in registered form, which would leave some foreign issuers with no choice but to be exposed (at least in principle) to a very significant excise tax.

In light of these elements, we urge the U.S. House of Representatives and the U.S. Senate to re-consider the possibility to maintain the existing exceptions for foreign-targeted bearer bond until such time as the potential impact has been thoroughly investigated. Over time these exemptions have served issuers, intermediaries and investors worldwide very well and that have helped maintain a level-playing field access to the international capital markets. In our view, the repeal of these exceptions needs to be carefully planned and considered to avoid a major disruption in a multi-trillion dollar market which would affect U.S. issuers, non-U.S. issuers,

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[2] i.e. securities primarily issued and deposited with the ICSDs, Clearstream Banking and Euroclear Bank.

[3] BIS Quarterly Review, September 2009

[4] Tax Equity and Fiscal Responsibility Act, which requirements and procedures are designed to ensure that the concerned securities are not offered to or acquired by U.S. persons.

[5] Whether or not these non-U.S. issuers would then be exposed to U.S. sanctions such as the Excise Tax is linked to the question of U.S. tax laws extra-territoriality.

many market intermediaries including the major U.S. banks, and, ultimately, the investors. To this effect, the ICMSA supports the recommendation made by other industry groups that Congress requests a report regarding the potential consequences of the repeal of the foreign-targeted bearer bond exceptions.

We thank you again for the opportunity to present our understanding of the proposed legislation and of its likely consequences should the current draft be adopted. We hope the arguments and recommendations we have put forward in this letter will be considered and will provide useful guidance in the elaboration of any proposed legislation.

Yours Sincerely,
Graham Cox
Chairman
ICMSA

Letter of Martin Egan and Kate Craven

Dear Sirs,

The Foreign Account Tax Compliance Act of 2009

1. We write in relation to the bill (the "**Bill**") currently before the U.S. Congress concerning the above.
2. The International Capital Market Association ("**ICMA**") is a self regulatory organisation representing a broad range of capital market interests including global investment banks and smaller regional banks, as well as asset managers, exchanges, central banks, law firms and other professional advisers amongst its 400 member firms. ICMA's market conventions and standards have been the pillars of the international debt market for over 40 years, providing a self regulatory framework of rules governing market practice which have facilitated the orderly functioning of the market. ICMA's primary debt market committees[1] gather the heads and senior members of the syndicate desks and legal transaction management teams of around 20 ICMA member banks most active in lead-managing syndicated bond issues in Europe. Eurobond issuance so far this year has reached approximately USD 2.4 trillion (about half of total global debt issuance).
3. We understand the Bill is intended to clamp down on U.S. tax evasion and improve U.S. taxpayer compliance by giving the U.S Internal Revenue Service ("**IRS**") new administrative tools to detect, deter and discourage offshore tax abuses. We fully support Congress in this respect. ICMA does, however, have concerns that the Bill in its current form may have some serious side effects not intended by Congress and regarding which we would like to assist Congress.
4. In particular, we understand that one of the Bill's provisions would end the practice of selling bearer bonds to foreign investors under the 'TEFRA C' and 'TEFRA D' exemptions pursuant to the Tax Equity and Fiscal Responsibility Act. This would *inter alia* purport to cause non-U.S. borrowers issuing bearer bonds outside the U.S. to non-U.S. persons to be subject to a U.S. excise tax equal to 1% of the principal amount of such bonds multiplied by the number of years to their maturity.
5. We fear some of the Bill's other provisions that impose substantial new compliance requirements on non-U.S. institutions might cause some such institutions to reconsider their involvement with U.S. securities and/or U.S. market participants.
6. Like other international markets, the Euromarket has developed along historically different lines to the U.S. market and ever since it became established in the 1960's it has been a bearer bond market. Since then, the Euromarket, through the various TEFRA exemptions, has co-existed successfully with the U.S. market.
7. The overwhelming majority of Euromarket securities are held through the Euroclear and Clearstream depositaries, which operate on a book-entry basis effectively similar to French, Italian and Spanish 'dematerialised'/'immobilised' bonds that are deemed to be in registered form for U.S. tax purposes. We note IRS Notice 2006/99 in this respect. Congress's aim on tax evasion seems rather

[1] http://www.icmagroup.org/about1/isma1/legal_and_documentation.aspx and http://www.icmagroup.org/about1/isma1/primary_market_practices.aspx.

to primarily relate to bearer bonds in 'definitive' form that are physically held by individual investors—we wish to assist Congress in this aim.

8. From the above, it seems the timeline for passing and implementing of the Bill needs to be revised to allow further evaluation of its potential impact. In particular, Congress may wish to consider:

- market stability (as mentioned above)—the proposed changes may affect issuers' willingness to go to market and may affect stability of bond markets generally;
- the increased compliance cost burden on the international debt markets—aside from the above, there would be consequential changes to clearing systems, tax treatments (including impacts on many tax treaties), documentation etc.;
- potential fragmentation of markets and corresponding lack of global liquidity;
- restricting U.S. borrowers' and investors' ability to access international funding and investment;
- practicalities for transitional arrangements, including re-financing and other transitional issues and, in relation to U.S. issuers, allowing sufficient time for the relevant markets to put systems in place to collect and deliver the relevant IRS forms (failing which U.S. issuers may be at a significant albeit temporary competitive disadvantage to non-U.S. multinational issuers); and
- the practicality of the Bill's stated 180 day implementation timetable.

9. ICMA would be happy, at your convenience, to explain its concerns and suggestions (including possible clarification that book-entry bearer bonds are not treated as bearer debt for the Bill's purposes) in more detail.

Yours faithfully,

Martin Egan, BNP Paribas—Chair, ICMA Primary Market Practices Committee
Kate Craven, Barclays Capital—Chair, ICMA Legal & Documentation Committee

Statement of Investment Fund Institute of Canada

On behalf of The Investment Funds Institute of Canada (IFIC), I would like to provide some preliminary comments on the proposed *Foreign Account Tax Compliance Act* (the "Bill"), published on October 27, 2009. IFIC is the voice of Canada's investment funds industry, including fund managers, distributors and industry service organizations with assets under management of $471 billion ($US)—the eighth largest mutual fund market in the world after that of the United States. The U.S.-Canadian relationship is unique—as notes the U.S. Department of State: "Since Canada is the largest export market for most States, the U.S.-Canada border is extremely important to the well-being and livelihood of millions of Americans. . . . The U.S. is Canada's largest foreign investor . . . and Canada is the fifth largest foreign investor in the U.S." *(November 2008).*

The following are general comments only as our members are currently reviewing the Bill to determine if there are other legal impediments to our members complying with the legislation. We will forward any such additional specific comments to you at a later date.

1. In principle, we believe that matters addressed in the Bill (that is, the exchange of information and withholding tax issues) should be addressed under the *Convention between The United States of America and Canada with respect to Taxes on Income and on Capital, signed at Washington on 26 September 1980 as Amended on 21 September 2007.* The latest Protocol to the Convention came into force on December 15, 2008—less than 12 months ago.

2. In terms of specifics, we would like to bring the following practical concerns to your immediate attention:

a. We believe that the effective date of the Bill—for years beginning after December 31, 2010—is not feasible given the lack of precision in certain aspects of the Bill, the expectation of extensive new procedural requirements in as-yet-undrafted regulations and the global reach of the Bill. We believe the effective date should be postponed to two years following finalization of required regulations governing procedural matters.

b. We have serious concerns with the requirement to share personal client information between affiliated companies on a worldwide basis as contemplated in the Bill, given that it may be contrary to privacy legislation of countries that may, in fact, have privacy laws similar to those enacted in the U.S. Canada has a strong commitment to maintaining the privacy of personal records, as exemplified by its *Personal Information Protection and Electronic Documents Act (PIPEDA)* legislation. Given the nature of the information that is required to be disclosed, we believe that the Secretary should continue to rely on longstanding formal bilateral agreements between the U.S. and Canadian government agencies that provide for mutual co-operation and the exchange of relevant information. The U.S. government itself has extensive concerns about cybersecurity, and the Bill's proposal for additional sharing of information across countries presents risks that the confidentiality of personal information will be breached. To address some of these concerns, we recommend that consideration be devoted to giving the Secretary of the Treasury the right to provide exceptions and grant relief from disclosure in appropriate cases.

c. Gross proceeds, including invested capital, appear to be caught in the ambit of the Bill and would be subject to the 30% withholding tax. We believe that these amounts should be grandfathered.

d. We believe that the legislation is unclear with regard to third-party intermediaries in the case of entities acting for clients holding their investments in nominee form. We think that third-party intermediaries should be responsible for reporting.

We hope that the Bill will be amended as requested above to avoid negative repercussions on Canadians' investment in the U.S. As noted above, our members continue to review the documentation and seek guidance, after which point we may provide additional comments. We would appreciate being including in any further communications on this subject and would be pleased to elaborate on our comments at your convenience.

Yours sincerely,
Original signed by J. De Laurentiis
President and CEO

Statement of The Investment Industry Association of Canada

The Investment Industry Association of Canada (**IIAC**) would like to take this opportunity to submit comments to the House Ways and Means Select Revenue Measures Subcommittee with regard to the draft legislation impacting foreign financial institutions (**FFIs**) contained in HR 3933, the *Foreign Account Tax Compliance Act of 2009* (the **Act**) filed by Chairman Rangel on October 27, 2009. We would kindly ask that you consider these comments, and include them in the record for the hearing held on November 5, 2009.

BACKGROUND INFORMATION

The IIAC is Canada's equivalent to the Securities Industry and Financial Markets Association (**SIFMA**) in the United States, and represents over 200 investment dealers across Canada.

In June 2000, the Department of Finance Canada reported that there were 188 securities firms in Canada at the end of 1999 and that the 7 largest firms accounted for approximately 70% of the industry's capital. At that time, all but one of Canada's large, full-service securities firms were bank owned. The landscape of the Canadian securities industry has not changed significantly since that time.

In August 2001, the Department of Finance Canada estimated that banks accounted for approximately 70% of the total domestic assets held by the financial services sector, and that the six major domestic banks accounted for over 90% of the assets held in the banking industry.

GENERAL CONCERNS REGARDING THE ACT

The IIAC understands the U.S. government's concerns regarding the use of offshore accounts and entities by certain persons to evade U.S. tax. This is a concern shared by the governments of many countries, and we have observed increased global efforts and inter-governmental cooperation through the inclusion of tax information exchange provisions in many new income tax treaties and protocols to existing treaties, as well as an increase in the number of tax information exchange agreements between countries that do not have income tax treaties in effect.

We recognize that an opportunity exists for the Internal Revenue Service (**IRS**) to use its influence over FFIs in the U.S. government's efforts to identify U.S. persons that may be evading U.S. taxation of income earned, directly or indirectly, through offshore accounts. Implementing the Act as proposed would allow the IRS to receive information automatically from FFIs and avoid having to make requests to foreign governments under tax information exchange agreements or under exchange of information provisions contained in income tax treaties. However, we believe that a more appropriate means to address tax evasion is by the use of international solutions developed through negotiations between governments, not through negotiations and agreements between the IRS and private entities.

We are extremely concerned that compliance with the Act will impose a significant level of additional cost and operational risk on FFIs that will be disproportionate to the amount of additional U.S. tax revenue generated. In particular, we are concerned that many FFIs will not find it economically feasible to enter into agreements with the IRS under proposed section 1471(b) **(FFI Agreements)** and to continue to operate as Qualified Intermediaries (**QIs**). It would be unfortunate to see foreign financial institutions forced to exit the QI regime into which they and the IRS have invested significant resources.

Foreign financial institutions will also need to consider the impact on their clients. It will be difficult to justify additional burdens and costs being placed on non-U.S. account holders with no investment in U.S. securities. Ultimately, this will likely have a detrimental impact on U.S. capital markets generally by creating disincentives for Canadians and other foreign investors to invest in the U.S. The "green shoots" of economic recovery in the U.S. could be stunted by the disproportionately onerous provisions of the Act. It could also result in a loss of opportunity for American investors by creating disincentives for U.S. persons to open accounts in Canada and elsewhere, disrupting the flow of global capital markets.

If the Act is enacted, it is critical that the Department of the Treasury (**Treasury**) and the IRS work closely with FFIs to ensure that the detailed requirements strike a reasonable balance between increasing U.S. tax revenue by identifying tax evasion by U.S. persons, and the additional financial burden and operational risks being imposed upon FFIs, in an effort to maximize the continued participation of such institutions in the QI regime and the number that enter into FFI Agreements with the IRS.

CONCERNS REGARDING SPECIFIC PROVISIONS OF THE ACT

Below we have summarized our concerns regarding specific provisions of the Act. Our comments are limited to the proposed new Chapter 4 of the Internal Revenue Code.

1. ***Effective Date***

The Act provides that new Chapter 4 will generally apply to payments made after December 31, 2010.

We strongly believe that the implementation of the Act's requirements with respect to the identification and reporting of certain foreign accounts will require a substantially longer timeframe, especially given that much of the detail about implementation will be contained within regulations to be developed by Treasury, and within the FFI Agreements to be negotiated between FFIs and the IRS.

Once the Act is enacted, Treasury and the IRS will need to develop detailed regulations, model FFI Agreements, reporting forms, and other guidance. Until these details are finalized, an FFI will not be in a position to fully assess the costs and risks associated with compliance, and ensure that there are no legal or operational restrictions which would impede the FFI's ability to comply with the terms of the FFI Agreement.

An FFI cannot make the business decision to enter into such an agreement without completing this internal review and analysis.

Once an FFI has confirmed that it can and will enter into an FFI Agreement with the Secretary, it needs time to make the necessary systems and operational changes to gather and record the additional information required for the purposes of identifying United States accounts, as well as accounts that are excluded from the requirements, and to modify systems to be able to produce the necessary reporting information. For most large FFIs, the minimum period required to make the necessary changes will be at least two years.

If FFIs are not given enough time to make the changes necessary to be able to comply with the terms of the FFI Agreement, there is a risk that they will delay entering into such agreements until they are able to comply, even if this is after the effective date. If this results in the application of the 30% withholding on payments to the FFI in the interim, it could be extremely disruptive to the flow of U.S. withholdable payments and investment in the U.S. market.

Withholding agents will also need to identify their FFI clients and determine which ones have entered into FFI Agreements. Those FFIs that do not currently have the capability to withhold 30% tax on withholdable payments made to other FFIs or applicable non-financial foreign entities will need to implement the necessary changes. For many such FFIs, withholding on gross proceeds may present the greatest challenge.

Significant IRS resources will also be needed to process large numbers of FFI Agreements in a very short time period. A large affiliated group of FFIs could easily be operating in more than 50 countries and may have multiple legal entities within each of those countries that might enter into FFI Agreements. Whereas there are currently approximately 5,500 entities that have QI Agreements with the IRS, given the broad definition of FFI, there are potentially hundreds of thousands of entities that could be in position to enter into FFI Agreements with the IRS.

We recommend that the effective date of December 31, 2010 be removed from the Act and replaced with a provision giving power to the Secretary to devise a flexible or staggered effective date under the accompanying regulations. The effective date should be determined with regard to finalization of regulations, guidance and agreements.

2. ***Authority of the Secretary of the Treasury***

The Act provides that the "Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the purposes of this chapter." Throughout proposed new Chapter 4, there are numerous provisions that give the Secretary the authority to define exceptions and exclusions from the requirements, as well as the detailed requirements.

However, there are certain additional areas where we would like to see greater authority given to the Secretary:

- Authority to define exceptions to the requirement in section 1471(b)(1)(A) to obtain information from each holder of each account maintained as is necessary to determine which accounts are "United States accounts".

  For example, it may be appropriate for the Secretary to provide exceptions for accounts existing on the effective date or accounts that are regarded as posing a low risk of tax evasion.
- Authority under section 1471(b)(1)(E)(ii) to provide alternatives to closing United States accounts for which the FFI is unable to obtain a valid and effective waiver under section 1471(b)(1)(E)(i) where foreign law prohibits the closing of such accounts.
- Authority to define the thresholds under which depository accounts for individuals are excluded from the definition of "United States account". See additional comments under point 5 below.

3. ***Information to be reported on United States Accounts***

Section 1471(c)(1) sets out very specific requirements with respect to the information to be reported on United States accounts, including the following:

- Name, address and TIN of each account holder that is a "specified United States person," and in the case of an account for a "United States owned foreign entity," the name, address and TIN of each "substantial United States owner" of the entity.
- Account number.
- Account balance or value (determined at such time and in such manner as the Secretary may provide).
- Gross receipts and gross withdrawals or payments from the account (determined for such period and in such manner as the Secretary may provide).

With respect to account balance or value, and gross receipts, withdrawals or payments, our understanding is that the Secretary only has the authority to determine the time or reporting period, and the manner in which such information is to be provided, but not whether or not such information must be reported.

There may be situations in which reporting such information may be extremely onerous and/or not particularly meaningful or useful to the IRS. For example, in some financial institutions, clients may have a depository account to hold cash and a custody account to hold securities. In such situations, purchases, sales and income transactions will be reported in both the depository account and the custody account. If both of these accounts report the proposed amounts, the information provided to the IRS will be overstated and misleading. We recommend that section 1471(c)(1) be amended to delete (D) and replace the current requirement under (C) with a more general requirement for such additional information and in such manner as the Secretary may provide.

4. ***Reliance on Certification from Account Holders***

Although the Act does not set out specific requirements regarding the methods that an FFI is to employ for purposes of identifying its United States accounts, there is a degree of protection provided to the FFI in section 1471(c)(3), allowing them to rely on a certification from an account holder "if neither the financial institution nor any entity which is a member of the same expanded affiliated group as such financial institution knows, or has reason to know, that any information provided in such certification is incorrect."

Most FFIs that belong to an affiliated group will not be able to make use of the protection that this provision is intended to provide, primarily for the following reasons:

- Most affiliated groups of financial institutions do not have common operating systems or systems that have the ability to communicate with one another. In many cases, groups have grown and expanded through acquisitions, with each new acquisition bringing their legacy systems with them. Even within a single legal entity, there are frequently a number of different systems being used to support the diverse range of products and services that the FFI offers.
- In most jurisdictions, there are legal restrictions which prevent the sharing of information between separate legal entities without explicit client consent.

We recommend that section 1471(c)(3) be amended to limit the FFI's knowledge, or purported knowledge, that any information provided in a certification is incorrect to the information that the FFI has in its own electronic files. We understand the concern that an account holder could provide information to one entity within an affiliated group indicating that they are not a United States account holder, and they could also have an account with another member of the affiliated group that has information on file indicating that the account holder is a U.S. person. However, given that information about the account with the second affiliated entity would be reported to the IRS, the IRS is already being provided with adequate information regarding the U.S. person which could then be used to request additional information for this person under income tax treaties or tax information exchange agreements.

5. ***Exception for Certain Accounts Held by Individuals***

The definition of "United States account" provides an exception for depository accounts held by natural persons where the aggregate value of all depository accounts held does not exceed $10,000, or $50,000 where all such account were already in existence on the date of enactment.

While we understand that this "*de minimis*" type exception was likely created with the intention of providing some relief to FFIs, the exception as currently drafted is operationally impractical, and would provide little or no relief to FFIs that would need to build the exception into their reporting systems. It would be extremely difficult and costly for an FFI to identify all accounts held by an individual, particularly where the individual only has a partial interest. In addition to the practical considerations, as discussed above under point 4, most jurisdictions impose legal restrictions which restrict the sharing of information between legal entities.

We recommend that the provision be amended to apply on an account by account basis and that authority be given to the Secretary to define the thresholds.

6. ***Termination of the Agreement***

The Act provides that the FFI Agreement to be executed by the FFI and the Secretary may be terminated by the Secretary upon a determination that the FFI is out of compliance. A reciprocal provision should be added allowing the termination of the agreement by the FFI upon notice to the Secretary.

The IIAC appreciates the opportunity to provide you with this submission and would very much like to meet with your committees and staff to discuss our position and recommendations. To arrange a meeting, please contact the undersigned or Andrea Taylor, Assistant Director.

Yours sincerely,
Ian Russell
President

Statement of the Organization for International Investment

The Organization for International Investment (OFII) is a business association representing the U.S. subsidiaries of many of the world's largest international companies. The U.S. subsidiaries of companies based abroad directly employ over 5 million Americans and support an annual U.S. payroll of over $364 billion. As evidenced by the attached OFII membership list, many OFII members are household name companies with historic and substantial U.S. operations. On behalf of these companies, OFII advocates for the fair, non-discriminatory treatment of U.S. subsidiaries. We undertake these efforts with the goal of making the United States an increasingly attractive market for foreign investment, which will ultimately encourage international companies to conduct more business and employ more Americans within our borders. Given the recent global financial turmoil, as well as companies increasing ability to conduct worldwide operations through other jurisdictions, OFII's mission is more critical than ever to sustaining and rebuilding the American economy.

On October 27, 2009, the Chairman of the Senate Finance Committee, Max Baucus, and Senator John Kerry, and the Chairman of the House Ways and Means Committee, Charles Rangel, and Representative Richard Neal, released proposed legislation titled the *Foreign Account Tax Compliance Act of 2009* (FATCA). The proposed legislation adopts and revises many of the proposals set forth in President Obama's Administrative Proposal titled *Leveling the Playing Field: Curbing Tax Havens and Removing Tax*

Incentives for Shifting Jobs Overseas that was released in May 2009.

OFII welcomes the initiative of Congressional leaders to enhance the ability of the Internal Revenue Service to police tax evasion perpetuated by U.S. persons through the use of offshore accounts and entities. All legitimate business enterprises benefit from a tax system that is respected by taxpayers and key to that respect is confidence that everyone is paying their fair share. Accordingly, OFII not only endorses the aims of the proposed legislation but is anxious to work with Congress to formulate rules that aid the Internal Revenue Service in the detection of tax evasion and increases the flow of information to the Internal Revenue Service while, at the same time, does not impede the orderly conduct of legitimate business commerce nor disrupt or discourage foreign investment into the United States.

Our comments below are limited to those aspects of the proposed legislation that are most relevant to our members, the U.S. subsidiaries of foreign multinational corporations, and to their parent companies. We stand ready to offer our assistance in refining the legislation to achieve its important goals without disrupting legitimate business activities.

We have organized are comments as follows:

Section I—Limiting the Scope of New Chapter 4 to Target Circumstances in Which the Most Realistic Potential for Abuse Exists Without Unnecessarily Impeding International Commerce.

Section II—Refining the New Rules to Maintain Equitable Treatment.

Section III—Preserving the Ability of Multinational Corporations to Access the Eurobond Market.

Section IV—Making the New Rules More Workable.

Section I

Limiting the Scope of New Chapter 4 to Target Circumstances In Which the Most Realistic Potential for Abuse Exists Without Unnecessarily Impeding International Commerce.

1. *Targeting the Section 1472 Documentation Requirements to Areas of Concern*—Section 1472 imposes burdens on foreign enterprises that can be difficult, and, in some cases, impossible to meet. Determining the U.S. tax status of minority owners and tracing indirect ownership through private equity funds can place an impractical burden on business enterprises that are not the logical targets for offshore tax evasion. Any foreign corporation that does not qualify for the exception for corporations publicly-traded on an established securities market (or that could become non-public in the future) could be seriously impacted by this part of the legislation.
   - *The category of foreign entities subject to the increased documentation requirements should be narrowed*—We believe that the category of foreign entities subject to this burden be narrowed as follows:

- The exclusion for publicly-traded companies should be expanded. Many countries have not developed their capital markets to the level of the United States. As a result, many widely-held foreign enterprises may be within the spirit of the exclusions in Section1472(c) but do not meet the requirement of being traded on "an established securities market."

OFII Recommendation: Section 1472(c) should be modified to address alternative markets, similar to Section 7704(b)(2), by adding at the end: "or is readily tradable on a secondary market (or the substantial equivalent thereof)."

- Section 1472 can be further refined to exclude companies that are unlikely to be candidates for utilization by tax evaders. This can be best accomplished by using precedent in the tax law to identify the appropriate category of corporations that are most susceptible to improper use and can most readily apply the operative rules.

OFII Recommendation: An exception to the application of Section 1472, patterned after the original Code section aimed at inappropriate use of offshore companies—the now-obsolete foreign personal holding company regime, should be added. Section 552(a) included an ownership test which was met if 5 or fewer individuals who are U.S. citizens or residents owned over 50% of the company, by vote or value, at any time during the taxable year. This test is appropriately aimed at the right class of companies and is a test that would be practical for foreign companies to apply. Utilizing an ownership test that is relatively easy for the company to apply is likely to be more effective than using a more expansive standard that may not be practical for many companies to apply.

- Foreign pension funds and sovereign wealth funds are major sources of foreign investment in the United States and generally are exempt from U.S. taxation on U.S. source investment income under Section 892.

OFII Recommendation: Foreign pension funds and sovereign wealth funds should be excepted from Section 1472.

- *The category of payments to which expanded documentation applies should be narrowed*—Many foreign business enterprises may have a high volume of payments receivable from payors in the ordinary course of business that would be subject to the increased documentation obligations, including broad disclosure of ownership information to the payors. For example, a UK company licensing software to U.S. users may have thousands of customers making royalty payments. Section 1472(b) would require the software company to provide every U.S. customer with the name, address, and U.S. taxpayer identification number of each of its U.S. substantial owners (including indirect ownership) or certify that there is no U.S. ownership.

OFII Recommendation: The intent of Section 1472 can be achieved by limiting its application to payments of dividends and interest without disrupting the ordinary course of commerce.

2. *Clarify That Internal Holding and Finance Companies Are Not Financial Institutions Within the Scope of Section 1471*—Section 1471(d)(5)(C) includes in the definition of a financial institution any entity that is engaged in the business of investing in securities. Many foreign multinational enterprises have holding and finance companies within the corporate, whose sole purpose is to hold shares of affiliates or to act as an internal central financing vehicle for intercompany loans. These internal special purpose entities may exclusively operate to hold securities—equity of affiliates or notes from affiliates. The Section 1471(d)(5)(C) definition could be read to treat these internal holding and finance companies as foreign financial institutions.

OFII Recommendation: The Section 1471(d)(5)(C) definition of a "financial institution" should be clarified to make clear that a holding or finance company (including the parent of an affiliated group that holds the shares of its subsidiaries) that predominantly holds securities of affiliates does not fall within this definition.

Section II

Refining the New Rules to Maintain Equitable Treatment

1. *Maintain Parity of Treatment for U.S. Subsidiaries of Foreign Multinationals*

- *The definition of "specified U.S. person" should treat subsidiaries of publicly-traded foreign corporations comparably to subsidiaries of publicly-traded U.S. corporations*—Section 1473(3) defines "specified United States person" which defines the category of accounts subject to the new proposed reporting rules of Chapter 4. The first exclusion is any U.S. person that is a publicly-traded corporation. The second exclusion is any corporation that is a member of the same expanded affiliated group as the publicly-traded corporation. This formulation could be read as not including U.S. affiliates of foreign publicly-traded corporations. This potential discrimination between a U.S. subsidiary of a U.S. publicly-traded corporation and U.S. subsidiary of a foreign publicly-traded corporation is not justified. It is not clear this distinction is intended.

OFII Recommendation: Section 1473(3) should be clarified to make clear that U.S. subsidiaries of foreign corporations are treated comparably to U.S. subsidiaries of U.S. corporations. This could be accomplished by adding to the end of Section

1473(3)(B) the following: "without regard to whether the corporation described in subparagraph (A) is domestic or foreign."

2. *Foreign Financial Institutions That Do Not Enter Into Chapter 4 Agreements Should Not Be Denied Statutory Tax and Treaty Benefits*—In addition to requiring 30% withholding on the expanded category of withholdable payments for financial institutions that do not enter into an agreement with the IRS, Section 1474(b)(2) would further burden these foreign financial institutions with the denial of interest on refunds and the denial of current statutory exemptions from tax with respect to income beneficially owned by the institution. These additional burdens imply that if a foreign financial institution does not enter into a Chapter 4 agreement, it is unwilling to cooperate on combating tax evasion. However, the Chapter 4 agreement can be quite burdensome on a financial institution and some institutions may make a business judgment, based on their customer base and operations, that the benefits of entering into an agreement with the IRS are outweighed by the burdens that the agreement would impose on them. This is a "benefits and burdens" business decision; not typically motivated by willingness to aid in the perpetuation of tax evasion. The burden of a 30% withholding tax on all withholdable payments to the foreign financial institution achieves the basic compliance goal of Section 1471. The additional burdens respecting withholdable payments made to a foreign financial institution for its own account are punitive in nature, unjustified, and set a dangerous precedent.

OFII Recommendation 1 (No impairment of treaty benefits): The disallowance of interest with respect to a credit or refund of over withheld tax (under Section 1474(b)(2)(A)(i)) if the beneficial owner of the payment is entitled to a reduced rate of tax under a U.S. income tax treaty would impose an effective tax penalty on the treaty benefit—an unprecedented partial clawback of treaty benefits. *This would be a dangerous precedent and should be eliminated.*

OFII Recommendation 2 (Reinstate statutory tax benefits): The denial (under Section 1474(b)(2)(A)(ii)) of the benefit of tax reductions for several types of payments that are currently statutorily exempt from tax, including the exemptions for bank deposit interest, short-term original issue discount, and portfolio interest, and payments representing effectively connected income that may otherwise be subject to a lower net income tax should be eliminated. Denial of any reduction from the 30% tax on gross proceeds, to account for return of basis, is particularly penal in nature. We are very concerned about the impact the denial of the portfolio interest exemption would have on the ability of issuers of portfolio debt instruments, as it would interfere with an important secondary market for the sale of these debt instruments within the banking community.

3. *The Proposed Override of the existing Withholding Rules Should Be Limited in Scope*—The existing withholding rules under Chapter 3 of the Code (Sections 1441–1446) have been developed over a long period of time and contain numerous exceptions, limitations, and coordination rules that further the policies behind the withholding rules and assure their proper interaction with other Code provisions. Section 101(b) of the proposed legislation provides coordination rules that would appear to override all the above limitations and exceptions. For example, current law Section 1441 excludes from its scope U.S. FDAP that is effectively connected with the conduct of a U.S. trade or business (which must be evidenced by the payee providing Form W–8ECI) whereas the proposed Chapter 4 definition of a withholdable payment appears to include FDAP that is also effectively connected income. Other examples include rules coordinating the interaction of Sections 1441, 1445, and 1446 and the waiver of interest and penalties for underwithholding where the withholding agent establishes that the full substantive tax liability has been satisfied.

OFII Recommendation: The legislative history should make clear the expectation that Treasury will apply the exceptions, limitations, and other coordination rules that currently exist under Chapter 3 withholding rules to the extent not in conflict with the purpose behind new proposed Chapter 4.

Section III

Preserving the Ability of Multinational Corporations to Access the Eurobond Market

We believe that Section 102, repealing tax benefits for foreign-targeted bearer bonds should be stricken and Treasury be instructed to review the foreign targeting rules to determine whether they need to be revised to minimize the risk of these bonds being utilized as a vehicle for U.S. tax evasion. In today's market place, the distribution and transfer of bearer bonds is carried out through a regimented system in which these bonds typically are not physically transferred but are "immobilized" by being physically held by the major clearing houses. Ownership interests are transferred through a largely book entry system maintained by clearing houses, brokers and dealers. The use of foreign-targeted bearer bonds is the traditional means by which bonds are floated in the Eurobond market. The repeal of the U.S. tax benefits for issuers and holders of these bonds could be a major impediment to the ability of U.S. corporations to float debt in the Eurobond market. Any perceived concern about bearer bonds could be addressed by Treasury regulations treating immobilized obligations as either registered or as the only acceptable form of bearer bonds. We note that, in order to claim the portfolio interest exemption for registered bonds, the beneficial owners have to provide IRS Form W–8BEN to the payor of the interest. Requiring every holder of a Eurobond to submit a U.S. tax form would be a significant impediment to floating Eurobonds that would put U.S. corporations, and some foreign corporations (see immediately below), at a substantial disadvantage.

In addition, foreign corporations that are entitled to the benefit of a U.S. income tax treaty typically are able to loan funds to their U.S. affiliates and obtain the benefit of the reduced rates of tax, or exemption from tax, on interest paid by the U.S. affiliate. However, if the lender of the funds (or a related party) to the U.S. affiliate has borrowed funds and the interest on the borrowed funds would not be entitled to a comparable U.S. tax reduction had the borrowed funds been lent directly to the U.S. affiliate, the treaty benefit may be denied under the U.S. anti-conduit regulations under certain circumstances. Currently, if the foreign affiliate borrowed funds in the Eurobond market by the common practice of issuing foreign-targeted bearer bonds, the anti-conduit rules would not be applicable because, had the U.S. affiliate issued the bearer bonds directly, the interest would have been exempt from tax under the portfolio interest exemption. The repeal of the exemption for foreign-targeted bearer bonds would mean that this protection from the application of the anti-conduit regulations would no longer be available.

Section IV

Making the New Rules More Workable

1. *The Proposed Effective Date Rules Are Unrealistically Short*—The new proposed Chapter 4 withholding rules are proposed to be effective for payments made after December 31, 2010. Neither the government nor taxpayers are likely to be able to comply with this effective date. Most financial institutions have sophisticated and complex systems in place, many of which have been adapted over time to conform to U.S. tax compliance requirements. A great deal of time, expense, and energy will be required to alter, or replace, these systems and operating procedures. Financial institutions with retail banking operations that have documented their account holders based on local identification cards or by employing know-your-customers procedures will have no reliable means of determining whether account holders are U.S. citizens or residents without requesting new documentation from every customer. New procedures will be required to determine which foreign entity account holders are themselves foreign financial institutions under the expansive definition of a foreign financial institution and, once that determination is made, which foreign entities have substantial U.S. owners, which will require determining both the direct and indirect U.S. ownership of the foreign entity by both vote and value. The challenges foreign financial institutions will face with regard to account holders that are trusts is discussed in Paragraph 5, below. Similarly, it will require time to educate foreign entities that are not financial institutions to the new compliance requirements and to put adequate procedures in place. Foreign financial and non-financial institutions that will want to become compliant with the requirements of the new legislation, which is proposed to become effective for payments made after December 31, 2010, would not have sufficient time to ensure that their systems are adequate to provide the required information.

OFII Recommendation: The statute should delay the effective date of new proposed Chapter 4 for at least an additional year with express authority vested in the Secretary to delay the effective date to assure adequate time for both the government and taxpayers to adapt to the new rules.

2. *The FATCA Provisions Should Not Apply to Transactions Already in Place*—Effective dates for many provisions of the proposed legislation do not take into account existing financial arrangements. For example, under Section 501, the treatment of certain notional principal contract payments made to

foreign persons as U.S. source dividends for U.S. tax purposes applies to payments made on or after a date that is 90 days after the date of enactment. Even if the scope of the rule were specifically defined, which it is not, as the Secretary would have broad authority to prescribe its scope, the effective date is unrealistically short to permit the orderly unwinding of existing contracts.

OFII Recommendation: The effective date rules should be revisited with a view to a more equitable transition to the new rules. As in the case of the above recommendation with regard to the effective date of Chapter 4, the Secretary should be given the discretion to delay the prescribed effective dates.

3. *Individual Reporting Requirements for Interests in Foreign Financial Assets Should Not Be Duplicated*—New Section 6038D would add new information reporting by individuals that hold any interest in a "specified foreign financial asset." The new reporting would overlap with the reporting of foreign financial accounts under the TD F 90–22.1 (FBAR) reporting regime.

OFII Recommendation: One or the other regime, but not both, would allow filers to conform to a rational set of rules. If Section 6038D reporting is selected, care should be taken to ensure that individuals with only signature authority and no financial interest in the account are not considered to "hold an interest in a foreign financial asset." As noted in the comments made by OFII in relation to FBAR reporting in the 2009 letter concerning Notice 2009–62, the administrative burden and complexity must be reduced as a matter of encouraging compliance.

4. *Making Compliance by Foreign Financial Institutions Workable*—Chapter 4 impacts every foreign financial institution that exists outside the United States, including a great many entities that do not traditionally fall into the category of a financial institution. Below we include two specific recommendations to make the rules more workable for these institutions and entities, brought to our attention by OFII members. We expect that many impacted entities and trade associations will provide Congress with more extensive input on the practical implications of Chapter 4 for foreign financial institutions. The two recommendations below are not intended to be a comprehensive identification of all the practical hurdles these institutions may face.

- *Workable due diligence and verification procedures need to be established.*—Section 1471(b)(1)(B) provides for verification and due diligence procedures as the Secretary may require with respect to the identification of United States accounts. If such procedures include an external audit, it would add a significant cost for foreign financial institutions, especially if it required a regular audit process rather than the existing QI agreed-upon procedures.

OFII Recommendation: We suggest that the financial institutions should have the option to be able to make representations to the IRS concerning their verification and due diligence procedures and that there have been no breaches of such procedures under an internal rolling risk evaluation program that the institution has agreed with the IRS.

- *Application of Chapter 4 rules to trusts needs to be practical*—There is a practical issue caused by the interaction between Bill sections 101 and sec. 402, which introduces a new presumption rule for foreign trusts under new sec. 679(d). The new presumption rule states that if a U.S. person directly or indirectly transfers property to a foreign trust (other than a trust established for deferred compensation or a charitable trust), the trust shall be presumed to have a U.S. beneficiary, unless such person can demonstrate to the satisfaction of the Secretary that pursuant to the trust deed: (1) no income or corpus of the trust may be paid or accumulated during the tax year to or for the benefit of a U.S. person; and (2) if the trust were terminated during the taxable year, no part of the income or corpus could be paid to or for the benefit of a U.S. person. In addition, the U.S. transferor must submit all information required by the Secretary to avoid the U.S. beneficiary presumption.

As a result of the U.S. beneficiary presumption, existing section 679(a) would treat the U.S. transferor as an owner with respect to the portion of the trust attributable to such property and thus treat the trust as a grantor trust. Under new section 1473(2), a "substantial United Sates owner" is defined to include any specified United States person treated as an owner of any portion of a grantor trust. Hence, it will be necessary for a foreign entity to monitor all transfers to all trusts to determine if they were made by a U.S. person and examine the trust documentation to determine if no income could be paid to or for the benefit of a U.S. person, in order to see whether it must apply the presumption and be required to treat the trust as a grantor trust with a U.S. owner and thus a substantial United States owner.

Accordingly, a foreign financial institution would be required to withhold or report, obtain the necessary certification, etc. and a non-financial foreign entity would be required to treat all trusts as a "substantial U.S. owner." Such monitoring and review of trust documentation will be nearly impossible. Foreign financial institutions may have thousands of trust accounts, which would place the foreign financial institution at risk.

OFII Recommendation: Either the presumption rule should be eliminated or section 1473(2)(iii) should be modified to exclude the applicability of the new presumption rule in determining whether a trust is a grantor trust (e.g., add to the end of clause (iii) the words "without regard to section 679(d)" or similar verbiage).

We also note that the definition of substantial United States owner does not address other types of trusts such as complex and simple trusts, which perhaps implies that there is no requirement to look through such trusts.

Clearing House Association L.L.C., letter

Dear Chairman Neal and Ranking Member Tiberi:

The Clearing House Association L.L.C. ("The Clearing House"), an association of major commercial banks,[1] welcomes the opportunity to present comments on the Foreign Account Tax Compliance Act of 2009 introduced by the Chairmen of the House Ways and Means and Senate Finance Committees on October 27, 2009 (the "Bill"). We believe a detailed and thoughtful comment letter that represents the views of our members will be the most helpful to you. Therefore, we intend to submit a more detailed comment letter that will express our members' views and concerns once we have had the opportunity to fully review and discuss these matters. In recognition of the November 19th deadline for submitting written comments to be included in the record of the November 5th hearing on the Bill we wanted to inform you of the provisions of the Bill upon which we expect to comment, including: (i) the provisions in Section 101 of the Bill that impose a 30% withholding tax on all US-source payments received by a foreign financial institution unless that institution (and each of its foreign affiliates) enters into an agreement with the Treasury Department to report certain customer information; (ii) the provisions in Section 101 of the Bill that require withholding on payments to foreign entities that have not identified their substantial U.S. owners; (iii) the provisions of Section 102 of the Bill, which would repeal the exception to registration for foreign targeted issuances (*i.e.,* the bearer debt provisions); (iv) the provisions of Section 301 that would require a "material advisor" to notify the IRS if they assist a U.S. individual in the direct or indirect acquisition of a foreign entity; (v) the provisions in Sections 201, 202 and 203 of the Bill that relate to newly proposed FBAR-like reporting by holders of foreign assets; and (vi) the provisions in Section 501 of the Bill that would impose a withholding tax on dividend equivalent amounts. Perhaps most importantly we expect to comment on, and suggest several changes to, the effective dates in the Bill as the Bill would impose substantial new reporting requirements that would take substantially more time to implement than the current effective dates contemplate. We expect that our comments will include suggestions that further the policies espoused by the Bill's sponsors while minimizing the burdens that would be placed upon financial institutions and others by the Bill as currently drafted.

We would also like to express our concurrence and support of the views set forth in the November 19, 2009 letter sent to you by Securities Industry and Financial Markets Association.

We appreciate your consideration of these comments and those to be set forth in our upcoming letter. If you have any questions or if the members of The Clearing House can assist you in considering these important issues, please contact me at (212) 612–9234.

Sincerely,

JRA:kp

[1] The members of The Clearing House are: ABN AMRO Bank N.V.; Bank of America, National Association; The Bank of New York Mellon; Citibank, N. A.; Deutsche Bank Trust Company Americas; HSBC Bank USA, National Association; JPMorgan Chase Bank, National Association; UBS AG; U.S. Bank National Association; and Wells Fargo Bank, National Association.

European Banking Federation's Letter

Dear Chairman Neal and Ranking Member Tiberi:

The European Banking Federation ("EBF") and the Institute of International Bankers ("IIB") appreciate the opportunity to comment on the Bill's proposed new reporting and withholding tax system (Section 101 of the Bill, which would add new Chapter 4, containing Sections 1471–1474, to the Internal Revenue Code).[1]

The EBF is the voice of the European banking sector (EU and EFTA countries). The EBF represents the interests of some 5,000 European banks, and encompasses large and small, wholesale and retail, local and cross-border financial institutions. The IIB represents internationally headquartered financial institutions from over 30 countries, including Europe, the Americas and Asia, with banking and securities operations in the United States. Together, the EBF and IIB represent most of the non-U.S. banks and securities firms around the world that are affected by the Bill.

OVERVIEW

We understand and support the Bill's goal of tackling offshore tax evasion by U.S. persons. We offer the recommendations herein to further that goal in a manner that takes account of the structure and operations of financial intermediaries and the markets that they serve, as well as compliance costs and burdens.

We have worked closely with the Treasury Department and the Internal Revenue Service (the "IRS") for over a decade in seeking to improve the U.S. reporting and withholding tax rules, including the development and implementation of the qualified intermediary ("QI") system. Our member banks have expended enormous amounts of money to implement the QI system and other reporting rules, and believe that overall the system works well and achieves its objectives.

Nonetheless, it is evident that there are gaps in the existing rules that need to be addressed. The Bill builds on the Treasury's May 2009 Green Book proposal for closing the perceived gaps, and we are grateful that the Bill takes into account a number of practical administrability and market impact concerns that we expressed regarding the Green Book proposal.

In our discussions with the Congressional tax-writing staffs and the Treasury Department and IRS this past summer regarding the Green Book proposal, we focused on two very difficult issues—(i) how, as a practical matter, can a financial institution identify its U.S. accountholders within its vast number of worldwide accounts and business lines if the scope of U.S. tax reporting is expanded beyond the discrete custodial business involving investments in U.S. securities that is the realm of the existing QI and other U.S. tax reporting rules and (ii) how to address the problem of getting information regarding U.S. persons that hold accounts or other investments through a foreign entity or through multiple tiers of foreign entities, including investment vehicles and non-QIs ("NQIs").

The Bill's approaches to resolving these issues raise serious concerns regarding the practicality, feasibility, costs and burdens of implementation as well as their potential impact on capital flows into the United States. We accordingly provide below eight key recommendations of changes in the statutory language and legislative history of the Bill that are intended to improve the likelihood that it will succeed in achieving its objectives. Recommendation 1 deals with the effective date; recommendations 2 and 3 deal with the problem of identifying U.S. accountholders; recommendations 4 and 5 deal with the issue of indirect U.S. ownership through foreign entities; and recommendations 6, 7 and 8 deal with certain administrability and refund concerns.

The Bill appropriately provides substantial flexibility to Treasury and the IRS to issue regulations to fill in the numerous details on how the new reporting and withholding tax rules will work. We stand ready to work closely with them to try to strike the delicate balance between the compliance goal of the Bill to combat U.S. tax evasion and the inevitable costs and burdens associated with that goal that could cause many non-U.S. institutions to opt out of the new system.

The challenges in achieving that balance should not be underestimated. Indeed, one might reasonably conclude that the goals of the Bill are unattainable absent a multilateral agreement regarding uniform, universal identification and reporting standards that reflect an appropriate balance between implementation costs, the associated risks of such a system, and the compliance goal of providing taxpayer specific information to a variety of countries.

[1] Our membership's concerns and comments on other sections of the Bill have been expressed by other commenters.

In any event, the development and implementation of this new regime will require a substantial commitment of human resources and funding by both the financial and investment industries and the Government. We respectfully urge Congress to provide the IRS with sufficient funding to enable it to fulfill this challenging mandate in a timely and efficient manner.

RECOMMENDATIONS

1. Effective Date

***Recommendation*:**

We recommend that new Chapter 4 (Sections 1471—1474) should be effective only when and to the extent provided in Treasury regulations. We understand that Congress may wish to express in legislative history an appropriate timetable for the Treasury Department to issue any such implementing regulations. In addition, it would be helpful if the legislative history encourages the Treasury Department to adopt regulatory effective dates that will allow for an orderly transition by the financial industry and the IRS to the new withholding tax regime envisioned by Chapter 4 after final regulations are issued.

In particular, the legislative history should clarify that Congress anticipates that Treasury will adopt effective dates that enable financial institutions to put in place, or adapt, automated systems to effectuate the new rules, and to train personnel in applying the new rules. Likewise, the legislative history should encourage the Treasury Department to consider the time necessary for the IRS to publish a form of agreement with foreign financial institutions ("FFIs") under Section 1471(b) (an "FFI agreement") and to finalize such agreement; to sign up those FFIs deciding to enter into such agreements and to publish a list of such qualifying FFIs; to revise Forms W–8 to better collect data related to the new rules; and to put in place streamlined refund and credit processes for any over-withholding that results from the new rules. (Based upon the financial industry's experience with the implementation of the QI regime, we believe it likely that three years from the time the implementing regulations are finalized will be required to accomplish the above tasks.)

***Rationale*:**

Proposed section 1474(d)(1) provides that new Chapter 4 will generally apply to payments made after December 31, 2010. Chapter 4, however, simply sets forth a framework that requires extensive guidance by the Treasury Department before it can be implemented, and grants to Treasury substantial flexibility in issuing regulations detailing how those rules will work in practice.

We support the approach of providing Treasury with the flexibility to work with the financial industry and the IRS to find an appropriate balance between the compliance goal of the Bill to combat U.S. tax evasion and the inevitable costs and burdens associated with that goal. Such a balancing effort is crucial in order to try to minimize the disruptions to the U.S. capital markets if a critical number of FFIs were not to "buy in" to the new regime because the costs and risks associated with FFI status were disproportionate to the compliance goal.

We believe that the sort of flexible approach envisioned by the Bill necessarily calls for an effective date that is tied to the issuance of regulations and a sufficient time period to permit their orderly implementation by the financial industry. No FFI will be in the position to determine if it should sign an FFI agreement without understanding what costs and risks are associated with that agreement as detailed in the implementing regulations. Furthermore, a failure to provide sufficient time for the financial industry to build the systems and processes to comply with any final regulations could lead to massive amounts of over-withholding, contrary to the intent of the Bill. Accordingly we strongly urge Congress to provide the Treasury Department with the authority to design an appropriate timetable for implementation and not tie its hands with a statutory effective date as of a date-certain.

2. Identifying U.S. Accounts Through Available Databases

***Recommendation*:**

The legislative history should clarify that in issuing guidance as to how an FFI or other withholding agent may determine whether an account is a "United States account," the Treasury Department should take into consideration the practical, political and commercial difficulties of obtaining certifications or other representations of non-U.S. tax status from a vast number of non-U.S. accountholders serviced by an FFI (and its affiliates) in order to identify a relatively small number of potential U.S. persons. Most of an FFI's non-U.S. customers will have no reason to provide such a certification or representation since they are not expecting to earn any material amounts of U.S. source FDAP income or gross proceeds from investments that give rise to U.S. source dividends or interest. Accordingly, an FFI or other withholding agent generally should be allowed to rely on its existing procedures, systems and electronic database entries to reasonably identify potential U.S. persons (for example, by conducting automated searches of residence or address fields or any applicable residency or citizenship codes that might indicate U.S. status), without a requirement that it solicit additional information, such as a Form W–9 or W–8 or an explicit statement of non-U.S. status, from the accountholder in the absence of indicia of a U.S connection. To reflect this intention, proposed Section 1471(b)(1)(A) should be revised to say, "to obtain such information *regarding* each holder etc." instead of "to obtain such information *from* each holder etc." (emphasis added).

***Rationale*:**

Proposed Sections 1471 and 1472 will apply to virtually every customer relationship of an FFI, including a bank's entire depositor base, as well as to many transactional or investment relationships that give rise to non-public debt or equity interests in the financial institution. In the case of many non-U.S. financial institutions, this may cover tens of millions of non-U.S. owned accounts per institution. It is untenable for an FFI to request confirmation of non-U.S. status from such a huge number of existing non-U.S. accounts in order to prove the negative presumption of U.S. status contained in the Bill.

Moreover, even as to new accounts, it is commercially and politically impractical for a financial institution to request U.S. tax-specific information from an overwhelmingly non-U.S. client base that is not investing in U.S. securities. For example, a European bank wanting to comply with the FFI regime would likely find many of its accountholders refusing to provide a certification that they (and in the case of an entity, its owners) are not U.S. persons as a condition to opening a bank account at a local branch that has no connection with any U.S. investment or account.

Under existing regulations, a certification (e.g., on IRS Form W–8BEN) provides, in effect, a safe harbor for establishing that a person is not a U.S. person; in lieu of obtaining a certification, a withholding agent may rely on certain documentary evidence (see Treasury regulation Section 1.6049–5(c)). However, the Bill would require an FFI to obtain information that typically is not available under applicable KYC and AML rules or account opening procedures, including as to any substantial U.S. ownership of each accountholder that is a foreign entity (applying a 0 percent threshold for U.S. owners of foreign investment entities described in Section 1471(d)(5)(C) and a 10 percent threshold for other entities).

While it is generally feasible to obtain a certification or other documentation as to U.S. tax status from accountholders and investors that expect to invest, directly or indirectly, in U.S. securities, as noted above it is not practicable to do so from an overwhelmingly non-U.S. client base that is not investing in U.S. securities. This problem will be greatly exacerbated under the new rules' requirement that the FFI identify substantial U.S. owners of foreign entities that are accountholders.

Accordingly, many FFIs will not be able to comply with the new requirements unless the Treasury Department issues guidance—targeted especially to accounts that are not expected to invest, directly or indirectly, in material amounts of U.S. securities—that allows an FFI to rely on its existing procedures to capture relevant accountholder information (for example, address information or applicable residency or citizenship information) in the absence of indicia of a U.S connection. For those accountholders that do have such indicia of a U.S. connection, the FFI would solicit Forms W–9 or W–8 from them to establish either their U.S. or non-U.S. status and provide the information on any U.S. persons so identified in their annual report to the IRS.

3. Due Diligence for Determining U.S. Accounts

***Recommendation*:**

In light of Comment 2 and the impracticality of collecting certifications from largely non-U.S. customer bases, we recommend that proposed Section 1471(c)(3) be removed from the Bill, and instead that Treasury issue appropriate identification rules under section 1471(b)(1)(A) as revised per our recommendation. However, if proposed Section 1471(c)(3) remains, the clause "if neither the financial institution nor any entity which is a member of the same expanded affiliated group as such financial institution knows, or has reason to know, that any information provided in such certification is incorrect" should be replaced with "if the financial institution does not know, or have reason to know, that any information provided in such certification is incorrect, applying the due diligence procedures required by the Secretary pursuant to paragraph (b)(1)B)." The legislative history should clarify that in the absence of reckless disregard of information or a pattern of recording (or omitting to record) information in a manner designed to make it difficult to identify United States accounts, a financial institution generally will not be deemed to know or have reason to know that information provided in a certification is incorrect where any information to the contrary is contained on a database that is not readily accessible to the business unit in which the account is held or is contained in paper files.

***Rationale*:**

We discuss in Comment 2 above our view that a certification requirement that applies to an FFI's entire non-U.S. customer base will be so commercially, and even politically, impractical that few if any FFIs could ever make use of it. However, Section 1471(c)(3) additionally envisions that a financial institution collecting such a certification from an account holder to satisfy Section 1471(b)(1)(A) could only rely on that certification by determining that none of its worldwide affiliates or branches has information contradicting the certification. We believe that Section 1471(c)(3) likewise implies strongly that it would be appropriate for Treasury to issue due diligence and verification procedures under Section 1471(b)(1)(B) to provide for such "worldwide due diligence" even if a financial institution did not collect a certification but used other means to reasonably identify its U.S. customers.

We do not believe that a "worldwide due diligence" standard is feasible. Few, if any, multinational financial institutions have integrated databases and automated systems that would allow a business unit servicing an account to determine if one of its related affiliates or branches—or even separate business units in the same location—had information contradicting its assessment that an account were non-U.S. Such a worldwide due diligence standard becomes even more impracticable if the business unit would also be charged with "knowing" the contents of paper files, especially (but not only) if they are held outside the business unit itself. Finally, in many jurisdictions, information on account holders simply may not be shared between entities or business lines due to relevant privacy, securities and other regulatory rules.

Accordingly, a worldwide due diligence standard would present FFIs with potentially unacceptable systems integration costs, unmanageable risks for a business unit failing to know what information held by a related entity or business line might contradict its assessment of the U.S. status of an account, and legal impediments preventing it from being able to comply. Given these substantial problems, we believe that a worldwide due diligence approach would cause most FFIs, including even some large QIs, to opt out of the system envisioned by Chapter 4. Such FFIs would have little option, not because they would not want to comply, but because they could not comply.

4. FFI Agreements with the IRS

***Recommendation*:**

The legislative history should clarify that Congress expects that the Treasury Department will issue guidance exempting categories or classes of FFIs from the requirement that they enter into FFI agreements with the IRS provided that such FFIs either comply with the requirements of proposed Section 1472 or present a sufficiently low risk of tax evasion that they should be totally exempted from the new Chapter 4 rules.

***Rationale*:**

Proposed Section 1471(b) would require the approximately 5,500 financial institutions that currently are QIs, as well as the several tens of thousands of financial institutions that are eligible to become QIs but have not done so (i.e., NQIs), to enter into agreements with the IRS. In addition, hundreds of thousands of foreign investment entities—including hedge funds, private equity funds, mutual funds, securitization vehicles and other investment funds (whether publicly held or privately owned, and even if they have only a handful or fewer investors)—would be required to enter into agreements with the IRS.

While the precise responsibilities of an FFI under an FFI agreement are unclear at this time, at a minimum an FFI would need to set up identification, reporting and withholding systems and procedures covering virtually every business line around the world, and may be subject to outside verification obligations. Even existing QIs (few of whom have today assumed primary withholding responsibility) would need to revise their systems to address potential withholding tax on gross sales proceeds from U.S. securities, which requires a transaction-based architecture that is completely different from the systems that have been developed to capture information regarding U.S. source interest, dividends and other FDAP income. The enormity of this task—both for individual FFIs and across the financial and investment industries—cannot be overstated, nor can the risk of a broad application of the new 30% withholding tax on withholdable amounts, with potentially disruptive effects on the U.S. capital market.

We would expect that most large international banks that are QIs and that have substantial U.S. operations, as well as large investment fund groups with significant U.S. investments, will enter into FFI agreements and make every effort to comply with these new requirements, despite the significant costs. We are very concerned, however, that many other QIs, NQIs and foreign investment entities will not be able and/or willing to enter into such agreements, either because of the costs and burdens of compliance, as well as the exposures from an inability to comply, or—especially in the case of smaller FFIs—because of a concern about entering into an agreement with a distant tax authority.

If, as we fear, more than an insubstantial number of FFIs do not enter into FFI agreements with the IRS, there is a risk of considerable shifts in capital flows, as many FFIs (including possibly some large institutions) move investments from the United States in order to avoid the withholding tax while investors that wish to continue to invest in the United States move their investments to qualifying FFIs.[2] We are not in a position to quantify the potential extent of any disinvestment from the United States or other market disruptions, but we urge Congress and the Treasury Department to carefully evaluate these risks. In this regard, we note that these adverse results, were they to occur, would be very detrimental to the business of international financial institutions, and thus our memberships share a strong common interest with the U.S. Government in ensuring that the new rules do not produce material adverse consequences to financial markets and capital flows (in addition to our common commitment to combat tax evasion).

Moreover, we are concerned that if more than an insubstantial number of FFIs do not "buy into" the new regime, a two-tier financial system will emerge, in which some financial institutions that are non-qualifying FFIs may become a haven for U.S. tax evaders.

In our experience, a very high percentage of NQIs are fully compliant with the existing reporting rules. These institutions have not become QIs not because they wish to facilitate U.S. tax evasion but, rather, because their U.S. investment base is too small to justify the costs and burdens of being QIs. We would expect that these NQIs would be prepared to comply with expanded requirements that they identify their direct U.S. accountholders as well as the substantial U.S. owners of their accountholder entities, if these requirements are properly and reasonably designed.

As noted elsewhere in this letter, developing a workable system for identifying substantial U.S. owners is itself a very challenging task, particularly given that there are often multiple tiers of FFIs. However, we would expect that FFIs will more readily be able to obtain the necessary U.S. tax-specific information regarding substantial U.S. owners from accountholder entities that are investing in material amounts of U.S. securities, whereas in the case of accountholder entities that are invested in non-U.S. accounts and securities, the FFIs will necessarily need to rely on information that is already in their databases.[3]

We have no experiential basis to be able to determine whether foreign investment entities that are unable or unwilling to enter into FFI agreements would nonetheless be able and willing to comply with a Section 1472-type reporting regime. However, based on the fact that many NQIs and partnerships do comply with the requirements under existing law that they obtain and pass on certifications from their accountholders and beneficial owners, there is reason to believe that many such foreign investment entities would be prepared to comply with expanded requirements that they determine substantial U.S. owners of their accountholder entities, if these

[2] In practice, many investors may not take the affirmative steps to maintain their U.S. investments due to deference to the recommendations of their investment advisers, inertia or other reasons.

One of the unfortunate consequences of this new regime, which may contribute to such capital flow shifts, is that it will result in withholding tax on payments to a beneficial owner who fully complies with the U.S. tax rules (e.g., by providing a W–8BEN to a QI in which he/she holds an account) if any entity in the chain of FFIs through which it invests in U.S. securities fails to enter into an FFI agreement. Many investors may regard the prospect of eventually receiving a refund if the investor files, and is able to substantiate, a claim as more theoretical than real.

[3] Depending on the country, the applicable KYC and AML rules and account opening procedures do require that an FFI obtain information concerning an entity accountholder's substantial owners that would be useful for U.S. tax compliance, although typically the thresholds are above the 0 percent threshold for U.S. owners of foreign investment entities and a 10 percent threshold for other entities, and these rules and procedures generally are focused on the identity of the owner rather than the person's tax status.

requirements are properly and reasonably designed (as discussed above). In any event, we believe that a significantly higher percentage of such foreign investment entities will be able to comply with the rules (and will therefore remain invested in U.S. securities) if they are given the choice of a Section 1471 or 1472 regime (which is similar to the choice that financial institutions have today to either become a QI or to report under the NQI rules) than if they are forced to enter into FFI agreements in order to avoid withholding tax.[4]

We also stand ready to work with Treasury and the IRS to identify those foreign entities that should be exempted from both the Section 1471 and 1472 requirements on the basis that they do not present the United States with a substantial risk of tax evasion activity.

5. Adjusting the Threshold for Determining Substantial United States Owners

***Recommendation*:**

The statute should give the Treasury Department the flexibility to set the appropriate threshold (or thresholds) for determining whether a foreign entity has a "substantial United States owner," which is now set at "more than 0%" in the case of foreign investment entities and "more than 10%" in the case of most other foreign entities.

***Rationale*:**

We understand the rationale behind the Bill's requirement that FFIs and other withholding agents obtain information regarding substantial U.S. owners of foreign entities, and we agree that the failure of the existing rules to look behind corporate entities and certain trusts present unacceptable opportunities for tax evasion by U.S. persons.

However, as indicated above, the requirements of the Bill relating to the identification of U.S. accounts and FFI agreements raise extraordinarily complicated implementation issues, which may dissuade FFIs from entering into FFI agreements. To a great extent, these issues are magnified by the requirement that FFIs and other withholding agents obtain information regarding substantial U.S. owners of foreign entities. We are very concerned that, in many cases, FFIs simply will not be able to apply the 0%/10% thresholds, because such information is not required to be gathered for AML/KYC purposes and is impractical to secure otherwise. Also, having separate thresholds for foreign investment entities and other foreign entities introduces an additional complication of having to distinguish between those two categories of entities.

Striking a balance between the important objective of combating tax avoidance and practical administrability considerations in this context is best done by Treasury after due evaluation of the relevant factors. In view of the reported cases of U.S. individuals setting up foreign shell companies to hold offshore accounts, we respectfully submit that perhaps a threshold that requires, say, at least 50% ownership would better target the tax compliance objective of the United States to identify U.S. persons controlling offshore entities for tax evasion purposes.

6. Add an Exclusion for U.S. Branches of Foreign Banks and Clarify Treasury Authority to Provide Other Exclusions

***Recommendation*:**

The definition of "withholdable payment" for purposes of Section 1471 should be amended to exclude payments to a U.S. branch (or agency) of a foreign bank. In addition, the statute and/or legislative history should clarify that the Treasury Department has the authority to exclude other payments.[5]

***Rationale*:**

U.S. branches (and agencies) of foreign banks conduct extensive operations in the United States and engage in hundreds of millions of financial services and other transactions each year. Unless payments to such branches are excluded from the

[4] We acknowledge that one potential challenge in successfully applying a Section 1472 regime to tiers of FFIs may be a reluctance of one FFI to disclose its customer (or investor) base to another; similar concerns contributed to the development of the QI system. Giving FFIs a choice between a Section 1471 or 1472 regime may mitigate this challenge.

[5] More generally, in order to allay any concerns regarding the scope of Treasury's authority to provide guidance regarding Chapter 4, it may be advisable for Section 1474(d) (granting authority to Treasury to "prescribe such regulations or other guidance as may be necessary or appropriate to carry out the purposes of this chapter") or its legislative history to explicitly state that the grant of authority includes the authority to provide such exclusions from the terms of Chapter 4 as Treasury deems appropriate.

definition of “withholdable payments,” each payor of a withholdable payment to such a branch would need to ensure that the bank has entered into an FFI agreement before making payments to the branch. Such a requirement would place U.S. branches of foreign banks at a competitive disadvantage compared to U.S. banks. Moreover, U.S. branches of foreign banks are treated as U.S. persons for most information reporting rules and thus, for example, file IRS Forms 1099 with respect to payments to non-exempt recipients. Consequently, they should be treated as U.S. withholding agents that are not FFIs for purposes of Sections 1471 and 1472.

7. Contents of an FFI’s Annual Report

***Recommendation*:**

Section 1471(c)(1) requires that an FFI that has entered into an FFI agreement must provide the IRS with an annual report providing details about accounts owned by its direct and indirect U.S. customers and lists the items that must be provided in the report with respect to such U.S. accounts. We recommend either that section 1471(c)(1)(D) be removed from the Bill (our preferred approach), or that the phrase “To the extent required by the Secretary” be added as a modifier at the beginning of section 1471(c)(1)(D), which requires the FFI to provide the “gross receipts and gross withdrawals or payments from the account (determined for such period and in such manner as the Secretary may provide).”

***Rationale*:**

New chapter 4 presents many operational challenges and expenses for financial institutions. We believe that such expenses should be minimized in those instances where the compliance goal of the IRS would not be adversely affected and each data element that must be captured and reported necessarily increases the cost of compliance. With respect to the annual report, most of the account details required in the annual report are “static” in nature, such as name, address, TIN, account number and account balance at a specified time (presumably year-end). An FFI should be able to capture such data elements even if it must prepare an “exceptions” report to do so. However, tracking flows into and out of accounts is a much different matter and for some FFIs (or some business lines thereof) would require potentially far greater systems changes. We also question whether this information is necessary in all instances to provide the IRS with the necessary tools to identify potential U.S. tax evaders, given that the annual report will otherwise identify U.S. persons invested in non-U.S. accounts and securities and which of those U.S. persons have accounts large enough to merit closer IRS examination. Accordingly, we suggest either that section 1471(c)(1)(D) be removed from the Bill or, at a minimum, that the Treasury Department be granted flexibility to determine the circumstances in which this information must be provided.

8. Expand Availability of Credits and Refunds to FFIs

***Recommendation*:**

Proposed Section 1474(b)(2) denies a credit or refund to an FFI that is the beneficial owner of a payment except if and to the extent that the FFI is eligible to a reduced treaty rate of withholding. We recommend that the statute be amended to permit the Treasury to provide for credits and refunds in appropriate circumstances. The legislative history should indicate Congress’ intention that such credits and refunds be available where the withholding was done inadvertently or as a result of a technical “footfault” on the part of the FFI or the withholding agent, where the FFI has acted in good faith, or where the Treasury concludes that permitting such credit or refund is in the best interest of fostering compliance with Chapter 4. The legislative history should also indicate Congress’ intention that Treasury set up procedures permitting FFIs and other withholding agents to obtain refunds on behalf of their direct or indirect account holders.

***Rationale*:**

We understand that the intention of the new rules under Chapter 4 is to encourage FFIs to disclose their U.S. accounts, not to collect additional withholding tax. However, we are concerned that due to the complexity of the rules and the difficulty in achieving 100% compliance across the vast number of financial market participants, there inevitably will be a substantial amount of over-withholding. Moreover, by imposing withholding tax also on gross proceeds (which are exempt from substantive tax) and on payments to foreign financial institutions that have no material economic stake in those payments the withholding tax can be harsh and punitive in its impact, especially if the opportunity to obtain refunds or credits of such over-withheld amounts is restricted. Investors and FFIs will be evaluating their potential exposures under these rules in determining whether to invest in U.S. securities and to enter into FFI agreements. Accordingly, we recommend that every effort be made to have refund and credit procedures that maximize the ability to rectify over-withholding situations.

We look forward to continuing to work with the Congressional tax-writing committees, the Treasury Department and the IRS to achieve an effective, balanced and workable approach to addressing the gaps in the existing reporting and withholding tax rules.

EUROPEAN BANKING FEDERATION	INSTITUTE OF INTERNATIONAL BANKERS
Guido Ravoet *Secretary General*	Lawrence R. Uhlick *Chief Executive Officer*

Statement of the U.S. Public Interest Research Group

The following testimony represents the views of the U.S. Public Interest Research Group (PIRG), the federation of state Public Interest Research Groups, which is a non-profit, non-partisan public interest advocacy organization.

The Need for Real Reforms, and Why They Matter to Taxpayers

Even as many American families are struggling to make ends meet and businesses are fighting to keep their doors open, Main Street still manages to pay their taxes.

Taxpayers have also made an unprecedented investment in the banking, auto and insurance industries. These industries have made increasing use of complex schemes to avoid paying their own taxes. For instance, over 80% of the biggest U.S corporations maintain revenues in offshore tax haven countries.[1] The names on the list are familiar: American Express, A.I.G, Boeing, Cisco, Dow, Hewlett-Packard, J.P. Morgan Chase and Pfizer—among others.

In U.S. PIRG's report, "Who Slows the Pace of Tax Reforms," it's been found that even a modest number of corporations—just twelve—that oppose tax reforms of any kind, have over 440 subsidiaries in tax haven countries.[2]

These corporations move their revenues, manipulate their costs and take generous deductions in order to pay minimal, if any, U.S. taxes. In fact, Goldman Sachs, which received $10 billion in federal bailout dollars, paid just a 1% tax rate in 2007.[3]

The Senate's Permanent Subcommittee on Investigations concluded that the U.S Treasury loses up to $100 billion per year because of tax haven abuse.[4] U.S. PIRG has further analyzed that figure to establish the state shares of these revenue losses in its April 15, 2009 Report, "Tax Shell Game: The Cost of Offshore Tax Havens to Taxpayers."

The massive losses in revenue must ultimately be made up by taxpayers. When companies "change the geography" of their earnings, their headquarters or their subsidiaries to tax haven countries—the taxpayers must pick up the tab by paying higher taxes themselves or suffering from reduced public services.

When big businesses abuse tax havens, it puts ordinary businesses—especially small businesses—without elaborate tax schemes and access to havens at a competitive disadvantage. Businesses should thrive based on their ability to be efficient and innovative, not their access to the best tax lawyers or their aggressiveness in hiding assets offshore. Companies that create jobs here in the United States should not be at a competitive disadvantage against other companies that are nominally registered in tax havens or that move their earnings to such places. Companies that share the same access to U.S. markets and U.S. consumers should compete on a level playing field.

The negative impact of offshore tax havens extends beyond the burden it places on other taxpayers. According to the IRS, "At least 40 countries aggressively market themselves as tax havens. Some have gone so far as to offer asylum or immunity

[1] Government Accountability Office, *International Taxation: Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions,* Dec 2008.

[2] https://www.uspirg.org/home/reports/report-archives/campaign-finance-reform/campaign-finance-reform/who-slows-the-pace-of-tax-reforms

[3] http://www.bloomberg.com/apps/news?pid=20601110&sid=a6bQVsZS2_18

[4] Committee on Homeland Security and Governmental Affairs, Permanent Subcommittee on Investigations. *TAX HAVEN BANKS AND U.S. TAX COMPLIANCE STAFF REPORT*

to criminals who invest sufficient funds. They permit the formation of companies without any proof of identity of the owners, perhaps even by remote computer connection."[5] Corporate and bank secrecy set up breeding grounds for money laundering, drug trafficking and terrorism—both offshore and here in the United States.

Similar alarm has been sounded by Nobel-prize winning economist Joseph Stiglitz, who chairs the Commission of Experts of the U.N. General Assembly on reforms of the international monetary and financial system. He makes clear that tax havens are a losing proposition on all sides. "Secret tax havens . . . are bad for developing countries, bad for money laundering, drugs corruption—bad in every dimension."[6] Mr. Stiglitz indicates that the secrecy assists terrorists using these shadow markets to finance their agenda.[7]

Finally, many bills making their way through Congress so far this year could use the additional revenue that would be retained in this country by restricting tax havens as a way to pay for other programs. U.S. PIRG does not advocate using revenues that would be recaptured from shedding light on tax haven abusers for any particular program. However, when Congress is struggling to find ways to find revenue sufficient for two wars, an economic recovery effort, and other major reforms, how can it look the other way when companies that benefit heavily from government contract work and government bailouts fail to pay their fair of taxes?

Corporate Tax Rates and Competition

When lobbyists defend the existence of offshore tax havens, they typically argue that American corporations are already taxed enough. They refer to a claim that corporations pay a *statutory tax rate* of 35%, which is simply based on the law or "statute." However, the amount corporations actually pay is instead indicated by their *effective tax rate,* which is the percentage of their profit that they actually pay in taxes. And after corporations use myriad deductions, credits for business-related expenses and depreciation allowances, the amount of tax they actually pay on profit decreases dramatically—in some cases to nothing at all.[8]

In 2008 the GAO reported that effective taxes rates end up varying greatly across corporations depending on their ability to use such tax-reduction techniques.[9] Another 2008 GAO study showed that 25% of U.S. corporations with more than $250 million in assets or $50 million in sales paid no federal income taxes at all in 2005, the most recent year for which such data is available.[10] It has been widely reported that Goldman Sachs paid an effective tax rate of just 1% in 2008, citing they had made "changes in geographic earnings mix."

But this is really a separate issue. Whatever one thinks is the proper rate of corporate taxation, there should not be a parallel shadow system of tax avoidance that leaves other taxpayers shouldering the burden. When secrecy keeps individuals, governments and other banks from knowing exactly what is on the books and behind bank assets, it creates a false sense of security, making businesses more susceptible to the downward spiral we've seen over the last year.

The mythical threat of "double taxation" is often re-circulated by businesses that oppose reform. This is a baseless threat, because the foreign tax credit already protects against double taxation—and no one is proposing repealing that. There's a proposal by the Obama Administration to make this tax credit reflective of the average of all the tax rates that apply to a business so businesses cannot effectively choose which rate they want to pay, regardless of where they do business.

Reforming the Broken System

The ***Foreign Account Tax Compliance Act*** is a step in the right direction to reform a broken system where tax dodging individuals and corporations offload their burden on ordinary taxpayers. Holding foreign banks and corporations accountable for their clients can only help the process of ending bank secrecy.

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[5] Internal Revenue Service website. Viewed 4 April 2009 http://www.irs.gov/businesses/small/article/0,,id=106568,00.html

[6] "Economist calls for tax havens to be closed down." *Cayman News Service*. 26 Aug. 2008 http://www.caymannewsservice.com/business/2008/08/26/economist-calls-tax-havens-be-closed-down

[7] "Economist calls for tax havens to be closed down." *Cayman News Service*. 26 Aug. 2008 http://www.caymannewsservice.com/business/2008/08/26/economist-calls-tax-havens-be-closed-down

[8] Huang, Chye-Ching. *Putting U.S. Corporate Taxes in Perspective.* Center on Budget and Policy Priorities. 27 Oct. 2008

[9] Government Accountability Office, *Effective Tax Rates Are Correlated with Where Income Is Reported.* Aug. 2008

[10] Government Accountability Office, *Comparison of the Reported Tax Liabilities of Foreign- and U.S.-Controlled Corporations,* 1998–2005. July 2008

However, the bill can certainly be improved through even stronger enforcement mechanisms for the U.S. government, aggressive measures to tax shell companies and making sure that transactions have some economic purpose other than tax avoidance.

When it is reported that Cayman Island financiers are breathing a giant sigh of relief and making official gestures of "congratulations to Chairman Baucus and Chairman Rangel," then Congress should stop to see what's missing.[11] The following are U.S. PIRG's recommendations for comprehensive reform.

Codify the Economic Substance Doctrine

The bill should change the IRS code to ensure that a transaction has a purpose aside from reduction of tax liability in order to be considered valid. This covers any tax avoidance scheme into the future—which is a critical tool for law enforcement.

Address the Offshore Shell Companies and Collect Taxes

Companies that exist only on paper or via a Post Office box in the Cayman Islands—but take advantage of American markets, have access to our consumer base, use our physical and financial infrastructure and are protected by the U.S. military—should pay U.S. taxes.

Specific quantitative standards can be established to determine if a company is owned and controlled here in the United States in order to apply the correct level of taxation.

Repeal "Check the Box"

A provision should be added to keep companies from being able to simply check a box on a form to determine their business entity classification (to be most advantageous based on their location and tax treatment). This loophole has been abused in order to have the advantages and protections associated with incorporation, but not have to be taxed as such.

Ban "Tax Strategy" Patents

As we said in a coalition letter to this Committee earlier this year, U.S. PIRG supports banning patents on complex tax transactions and strategies used to avoid, reduce or defer taxes.

Our government should not be in the business of rewarding tax lawyers who help clients dodge their taxes. There is no patent protection for finding new ways to steal cars, and there shouldn't be protection for finding new ways to dodge taxes. These patents pose a significant threat to taxpayers and their advisors.

Legislation to accomplish this was passed in the House last year by a vote of 220 to 175 as part of larger patent reforms. As of the writing of the letter, 82 tax strategy patents had been issued, with 133 pending.

Conclusion

By taking on this issue in a serious way Congress can demonstrate that it puts taxpayers first.

Tax haven abuse is only legal because the law has not caught up to reality. It used to be legal to use other people's credit card numbers, dump raw sewage in rivers, and import radioactive materials—until we updated laws to stop it.

[11] http://www.reuters.com/article/pressRelease/idUS210981+28-Oct-2009+PRN20091028

Swiss Bankers Association, statement

SwissBanking

The Honorable Charles Rangel, Chairman
Committee on Ways & Means
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Max Baucus, Chairman
Senate Finance Committee
United States Senate
Washington, DC 20510

November 27, 2009

Foreign Account Tax Compliance Act of 2009 (H.R. 3933, S. 1934)

Dear Chairman Rangel and Chairman Baucus:

The Swiss Bankers Association (SBA) appreciates the opportunity to comment on the proposed draft bill for the Foreign Account Tax Compliance Act of 2009 (the "Bill").

The SBA understands the desire of the United States to improve tax compliance on the part of its citizens. We have worked closely with the Treasury Department and the Internal Revenue Service (the "IRS") for over a decade in the development and implementation of the qualified intermediary ("QI") system. In this context our member banks have expended large amounts of money and dedicated substantial personnel resources to implement the QI system rules. We believe that overall the QI system works well in achieving the objectives for which it was designed.

More recently, the SBA has been an active participant in dialogues with Congressional tax-writing staffs and the Treasury Department regarding the Bill. In addition we have fully participated in the efforts of the European Banking Federation (the "EBF") and the Institute of International Bankers (the "IIB") to bring about an international consensus with respect to the overall impact of the proposed legislation and in raising practical considerations that must be addressed if the Bill is to succeed in the manner envisioned by Congress and the Treasury Department.

The SBA fully supports the comments that have been filed by the EBF and the IIB. Specifically, the SBA believes changes should be made to lengthen the Bill's effective date; clarify the process for identifying U.S. accounts, particularly with respect to populations of existing accounts; clarify the requirements for certifying accounts as either U.S. or non-U.S. and authorize Treasury to exempt categories or classes of foreign financial institutions with respect to agreements with the IRS.

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SwissBanking

Consistent with the comments filed by the EBF and the IIB on November 27, 2009, we have significant concerns with respect to the substantial resource and operational burdens that will be imposed by the Bill. In particular, we have concerns with the enormously complicated due diligence obligation that will be imposed on the very large population of foreign financial institutions to identify U.S. tax payers from among groups of account holders that may be citizens of other countries but that hold U.S. green cards or from individuals born in the U.S. but who have never resided there. Under the Bill our banks will also be expected to look behind every non-publicly traded corporate entity for which they may hold an account to determine if U. S. investors are involved (again including green card holders) and, if so, the appropriate tax treatment that should be applied.

Large global banks that have already invested in sophisticated computer systems may have the operational wherewithal ultimately to comply with the requirements of the Act, but even for these institutions the one year contemplated effective date is far too ambitious. Significant operational considerations (such as the extent of due diligence that must be performed on existing client populations) still need to be resolved. The situation for smaller and medium-sized financial firms is far more vexing. For institutions in these categories, the question would boil down to a basic cost-benefit analysis, whether the benefits of continuing business relationships with U.S. persons is worth the reputational and tax penalty risks envisioned by the Bill. We believe there is a substantial possibility that smaller and mid-market firms will decide that the better alternative is to discontinue serving US clients and, to rid all portfolios of U.S. securities. There is evidence that this is occurring already. Financial institutions are just about to start to limit the financial services that are available to U.S. citizens abroad (see ACA letter in the annex).

The potential implications on investments in U.S. securities should not be underestimated, particularly as economies around the world look to recover from the global financial crisis. Given that U.S. government debt issuances will compete with rapidly growing government debt issuance in Europe and Japan, the Bill could have unintended consequences for future capital flows to the U.S., and it could affect international trade and investments flows, exchange rates, and interest rates. The compliance risks of the Bill and the risk of foreign financial institutions (FFI) and their clients (U.S.-clients and non-U.S.-clients alike) of being penalized with a 30 percent withholding tax may cause a substantial number of FFIs to cease holding and trading US securities. While there certainly will continue to be demand for US securities, the risk premium may rise with consequences for interest rate levels, growth and employment in the US.

Thank you again for the opportunity to comment and we urge you to consider these comments as you revise the legislation.

Yours sincerely,
Swiss Bankers Association

U.Ph. Roth U. Kapelle

American Citizens Abroad

The Voice of Americans Overseas

To: The Honorable Charles Rangel, Chair, W & M Committee: FAX: 202-225-0816
Mathew Beck (Rep. Rangel Contact W & M Committee): FAX: 202-225-2610

The Honorable Richard E. Neal, Chair, Select Revenue Measures Sub-committee of the Ways and Means Committee: FAX: 202-225-8112
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The Honorable Senator Max Baucus, Chair, Senator Finance Committee:
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November 3, 2009

Concerns: **Foreign Account Tax Compliance Act – HR 3933**

Dear Sirs:

American Citizens Abroad (ACA), the voice of Americans overseas, is a non-profit, non-partisan all-volunteer organization that represents the interests of Americans living and working outside the U.S. to the Executive Branch of the U.S. Government, the U.S. Congress, and the U.S. Federal Judiciary to insure that Americans overseas are treated with equality and fairness. ACA keeps Americans overseas informed and supports their role as informal representatives of the United States. More can be learned about ACA through our website, www.americansabroad.org.

We are submitting this written comment to the hearings on HR 3933 which will take place on November 5, 2009 and request that this submission be included in the record. These comments are addressed to the four members of Congress who jointly issued the Congressional press release of October 27, 2009 supporting HR 3933, as the close coordination between the Senate Finance Committee and the Ways and Means Committee on this issue is apparent.

American Citizens Abroad is dismayed to see the contents of the proposed ***Foreign Account Tax Compliance Act*** which, if passed, will create a backlash from foreign governments in response to what is openly referred to overseas as the financial imperialism of the United States. This legislation aims to significantly expand the reach of the Qualified Intermediary (QI) regulations. Whereas the current QI regulations are concerned principally with investment accounts, the ***Foreign Account Tax Compliance Act*** would apparently cover all bank activity, including current accounts. As stated in the joint press release, "The ***Foreign Account Tax Compliance Act*** would force foreign financial institutions, foreign trusts, and foreign corporations to provide information about their U.S. accountholders, grantors, and owners, respectively. The nonpartisan Joint Committee on Taxation has estimated the provisions of the ***Foreign Account Tax Compliance Act*** would prevent U.S. individuals from evading $8.5 billion in U.S. tax over the next ten years." This legislation would significantly enhance the authority of the Treasury in imposing the QI regulations and, in fact, requires foreign financial institutions to become policemen for the IRS. The administrative burden and costs associated with compliance will be significant for foreign financial institutions. And the associated legal risk is perceived as high.

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As stated by Chairman Rangel in the Congressional press release, "This bill offers foreign banks a simple choice – if you wish to access our capital markets, you have to report on U.S. account holders. I am confident that most banks will do the right thing and help to make bank secrecy practices a thing of the past." In the same press release, Ways and Means Select Revenue Subcommittee Chairman Neal stated: "I believe this bill provides the Treasury Department with the tools it needs to crack down on those Americans hiding assets overseas."

This legislation assumes that banks will submit passively to the U.S. rules and that business will go on as usual. But this will not be the case. UBS in Switzerland has already announced that it will no longer accept as a client any American person residing in the United States. Many other foreign banks are adopting the same policy in a more discrete way.

With regard to American citizens residing abroad, a group of major UK banks has already stated that they will close accounts of American citizens if the proposed QI regulations of January 1, 2010 become effective. We know for a fact that Swiss, Dutch and Spanish banks are refusing American citizens residing in their countries as clients and are closing accounts. Do not forget that there are over 5 million American citizens residing abroad. These people need to maintain foreign bank accounts in the country where they reside to make current payments receive salaries and hold their investments. The proposed legislation and reinforced QI regulations will make it all the more difficult for overseas Americans to maintain a bank account where they reside.

Although ACA understands and sympathizes with the efforts of the U.S. Congress to close the door to tax cheats, you must remember that most Americans working and living overseas are not tax cheats but are performing significant services for the United States in representing American companies and products. The proposed legislation specifically discriminates against one category of U.S. citizens – those residing overseas. Imagine the uproar if Congress passed a law that all residents of New York would have their bank accounts submitted to special investigation, including the total of debits and credits in a year and the maximum balance in the account.

Closing accounts is just one reaction to the U.S. overreach. The United States imposing its laws on foreign countries is creating a poisoned atmosphere which will hinder the positive development of international trade and finance. One Swiss bank has already publicly announced that it will no longer invest in any American securities for any of its clients. Since that announcement, which received substantial press coverage, and the explanation of US tax legislation behind that statement, foreigners are already beginning to divest of U.S. stocks. The U.S. tax code states that if a foreigner owns more than $60,000 of U.S. securities at the time of his death, his estate becomes subject to U.S. inheritance laws. At a time when the United States should aim to attract foreign capital, its legislation will discourage investment in the United States. As the United States government depends on foreign investors to purchase a large share of Treasury bills, the threat of a significant divestment out of the United States is not to be taken lightly.

While there is no doubt that the United States remains a financial powerhouse, it is no longer the only option for investment purposes. With the U.S. dollar devaluing against other currencies, many individuals are focusing investments in currencies other than the U.S. dollar. The United States risks losing investment flows into the country and compromising free flow of trade if people located outside of the United States view compliance as administratively too burdensome. Furthermore, the probable restriction on access to bank accounts overseas by American citizens and corporations will put a restrainer on the free development of trade. The new movement away from the U.S. stock market is just one form of backlash on American policies, and all of the publicity linked to the bank secrecy issue has made foreigners sensitive to the implications of any relationship with the United States.

The United States also risks facing measures of reciprocity from foreign governments. In fact, the perspective of the United States on bank secrecy and fiscal paradises is very hypocritical. On November 2, 2009, a Financial Secrecy Index was been published for the first time by the

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International network for fiscal justice, co-founded by the South Alliance and the Declaration of Bern. Ranking number one in the overall index of secrecy is Delaware in the United States with a heavy weight in international transactions. In terms of secrecy, Delaware ranks on a par with the Cayman Islands, Bermuda and Dubai.

The U.S. one way approach has also been illustrated by the fact that when Mexico asked for United States assistance in providing the names of Mexican citizens with money hidden in the United States, the United States refused to collaborate. The OECD countries are also building up forces to obtain transparency of their nationals. This movement will extend to money held in the United States as well as to other foreign banks.

American Citizens Abroad fears that the current Congressional approach to stop the few thousand American citizens that evade taxes by imposing its laws on other nations risks to open up Pandora's box, to create suspicion and friction with many other governments and to have a long-term negative impact on U.S. trade and commerce in general. The costs to the United States could far exceed the $850 million annual revenue projected to be collected by the Joint Committee on Taxation due to the proposed HR 3933. Right now the United States should be encouraging more foreign trade to increase the nation's exports, not develop legislation reaching beyond its borders, which will hinder that free movement of trade.

American Citizens Abroad supports Congress in its efforts to eliminate tax evasion, but asks that the current legislation be revised and rewritten so as not to discriminate against Americans living and working abroad and not to negatively impact continued foreign investment in the US. ACA feels it imperative to warn Congress of the serious risks for the United States related to the current drafting of the ***Foreign Account Tax Compliance Act***.

We thank you for your attention.

Sincerely yours,

Marylouise Serrato Executive Director	Jacqueline Bugnion Director

cc: Americans Abroad Caucus
The Honorable Timothy F. Geithner, Secretary of the Treasury
The Honorable Paul Volcker, Chairman, Presidential Task Force on Tax-Code Review

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State Street Bank and Trust, letter

STATE STREET.

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November 20, 2009

The Honorable Max Baucus
Chairman
Senate Committee on Finance
219 Dirksen Senate Office Building
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The Honorable John F. Kerry
United States Senate
218 Russell Senate Office Building
Washington, D.C. 20510

The Honorable Charles B. Rangel
Chairman
House Committee on Ways and Means
2354 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Richard E. Neal
Chairman
House Ways and Means Select Revenue Measures Subcommittee
2208 Rayburn House Office Building
Washington, D.C. 20515

Re: Foreign Account Tax Compliance Act of 2009 (S. 1934 and H.R. 3933)

Dear Sirs,

State Street Bank and Trust Company (State Street) welcomes the opportunity to submit comments on the Foreign Account Tax Compliance Act of 2009, S. 1934 and H.R. 3933 (the Bill), introduced on October 27, 2009. State Street wishes to encourage the House Ways and Means Committee and the Senate Finance Committee in their efforts to clarify and implement the Bill. The Bill's basic goals are laudable, and are broadly consistent with many of the Administration's proposals, as described by Messrs. Shay and Wilkins at their appearances before the House Ways and Means Select Revenue Measures Subcommittee on November 5, 2009.

Although State Street supports the Bill's objectives, there are several issues the Committees should consider as the legislative process moves forward. The following list is not exhaustive, but represents the issues of greatest concern to State Street from its perspective as a provider of financial services to institutional investors:

Bill section 101

1. Provide for effective date flexibility

The proposed effective date – payments made after January 1 2011 – is much too early. It likely will take Treasury and the IRS twelve to twenty-four months to provide final guidance and a form of agreement for the affected foreign financial institutions (FFIs). It also will take the financial services industry up to twenty-four months to create a reporting and withholding regime for the FFIs and their assets, as well as a parallel program to address non-financial foreign entities. We have seen similar timetables in the development of the Qualified Intermediary regime, as well as with basis reporting.

Note that overlap of the government and industry implementation periods will be quite limited. In our experience, we cannot properly begin software and processing modifications until we have final guidance. Bill section 101, by itself, would not provide the details needed for implementation – only Treasury and the IRS could provide that information.

To accommodate these implementation issues, the effective date of section 101 should be extended. The earliest practical statutory effective date should be for payments made after December 31, 2013 (assuming prompt passage of the Bill). If the Bill's current effective date is not changed, Treasury should be instructed to produce early guidance to enable U.S. withholding agents and FFIs to comply. Further, and regardless of the Bill's effective date, Treasury and IRS should be provided discretion to defer implementation until at least eighteen months after final guidance and the FFI agreement are available. Our recommendations are consistent with the comments of Mr. Wilkins at the November 5, 2009 Select Revenue Measures Subcommittee hearing, where he said that Congress should provide broad effective date flexibility to ensure effective implementation of the Bill's FFI reporting regime.

2. Exclude US CFCs from FFI status

Some foreign entities (including controlled foreign corporations and majority-US owned foreign partnerships) currently are US payors for information reporting purposes. The Internal Revenue Code already tasks these entities with US tax processing for customers and investors. Subjecting them to the FFI reporting regime would be duplicative, and would add compliance expense. Therefore, we propose that these entities be excluded from FFI status, by statute or guidance to Treasury. Such an exception would lower the costs of implementation while continuing the current scope of reporting. It also would be consistent with the Bill's proposed Code section 1471(c)(2) election for an FFI to be subject to the same 1099 reporting regime as applies to U.S. financial institutions. That election would create a parallel, and greatly overlapping, reporting regime for CFCs that are FFIs. However, the Bill's implementation would be less expensive and cumbersome if the chapter 4 process and the proposed agreement are not required in this context.

3. Clarify the scope of reason to know by FFIs

Proposed Code section 1471(c)(3) allows an FFI to accept a customer/account holder's representation that an account is not a US account unless the FFI or <u>others in its expanded affiliated group</u> know or have reason to know that the account holder's certification is incorrect. There is no way for a large financial organization to capture worldwide knowledge among its affiliates because disparate systems and databases often are not connected. Additionally, some markets' data privacy rules would bar cross-use of information.

Earlier Congressional hearings identified instances of structuring to avoid US information return processing for entities owned by US persons, and we acknowledge that the Bill should address that behavior. To accomplish the goal of the proposed Code section, we propose that the scope of the knowledge test be narrowed to include only the knowledge of the affected entity (the FFI), together with the absence of material tax structuring assistance known to the FFI. This would mean that, prior to the FFI's acceptance of a customer certification of non-US status, (i) the FFI would apply its knowledge, and (ii) the FFI would have "clean hands".

Bill section 301

4. Clarify the definition of "material advisor"

Bill section 301 creates a disclosure regime when a "material advisor" assists in a "foreign entity transaction." This regime presumably will operate in parallel to the current Code section 6111 disclosure regime. However, we are concerned that this new regime could be unintentionally overbroad.

State Street often provides customers and potential customers with information about markets and investment structures. Much of this information is publicly available; some of it is proprietary. In all cases State Street discusses the investment landscape at no separate charge to customers. Of course, State Street provides a broad range of investment services to customers, and we bill for those services. Bill section 301 should not encompass routine no-cost assistance to customers that might be related to "foreign entity transactions" simply because gross income derived from other normal services exceeds the proposed statutory threshold. The Bill does have a provision allowing for exemptions from disclosure, and we suggest that the Bill provide Treasury clear authority to narrow the scope of disclosable activities.

I would be happy to discuss these issues with you and your staff in more detail. Please feel free to contact me.

Best regards,

Robert J. Foley

Robert J. Foley

cc: Dennis E. Ross
State Street Global Tax

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Statement of the EFAMA

Additional Comments on the Foreign Account Tax Compliance Legislation introduced by Chairmen Rangel and Baucus

1. EFAMA[1] recognizes and supports the intent of the Rangel-Baucus Bill of better detecting and discouraging offshore tax evasion by U.S. persons. Our comments set forth below are intended to contribute to solutions in this respect that are workable in the context of prevailing intermediated investment structures and that take into account the specific characteristics of investment funds.

Our concerns

2. The new regime brings into scope fund entities, and fund managers, who were not within the scope of the USQI regime. The Foreign Account Tax Compliance Act 2009 ("the Bill") will go beyond the QI regime in imposing a new withholding tax or a new information reporting requirement that applies for the first time directly to funds and fund managers, as opposed to their custodian banks. The new, very broad, definition of a "foreign financial institution" ("FII") and the requirement that such an FII enter into agreements with the IRS and provide annual reporting in order to avoid new withholding tax rules on U.S. source investment income and on U.S. related gross proceeds will have profound implications.

   It has taken some time since the publication of the Bill on 27 Oct to assess all the implications and consequences it potentially has for our industry, especially within organizations which have no experience of the similar, albeit narrower, QI rules, and the impact analysis is still ongoing. Please note there are 53.000 funds represented by EFAMA's member national bodies. The technical position under the new rules will typically involve an interplay between the custodian, broker, fund entity and fund manager.
3. The current effective date of the bill is December 31 2010. The provisions laying down information reporting and withholding requirements will apply for payments made after that date. The scale of this task for FFIs that have no existing U.S. tax information reporting systems is very substantial, and we are concerned this timeline is not achievable.
4. As pointed out in our previous letter of 20th November 2009, many investment funds will usually encounter real difficulty entering into an agreement with the IRS that requires the fund to report details on every U.S. account holder. The reason for this difficulty arises from the little that is usually known at fund level about the investors of the fund.

   - In most of the European market, the process of subscribing to investment funds is heavily intermediated. In most European countries, the standard distribution model for retail and other widely held mutual funds is via local bank branch networks.
   - In other countries (such as the UK) distribution is increasingly intermediated through independent fund advisers who access funds through so-called "platforms". Platforms themselves can in some circumstances be accessed directly by end investors which enables the investors to purchase the funds directly. Typically this will be via an automated sales process, i.e. via the internet. This process of often results in the creation of two layers of nominee, i.e. the register of the fund will show the platform as nominee, and platform's records will often just provide the financial adviser's name. It will be the financial adviser who will have a record of the beneficial owner.
   - Share or unit purchases are only rarely made by retail investors directly with the Collective Investment Vehicle (CIV) or its transfer agent (and in some European markets, never). In the overwhelming majority of cases CIVs will enter into distribution arrangements with distributors who will themselves enter into further arrangements with downstream distributors or "intermediaries" in the distribution chain (such as banks, insurance companies or independent advisors).

[1] EFAMA is the representative association for the European investment management industry. It represents through its 26 member associations and 44 corporate members approximately EUR 11 trillion in assets under management of which EUR 6.4 trillion was managed by approximately 53,000 funds at the end of June 2009. Just over 37,000 of these funds were UCITS (Undertakings for Collective Investments in Transferable Securities) funds. For more information about EFAMA, please visit www.efama.org.

- Intermediated purchases of CIV shares or units are typically held in an omnibus or nominee account. The use of omnibus or nominee accounts has developed for a variety of reasons. It can for example assist intermediaries in terms of simplifying their computerized administration and reporting systems and thus gives rise to economies of scale.
- In addition, as mentioned above individual customer information is generally regarded as valuable proprietary information. Therefore this information will not be passed up the chain of intermediaries to the CIV, a problem compounded by the additional costs this would entail, which might well eliminate the economies of scale arising from the use of omnibus/nominee accounts. In an omnibus account sales and purchases are usually made on behalf of collections of investors on a net purchase or net sales basis. Those transactions can thus not be attributed to individual investors behind the nominee.
- An additional difficulty arises from the fact that the investor base of a widely-held CIV changes on a daily basis.

5. Significant practical difficulties will arise because of local country data protection legislation in a number of countries. Under these laws, no financial institution is allowed to submit client details to another institution or person without the formal approval of the relevant client. In order to prove that the approval procedure has been correct, usually the client approval is asked for in written form.
6. Against this background serious consideration should be taken with regard to how to address the problem of identifying U.S. persons that hold accounts or other investments through multiple tiers of foreign entities such as investment vehicles. For the reasons given above it will in many cases simply not be possible for funds or their managers to identify such persons. As you may be aware, this problem is one of the issues which is being addressed as part of the OECD's project on the Taxation of Collective Investment Vehicles and Procedures for Tax Relief for Cross-Border Investors in the context of Double Taxation Agreement benefits for CIVs. The U.S. government of course is one of the participants in that project. This project has been ongoing for many years not least because of the complexity of the task of taking into account the intermediated investment landscape and in particular the fund environment with its vast distribution channels for purposes of enabling treaty relief and reporting. We look forward to working constructively in the course of 2010 with the IRS to address these issues.
7. We believe it will be a very challenging and onerous task for the non-US funds industry to introduce a wholly new U.S. tax reporting system that affects several times more financial institutions than USQI. But an additional concern is the aggregate practical burden for millions of investors and the financial intermediaries who act for them. This seems out of proportion to the small number of targeted U.S. account holders. Non U.S. investors with no connection to the U.S. will be reluctant to make declarations relevant only for U.S. federal tax purposes, particularly in the case of funds which have little or no direct U.S. investment. This will make it difficult to achieve compliance even where there is no U.S. tax evasion.
8. Even where adaptations to the current proposed mechanisms are foreseen, it is likely that many widely-held investment funds simply cannot comply with the remaining requirements. Where disinvestment in the U.S. capital markets is not an option, the punitive withholding, including the 30% withholding on gross proceeds, will not be commercially viable for the concerned investment funds. There is a reasonable prospect of many of the concerned vehicles facing the alternative of having to close down or eject a significant proportion of their investor base (and thus shrink its investment volume). We genuinely believe the medium term impact could be to cause a measurable outflow from U.S. capital markets, especially if insufficient transitional reliefs are made offered.

Our suggestions

1. **Exemptions** In part to avoid U.S.C reporting requirements, many Collective Investment Vehicles ("CIVs") established in European countries go to some lengths to avoid U.S. persons investing in such funds. In such cases the prospectus will typically provide that the fund is not open to U.S. investors and the application form will contain a representation to this effect too. If a U.S. investor incorrectly states that he is eligible to invest and the fund manager subsequently discovers that the investor is a U.S. citizen then the investor

will be required to redeem his investment immediately, at net asset value at that time. As such, we would urge that investment funds that specifically prohibit investment by U.S. persons be exempted from the new reporting regime. In the enclosed appendix we include two typical examples of prospectus wording.

We would also ask the IRS to consider a more general exemption from the new regime for widely held and regulated collective investment vehicles, especially in situations where particular administrative difficulties apply. EU countries typically have very wide-ranging regulatory rules which determine the nature of investments, risk profile, diversification strategies and levels of gearing which a fund can have, and highly prescriptive rules as to the nature, content and distribution of fund legal financial and marketing documentation. In the case of UCITS, the pan European regulated retail fund product, these rules are very onerous. With such funds an individual investor can have no control over the investment strategy or the continued existence of the fund, which would make such a fund a less attractive vehicle for tax evasion by larger investors.

2. In our view also the treatment of pension funds needs to be clarified. EFAMA does not represent pension funds. However, it would be an odd outcome of such funds, which could not be used as investment vehicles for U.S. tax evaders, were to be included; no doubt other bodies are making representations on their behalf.
3. **Tiering** As pointed out in our letter, investors typically invest through layers of intermediaries, with the legal ownership held by nominees. The intended application of the new regime to these multiple tiers is not sufficiently clear. Guidance should be developed that a fund that needs to enter into the reporting regime can accept any one of four formal certifications from each registered unitholder:
    a. That the unitholder is a registered reporting agent under the new regime. *This would typically apply to fund of funds and distributors (such as branch banks and fund platforms).*
    b. That the unitholder is an entity that does not have substantial U.S. ownership. In the case of an 'ordinary corporate' that would mean <10% U.S. ownership (and at 7. below we request this 10% threshold be extended to investment vehicles also). *This would typically apply to unlisted companies that are not themselves FFIs..*
    c. In the case of direct investments in the fund by individuals: That the unit holder is a non-US person.
    d. In the case of direct investments in the fund by individuals or entities: That the unit holder's interest is to be treated as a U.S. account
4. **Direct reporting on request.** Where a.) above applies, it should be clarified in the final regulations and in the model agreements issued by the IRS that the distributor with direct client contact should report details of U.S. accounts directly to the U.S. government and not to the fund. This distributor will be closer to the investors in the fund and will thus be in a better position to respond to the information requirements. We further suggest that, to make the scheme more practical for the IRS to administer, such data should be provided in response to a request by the IRS (i.e. in areas of particular interest to them) rather than automatically.
5. Withholding as a solution to the **'cliff edge problem'.** The bill as currently drafted means that any FFI that needs to become a reporting agent must provide information as to *all* accounts. Failure to obtain information about just one out of possibly thousands (or hundreds of thousands) of accounts means the FFI has failed in its duties as reporting agent; the penalty for this is not currently clear, but could presumably extend to the re-imposition of the 30% withholding on all of that FFI's U.S. source receipts. We believe it should be sufficient remedy for the U.S. government's purpose that the FFI withholds 30% from payments to just the small minority of non-compliant accounts, and remits that amount to the US.
6. **Documentation** We would urge Treasury to introduce commercially reasonable standards for identifying U.S. accounts. A great difficulty would be connected with obtaining certifications or other evidential material on the non-US tax status from thousands of non-US account holders for the purpose of identifying a small number of potential U.S. persons. The vast majority of accountholders which are non-US persons not seeking in particular U.S. investments or U.S. source investment income would see no grounds for providing such certification, in particular where such certification consisted in

U.S. tax forms. We note that under the USQI system it is possible to obtain IRS rulings to allow reliance on KYC and AML procedures. We suggest it should be possible for CIVs to obtain similar rulings from the IRS that KYC-based procedures for excluding U.S. persons are sufficiently robust that the CIV need not enter into a full reporting agreement. We would suggest that an FFI should have the possibility to fulfill obligations under the new regime more generally by using information in its possession or relying on existing procedures.

7. Where such an IRS ruling were not be granted we believe that neutral investor self declaration forms should be used. It will be an extra deterrent that investors are asked to complete a U.S. form, just as the average U.S. investor would be reluctant to complete say a French or German government form. We therefore believe that short of IRS ruling allowing the reliance on KYC and AML procedures the form of Investor Self Declaration envisaged in the OECD process would better achieve the universal compliance the U.S. seeks than the use of U.S. tax forms. This would have the additional advantage of allowing authorised, industry standard, local language versions to be produced.
8. **De minimis** threshold. The bill as drafted defines a corporate to have 'substantial U.S. ownership,' such that any account belonging to that corporate is a 'US account,' where U.S. ownership exceeds 10%. In the case of an 'investment vehicle,' however, that limit is reduced to zero. We believe that adds to the difficulty of the tiering problem, and will result in entities that could otherwise have simply certified as 'non-US owned' instead entering into reporting agreements. We suspect the number of such reporting agreements the IRS will have to administer is very large, and any measure to reduce their number will enhance the workability of the overall system. We would therefore suggest that the differential limit for 'investment vehicles' is either abandoned altogether, or at the very least set at a figure higher than 0%.

Transitional and administrative measures

1. **Effective date.** We would urge that this proposed effective date be delayed in order to allow adequate time for the substantial number of Foreign Financial Institutions (FFIs) directly affected by the new regime to implement the required complying mechanisms and associated systems changes. Further impact analysis and industry consultation will be required to define the date by which compliant systems could be built; but the degree of delay needed will also be a function of the willingness of the U.S. authorities to grant the transitional reliefs requested below.
2. **Transition** We would urge that a transition relief and implementation schedule be introduced in order to allow sufficient time for introducing necessary industy practice and systems changes. The bill would require foreign financial institutions, among other things, to obtain such information from its clients "as is necessary" to determine the accounts of U.S. persons and to report items including the person's name and taxpayer identification number. Because the local jurisdictions in which many of these institutions operate have client identification rules that may not comply in all respects with what the U.S. may deem "necessary," it is important that these institutions be able to rely on their existing know your customer and other client identification rules while they gather the information necessary to comply with the new U.S. rules.

   a) Such transition relief could include reliance on existing client identification information for all current accounts with the new rules applying only to accounts opened after an agreed future date.
   b) Alternatively, if additional information must be collected from existing clients to meet the new "as is necessary" standard, institutions should be given a number of years to collect this information, with a gradually increasing percentage requirement for each year of the old accounts for which the new "as is necessary" information test must be met.

   We would suggest that consideration be given at least initially to applying the legislation on a duty of care/best endeavours basis, whereby for example it is reasonable to assume that if the investor does not have a U.S. address or a U.S. bank account, then it is reasonable to conclude that the relevant individual is not a U.S. person.
3. **Group filing election** We believe that in many cases it will be necessary for the fund manager, and each fund in the fund manager's range, to enter

into reporting agreements if the punitive withholding is to be avoided. Typically, a fund manager will of course run tens or hundreds of funds. We believe it would be to the benefit of both the fund management industry and to the IRS to allow the fund manager to elect that a single reporting agreement, and reports of U.S. Accounts under it, should cover both the fund management company and all funds managed by it on a consolidated basis.

4. **Small accounts** The bill as currently drafted allows a reporting exemption for accounts of less than $10,000 (with a grandfathering at $50,000 for preexisting accounts) where these accounts are held by individuals. We believe this exemption could be extended to accounts held other than by individuals, without obviously exposing the U.S. to greater risk of tax evasion. This would again reduce the volume of reporting the IRS must deal with, and also make this exemption much easier for FFIs to operate.

Appendix

Examples of selling restrictions:

- The Company is a recognised scheme under Section 264 of the United Kingdom Financial Services and Markets Acts 2000.

"The shares have not been and will not be registered under 1933 Act or the securities laws of any of the States of the United States. The Shares are being offered and sold solely outside the United States to non-US. persons in reliance on regulation 5S? of the 1933 Act. The company has not been and will not be registered under the 1940 Act but will be exempt from such registration pursuant to Section 3 © (7) thereof. The outstanding securities of issuers relying on Section 3 c 7, to the extent that they are owned by U.S. persons (or transferees of U.S. persons), must be owned exclusively by persons who, at the time of acquisition of such securities, are "qualified purchasers" within the meaning of Section 2 a 51 of the 1940 Act. Any U.S. purchaser of the Company's shares must therefore be both a "qualified institutional buyer" under Rule 144 A under the 1933 Act, the 1933Zct, the CEA, or U.S. income tax unless prior consent is obtained from the manager. Please see Appendix IV for the definition of U.S. persons and additional information on the restrictions pertaining to U.S. persons.

Applicants for shares will be required to certify that they are not a U.S. person."

- Specimen declaration included in the application form of an Irish investment fund which prohibits investment by U.S. persons.

"The Applicant represents that the Applicant understands that (i) the Fund will not be registered under the U.S. Investment Company Act of 1940, as amended, (ii) the Shares have not been and will not be registered under the U.S. Securities Act of 1933, as amended (the "1933 Act"), or under the securities laws of any State or other jurisdiction within the United States, (iii) the Shares may be resold only in transactions that are not subject to or are exempt from the registration requirements of the 1933 Act, and (iv) the Shares may not be offered, sold or delivered, directly or indirectly, in the United States, or to or for the account or benefit of any "U.S. Persons," as such term is defined in the Prospectus.

The Applicant represents that (i) the Applicant is not, and the Shares will not be purchased or held for the account or benefit of, or purchased with funds obtained from, a U.S. Person, as defined in the Prospectus, (ii) the Applicant has not used, to effect the purchase of Shares, any funds obtained in gross income from any U.S. Person, (iii) the Applicant will not transfer or deliver, directly or indirectly, any of the Shares or any interest therein to a U.S. Person, (iv) the Applicant was not solicited to purchase and did not acquire any of the Shares while present in the United States, (v) the Applicant is acquiring the Shares for investment purposes only, (vi) the Applicant will notify the Fund in the event the Applicant becomes a U.S. Person at any time that the Applicant holds any of the Shares, (vii) the Applicant will not transfer or redeem any of the Shares while present in the United States, its territories or possessions, or areas subject to its jurisdiction, and (viii) if the Applicant is a bank, broker or dealer, and the Applicant is acquiring Shares on behalf of clients for investment purposes, that such clients are not U.S. Persons, that the Applicant will notify the Fund if it shall come to the Applicant's knowledge that any such client has become a U.S. Person, that the Applicant will not at any time knowingly transfer or deliver Shares or any part thereof or interest therein to or for the account or benefit of a U.S. Person *and that the Applicant will not make any transfer of delivery thereof directly orindirectly into the United States.*

Definition of a U.S. Person per Prospectus

"U.S. Person" means a "U.S. Person," as defined by Rule 902 of Regulation S under the U.S. Securities Act of 1933, as amended (the "Securities Act"), including:

(i) any natural person resident in the United States;

(ii) any partnership organised or incorporated under the laws of the United States;

(iii) any estate of which any executor or administrator is a U.S. Person;

(iv) any trust of which any trustee is a U.S. Person;

(v) any agency or branch of a non-U.S. entity located in the United States;

(vi) any non-discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary for the benefit or account of a U.S. Person;

(vii) any discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary organised, incorporated, or (if an individual) resident in the United States; and

(viii) any partnership or corporation if:

(a) organised or incorporated under the laws of any non-U.S. jurisdiction; and (b) formed by a U.S. Person principally for the purposes of investing in securities not registered under the Securities Act, unless it is organised or incorporated, and owned, by accredited investors (as defined in Rule 501(a) of Regulation D under the Securities Act) who are not natural persons, estates or trusts.

Notwithstanding the preceding paragraph, "U.S. Person" shall not include:

(i) any discretionary account or similar account (other than an estate or trust) held for the benefit or account of a non-U.S. Person by a dealer or other professional fiduciary organised, incorporated, or (if an individual) resident in the United States;

(ii) any estate of which any professional fiduciary acting as executor or administrator is a U.S. Person, if:

(a) an executor or administrator of the estate who is not a U.S. Person has sole or shared investment discretion with respect to the assets of the estate, and (b) the estate is governed by non-United States law;

(iii) any trust of which any professional fiduciary acting as trustee is a U.S. Person if a trustee who is not a U.S. Person has sole or shared investment discretion with respect to the trust assets and no beneficiary of the trust (and no settlor if the trust is revocable) is a U.S. Person;

(iv) an employee benefit plan established and administered in accordance with the law of a country other than the United States and customary practices and documentation of such country;

(v) any agency or branch of a U.S. Person located outside the United States if:

(a) the agency or branch operates for valid business reasons, and (b) the agency or branch is engaged in the business of insurance or banking and is subject to substantive insurance or banking regulation, respectively, in the jurisdiction where located;

(vi) certain international organisations (and their agencies, affiliates and pension plans) as specified in Rule 902(k)(2)(vi) of Regulation S under the Securities Act; or

(vii) an entity excluded or exempted from the definition of "U.S. Person" in reliance on or with reference to interpretations or positions of the U.S. Securities and Exchange Commission or its staff."

[09–4107]

Australian Bankers' Association, Inc., statement

AUSTRALIAN BANKERS' ASSOCIATION INC.

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4 December 2009

The Honorable Charles Rangel
Chairman
Committee on Ways and Means
US House of Representatives
Washington, DC 20510

The Honorable Richard Neal
Chairman
Committee on Ways and Means Subcommittee on
Select Revenue Measures
US House of Representatives
Washington, DC 20510

Foreign Account Tax Compliance Act of 2009

Dear Congressmen,

The Australian Bankers' Association (the "ABA") would like to share with you significant concerns that its members have with respect to certain aspects of the proposed "Foreign Account Tax Compliance Act of 2009" (the "Bill"). By way of introduction, the ABA is an organisation of Australian banks that works with and on behalf of its member banks to provide analysis, advice and advocacy relating to the development of public policy impacting the banking and financial services industry in Australia.

The Bill's new reporting and withholding regimes are intended to detect and prevent US tax evasion by US taxpayers. While we understand and support the ultimate goal of Congress (which is not very different from that of various initiatives of the Australian Tax Office in recent years), we believe that the Bill, as currently proposed, would have far-reaching and disruptive effects on the operations of the ABA's members and also on the markets in which they conduct business. This may in some cases force Australian banks to withdraw from investments in the US (including on behalf of their customers) if such banks are unable to sustain the steep costs of compliance with the new reporting and withholding requirements of the Bill.

We understand that revisions will be made to the Bill in response to the volume of comments from many other industry associations and, on that basis, we believe that it would be most useful to you if, rather than providing specific comments on the drafting and mechanics of the Bill, we drew your attention to a handful of significant issues that are of the greatest concern to Australian banks. These issues are as follows.

A. Information Reporting & Withholding under New Sections 1471 – 1474.

The Bill would add a new Chapter 4 to the US Internal Revenue Code, which would essentially require foreign financial institutions (including Australian banks operating outside of the United States) to identify from among all of their customers any US persons and any "United States owned foreign entities" and then to report to the US Internal Revenue Service (the "IRS") on all payments to, or activity in the accounts of, such persons.

This would be extremely onerous and costly (as described further below) for what we believe to be a small benefit to the US. As Australia has a double tax treaty and information sharing agreement with the US, the risk of US citizens hiding income through our country's banking system appears to be low.

We have several concerns about these provisions in their current form:

Inability to Obtain Necessary Information. Even though many Australian banks would be willing to make a good-faith effort to comply with these new requirements, in many cases it may not be possible for them to obtain the required information. Most Australian banks will not have the requisite information on file with respect to their current customers, because they would have had no reason to ask in the past whether their customers are US citizens or otherwise US persons and certainly no reason to ask whether a non-US entity might be owned by US persons.[1]

Essentially, this would mean that these Australian banks would be required to mail or otherwise contact their existing customers to try to obtain this information. As we all know, mass mailings and telemarketing calls to millions of customers often generate minimal responses, particularly when the subject does

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[1] In Australia, for a natural person to open a bank account, the person must show, among other items, proof of residence (i.e., a permanent address), but information on nationality is not required even where available. With respect to a legal entity, while requirements may vary depending on the type of entity, in general, the existence of the entity must be established as well as the name and address of any beneficial owner (but, again, not nationality). In addition, for account holders and recipients in Australia, a bank would generally need to know whether the person was a foreign company, trust or partnership. An estate here would normally be held in trust. A bank would also know if an individual was non-resident (as residential address must be verified), and may also have other obligations in such cases under Politically Exposed Persons requirements. However, none of these existing requirements would generate information that a bank could use to determine whether or not a person is a US taxpayer or substantially owned by US taxpayers as required by the Bill.

not appear to have any relevance to the customer, which would be the case for the typical Australian deposit holder.

Furthermore, existing customers may not be willing to provide the requisite certifications or representations to a bank, particularly if they are not expecting to earn any material amounts of US-source income or to receive the gross proceeds from the disposition of investments that give rise to US-source income. Such customers may be unwilling to do so for any number of legitimate reasons, including concerns over identity theft and basic privacy, rather than any intention of avoiding US federal income tax.

Even with respect to new accounts, it may be commercially impractical for an Australian bank operating outside of the US to attempt to compel a potential new customer to provide a US taxpayer certification when such customer has no connection to the US or interest in investing in US securities.

Another context in which it would be difficult, if not impossible, to obtain the requisite information is with nominee entities or custodians. The Bill as currently drafted defines an account to include any equity or debt instrument issued by the financial institution that is not regularly traded on an established securities market.

There is significant concern about how Australian banks can identify whether their securities holders are US persons or United States owned foreign entities when a number of the registered holders will be nominee companies or custodians. Similarly, a number of customers of an Australian bank may be other financial institutions holding on behalf of their own customers. These nominees and custodians may choose not to provide customer information for a number of reasons, including not wanting to hand the names of customers over to a potential competitor. Furthermore, in a tiered structure, banks may be unable to obtain information regarding "substantial US owners" of its customers' foreign owners. In addition, it is unclear, in all of these cases, who in the chain of ownership or payments would bear the primary responsibility for information reporting and withholding.

There are obviously a number of different ways that Congress could address these concerns, some of which various commentators have already suggested. These include allowing foreign financial institutions to rely on existing information in their files, using existing "know-your-customer" and anti-money laundering procedures, expanding the minimum account balance exception so that banks can reasonably eliminate significant portions of their customer base that do not pose a US tax evasion risk,[2] allowing foreign financial institutions to rely on certifications made by other financial institutions and/or providing for clear "safe harbours" of conduct so that inadvertent mistakes do not lead to disproportionate

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[2] The proposed de minimus amounts ($50,000 for existing accounts and $10,000 for new accounts) are inadequately small and require an aggregation of accounts of subsidiaries and branches worldwide (which would in itself require significant upgrades and linkages of existing systems). Accordingly, we do not believe that this exception as currently proposed provides much relief.

sanctions. This is an area where explicit authority should be granted to Treasury to write regulations and agreements with the banks that would enable banks to comply in the most practical way possible while still focusing on the key areas with which Congress is concerned.

Information Required to be Provided about US Accounts. As currently drafted, the proposed Section 1471(c)(1) would require a foreign financial institution to report gross receipts, gross withdrawals and payments from an account and would give the Treasury discretion only to determine for which periods and in which manner to provide such information. Current systems generally lack the capability to record and report such information on a periodic basis. Such a requirement would be particularly onerous for our member banks, and it is not clear whether the additional information provided would be more than marginally beneficial to the IRS. The requirement could generate an enormous amount of unhelpful information, particularly in situations where a customer is maintaining a custodial account to hold securities. Considering the amount of transfers people routinely make between accounts, and the fact that as a result, multiple accounts would be generating redundant information with respect to a particular taxpayer, Congress should remove this requirement under Section 1471(c)(1)(D) and authorise the Treasury to designate the information it requires to be reported under Section 1471.

Significant Costs of Compliance. We would like to emphasise the very significant costs that each bank would have to incur in order to comply with the requirements of the Bill. These costs would include hiring numerous additional employees, the development of sophisticated IT systems capable of tracking and processing the required information across a large number of jurisdictions around the world and over a large number of existing platforms, the development of procedures across affiliated companies to produce consistent and compliant information reporting, and the training of branch managers and account officers in subsidiaries and branches worldwide to familiarise them with the new requirements and procedures. We would also like to emphasise that, after all of this work, we believe the number of "US Accounts" that will be found in Australia would be relatively small, even including the non-Australian operations of Australian banks.

Due to the significant costs of compliance and the potential difficulties in obtaining the requisite information from current and future customers, foreign financial institutions (particularly smaller ones) that would otherwise be willing to enter into information sharing agreements with the Treasury under the proposed Section 1471(b) and that have no interest in facilitating tax evasion may find that they are economically compelled to abstain from such arrangements and to dispose of their US investments (both for their own account and for their customers). This would pose a significant challenge to the US government and US businesses at a time when they are seeking to attract capital, particularly from international financial markets. Accordingly, Congress should consider whether changes can be made, or authority given to the Treasury, to provide exceptions that would lower the costs of compliance. Furthermore, as many others have noted, in light of the significant infrastructure and procedural changes that will need to be implemented, January 1, 2011 is an unrealistic effective date. We support the proposals to give the Treasury authority to set the effective date based on the development of regulations and model agreements. Finally, we would like to note that, with respect to foreign financial institutions that are already participants in the Qualified Intermediary ("QI") program, the Bill proposes to add requirements in addition to those already imposed under the QI program. We encourage Congress to allow QIs to use their existing systems to comply with the QI program and, other than in abusive cases, exempt QIs from the Bill's proposals.

Conflict with Local Legal Requirements. The Bill as currently drafted contemplates the sharing of personal client information with the US government, as well as between affiliated companies across multiple jurisdictions. It may be a violation of the privacy and confidentiality laws of various countries for a bank to comply with such disclosure and information sharing requirements. In particular, while we have not had the opportunity to evaluate this issue in depth with Australian or New Zealand legal counsel, we believe the relevant banking laws of Australia and New Zealand may prohibit banks in their jurisdictions from sharing customer information without the consent of the customer. Furthermore, the Bill's proposed solution to this issue (*i.e.*, refusing to open, or closing an existing, account) might contravene other local requirements, such as those in Canada,[3] to provide bank account facilities where a potential customer has provided sufficient proof of identification for the purposes of that jurisdiction. Congress should consider whether diplomatic measures should be taken to facilitate the implementation of the Bill. Otherwise, a number of banks may find themselves trapped between conflicting laws.

B. Repeal of Exemption from Registration Requirements for Foreign-Targeted Bearer Bonds

Section 102 of the Bill would repeal the present exemption from sanctions under the TEFRA rules for foreign-targeted bearer bonds. As proposed, the Bill would expose non-US issuers issuing debt in non-US jurisdictions — for example Australian banks accessing the European bond markets — to a significant excise tax if the bonds, as is typically the case in Europe, are in bearer form for US federal income tax purposes.

We note that such bonds are customarily registered in a clearing system and commonly recognised as registered except by the IRS. We do not believe that the imposition of an excise tax is appropriate in these circumstances and would encourage Congress to consider an exemption for such situations, whether such exemption is based on the identity of the issuer or based on relaxing the definition of what is considered registered in order to be consistent with existing clearing and settlement systems.

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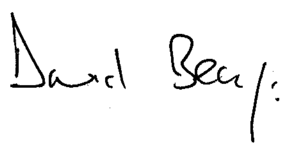
3 We have in mind Canada's Access to Basic Banking Services Regulations.

The ABA appreciates the opportunity to share its concerns regarding the Bill. We would be happy to discuss these comments with you further or to assist you in any other way.

Yours sincerely



David Bell

cc:

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The Honorable Kent Conrad
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The Honorable Pat Tiberi
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