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United States Senate

COMMITTEE ON
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

WASHINGTON, DC 20510–6250

January 11, 2012

VIA U.S. MAIL & EMAIL (Floyd.Williams@IRS.gov and Sandra.Salstrom@treasury.gov)

The Honorable Douglas H. Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Ms. Emily McMahon
Acting Assistant Secretary for Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

RE: Notice 2011-34: Implementing the Foreign Account Tax Compliance Act

Dear Commissioner Shulman and Ms. McMahon:

The purpose of this letter is to comment on Notice 2011-34 which proposes draft guidance addressing the implementation of new reporting and withholding requirements under Chapter 4 of Subtitle A of the Internal Revenue Code, the Foreign Account Tax Compliance Act (FATCA), enacted as part of the Hiring Incentives to Restore Employment Act of 2010, P.L. 11-147. These comments seek to encourage the development of guidance that will assist foreign financial institutions in meeting their legal obligations, while facilitating law enforcement's use of foreign account information to combat tax evasion, money laundering, and other misconduct.

Notice 2011-34 presents a set of revised guidance provisions and requests comment on a variety of issues important to the effective implementation of FATCA. This letter addresses eight of those issues: (1) it supports certain revised definitions and other provisions that strengthen the obligation of foreign financial institutions (FFIs) to review their anti-money laundering (AML) and know-your-customer (KYC) account documentation; (2) it advocates a better method for determining account balances; (3) it recommends corrections to the required FFI review of Private Banking Accounts; (4) it recommends 45-day and 90-day deadlines for new and existing recalcitrant accountholders to provide requested documentation; (5) it identifies possible sanctions for recalcitrant accountholders; (6) it discusses what FFIs should be deemed compliant with the Act; (7) it supports the creation of FFI Groups, while opposing the inclusion in those groups of non-participating FFI affiliates; and (8) it supports the designation of U.S. shareholders of a controlled foreign corporation (CFC) that is an FFI to function as the CFC's lead or Compliance FFI under certain conditions. This letter also urges treating FATCA offshore account information as non-tax return information to ensure its accessibility to law enforcement and national security communities combating crimes other than tax evasion.

(1) Strengthened Definitions

The Notice contains several revised definitions that have been clarified or strengthened to advance FATCA's objective of ensuring the disclosure of U.S. accounts at FFIs.

First, the definition of "private banking account," has been strengthened by including "any account held by any entity, nominee, or other person to the extent the account is associated with the private banking relationship with an individual client." This definition makes clear that accounts opened by U.S. persons but held in the name of, for example, an offshore corporation, trust, trustee, attorney, or corporate or trust service provider must nevertheless be disclosed by FFIs as U.S. accounts. This change is an important one to ensure that private banking accounts that have been opened by U.S. persons but held in the name of an offshore entity or other nominee are reported to the IRS. The guidance should be further strengthened by explicitly applying this same principle to all types of financial accounts, not just private banking accounts.

Second, the definition of "documentation" has been clarified by indicating that it includes "all information in written or electronic form ... that is collected in connection with a financial account (e.g., for purposes of ... complying with regulatory or AML/KYC requirements)." This clarification is critical to ensuring that FFIs review documents they've collected in response to their own country's AML and KYC requirements to determine whether an account is held by a U.S. person. Reviewing this information will not impose additional costs; in fact, it may save both time and resources by ensuring FFIs utilize the information they have already collected in connection with their accounts. In addition, it may improve AML compliance by fostering the sharing of AML/KYC information across an FFI's internal departments. This clarified definition should help ensure that FFIs routinely review their own AML/KYC documentation when analyzing accounts for purposes of FATCA compliance.

Both of these revisions represent important improvements to the FATCA guidance and should be retained.

(2) Preexisting Accounts

The Notice presents revised procedures for FFIs to use in reviewing their preexisting accounts to determine which are U.S. accounts that must be disclosed under FATCA.

(a) Documented U.S. Accounts

The Notice presents as "Step 1" treating as U.S. accounts "[a]ll account holders already documented as U.S. persons for other U.S. tax purposes." Essentially, this step allows FFIs to use any W-9 or W-8 forms that already identify U.S. accountholders or beneficial owners. This common sense starting point could be made even more efficient and effective, however, if it applied to all accountholders already documented as U.S. persons "for U.S. tax purposes or under an FFI's preexisting AML/KYC procedures." Many FFIs already have AML/KYC procedures in place that have determined whether a particular accountholder or beneficial owner of an account is a U.S. person. Step 1 should make use of those preexisting procedures, paperwork, and determinations.

(b) Accounts of $50,000 or Less

The Notice presents as "Step 2" treating accounts with $50,000 or less as non-U.S. accounts. A key issue here and throughout the Notice, however, is how to determine the account balance or value. The Notice indicates in Section IV(A), that Treasury and IRS have determined to take a new approach to this issue by requiring account balances to be determined as of year-end. This approach represents a substantial weakening of the original approach in Notice 2010-60, which required FFIs to use the highest month-end balance during the covered year as the account balance or value. Notice 2011-34 explains that the new approach was adopted, because some FFIs do not track month-end balances for clients and would incur prohibitive costs to set up such a tracking system.

The problem with the new approach, however, is that it is highly susceptible to manipulation, has proven untrustworthy in the past, and could easily defeat FATCA's disclosure obligations. Accountholders could simply transfer some or all of the funds from their accounts prior to the last day of the year to get under the $50,000 figure, redeposit the funds the day after, and thereby avoid reporting any funds on the end-of-the-year reporting date. The same is true for other guidance provisions reliant on an account balance or value. This proposed change is a very troubling aspect of Notice 2011-34.

The potential for abuse could be easily remedied by using an alternative, low-cost approach already used for U.S. taxpayers required to file Foreign Bank Account Reports (FBARs). In the FBAR, taxpayers are currently required to report the "maximum value of account during calendar year reported."[1] In FATCA reporting forms, which are also due on an annual basis, the amount used to determine the account balance or value could be the maximum value of the account attained during the covered 12 month period. Keeping track of the highest balance in a client account over the course of a year would not be difficult for any FFI; a software or paper-based system could easily retain this single figure. In addition, this method for determining the account balance would be easy to explain and verify, would not require calculations or monthly recordkeeping, and would provide highly useful information to Treasury and the IRS.

This method of determining account balances was chosen for FBARs after reports of persons manipulating the amount of funds in their accounts at the end of the year to avoid FBAR reporting requirements. That manipulation became ineffective once the FBAR reporting standard was revised to its current form. The same problem would likely plague FATCA if it were to use the discredited approach that the FBAR has already abandoned and replaced. If FATCA's implementing rules were instead to utilize the same "maximum value" approach now used on the FBARs, it would not only offer a bright-line, easy to understand rule, but also have the added advantage of allowing Treasury and the IRS to verify an account balance reported under FATCA by cross-checking the value reported on an account holder's FBAR.

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[1] Form TD F 90-22.1. See also 31 U.S.C. § 5314; 31 C.F.R. § 103.24.

(c) Private Banking Accounts

The Notice presents as "Step 3" a series of procedures for FFIs to review their existing private banking accounts. These accounts are of particular interest since they are, by nature, high dollar accounts and the identity of the account holder should be known to the FFI.

The guidance has been strengthened by stating explicitly that a private banking manager must identify "any client ... for which the private banking manager has actual knowledge that the client is a U.S. person." It also states that an FFI may not "rely on any documentation received from a client or from an individual holding an account associated with the client if the private banking relationship manager knows or has reason to know that the information contained in such documentation is unreliable or incorrect." Both of these provisions are improvements that will help identify U.S. accounts. Both, however, also contain technical defects that currently fail to address the situation in which an account "client" is an entity or nominee being used to conceal the identity of the true accountholder. In that circumstance, which is common in cases of wrongdoing, the relationship manager could decide that the "client" is a non-U.S. corporation, trust, attorney, or corporate service provider, and that FATCA does not require any effort to look behind that client to determine whether the beneficial owner of the account is a U.S. person. Those problems could be easily remedied.

Documentation Instead of Records. The first technical defect is that Step 3(A)(ii) requires the private banking relationship manager to "perform a diligent review of the paper and electronic account files and other records for each client" (emphasis added) and to identify each client that has certain information indicating a relationship to the United States. The provision, as currently drafted, uses the term "records" instead of the key term, "documentation," which the guidance defined earlier as including an FFI's AML/KYC records. By using the word "records" instead of "documentation," the provision imposes no obligation on the private banking relationship manager to review the AML/KYC records for each client. To correct this problem, the provision could easily be reworded to require the relationship manager to "perform a diligent review of the paper and electronic account files and other account documentation for each client". Using "documentation" in the provision would ensure that the relationship manager would have to review each client's AML/KYC records.

Beneficial Owners Instead of Family Members. The second technical defect is that Step 3(A)(ii) requires private banking relationship managers to "identify each client (including any associated family members) who, to the best of the knowledge of the private banking relationship manager" has certain connections to the United States. The problem here is that the provision fails to address the situation where the "client" is an entity or nominee being used to conceal the account's true owner. To address that situation, the provision should be revised to require private banking relationship managers to "identify each client (including any beneficial owner or family member associated with an account opened in the name of an entity or nominee)". Use of the term "beneficial owner," which is an internationally recognized term of art, would ensure the relationship managers identify the true owners behind any nominal accountholder.

W-8 Forms Plus AML/KYC Documentation. The third problem involves the rule's treatment of W-9 and W-8 forms. W-9 and W-8 forms are one-page IRS forms that provide very basic information about an account, primarily the accountholder's name, address, and taxpayer identification number. W-9 forms are supposed to be filed by U.S. persons, while W-8 forms, of which there are several variations, are supposed to be filed only by non-U.S. persons who are the beneficial owners of the accounts in question. The W-8 forms also require identification of a beneficial owner's country of residence.

In Step 3, the guidance indicates that FFIs may rely on the W-9 and W-8 forms submitted by a private banking accountholder to determine whether an existing private banking account should be deemed a U.S. account that must be disclosed to the IRS, unless the "relationship manager knows or has reason to know that the information contained in such documentation is unreliable or incorrect." The guidance provides further that, if the Step 3 review reveals U.S. indicia, FFIs are required to request additional documentation from the accountholder.

The problem here is that existing IRS regulations explicitly permit non-U.S. corporations and trusts to file W-8 forms, even if the foreign corporation is beneficially owned by a U.S. person or the foreign trust has U.S. beneficiaries. If the foreign corporation or trust completes a W-8 form using an address in a non-U.S. country where account information can be sent – such as the address of a corporate or trust service provider in a tax haven jurisdiction – the FFI could then presumably treat those forms as containing reliable information and treat the accounts as held by non-U.S. persons. The FFI would never have to review additional account documentation that might reveal that the nominal accountholder is concealing a U.S. person.

To remedy this problem, the guidance could simply require the relationship manager, in connection with any W-8 form, to also review the AML/KYC documentation for the private banking account and any related accounts within the bank to identify the account's beneficial owners and determine whether they are U.S. persons. Allowing FFIs to rely on W-8 forms provided in connection with private banking accounts, without explicitly requiring them to also examine the account's AML/KYC records disclosing the account's beneficial owners, would essentially defeat the purposes of the Act.

(d) Accounts with U.S. Indicia

The Notice presents as "Step 4" a review by the FFI of accounts with "U.S. indicia." The proposed guidance identifies these accounts as those which have not been reviewed under the previous three steps and which "electronically searchable information maintained by the FFI" for those accounts include any of six characteristics, including identification of the accountholder as a U.S. resident or citizen; a U.S. place of birth for the accountholder; a U.S. residence or correspondence address; standing instructions to transfer account funds to a U.S. account; a hold mail address; or a power of attorney or account signatory by a person with a U.S. address.

These six characteristics offer common sense ways to identify accounts that may have been opened by a U.S. person. In addition, the proposed guidance makes clear that electronically searchable information includes "an FFI's primary files for maintaining account holder information, such as information used for contacting account holders and for satisfying

AML/KYC requirements." Explicit reference to the FFI's AML/KYC documentation will help ensure that it uses that existing account information to identify the beneficial owners of each account and to uncover any other U.S. indicia. The provision could be further strengthened if it were to state that FFIs may not keep account documentation in paper form to defeat the requirements of Step 4.

The Notice proposes giving FFIs one year from the date of its FATCA agreement to request documentation from accountholders to determine whether an account with U.S. indicia is, in fact, a U.S. account. The Notice proposes giving accountholders another whole year to respond, requiring them to be classified as "recalcitrant account holders" only when they "have not provided appropriate documentation within two years" of the FFI's agreement. As discussed further below, those time periods are excessive, are out of line with the time periods that banks normally use to obtain KYC documentation from accountholders, and would unnecessarily delay FATCA implementation. They would also give hidden U.S. accountholders two more years to conceal their assets from the IRS.

(e) Accounts of $500,000 or More

The Notice presents as "Step 5" requiring FFIs to perform a "diligent review" of all accounts with a balance or value of $500,000 or more at the end of the year preceding the date of the FFI's FATCA agreement, if the accounts have not already been reviewed under the previous four steps. This proposal is an efficient means of focusing FFI attention on key accounts. The proposed Step 5 should be strengthened, however, by changing how the account balance or value is determined, as suggested in connection with Step 2. The account balance or value should be determined by the maximum value in the account during the relevant year. In addition, the Notice proposes giving accountholders two years to provide the requested account information, a time period that is, again, excessive, extends much longer than the time periods banks normally use to obtain KYC documentation from accountholders, would unnecessarily delay FATC implementation, and would provide hidden U.S. accountholders with another two years to conceal their assets from the IRS.

(f) Minimizing Accounts Subject to Step 5

The Notice solicits comment on appropriate ways to modify its procedures so that the private banking test in Step 3 applies "whenever practical, to the accounts of high-net-worth individuals and individuals who receive from FFIs services of the type described in Section I.A.1(3)(D)(i) in the definition of a private banking department and thereby reduce the number of accounts that will be subject to Step 5." Minimizing use of Step 5 to reduce FFI costs makes sense, but will be appropriate only if the prior steps take needed measures to establish beneficial ownership of the affected accounts. FATCA's effectiveness will depend in large part upon FFIs looking past the nominal owners of their accounts to identify the true owners, and disclosing to the IRS the accounts beneficially owned by U.S. persons. The key to effective identification of an account's beneficial owners is to require FFIs to review their existing AML/KYC documentation, which is designed to look past any account nominee, shell corporation, or other account owner of record and instead ascertain the true owner of the account assets. Unless Steps 3 and 4 require review of AML/KYC documentation for all accounts in which a W-8 form has

been filed, thereby necessitating a review of the beneficial ownership information already in the possession of the relevant FFI, Step 5 will be critical to determine the actual ownership of the accounts.

The Notice also solicits comment on whether the same Steps should be applied to accounts other than bank and brokerage accounts. Since they represent a logical, efficient, and effective method for reviewing existing accounts to determine whether they are U.S. accounts that need to be disclosed under FATCA, the same methodology should be broadly applied to all other types of financial accounts subject to FACTA, including private placement life insurance accounts, hedge fund accounts, and private equity accounts.

(3) Recalcitrant Account Holders

Section 1471(c) of FATCA requires each participating FFI to provide information about each U.S. account covered by an FFI Agreement, including the name, address, taxpayer identification number of the relevant account holders; and, in the case of any account holder which is a U.S.-owned foreign entity, the name, address, and taxpayer identification number of each substantial United States owner of such entity. Under section1471(b)(1)(D)(I), if an FFI is unable to obtain the required information from a recalcitrant accountholder, the FFI must withhold 30% of certain payments made to the relevant account and forward that money to the IRS.

Under the proposed guidance, recalcitrant accountholders are accountholders that either: (a) fail to comply with reasonable requests for information by the FFI to comply with its FATCA disclosure obligations; or (b) fail to provide a waiver when a waiver is required by foreign law before an FFI can obtain and disclose the required client information to the IRS.[2] Under the proposed terms of the FFI Agreement, if a U.S. accountholder were to refuse to provide a waiver required by foreign law before account information can be disclosed by the FFI to the IRS, the FFI would be required to close that account. The Notice states that Treasury and the IRS continue to consider what measures should be taken to address long-term recalcitrant accounts, including whether, and in what circumstances, FFI Agreements should be terminated due to the presence of recalcitrant accountholders after a reasonable period of time.

(a) 45-Day Deadline for New Accounts

FFIs that are generally compliant with FATCA should not be penalized because a few accountholders fail to promptly provide required client-specific information. Instead, the FFI should be able to provide a recalcitrant accountholder with a reasonable period of time to provide requested information, without the FFI's being considered in violation of its FFI Agreement. If the accountholder then fails to provide the information by the end of that time period – whether by not supplying a required waiver or providing the information itself -- the FFI should then be required to close the account.

Account opening procedures for new accounts typically require specified information and documentation to be provided either prior to opening the account or within a relatively short time

[2] See Section 1471(d)(6).

period after the account opening. Virtually no bank waits an entire year to obtain new account documentation, particularly KYC information required to combat money laundering and terrorist financing. It is also important to note, as both Notice 2011-34 and Notice 2010-60 explain: "withholding with respect to recalcitrant account holders is intended to provide relief for participating FFIs that would not otherwise be able to collect the information required to comply with their obligations under their FFI Agreements. It should not, however, become a permanent substitute for collecting and reporting information with respect to U.S. accounts."

The key to an effective procedure under FATCA is for the guidance to establish a mandatory deadline, such as 45 days after a new account is opened, for the FFI either to transmit the necessary account information to the IRS or close the account. That mandatory deadline would ensure that the FFI has a clear understanding of its obligations under FATCA, would provide a bright line standard for measuring FFI compliance with the Act, and would provide an appropriate penalty for recalcitrant accountholders – loss of their account. The 45-day period would also limit the amount of time that a U.S. accountholder could open and make use of funds in an FFI account without disclosure to U.S. authorities; any longer period of time would increase the opportunity for misuse of the account. It is also worth noting that new accountholders who delay providing information about their U.S. status present an increased risk of tax evasion or other misconduct; allowing them a lengthy period to comply with account opening documentation requirements would only increase that risk.

The guidance should not only provide a 45-day mandatory deadline for reporting new accounts, it should also prohibit an FFI, after the deadline, from sending the IRS withheld account funds in lieu of the required account information. FATCA's objective is to combat offshore secrecy; it is not intended to allow FFIs to provide accounts on an ongoing basis to hidden recalcitrant accountholders. The proposed guidance has already established a delayed effective date, to January 1, 2013, to ensure FFIs have ample time to inform their accountholders of the FFI's upcoming disclosure obligation, to establish the infrastructure needed to meet the new disclosure obligation, and to promptly close all undeclared accounts.

(b) Possible Sanctions

The Notice requests comment on what sanctions should be applied to FFIs that keep long-term recalcitrant accounts as customers, presumably in violation of FFI Agreement provisions requiring closure of those noncompliant accounts. The most obvious sanction would be to terminate the relevant FFI Agreement, which would then trigger the 30% withholding requirement. For this sanction to be effective, however, Treasury and the IRS would need to design a system that would effectively alert all U.S. withholding agents to an FFI's changed status under FATCA. Without that notice, U.S. withholding agents would be unaware of the need to withhold funds from payments to the FFI.

To encourage closure of long-term recalcitrant accounts, establishing an escalating set of sanctions culminating in the termination of an FFI Agreement would also make sense. One alternative would be to establish a system of automatic monetary penalties designed to encourage an FFI to come into compliance as quickly as possible with its FATCA disclosure obligations. That system could, for example, impose automatic monetary penalties whose amount would be

linked to the number and duration of the recalcitrant accounts and which would be paid through withholding on the offending FFI's U.S. payments, unless the FFI closed the accounts held by the recalcitrant accountholders by a date certain. Those amounts could be withheld, for example, from any interest owed on U.S. Treasury bonds, since payment of those amounts may be under the effective control of U.S. bank regulators.

In addition, Treasury and the IRS should consider establishing an even stronger sanction than terminating an FFI Agreement, such as one modeled after Section 311 of the Patriot Act, which would allow Treasury to prohibit U.S. financial institutions from doing business with an FFI in knowing violation of an FFI Agreement. That sanction could include, for example, prohibiting U.S. financial institutions from accepting wire transfers from the FFI, sending wire transfers to the FFI, or honoring any credit, debit or prepaid card issued by that FFI.

(c) 90-Day Deadline for Existing Accounts

The Notice currently suggests that after signing an FFI Agreement, an FFI's existing accountholders who are individuals be allowed to withhold needed documentation to establish their status as U.S. persons for one year, before being deemed a "recalcitrant account holder." Existing accountholders that are entities – such as corporations, partnerships, or trusts -- would be given two years. These proposed delays are excessive, unnecessary, and unwise.

Given that FATCA already provides FFIs with 3 years before they have to come into compliance with the statute, providing FFIs with one or two more years to identify their U.S. accountholders would discourage prompt FATCA compliance. FFIs are already hard at work notifying their clients of their upcoming FATCA disclosure obligations. In addition, most financial institutions already have AML/KYC data establishing who their U.S. clients are. Giving accountholders another year or two to respond to requests for documentation would undermine incentives for FFI's to provide disclosure information to the United States on a prompt and comprehensive basis. It would also enable hidden accountholders one to two more years to conceal their assets from the IRS while developing and executing new plans to continue that concealment.

Most banks typically require accountholders to respond to requests for information or documentation within a 30 to 60 day time period. As pointed out earlier, virtually no bank gives clients an entire year to respond to an information request, particularly for KYC information required to combat money laundering and terrorist financing. Moreover, existing accountholders who delay providing information about their U.S. status present an increased risk of tax evasion or other misconduct; giving them a year or longer to respond would only increase that risk.

A deadline of 60 days would be a more appropriate time period for existing accountholders to submit any requested documentation before being deemed a recalcitrant account holder, especially since FFIs likely already know, pursuant to their AML/KYC obligations, the beneficial owners of their existing accounts. Recalcitrant account holders of existing accounts could then be given an additional limited time period of 30 days before their accounts would be closed.

(4) Passthru Payments

The Notice provides new guidance on the obligations of FFIs to withhold certain amounts from "passthru payments" directed to recalcitrant accountholders or nonparticipating FFIs. The proposed guidance correctly rejects the suggestion that FFIs withhold funds only from clearly withholdable payments or payments that are directly traceable to a withholdable payment. That clarification is an important strengthening measure in the revised guidance. The rejected approach would otherwise allow FACTA to be easily circumvented, for example by running payments through "blocker" entities such as a participating FFI or an offshore entity prior to the funds being deposited into a nonparticipating FFI account. Allowing such circumventions could easily defeat the purpose of the law. The proposed rule instead offers several alternative methods for withholding appropriate amounts from passthru payments.

(5) Deemed Compliant Financial Institutions

The Notice requests comment regarding "certain categories of FFIs" that Treasury and the IRS plan to designate as "deemed-compliant FFIs" under section 1471(b)(2). The Notice indicates that such FFIs will have to apply to the IRS for "deemed-compliant status," obtain an FFI identification number, and certify to the IRS every three years that they continue to meet the requirements for that treatment under FATCA.

Three Proposed Categories. One such proposed category is a local network of affiliated FFIs whose members all operate within the same country, do not solicit accountholders from outside the country, and have policies and procedures to ensure that none of the network members open accounts for non-residents, nonparticipating FFIs, or NFFEs. A second category is a similar local network of affiliated FFIs in which all of the members agree to send any U.S. account, nonparticipating FFI account, or NFFE account to a participating FFI within the network, or else close the account or itself become a participating FFI. A third proposed category involves "collective investment vehicles" or funds in which all "holders of record" are participating FFIs, deemed-compliant FFIs, or certain government or international bodies; which prohibits any others from investing; and which promise to treat all passthru payments in accordance with FATCA. While these proposed categories make sense, policing compliance with their commitments will likely be difficult.

Exchange Traded Securities. The Notice also indicates that Treasury and the IRS are considering "under what circumstances certain foreign entities, all the interests in which are regularly traded on an established securities market (e.g., exchange-traded funds (ETFs)), could be deemed compliant." This proposal has potentially a very broad sweep and raises significant concerns. Since such foreign entities normally operate internationally and produce exchange traded securities that can be sold freely to an unlimited range of individuals and entities, treating those foreign entities as deemed compliant FFIs may be unworkable and unwise. A better approach would be to treat such foreign entities in the same manner as mutual funds, securities firms, and banks, requiring them to complete the same types of FFI Agreements with the same types of disclosure obligations.

Foreign Retirement Plans. Notice 2011-34 indicates that Treasury and the IRS plan to exempt payments by "foreign retirement plans" from FATCA withholding requirements, because such plans pose "a low risk of tax evasion" under Section 1471(f)(4). The Notice indicates that the agencies are still considering the types of foreign retirement plans that would qualify for this exemption. The proposed exemption may make sense for well-established retirement plans at large non-U.S. employers, but could open the door to abuse if provided to new retirement plans set up for shell operations or even nonexistent employers.

To prevent misconduct, Treasury and the IRS should propose a clear set of principles to identify eligible foreign retirement plans. Appropriate criteria might include retirement plans that have been in existence for at least one year, are registered with a government agency, operate under government oversight, and certify that they accept only company employees as plan participants. In addition, the criteria should limit eligible foreign retirement plans to those which can establish that they apply to employees of a business with a physical existence in one or more countries. Foreign retirement plans for businesses that have no physical presence in any country should be ineligible for the exemption due to the high risk of fraud and abuse. Treasury and the IRS may also want to consider requiring foreign retirement plans, as a condition to obtaining a FATCA exemption, to agree in writing to conduct an initial and periodic review of their plan participants to identify any U.S. persons; disclose any such U.S. persons to the IRS; and not to participate in transactions designed to help its participants conceal assets, circumvent FATCA disclosure obligations, or avoid or defer the payment of taxes.

(6) Expanded Affiliated Groups of FFIs

The Notice states that Treasury and the IRS intend to provide an affiliated group of FFIs, all of whose members are participating or deemed-compliant FFIs, with the ability to register as an "FFI Group" and designate a "lead FFI" as a central point of contact with the IRS. Each affiliate could have branches or offices in multiple countries. The Notice indicates that an FFI Group would be allowed to apply for this status through a coordinated application process. The lead FFI would complete the application, provide specified information about each FFI in the group, and submit documentation showing that each affiliate has agreed to the provisions of a group-wide FFI Agreement. Each FFI affiliate would then be assigned its own FFI-EIN identification number, and would be responsible for its own due diligence, withholding, and reporting obligations. The lead FFI would be responsible for communicating FATCA concerns to the Group's affiliates. This proposal offers a common sense and cost-effective approach for both the IRS and the FFI Group's members to interact with each other, but will require the designated lead FFI to agree to devote the resources needed to engage in an ongoing effort.

The Notice also indicates that Treasury and the IRS are continuing to study "whether and under what conditions it may be possible to allow an FFI Group to include one or more non-participating FFI affiliates." Enabling FFI Groups to include non-participating FFI affiliates would be ill-advised, since it would significantly ease the pressure on all members of the group to accept the FFI Agreement, would enable the non-participating FFIs to claim association with and operate under the umbrella of a participating group, would keep non-participating FFIs informed of IRS activities under FATCA, and could make it easier for non-participating FFIs to conceal assets belonging to U.S. persons. Including FFIs who refuse to accept FATCA's

disclosure obligations within an otherwise compliant FFI Group would undermine effective FATCA implementation and open the door to abuses even within groups professing to disclose all of their U.S. accounts.

The Notice indicates that Treasury and the IRS also intend to provide FFI Groups with a "centralized compliance option" in which some or all of the members of the group could designate an affiliate as their "Compliance FFI" that would assume certain compliance and oversight responsibilities on their behalf. For example, the Compliance FFI could develop FATCA policies and procedures for those affiliates, ensure their compliance with those policies and procedures, and report to the IRS on behalf of each such affiliate. Again, this arrangement offers common sense and cost-effective efficiencies, so long as the arrangements are clear and the Compliance FFI agrees to devote the resources needed to carry out its responsibilities. To clarify what affiliates are participating and what duties will be assigned to the Compliance FFIs, the FFI Agreement for the group should include a written addendum setting forth the compliance arrangements. To ensure that the compliance arrangement is an efficient one, Treasury and the IRS may want to require all FFIs in a particular country to participate or specify a minimum number of affiliates per Compliance FFI. If an FFI Group has more than one Compliance FFI, Treasury and the IRS may want to require that all such Compliance FFI's coordinate their policies and procedures, and operate in a consistent manner to the maximum extent practicable. In addition, Treasury and the IRS will need to develop methods to determine whether Compliance FFIs are actually carrying out their obligations.

The Notice seeks comment on whether Treasury and the IRS should allow U.S. shareholders of a controlled foreign corporation (CFC) that is an FFI to function as the lead or Compliance FFI. This approach could potentially apply to a wide variety of CFCs. Some CFCs controlled by U.S. persons are shell entities functioning as hedge funds, private equity funds, venture capital funds, or investment funds servicing one or more investors. These shells may have affiliates in other countries. Some of these CFCs have a physical presence only in the United States, despite claiming status as foreign entities. Their shareholders may be U.S. individuals, partnerships, trusts, mutual funds, or other entities. Other CFCs are subsidiaries of U.S. parent corporations and function as cash management and investment vehicles for the parent corporation's foreign affiliates. While some of those CFCs have a physical presence abroad, others have no physical office of their own in any jurisdiction and are run by employees of their U.S. parent corporation.

The distinguishing feature of all of these CFCs is that they have U.S. shareholders and a direct nexus to the United States. It makes sense for Treasury and the IRS to require or allow a CFC's U.S. shareholders to take on the responsibilities of a lead or Compliance FFI, even if those U.S. shareholders are not, themselves, FFIs, since such persons are directly subject to the legal authority of both agencies. At the same time, to carry out the responsibilities of a lead or Compliance FFI, the U.S. shareholders should have to demonstrate either a minimum level of competence or demonstrate their willingness to hire an agent with FATCA competence to carry out those duties. To clarify the arrangements, Treasury and the IRS should require the U.S. shareholders to enter into a written agreement on how they would carry out the duties of a lead or Compliance FFI for their CFC, including ensuring that any account held by a U.S. person is disclosed to the IRS.

(7) Treating FATCA Disclosures As Non-Tax Return Information

Finally, one additional issue is critical to successful implementation of FATCA's disclosure obligations: treating FATCA offshore account information as non-tax return information to ensure its accessibility to law enforcement and national security communities combating crimes other than tax evasion.

Although FATCA is structured to address offshore tax abuse, offshore account information has significance far beyond the tax context, affecting cases involving money laundering, drug trafficking, terrorist financing, acts of corruption, financial fraud, and many other legal violations and crimes. Given the importance of offshore account disclosures, FATCA guidance and implementing rule should create account FATCA forms that are not designated as tax return information but, like FBARs, may be provided to law enforcement, regulatory, and national security communities upon request. FFIs are not, after all, U.S. taxpayers, and will not be supplying tax information on behalf of their U.S. clients; they will instead be providing information about accounts opened by U.S. persons. The U.S. Supreme Court has long held that bank account information is not inherently confidential but is subject to inspection by law enforcement and others in appropriate circumstances. Foreign account information is too important to a wide range of civil and criminal law enforcement and national security efforts to be designated as tax return information bound by Section 6103's severe restrictions on access. FFI forms, like FBARs, provide account information rather than tax return information, and should be made available to the larger law enforcement and national security communities. Similarly, FFI Agreements, auditor verification forms, copies of actual account documentation, and similar materials should be treated as non-tax return information available to the larger law enforcement, regulatory, and national security communities.

In addition to giving FFI forms the same status as FBAR forms, the implementing rules should construct those forms to ensure that they collect and produce account information in a standardized electronic format that will enable efficient analysis of data. Treasury and the IRS should consult with IRS analysts and revenue agents as well as the Tax Division of the Justice Department to determine how the collected information should be structured to provide timely and usable data in tax enforcement efforts. Treasury and the IRS should also consider making the FFI data compatible with the existing FBAR database so that the two sets of forms can be easily analyzed in an integrated fashion.

Thank you for this opportunity to comment on the FATCA Notice.

Sincerely,

Carl Levin

Carl Levin
Chairman
Permanent Subcommittee on Investigations