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January 8, 2010

The Honorable Max Baucus
Chairman
Senate Finance Committee
219 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Charles B. Rangel
Chairman
House Ways and Means Committee
1102 Longworth House Office Building
Washington D.C. 20515

The Honorable Charles E. Grassley
Ranking Member
Senate Finance Committee
219 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable David Camp
Ranking Member
House Ways and Means Committee
1139E Longworth House Office Building
Washington, D.C. 20515

Re: Foreign Account Tax Compliance (“FATCA”) Provisions
of the Tax Extenders Act of 2009 (the “Bill”)

Dear Chairmen and Ranking Members:

The members of The Clearing House Association L.L.C. (“The Clearing House”), an association of major commercial banks,¹ appreciate the opportunity to provide comments on the FATCA provisions in the Bill. Our members support the goals of the proposed legislation and recognize that many of the financial industry’s concerns with respect to the first draft of the FATCA legislation (H.R. 3933/S. 1984, released on October 27, 2009) have been addressed. We are aware that accomplishing the goal of deterring tax evasion without interfering with ordinary business activities or capital markets is a challenge, and we welcome the opportunity to present our members’ views on how best to modify the Bill to meet this goal.

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.

Recommendations

1. Effective Dates.

A. Make Effective Date Subject to Issuance of Regulations.

We appreciate the extension of the effective date in the current draft of the Bill. We note, however, that many of the details needed to comply with the Bill's provisions would be provided by regulations and/or other guidance to be issued by the Department of the Treasury ("Treasury"). While we believe it would not be productive for the Internal Revenue Service (the "IRS") to rush to issue regulations, any delay in releasing guidance would reduce the time available for financial institutions to develop and implement the systems changes necessary to comply with the new requirements. Accordingly, we recommend that the Bill direct Treasury to delay the effective date of the reporting and withholding provisions until some period of time after regulations are issued.

B. Modify the Effective Date of Provisions on Substitute Dividends and Dividend Equivalent Payments.

Our members believe that the 90-day effective date that would apply to the withholding provisions on substitute dividends and dividend-equivalent payments does not allow enough time to design and implement a withholding system.

Substantial lead time would be required to modify systems and develop procedures to enable financial institutions to comply with these withholding requirements. Notional principal contracts and other derivatives are often highly customized products. Merely identifying the particular derivative contracts that would be subject to the Bill's substitute dividend and dividend-equivalent provisions would be a significant undertaking.

At a minimum, financial institutions would require sufficient lead time to (1) scope and budget the project; (2) develop a detailed implementation plan with input from various business areas including corporate tax, technology, and compliance; and (3) program and test the systems changes to ensure that accurate withholding takes place. Based on the amount of time it has historically taken to develop and implement such systems, we recommend that the effective date for this withholding be two years from the date of enactment.

2. Clarify the Definition of “Obligations” Under Grandfather Provisions.

We appreciate that the Bill includes a grandfather provision that, relative to its counterpart in the original FATCA legislation, is simpler but also broader in scope. The present formulation of the Bill’s grandfather provision, however, would exempt outstanding “obligations” from the Bill’s withholding rules without clearly defining what constitutes an “obligation” for this purpose.

We assume that Congress intends to grandfather all outstanding debt instruments and other non-equity instruments (including derivative financial products), each of which could potentially be an “obligation.” Accordingly, we recommend that the Bill exempt any obligation or nonequity instrument with a fixed maturity date that is outstanding on any date prior to the second anniversary of the Bill’s enactment. Alternatively, we would recommend that the Bill delegate authority to Treasury to define the scope of “obligations” that should be grandfathered from the Bill’s withholding provisions.

3. Certain Provisions Likely to Impact the Ability of U.S. Companies to Borrow Funds.

In the current economic climate, it would be counterproductive for the Bill to include provisions that adversely affect U.S. financial institutions’ ability to borrow funds competitively. As drafted, however, the Bill contains a number of provisions that could have this effect.

A. *Exclude Short-Term Funding from Definition of Withholdable Payments.*

Under current tax rules, short-term funding from foreign sources with a term of 183 days or less is exempt from U.S. withholding tax on interest and from a number of the typical tax documentation requirements. This facilitates short-term borrowing by eliminating unnecessary document collection and withholding. U.S. banks rely on short-term funding to support significant domestic lending to large and small businesses and to individuals in the form of mortgages and credit cards.

We are concerned that the availability of short-term financing will be curtailed if interest on these short-term obligations is treated as a withholdable payment. To the extent that foreign lenders receive little or no other U.S.-source income, foreign lenders may be unwilling to enter into information-reporting agreements with the IRS and pay a 30% withholding tax. Although the Joint Committee Report suggests that Treasury could exempt certain short-term instruments because they represent a low risk of tax evasion, the scope of this anticipated exemption appears limited to obligations of a foreign financial

institution (an “FFI”), and appears to not address obligations held by an FFI for the FFI’s account. We recommend 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.

B. Remove Provision that Makes Interest on Deposits with Foreign Branches of U.S. Financial Institutions Withholdable Payments.

Under the Bill, withholdable payments would include deposit interest paid by foreign branches of U.S. banks because the Bill would disregard the sourcing rule of Section 861(a)(1)(B) for the purpose of determining whether a payment is a withholdable payment.² Section 861(a)(1)(B), which treats deposit interest paid by foreign branches of U.S. banks as foreign source, has been in effect for many years, and allows for a level playing field between U.S. banks operating in foreign countries and foreign-country resident banks. Substantial commercial relationships and standard market practices have developed based on these existing rules, and we are concerned that these proposed changes would be a detrimental disruption to those relationships. For example, treating payments of deposit interest paid by foreign branches of U.S. banks as withholdable payments, while continuing to treat payments of deposit interest paid by foreign banks as remittances that are not withholdable payments would place foreign branches of U.S. banks at a substantial competitive disadvantage for deposits in countries where those branches operate, increasing their funding costs to the detriment of U.S. banks. This cannot have been intended. Furthermore, FFIs that have little or no other U.S.-source income may prefer to relocate their deposits to a foreign bank rather than enter into an agreement with the IRS to enable the FFI to continue doing business with the foreign branch of a U.S. bank. In light of this issue and the practical difficulties in implementing the required reporting and withholding provisions, we respectfully request that this provision of the Bill be removed.

² Unless otherwise noted, all Section references herein are to the Internal Revenue Code of 1986, as amended.

4. Modify Certain Reporting Requirements Imposed on an FFI That Has Entered into an Agreement with the IRS.

A. *Requirement that FFIs Report Gross Receipts and Gross Withdrawals.*

Concerns have been raised about the provision in proposed Section 1471(c)(1)(D) that would require FFIs (other than FFIs that elect under Section 1471(c)(2) to report with respect to their U.S. accountholders as if such FFIs were U.S. financial institutions) to report gross receipts (i.e., deposits) and withdrawals from foreign bank accounts. Many foreign financial institutions currently do not retain data on gross payments to and from their customer accounts, which would be necessary to report the information specified in proposed Section 1471(c)(1)(D). Moreover, given the other information that the Bill would require FFIs to report, it is not clear that the information required by proposed Section 1471(c)(1)(D) would be of additional value to the IRS because there is no way to determine how much, if any, of the gross payments to or withdrawals from an account would constitute income. Given these challenges and the limited value of this information to the IRS, we recommend that this requirement be limited to cover information that is useful to the IRS and also practical for FFIs to compile. We would be happy to work with you to determine what that would be.

B. *Information Reporting on the "Substantial United States Owner" of a United States Owned Foreign Entity.*

Proposed Section 1471 would require reporting of information on foreign entity account holders with "substantial United States owners." A substantial United States owner is a "specified United States person" that holds more than 10% of such entity. In the case of certain foreign investment vehicles, however, a "substantial United States owner" would also include "a specified United States person" that holds *any* ownership interest in the foreign investment vehicle, no matter how small. Although we recognize that "looking through" entities can be an important tool to prevent tax evasion, proposed Section 1471, as currently drafted, seems unmanageable for financial institutions and foreign investment vehicles. Without any *de minimis* threshold, it may be impossible to conclude that a foreign investment vehicle is exempt from reporting as it will be difficult, if not impossible, to determine conclusively that there is no U.S. ownership. Because of this very low threshold, the proposal likely would lead to frequent unintentional or unavoidable noncompliance by financial institutions, whose knowledge about the beneficial ownership of investment vehicles for which they maintain accounts will likely be limited to the information that can be obtained from the investment vehicles themselves. Moreover, determining whether the

0% ownership threshold or the 10% ownership threshold should apply to a particular entity could create substantial complexity.

We recognize and appreciate that newly proposed Section 1471(b)(2) was added to address the concerns expressed above. That provision would permit the IRS to exempt certain FFIs from the withholding provisions of proposed Section 1471(a) by deeming those FFIs to have met the Bill's reporting requirements of proposed Section 1471(b). While the intended scope of this proposal is unclear from the legislation, the Joint Committee Report provides some helpful guidance on the types of entities that would be exempted under newly proposed Section 1471(b)(2). In particular, the report states that "it is anticipated that the Secretary may provide rules that would permit certain classes of widely held collective investment vehicles to be deemed to meet the requirements of this provision."

We recommend that the authority granted in proposed Section 1471(b)(2) be exercised, as noted in the Joint Committee Report, to deem that widely held investment vehicles are in compliance with the Bill's reporting rules.

5. Clarify Definition of "Passthru Payments."

Under the Bill, an FFI that has entered into an agreement with the IRS would be required to: (1) withhold a 30% tax on "passthru payments" that are made to a recalcitrant account holder or to another FFI that either has not entered into an agreement with the IRS or has elected not to act as a withholding agent, or (2) elect to be withheld upon, rather than itself withhold, with respect to any withholdable payment to the FFI to the extent such payment is allocable to accounts held by recalcitrant account holders or FFIs that have not entered into agreements with the IRS. A "passthru payment" is defined in the Bill as (1) any withholdable payment or (2) any other payment that is "attributable to" a withholdable payment. Presumably, the extension of this provision to "attributable to" payments is intended to capture a payment that is directly contingent upon the amount of a U.S.-source withholdable payment. As drafted, however, the Bill does not provide a definition of the payments that might be "attributable to" a withholdable payment. This ambiguity could lead to significant difficulties with compliance and perhaps unintended over- and under- withholding. For example, it is conceivable that a dividend paid by a non-U.S. corporation with worldwide operations, including operations in the United States, could be considered "attributable to" a withholdable payment because such a dividend could be deemed to be indirectly derived from U.S.-source earnings. Although we do not expect that such an interpretation of the phrase "attributable to" would be consistent with Congressional intent, substantial

uncertainty will exist as to whether many payments are considered “passthru payments” under the Bill unless this phrase is clarified.

We recommend that the Bill be clarified to limit the definition of a “passthru payment” to a withholdable payment (i.e., U.S.-source FDAP and related gains) that is actually directly passed through, in a manner similar to the way a payment is passed through in a custodial relationship. Finally, simplifying and clarifying the definition of a “passthru payment” would ensure that financial institutions are able to apply this provision consistently, and we think consistent application of this provision is important to the success of the Bill.

6. Remove Limitation on Refunds to FFIs that Are the Beneficial Owners.

As drafted, an FFI that is the beneficial owner of a payment would not be entitled to a refund of the withheld tax unless the FFI is entitled to an exemption or reduction of tax under a treaty. This is unduly onerous in the case of an FFI that either (i) can establish that it has no U.S. account holders or owners or (ii) would otherwise qualify for an exemption from tax, such as the portfolio-interest exemption, under U.S. law. We recommend that, in these circumstances, an FFI be able to claim a refund of the withheld tax if it complies with the specified U.S. account reporting rules or is otherwise able to establish that withholding was not required.

7. Define “Dematerialized Book Entry System” Within the Provisions that Repeal the Exceptions for Bearer Bonds.

We appreciate that the Bill includes an expanded grandfather provision for existing bearer bonds and that the Bill specifically provides that a dematerialized book-entry system would be treated as a book-entry system. However, the term “dematerialized book entry system” is not defined in the Bill.

We believe that it would be helpful for the Bill to clarify that global notes held in Euroclear, Clearstream, and other clearing systems are treated as issued in registered form if physical securities can be delivered in only unusual circumstances, such as the insolvency of the clearing organization. Although the Joint Committee Report observes that “[a] debt obligation that is formally in bearer form is treated, for the purposes of Section 163(f), as held in a book entry system as long as the debt obligation may be transferred only by book entries and the holder of the obligation does not have the ability to withdraw the obligation from the book entry system and obtain a physical certificate in bearer form in the ordinary course of business” and that “[t]he issuance of physical certificates in bearer form in the event that the book entry system goes out of existence

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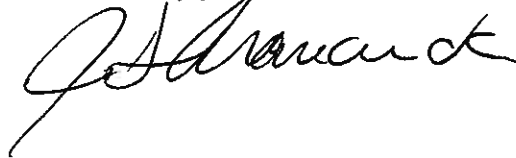
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would be an extraordinary event that is not in the ordinary course of business," we believe that capturing this concept in the statutory language would provide for greater market certainty.

Conclusion

We greatly appreciate your consideration of our comments. If you have any questions or if the members of The Clearing House can assist you in considering these important issues, please contact Joseph R. Alexander, Senior Vice President and Senior Counsel, at (212) 612-9234.

Sincerely yours,

A handwritten signature in black ink, appearing to read "J. Alexander", written in a cursive style.

JDA:kp

cc: The Honorable Michael Mundaca
Acting Assistant Secretary (Tax Policy), Department of the Treasury

Stephen E. Shay
Deputy Assistant Secretary (International Tax Affairs), Department of the Treasury

Thomas A. Barthold
Chief of Staff, Joint Committee on Taxation