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Basel, 10 June 2011

FATCA – Notice 2011: Submission of the Swiss Bankers Association

Dear Ms. Corwin and Messrs. Musher and Danilack,

The Swiss Bankers Association (SBA) appreciates the general aim of FATCA, which is to ensure that U.S. persons comply with U.S. tax laws. The SBA feels, however, that the implementation of the proposals contained in Notice 2011-34 would result in costs for the banks which substantially exceed the projected \$8.7 billion increase in tax revenue. The SBA believes that the aim of FATCA can be achieved at a far more reasonable cost through other means.

FATCA's implementation should take into consideration that FFIs all over the world might not have an in-depth knowledge of U.S. tax legislation. Therefore, in order to be accepted and implemented correctly by hundreds of thousands of FFIs worldwide, the rules must be easy to understand, practical to comply with and not overly costly to implement. This means that a large number of existing accounts must be excluded from additional documentation requirements because they represent a low risk of tax evasion. For all other accounts the documentation process must be simple to comply with and the number of different account classes and exceptions with different documentation requirements should be as small as possible.

The SBA therefore takes the opportunity to submit the following comments and proposals regarding Notice 2011-34.

1. Introduction

We would like to focus our comments on the following issues that we consider particularly sensitive for the Swiss banking sector:

- Classification of pre-existing individual accounts, certification process, identification of all accounts “associated with” a client identified as U.S. person and other documentation issues
- Passthru payments
- Deemed compliant status for certain FFIs and special treatment for certain FFIs

Notice 2011-34 does not ease the burden imposed on FFIs neither does it provide sufficient clarity needed to begin the implementation process. This is especially true in the case of the revised process for the identification of the pre-existing accounts held by individuals detailed in Notice 2011-34. It would appear that stakeholder comments that would reduce the administrative burden yet facilitate compliance have been largely ignored. As a result, Treasury and the IRS have seemingly moved in the other direction such that the account identification proposals contained in Notice 2011-34 are even more burdensome and labor-intensive than those of Notice 2010-60. For example, Private Banks which have almost exclusively private banking accounts are forced to review all accounts manually (instead of electronically as suggested in Notice 2010-60) and they need to conclude the review process within one year instead of two. Generally speaking, it is interesting to note that to manually review only 100,000 private banking accounts would result in additional cost equivalent of 100 man-years (assuming 2 additional hours for manual instead of electronic search, 8 working hours per day, 21 working days per month). Additional difficulties are also expected with respect to the proposed certification process as well as to identification of all accounts “associated with” a client identified as U.S. person.

Regardless of any level of resources put into implementing the proposals made in Notice 2011-34, there is a more fundamental problem. Unless the proposed passthru payment rules are substantially amended, banks will face practical difficulties that could interfere with their compliance, worse compliance may become impossible altogether.

While we commend Treasury and the IRS for providing a framework to permit banks to apply for deemed compliant status, the current procedures are far too restrictive and it is likely that only a handful of Swiss banks could qualify for such status. Deemed compliant status should also be possible for an FFI without application, if such an FFI is subject to audit by a local regulator which guarantees that no U.S. accounts or accounts of non-participating FFIs are maintained by such FFI.

Unfortunately Notice 2011-34 does not refer to comments made with respect to Notice 2010-60 (especially the treatment of pre-existing entity accounts). We strongly recommend considering far reaching exemptions for domiciliary companies when local KYC/AML rules foresee that beneficial owners are duly identified.

2. Classification of pre-existing individual accounts, certification process, identification of all accounts “associated with” a client identified as U.S. person and other documentation issues

a. Classification of pre-existing individual accounts

As a general matter, the new proposal for the handling of pre-existing individual accounts is far more burdensome and labor-intensive than the proposal contained in Notice 2010-60. We are very disappointed that many of the constructive comments submitted by various stakeholders which would have upheld the purpose of FATCA in a far less burdensome manner, were dismissed out of hand and not adopted in Notice 2011-34. Moreover, we are concerned that the manner in which Treasury and the IRS appear to be moving with respect to FATCA implementation illustrates a significant disconnect between industry practice and the presumed rationale behind the various proposals contained in Notice 2010-60 and Notice 2011-34. For example, to require a Form W-8BEN in addition to the usual documentation exceeds local practices and is of no significant benefit to the IRS. Furthermore, the distinction between the identification procedures for pre-existing individual accounts and new individual accounts only makes sense, if the date of the account opening takes precedence over the relationship between client and bank. While Treasury and the IRS might take the former position, industry practice suggests that opening of new sub-accounts under an existing relationship would not change the status of that relationship to that of a “new account”.

We are particularly opposed to the introduction in Notice 2011-34 of special due diligence procedures applicable to so-called “private banking accounts” and accounts valued at \$500,000 or more. These rules are unduly burdensome and do not provide any additional clarification relating to account identification procedures that were first proposed in Notice 2010-60. It is necessary to provide stakeholders with the ability to implement these proposals within the limited time available. In the limited time prior to FATCA’s effective date, it would seem more important to ensure that FFIs have the ability to understand the rules they are to implement than it would be to substantially expand operational burdens through the expansion of the account identification procedures. For instance, we continue to have concerns regarding the ability to utilize the de minimis rules in light of the aggregation requirements contained in the notices. It will not always be possible to aggregate all accounts of the same holder maintained by the FFI or its affiliates, due to incompatible IT systems or legal restrictions. The de minimis rules would be of practical use only if the aggregation requirement is eliminated.

Notice 2011-34 creates a new category account identification procedures for “private banking accounts”. The definition of private banking accounts is excessively broad. From a practical standpoint, virtually every account provided by a financial institution, which offers more than simple cash-service, would fall under this category. We would anticipate that a substantial number of accounts maintained in Switzerland would be characterized as private banking accounts simply due to the level of service provided to account holders at Swiss banks. We view it as inappropriate to impose increased compliance burdens on banks simply because of a higher level of service provided to a client. Particularly, this rationale is further supported as this burden may fall disproportionately on a particular jurisdiction, Switzerland. To the extent that KYC/AML informa-

tion will be reviewed for U.S. indicia and that Swiss standards are probably the most comprehensive among the world's banks, it would be appropriate to permit reliance on an electronic search of those records to identify U.S. indicia similar to what was initially required by Notice 2010-60. A manual search of client records or reliance on knowledge of bank employees would advance no purpose other than to substantially increase compliance costs. For example, to manually review only 100,000 private banking accounts would result in additional cost equivalent of 100 man-years (assuming 2 additional hours for manual instead of electronic search, 8 working hours per day, 21 working days per month). A larger bank would have to bear even higher costs reflecting the greater number of accounts maintained. Furthermore Notice 2011-34 imposes a deadline of one year for performing this review, compared to two years in Notice 2010-60.

We have grave concerns regarding the requirement in Notice 2011-34 that places certain verification requirements on the Relationship Manager (RM) who provides services with respect to the account. It is not possible, nor is it advisable, for the RMs to personally perform the "diligent review" for the hundreds of accounts they oversee in the time frame required by the Notice. As a practical matter, RMs are not the appropriate people to conduct such a review and from the above calculation it is obvious that the RM simply does not have sufficient time available to perform this review. In addition, while RMs may have direct contact with clients, RMs change and may not know the client personally. Moreover, a bank's practices may dictate that a team of RMs serve a group of clients, where no single RM is responsible for a particular client. It would be more practical to have a checklist with well-defined tasks so that the review can be performed by project teams or other suitably-trained compliance staff. It is not appropriate to place such burdens on RMs, who are not trained to conduct such a review and for other valid business reasons should not endorse the conclusions of such a review process. Such review must be limited to accounts with certain identifiable indicia; large banks would otherwise have to review tens of thousands of accounts.

The provisions regarding identification of "family members" should not be included in the final account identification rules. Swiss banks do not maintain information about family members; to do so might conflict with local laws on data protection. This information would not be available where the RM does not know the client personally. Moreover, to the extent the RM is personally acquainted with the client, there is always the possibility that the client's family situation might change after the account relationship is established.

The introduction of a \$500,000 threshold complicates the classification of accounts as well. It would also be costly to implement a system that keeps track of account balances and status. We regard the application of a "diligent review" to an account that had already subjected to an electronic search for U.S. indicia as a costly duplicative review that is unlikely to yield a result different from the prior electronic review. The place of birth in the documents might not necessarily be an obvious U.S. indicia, since there might be several locations bearing the same name in more than one country (e.g. Berne is the capital city of Switzerland, but there is also a Berne in Indiana, USA). Furthermore, an employee might not be able to allocate the name of a small, unknown place to a certain country. U.S. indicia according to the place of birth should therefore be restricted to cases where there is no doubt.

We would like to come back to some comments made to Notice 2010-60 with regard to documentation requirements for individual accounts with U.S. indicia. We would strongly recommend that the use of a Form W-8BEN should not be made compulsory in case of U.S. indicia. Documentary evidence, if necessary together with an additional statement, should in all cases be sufficient. We also recommend that in case of evidences of a U.S. place of birth or a green card the FFI may, at its discretion, rely on a copy of a completed Form DS 4083 or Form I-407, in order to establish the non-U.S. account status.

In our view, Notice 2011-34 does not reduce the number of pre-existing individual accounts that would need to be reviewed. Rather, Notice 2010-34 increases the burden imposed on Swiss banks when compared to the already burdensome procedures described in Notice 2010-60.

We therefore propose that:

- *FFIs should be able to rely on one-time electronic search for the classification of **all** pre-existing documented (documentary evidence or W8-BEN) individual accounts to be performed within two years (no categorization of accounts and no recurring review). If the electronic search results in finding U.S indicia, then a cure procedure should apply.*
- *An additional account opened under a pre-existing relationship should not change the status of the relationship to that of a new account and subsequently lead to a manual search.*
- *The new concept of "private banking accounts" as well as the \$500,000 threshold should be dropped.*
- *The RMs should not be involved in any review process.*
- *The provisions regarding "family members" must be deleted.*
- *The place of birth criteria as U.S. indicia must be limited to obvious cases.*
- *Form W-8BEN must not be compulsory in case of U.S. indicia.*

b. Certification process

Concerning the certification process, we think that it would be preferable to work on the basis of a checklist defining the tasks of the project team. If such a checklist can be established, for example by revenue procedure, and recognized as adequate to serve the purpose of FATCA, additional certification procedures performed by the chief compliance officer, as described in Notice 2011-34, would become superfluous.

We therefore propose that:

- *A checklist recognized as adequate is used by the project team for the certification process; no additional certification procedures should be performed by the chief compliance officer.*

c. Identification of all accounts “associated with” a client identified as U.S. person

Under Notice 2011-34, a participating FFI must treat all accounts “associated with” a client as U.S. accounts if the client is identified as a U.S. person. It is unclear, however, what search criteria the participating FFI should apply in order to identify such associated accounts. For purposes of determining account balances, Notice 2011-34 generally requires accounts to be aggregated only if those accounts are on the same computer or recordkeeping systems.

We therefore propose that:

- *The search requirements for accounts associated with a U.S. account be limited to accounts that have the same owner (identified by name) of the U.S. account, and accounts that may be searched on the same computer or recordkeeping systems as the U.S. account.*

d. Other documentation issues

Large banks often face the issue of so-called “dormant” accounts, where there has been no contact with the client for years. Usually, there is also no valid address available. If it appears that a dormant account contains firm U.S. indicia as a result of an electronic search the duty of the FFI should be limited to withhold on passthru payments. There should be no further obligations with regard to account closing activities.

Furthermore, the IRS should clarify that there is no renewal requirement in cases where documentary evidence is obtained for purposes of FATCA.

We therefore propose that:

- *The dormant accounts might remain subject to withholding as long as the necessary clarifications of the documentation are not completed.*
- *The documentation obtained for FATCA is not subject to renewal requirement.*

3. Passthru Payments

In our opinion the concept of passthru payments as described in Notice 2011-34 will cause many practical challenges, which will be virtually impossible to solve. It would appear that Treasury and the IRS decided to choose a broad definition of the term passthru payment in order to preempt any risk of circumventing FATCA. We are of the firm belief that this broad definition, which encompasses not only distributions directly attributable to a U.S. withholdable payment but also to each FFIs own payments will prove to be unworkable and expose the international financial system to unforeseen consequences.

The calculation of the passthru payment percentage would be very labor-intensive and burdensome especially for internationally active banks, because every FFI would be reliant on the timely publication of the percentage of other FFIs in order to be able to calculate its own percentage. The classification of assets into partial U.S. assets according to a percentage is not foreseen in today's IT systems and would require extremely costly enhancements. Each FFI would need to build a system to keep track of all the percentages published by hundreds of thousands of FFIs worldwide in order to apply these percentages to its own assets. We cannot begin to figure out how such a mechanism can work.

In addition, the FFI would need to build a system that classifies its own distributions (such as interests and dividends) partially as passthru payments. Since such distributions might be subject to domestic withholding taxes, the application of an additional FATCA withholding might be in conflict with local regulations and international standards, and may result in double taxation without any means for relief. In other words, to the extent that an FFI, engaged in the banking business, is required to pay U.S. withholding tax on an item of non-U.S. source income (determined pursuant to local and international laws and income tax treaties), the United States could be viewed as infringing on fiscal sovereignty as well as international tax treaties to which the United States is not a party.

Finally, we would like to stress that there is a substantial difference in the treatment of an FFI compared to a U.S. Financial Institution (USFI) in the passthru payment area. It is unacceptable that passthru payments are only applied to FFIs and similar rules are not imposed on USFIs. In other words, to guarantee a level playing field within the industry, a USFI would also need to apply the passthru percentage on its custodial payments (related to investments in FFIs) to a non-participating FFI or recalcitrant account holder. To the extent this is not the case, the rules will actually enable the harm they were designed to prevent (e.g., a non-participating FFI might choose to redirect payments from investments in participating FFIs through a custodial account of a USFI to avoid withholding tax).

We appreciate that the aim of the passthru percentage was to simplify the calculation required for this kind of payments. However, we strongly suggest that such percentage rules should be limited to passive investment vehicles such as mutual funds and similar products, with directly allocable investments in U.S. assets. This would mean that percentages are published per passive investment vehicle and not for other FFIs. All active FFIs must be excluded from the requirement of a passthru payment percentage

calculation. In addition, passthru payment percentage calculation on a quarterly basis is, in our opinion, too frequent and burdensome and should be reduced to a yearly calculation.

We therefore propose that:

- *Active FFIs such as banks and brokers are excluded from the passthru payment percentage calculation.*
- *Only mutual funds and similar products with directly allocable investments in U.S. assets must publish passthru payment percentages.*
- *Only distributions of such mutual funds and similar products are considered to be passthru payments.*
- *The concept of passthru payment must be fundamentally redesigned allowing for both a level playing field between FFIs and USFIs and a workable solution for all involved parties.*

4 Deemed compliant status for certain FFIs and special treatment for certain FFIs

a. Deemed compliant status for certain FFIs

The application process for FFIs subject to audit by a local regulator which guarantees that no U.S. accounts or accounts of non-participating FFIs are maintained by such FFIs should be simplified. For such FFIs a deemed-compliant status should be granted based on a confirmation issued by the local auditor without filing an application with the IRS.

The proposed requirements for deemed compliance status are far too narrow for local banks in Switzerland or for a local Swiss affiliate of a multinational banking group. Currently deemed compliant status is possible if:

- all FFIs in the expanded affiliated group are organized in the same country: This condition should be removed as it does not bear on compliance with the requirements of FATCA. In Europe, an FFI expanded affiliated group might provide banking services locally and nevertheless each affiliate may not be organized in the same country.
- no FFI in the expanded affiliated group maintains operations outside the country of organization: It is unclear what would constitute "maintaining operations outside the country of organization". If maintaining operations relates to branch operations beyond the borders of the bank, it is not clear why Treasury and the IRS have indicated a preference for one business methodology over a competing business model. It may well be that the local branch operates in the same manner in which a local bank organized in that jurisdiction would so operate.
- No FFI in the expanded affiliated group solicits account holders outside its country of organization: a distinction should be made between actively soliciting account

holders outside the country of organization and passively maintaining accounts for such account holders. For a small local Swiss bank it is quite normal to maintain accounts for non-residents, especially if they are located in a border region. More importantly, this restriction should be focused on prohibiting the solicitation of U.S. clients. It is not clear what interest the United States would have in prohibiting a Swiss bank from soliciting customers outside the United States if they are not U.S. persons.

We understand that independent FFIs (not belonging to an expanded affiliated group) are also covered by this rule.

We therefore propose that:

- *Simplified procedures (no application) should be applied to FFIs in countries in which adequate audit is performed by local regulators.*
- *The conditions for a local bank to apply for the deemed compliant status are limited to the condition that no U.S. accounts and no accounts of non-participating FFIs are maintained.*

b. Special treatment for certain FFIs

Unfortunately, Notice 2011-34 does not further specify the classification of pre-existing entity accounts. We therefore would like to refer to some proposals made in Notice 2010-60 where we appreciate the proposed classification into

- entities engaged in an active trade or business
- entities not engaged in an active trade or business

We support the proposal of Notice 2010-60 according to which entities engaged in an active trade or business other than a financial business should be treated as excepted NFFEs since they pose low risk of tax evasion. We also agree that entities engaged in an active financial business must become participating (or deemed compliant) FFIs, in order to avoid being subject to additional FATCA withholding.

However, there will be a large number of entities not engaged in an active trade or business which under the present proposal would most likely classify as FFIs. It should be avoided that all domiciliary companies need to apply for a participating or deemed compliant status. Please note that according to local KYC/AML rules Swiss banks need to identify the ultimate beneficiaries of domiciliary companies. We therefore come back to the proposal of Notice 2010-60 which contains the term of "small FFIs" and suggest that domiciliary companies with identified beneficiaries can be treated as "Small FFIs" and do not need to apply for a participating or deemed compliant status.

In addition, we are still expecting further clarification with regard to the treatment of retirement plans. The definition according to Notice 2010-60 was far too narrow. We therefore request that the numerous comments from the industry are considered and the definition of retirement plans is expanded in such a manner that retirement plans

would normally benefit from an exception (as excepted NFFEs), since they pose a low risk of tax evasion.

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We therefore propose that:

- *Existing accounts of domiciliary companies should be treated as small FFIs (if beneficiaries are identified based on the local KYC/AML rules)*
- *Clear definitions of retirement plans must be issued in order to allow most retirement plans to be treated as excepted NFFEs.*

5. Conclusion

We hope that Treasury and the IRS will take due consideration of our concerns and of our proposals for workable solutions, which we believe are consistent with the general objectives of FATCA. We feel that if our concerns, which are widely shared, are simply ignored, many FFIs will not be able to comply with FATCA and will be faced with no other choice but to not participate in FATCA. We understand that this is contrary to the objective of Treasury and the IRS. It is therefore necessary to expand the concept of deemed compliance so that as many small FFIs as possible can elect this status. It is also necessary to consider our proposals with regard to classification of pre-existing individual accounts as well as to fundamentally change the concept of passthru payments.

Yours sincerely,
Swiss Bankers Association

 

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