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April 13, 2011

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Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Comments on Proposed Treasury Regulations Relating to the Foreign Account Tax Compliance
Offset Provisions of the HIRE Act, P.L. 111-147 Certification & Verification

Dear Commissioner Shulman:

Enclosed are comments on proposed treasury regulations relating to the foreign account tax compliance offset provisions of the HIRE Act. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

William M. Paul
Chair, Section of Taxation

Enclosure

cc: Emily S. McMahon, Assistant Secretary (Tax Policy), Department of the Treasury
William J. Wilkins, Chief Counsel, Internal Revenue Service
Manal S. Corwin, Deputy Assistant Secretary (International Tax Affairs), Department of the Treasury
Michael J. Caballero, International Tax Counsel, Department of the Treasury

**ABA SECTION OF TAXATION
COMMENTS ON PROPOSED TREASURY REGULATIONS RELATING
TO THE FOREIGN ACCOUNT TAX COMPLIANCE OFFSET
PROVISIONS OF THE HIRE ACT, P.L. 111-147
CERTIFICATION & VERIFICATION**

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Alan I. Appel, Chair of the U.S. Activities of Foreigners and Tax Treaties Committee of the Section of Taxation (the “Committee”). Substantive contributions were made by Alan Granwell, Philip Hirschfeld, Dean Marsan, James McPherson, Susan Nevas, David Shapiro, and William Sherman. The Comments were reviewed by William B. Sherman, Committee Chair-Elect. The Comments were further reviewed by Fred F. Murray of the Section’s Committee on Government Submissions and by Joan Arnold, Council Director for the Committee.

Although many of the members of the Section of Taxation who participated in preparing these Comments have clients who may be affected by the federal tax principles addressed by these Comments, no such member or the firm or organization to which such member belonged while participating in the preparation of the Comments has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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Date: April 13, 2012

INTRODUCTION

On February 8, 2012, the Internal Revenue Service (the “Service”) and the U.S. Department of Treasury (the “Treasury”) released Proposed Regulations¹ to implement sections 1471-1474.² A significant portion of the Proposed Regulations are devoted to the terms of the agreement required to be entered into by a foreign financial institution, as defined by section 1471,³ (an “FFI”) to be compliant with the terms of section 1471(b). The Proposed Regulations ask for comments on a number of issues, including the terms of the required agreement (an “FFI Agreement”), no later than April 30, 2012. In discussions with the Service, comments on the requirements of the FFI Agreement were requested on an expedited basis.

EXECUTIVE SUMMARY

Pursuant to section 1471(b), in order to avoid a withholding tax of 30% on US source fixed or determinable annual or periodical income or on gross proceeds from the disposition of stock or bonds of US corporations, an FFI has to enter into an FFI Agreement with the Service. The Service is working on the development of the proposed terms of the FFI Agreement. These Comments provide recommendations on certain terms that may be included in the FFI Agreement, and certain recommendations as to the implementation of the FFI Agreement.

Specifically, the comments provide recommendations on:

- The requirement for an annual certification of compliance with the FFI Agreement to be filed by a responsible officer;
- Definition of a responsible officer;
- Permissive combined filing of a single certification in an expanded affiliated group;
- Consequences for a failure of the underlying certifications;
- Due dates for certifications and filing of the certifications;
- Potential for extending the certification periods for compliant FFIs;
- Procedures and results for missing certifications; and
- Penalties for not complying with the terms of the FFI Agreement.

¹Prop. Reg. §§1.1471-0 through 1.1474-7, Prop. Reg. §301.1474-1, Fed. Reg. Vol. 77, No 31 pg. 9022.

²All section references are to sections of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise noted.

³Prop. Reg. § 1.1471-4.

COMMENTS

In our view there should be a balance of the government's need to ensure that participating FFIs ("PFFIs"), as defined in Proposed Regulation section 1.1471-1(b)(23)(v), are making robust attempts to comply with sections 1471-1474 and the administrative burdens placed on business entities. Therefore, we considered and rejected approaches requiring either a very short certification, which simply stated that the PFFI certifies compliance with these rules, or a very detailed certification, which mirrors much of the details of the regulations and/or what must be done to comply. We attempted to strike a balance between these two extremes, as set forth below, which we believe reasonably addresses the government's concerns that the certifying person has reviewed what was needed to make sure there is compliance. With that in mind, we offer the following comments:

1. Certification Requirements.

Proposed Regulation section 1.1471-4 contains the general requirements applicable to the FFI Agreement. Section 1.1471-4(a)(6) provides in part that:

... a responsible officer of the participating FFI will periodically certify to the IRS the participating FFI's compliance with its obligations under the FFI agreement and may be required to provide certain factual information and to disclose material failures with respect to the participating FFI's compliance with any of the requirements of the FFI agreement.

...to the best of the responsible officer's knowledge, after conducting a reasonable inquiry, the participating FFI did not have any formal or informal practices or procedures in place from August 6, 2011, through the date of such certification to assist account holders in the avoidance of chapter 4 of the Internal Revenue Code. Practices and procedures that assist account holders in the avoidance of chapter 4 include, for example, instructing account holders to split up accounts to avoid classification as a high-value account.

To implement this Regulation, we recommend that the FFI Agreement provide that on an annual basis, by the due date specified below, a responsible officer of a PFFI, deliver to the Service a written certification (the "Certification") made under penalties of perjury, that states that, to the best of such person's knowledge and belief, the PFFI has:

(a) created internal procedures to ensure that the PFFI will comply with the provisions of the FFI Agreement and the relevant regulations and other administrative guidance including, but not limited to: (i) the due diligence procedures to determine the existence of U.S. investors with respect to existing accounts, as well as the procedures to identify the presence of U.S. investors for new accounts; (ii) the reporting requirements to the Service relating to U.S. investors that the PFFI has determined to exist; (iii) any applicable withholding under sections 1471 or 1472; and (iv) written policies and procedures and any other substantive requirements under the Chapter 4 Regulations;

(b) adopted internal systems to identify and monitor potential non-compliance with sections 1471-1474, and remedial procedures to address any discovered infirmities;

(c) followed, in all material respects, the procedures set forth in subsection (a) and the systems and procedures set forth in subsection (b); and

(d) maintained written or electronic documentation to substantiate the foregoing.

The PFFI may, but is not required to, use outside parties for any review needed to make such Certification, provided any Certification must be made by a responsible officer of the PFFI.

2. Definition of Responsible Officer.

The scope of who is a “responsible officer” is not specified in the Regulations.⁴ We believe that the Service’s need to know that a person with significant responsibility is involved should be balanced with the certifying person’s need to have enough direct exposure to the items in the Certification. We recommend that “responsible officer” be defined as “any officer of the PFFI who has been granted authority to oversee, implement and/or supervise the PFFI’s compliance with the provisions of Chapter 4 and/or adherence to the terms of the FFI Agreement or any other documentation provided to the Service under Chapter 4 that establishes that the FFI is a deemed-compliant FFI.”

We recommend that, if the PFFI is formed as a partnership under local law, a responsible officer should be an officer of a partner who can directly exercise management over the partnership and conduct day-to-day control over the affairs of the partnership or, if such partner is an individual, then such individual. Similarly, if the PFFI is formed as a limited liability company or similar entity under local law and a member of the company can exercise management and control over the company, then a responsible officer should include a responsible officer of such member or, if such member is an individual, then such individual.

3. Certifications for Expanded Affiliated Groups.

We recommend that the instructions permit a single Certification to be delivered on behalf of all members of an expanded affiliated group.⁵ In that case, the responsible officer of the member so certifying may rely on certifications by officers of the other members of the group that attest to the items set forth in the filed Certification. The Certification should refer to such other certifications, which should be made by a responsible officer of that other member. If one entity that is a member of an expanded affiliated group has management authority over other members of the expanded affiliated group by law or contract, then we recommend that a responsible officer of the managing entity be permitted to make certifications for such other members, provided that such certifications include copies of the contract or statutory provisions granting the member management authority over the other members.

⁴ See Prop. Reg. §§ 1.1471-1(b), 1.1471-4(c)(10).

⁵ “Expanded affiliated group” is defined in section 1471(e)(2).

We further recommend that the ability to file a single Certification for an expanded group be permissive and not mandatory. Under the current definition of an expanded affiliated group, many entities that are not effectively under common control are included in an expanded affiliated group. For example, if a PFFI is a “fund of funds” investment FFI, and it holds 51% of another PFFI that is an investment FFI, both PFFIs are in the same expanded affiliated group, but the managers of each PFFI are quite likely to be different, and no sharing of information will occur on internal systems. Requiring a combined Certification, especially if there are civil or criminal penalties related to inaccurate or incomplete disclosures thereon, would be inappropriate in such a case.

4. Identification of Failures.

If there are any material failures with respect to the PFFI’s compliance with any of the requirements of the FFI Agreement, we recommend that the responsible person include an attachment to the Certification setting forth: (i) the material failures; (ii) what remedial steps are being taken to address and remedy those failures; and (iii) the expected timetable for completion of those steps, which should not exceed one year.

Notwithstanding the delivery of the Certification, we recommend that a PFFI be under an obligation to immediately inform the Service of any material failure to comply with the terms of the FFI Agreement and, within sixty days of such notification, the PFFI should be required to provide the Service with a description of what steps are being taken to address and remedy such failures and the timetable for completion of such steps.

5. Date of Certification With Respect to Avoidance of Chapter 4.

The Proposed Regulation requires a responsible officer of a PFFI to make certain certifications. The first certification confirms that within one year of the effective date of the FFI agreement the PFFI has completed the required review of its preexisting accounts that are high-value accounts, and, to the best of the responsible officer's knowledge after conducting a reasonable inquiry, the PFFI did not have any formal or informal practices or procedures in place at any time from August 6, 2011 through the date of such certification to assist account holders in the avoidance of Chapter 4.⁶ We recommend consideration of an effective date later than August 6, 2011, such as the date of publication of the Proposed Regulations or the date regulations are adopted in final form. While we understand the concern that FFIs should not act in direct contravention of Chapter 4, our experience is that the rules have not been fully understood and analyzed by many FFIs prior to the release of the Regulations and thus it may be difficult for those FFIs to make this certification. We think the goal of the program should be to get as many FFIs into the program as possible, and that FFIs should not be faced with the difficult task of having to review its operations back to August 6, 2011, to determine what its formal or informal policies may have been, with the question of what is an “informal policy” itself being uncertain and requiring interpretation.

With respect to the definition of what may constitute practices and procedures that assist account holders in the avoidance of Chapter 4, we recommend that additional guidance be

⁶ Prop. Reg. § 1.1471-4(c)(10).

provided. Inappropriate behavior could include, for example, instructing account holders to split accounts to avoid classification as a high-value account. At the same time, we think clarification of activity that would not constitute such a practice and procedure would be helpful. We recommend that specified non-abusive activity include:

a) the transfer of accounts from the PFFI to a domestic affiliate or to another PFFI within the expanded affiliated group;⁷

b) the transfer of accounts as part of a bulk transfer of accounts (e.g., in connection with the purchase or sale of a business or other reorganization of the PFFI) to a PFFI or a Deemed-compliant FFI⁸; or

c) the transfer of accounts from a PFFI with existing know-your customer (“KYC”) or anti-money laundering (“AML”) processes to a domestic affiliate or to another PFFI within the expanded affiliated group that does not have such KYC/AML processes.

Such activities do not represent an opportunity to assist account holders in avoiding the information reporting required under Chapter 4, but do represent common transactions undertaken for legitimate business purposes, and thus should explicitly be permitted under the regulations.

6. Due Date of Annual Certification.

The general due date for reporting under the Proposed Regulations is March 31 for the prior calendar year.⁹ Some FFIs have raised significant concerns about their ability to report on a calendar year because they do not use the calendar year for any other purpose and their systems are not set up to capture information on that basis. Further, the three-month time frame is viewed as very short, and seems too short when compared to the length of time the Code generally provides to taxpayers for filing tax returns.

We recommend that, in general, the due date for the annual Certification be the end of the sixth month following the end of the calendar year. We recommend, however, that, if a FFI uses a fiscal year for its financial books and records, it be permitted to report based on that 12-month period. We recommend that the election be made on the FFI Agreement form.

We further recommend, given the relatively brief period for establishing compliance, that the Service provide a relatively short automatic extension of 30 days for filing the Certification upon request by the FFI. We also recommend providing for a discretionary further 90 day extension on the showing of hardship (such as due to a loss or destruction of records through a natural catastrophe, such as an earthquake, or other events beyond the control of the PFFI, such as a fire).

7. Period of Certification Going Forward.

To lessen the burden on both the PFFI and the Service in having annual certifications, once a PFFI has demonstrated consistent compliance, as illustrated by delivering annual Certifications

⁷Prop. Reg. § 1.1471-5(i).

⁸ Deemed compliant entities are defined in Prop. Reg. § 1.1471-5(f)

⁹ See Prop. Reg. §§ 1.1471-4(d)(3)(vi), (6)(v).

for a certain time period (*e.g.*, three years), which Certifications contain either no exceptions or exceptions that have been cured to the satisfaction of the Service, we recommend that annual Certification could be changed to a Certification due every two or three years, at the discretion of the Service. This would not limit the obligation of the PFFI to perform annual reviews to determine it is still in compliance.

8. Failure to Timely File the Certification.

If there is a failure to supply the Certification within the prescribed time period, we recommend that the Service should send a written notice to the PFFI advising it of the failure to provide the Certification and allow the PFFI to provide the Certification within (60) days of the sending of the notice. If the PFFI fails to file the Certification within the 60 day period, as of the end of the 60 day period, the FFI Agreement should be terminated, the FFI-EIN¹⁰ of that FFI should be revoked, the FFI should be subject to withholding under Chapter 4 on and after that date and the FFI should immediately cease to use the FFI-EIN supplied to eliminate withholding under Chapter 4 or otherwise.

9. Confirmation of Receipt of Certifications.

We understand that some FFIs have expressed a desire to be notified that their Certifications have been received and accepted. In our view, any universal notification system would be excessively burdensome to the Service; and we do not think that is a practical option. We do recommend, however, that a system be created pursuant to which a given PFFI can affirmatively verify receipt of its own, specific Certification.

10. Effect of Failure of Certifications.

As noted above, the proposed Certification may indicate material failures or exceptions to the foregoing in an Attachment, which would be required to indicate what steps are being taken to address such infirmities, the timeline for when those steps will be accomplished, which, at a maximum, must not exceed one year, and any other pertinent details. As in Announcement 2008-98,¹¹ we recommend that the Service indicate that it will remain flexible in its approach and strive to work together with any PFFI to remedy any exceptions or failures to comply so that the PFFI may be able to remain as a PFFI, but that commitment we believe should not ultimately bind the Service to accept any such exceptions that are deemed material and/or incapable, in the Service's view, of cure within an adequate time period. As a result, the Service should state its right either:

(a) to accept any Certification;

(b) not to accept any Certification and treat the PFFI as having failed to supply the Certification effective as of the date that is thirty (30) days after the date of notification by the Service of such deemed failure (the "Effective Date") if the levels of material failures or exceptions noted in the Attachment (or otherwise discovered by the Service) are so material and/or numerous as to indicate either significant non-compliance with the Chapter 4 Regulations

¹⁰ Prop. Reg. § 1.1471-1(b)(25).

¹¹ I.R.B. 2008-44, November 3, 2008.

and the FFI Agreement or intentional disregard of the Chapter 4 Regulations or the FFI Agreement; or

(c) conditionally accept such Certification but require a shorter time period to cure any such exceptions. In this latter case, a failure to cure such exceptions within the stated time period will be treated as a failure to supply the required certification effective as of the last day of such time period.

We recommend that if the FFI fails to cure exceptions as set forth in the conditional acceptance of a Certification, then upon the Effective Date, the FFI Agreement should be terminated, the FFI-EIN of that Revoked PFFI should be revoked, the FFI should be subject to withholding under Chapter 4 on and after that date and the FFI should immediately cease to use the FFI-EIN supplied to that person so as to eliminate withholding under Chapter 4 or otherwise.

11. Interaction of the Penalty Provisions with the FFI Agreement.

We express concern that some FFIs are unsure as to what criminal and civil exposure may result from entering into the FFI Agreement. Since many FFIs may not be familiar with the Code's criminal provisions (e.g., the felony provision for fraud/false statements of section 7206 or section 7207 and the misdemeanor provision for willful delivery or disclosure of fraudulent lists, returns, accounts statements, or other documents to a Service officer or employee) and numerous civil penalty provisions, we recommend that the text of the FFI Agreement contain references to the penalty sections that the Service thinks appropriate if there is a breach of the FFI Agreement, a material misstatement, or other action inconsistent with the terms of the FFI Agreement. While the scope of applicable penalties may be open to debate, we believe that if there is intentional fraudulent conduct relating to the FFI Agreement, then it is appropriate to apply civil or criminal penalties, as they currently exist or as they may be amended in the future, to address such conduct, and the existence and scope of those penalties should be specified in the FFI Agreement.