Post-trade made easy

CC:PA:LPD:PR (REG-121647-10)
Room 5205, Internal Revenue Service
PO Box 7604
Ben Franklin Station,
Washington, D.C. 20044.

Brussels, April 27, 2012

Subject: Foreign Account Tax Compliance Act
Proposed Regulations: Comments

Dear Sir, Madam,

Introduction

We are writing in response to the request for comments on the content of the proposed regulations relating to information reporting by foreign financial institutions and withholding on certain payments to foreign financial institutions and other foreign entities (REG-121647-10) (the "Proposed Regulations").

We welcome the evolution of the FATCA regime and the adjustments that have been made by the Proposed Regulations, which clearly show the willingness of Treasury and the IRS to make FATCA more easily administrable as a whole. There are however a number of points which in our view remain problematic, or at least require further clarification. These points are discussed further below, but the main ones which we would like to highlight are: limiting the scope of the election to be withheld upon[1], the concept of limited FFI[2], the importance of the link between FATCA and existing AML/KYC rules[3], and the special rule for clearing organizations in respect of gross proceeds[4].

---

[1] Section 4.1 below
[2] Section 2
[3] Section 6.2
[4] Section 4.5

Euroclear SA/NV
1 Boulevard du Roi Albert II
1210 Brussels, Belgium
RPM Brussels 0423 747 369
Tel. +32 (0)2 326 1211
www.euroclear.com

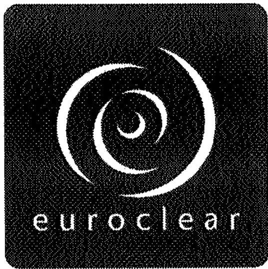
Post-trade made easy

1. Proposed FATCA Partnership Agreements

1.1. We welcome the initiative brought forward by the United States and the five partner countries. That said, it is crucial that the scope and timetable for implementation of these agreements be ascertained quickly. Indeed, whilst the dates for implementation of the various components of FATCA have been phased to assist FFIs in smoother implementation of the FATCA requirements, the implementation schedule remains very tight and requires that developments in Euroclear start in early Q4 of this year. It is important that we know before that time how the partnership agreements will impact our obligations under FATCA to avoid putting at risk our readiness and to avoid the expense of further costly system design changes at a later stage.

1.2. Aside from the timing of the partner agreements, it is also important that their scope is clearly defined and fully consistent with the FATCA requirements. The US and the five governments announced their intention to commit to "adapting FATCA in the medium term to a common model". It is to be hoped that standardisation will be the watchword from the outset. Indeed, if the scope, format or communication means were to vary between the various countries, this would have the effect that the partner agreements would make the implementation of FATCA more, not less, challenging, especially for global financial institutions.

1.3. In that same vein, clarity should be provided on the compliance framework for such partner agreements: where the rule under FATCA is to be that a responsible officer will certify compliance with the requirements (rather than the present Chapter 3 system of periodic external audits), the same should apply in the case of an FFI that has the status of registered deemed-compliant FFI pursuant to an agreement between the government of the United States and a foreign government. In summary, the obligations of a partner country registered deemed-compliant FFI should not go beyond the obligations that that FFI would otherwise have had under FATCA, had the partner agreement not been of application.



Post-trade made easy

2. FFI Agreement / Limited FFIs

2.1. We had previously raised concerns in relation to local law barriers to the reporting to the IRS of account details and balances, and the requirement to ultimately close accounts held by recalcitrant account holders. We welcome the fact that this has been addressed by the partner agreement initiative, on the one hand, and by the introduction of the limited FFI concept, on the other. It is clear that this will be of benefit to expanded affiliated groups with operations in several countries, such as is the case for the Euroclear Group. However, <u>we request that an entity classified as a limited FFI during the two year transition period will not be treated as a nonparticipating FFI ("NPFFI"), and will not be withheld upon,</u> provided that it takes as many steps as legally possible to comply with its FATCA obligations without violating local law.

2.2. Also of concern is the fact that, by the end of the two year transition period, where the limited FFI in question has, through no fault of its own (e.g. due to government unwillingness to make the necessary amendments to its local law), been unable to comply with FATCA, this will automatically render the expanded affiliated group as a whole non-compliant. This leads to the risk that expanded affiliated groups with limited FFIs will be entering into FFI agreements with the IRS without knowing what the implications will be for the group at a later stage. We therefore <u>request that, where full compliance has not been achieved by the end of the transition period, the limited FFI be treated as an NPFFI, but without impacting the FATCA status of the other affiliates of the group.</u>

2.3. The same "unknown" is present in relation to the notion of foreign passthru payments. We welcome the decision of Treasury and the IRS in this regard, not to introduce withholding on such payments earlier than January 1, 2017, and recognise that the intention (taking into account the requirement to report on certain non-US source FDAP income being paid to NPFFIs during a two year period) is to adopt a "wait and see" approach, allowing NPFFIs as much time as possible to become compliant. However, it is undesirable to enter into an agreement which will be of unknown or open-ended scope. <u>We therefore request that there</u>

Post-trade made easy

be an additional, separate agreement concerning foreign passthru payments, or, alternatively, that the initial FFI agreement be of limited duration, to coincide with the date of entry into force of the obligations related to foreign passthru payments.

2.4. The laws of the jurisdictions in which certain of the Euroclear Group CSDs operate require those CSDs to provide certain basic financial services to the general public. The result is that certain of the Group CSDs may not refuse a request to open an account for a prospective account holder who may be potentially recalcitrant. In light of this difficulty, we would request that consideration be given to expanding the concept of what constitutes a limited FFI.

3. Identification

3.1. The documentation requirements described under §1.1471-3 ("Identification of payee", p. 143 onwards) and §1.1471-4 ("FFI agreement", p. 224 onwards) are numerous and complex. They differ for pre-existing and new accounts as well as for the different types of entity categories. We would urge Treasury and the IRS to keep in mind the fact that a key component of the implementation of FATCA will be the translation of these requirements into operational procedures and systems in such a way that they are intelligible to all relevant operational personnel, not just those in the tax and legal departments. We feel that this is going to be quite a challenge. We see it as key to the success of FATCA as a whole that the applicable procedures be made as simple and as intelligible as possible for our clients and personnel alike, for example by allowing PFFIs to accept withholding certificates in a dematerialised form.

3.2. The comments in this section refer to the following provision of the Proposed Regulations - page 137:

- §1.1471-2(a)(4)(ii)(B): Requirement to deduct and withhold tax on withholdable payments to prima facie FFIs

We would like to receive confirmation that a non-US entity such as Euroclear can rely, as is the case for USFIs, on standardised industry

Post-trade made easy

codes such as the SIC codes to identify prima facie FFIs among its account holders. We also request that a larger array of SIC codes be used to classify entities as 'presumed' financial institutions under Chapter 4 to also include, among others:

6020: Commercial Banks;
6021: National Commercial Banks;
6282: Investment advice; and
6159: Misc. Business Credit Institutions.

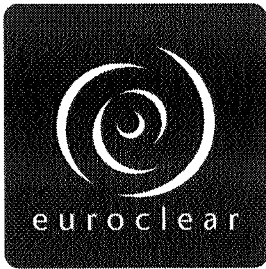
4. Withholding

4.1. The comments in this section refer to the following provisions: - pages 133 and 228

- §1.1471-2(a)(2)(iii)(A): Withholding on certain payments to QIs; and
- §1.1471-4(b)(1): Withholding requirements under the FFI agreement.

With these provisions, an FFI that is a QI with primary withholding responsibility must accept that its underlying FFIs who are not themselves QIs with primary withholding responsibility, delegate upward their chapter 4 withholding responsibility for U.S. source FDAP income. We strongly request that this obligation is not extended to other types of payments.

Indeed, as set out in our previous letters to you in which we provided comments on the guidance Notices, this provision would force QIs with primary withholding responsibility (in our case Euroclear Bank, Euroclear Sweden and Euroclear Nederland - the "(I)CSDs") to build complex systems to comply with such withholding obligation even when they had planned to introduce alternative safeguards to prevent that a chapter 4 withholding event could occur (for example by requiring clients to become PFFIs or by applying holding restrictions). Also, QIs that would want to benefit from such extension of the election would still need to provide the (I)CSDs with the details of the transactions to be withheld upon. Indeed, because of, among others, trade netting and the use of omnibus accounts (some transactions simply settle on the books of the QI without being reflected on the books of the (I)CSDs), the (I)CSDs would be unable to withhold the correct tax without receiving additional information from the



Post-trade made easy

QI. QIs would also still have to apply the tax to their own clients on their own books, thereby eliminating the business case for the QIs to transmit the information to the (I)CSDs rather than to the IRS directly.

In case an extension beyond simply US FDAP payments is made, we strongly request that regulations provide that the election should only be permitted with the consent of the withholding agent or that (I)CSDs be exempted from being elected upon under section 1471(b)(3). Without such clarification, a participating FFI would be able to pass on its withholding obligation, and the related reporting, without any regard to whether the (I)CSD has systems that can accommodate such obligation.

4.2. The comments in this section refer to the following provisions: - pages 137 and 234

- §1.1471-2(a)(4)(ii)(B): Requirement to deduct and withhold tax on withholdable payments to prima facie FFIs; and
- §1.1471-4(c)(3)(i): FFI agreement – Identification procedure and documentation for entity accounts.

Our reading of §1.1471-2 (a)(4)(ii)(B) is that it requires that prima facie FFIs be treated as NPFFIs from January 1, 2014 until such time as sufficient documentation has been received to establish a different FATCA status. This conflicts with §1.1471-4 (c)(3)(i), which allows FFIs a period of one year from the effective date of the FFI Agreement (i.e. until at least June 30, 2014) to complete the identification process for prima facie FFIs. Given the 30% penalty at stake, FFIs would in practice have only six months instead of one year to receive and process the necessary documentation from all prima facie FFIs. Given that FFIs account for the vast majority of the client base of the Euroclear Group, we request that prima facie FFIs be treated as NPFFIs as from the date falling 1 year after the effective date of the FFI agreement instead of January 1, 2014 so as to allow the Group a period of 1 year to complete the documentation procedure.

Post-trade made easy

4.3. The comments in this section refer to the following provision - page 140:

- §1.1471-2(b)(1): Requirement to deduct and withhold tax on withholdable payments to certain FFIs - Grandfathered treatment of outstanding obligations

We understand that the sentence should rather read as follows:

"...a withholdable payment or passthru payment does **not** include any payment made under a grandfathered obligation or any gross proceeds from the disposition of such an obligation."

We would be grateful if you would provide confirmation of this understanding.

4.4. The comments in this section refer to the following provision - page 318:

- §1.1471-5(h)(2) Definitions application to section 1471 – foreign passthru payment.

We very much welcome the phasing of the withholding obligations and the delay in the implementation of withholding on foreign passthru payments until at least January 1, 2017. However, the fact that the term "foreign passthru payment" is undefined gives rise to some uncertainty in terms of system build. While we appreciate that it may turn out that the implementation of the foreign passthru payment concept proves not to be necessary (because the vast majority of FFIs achieve – through whatever means – the status of participating, or deemed-compliant FFI), we would ask that if this element of FATCA is to be introduced, communication on the details of how it will be implemented be made at least 18 to 24 months before the effective date. We refer you in this regard to our comments made in paragraph 2.3 above.

4.5. The comments in this section refer to the following provision - page 340:

- §1.1473-1(a)(3)(i)(C) Special rule for gross proceeds from sales settled by clearing organization

We welcome the introduction of this special rule which reflects the use of omnibus accounts by certain FFIs and the market practice of netting.

However, applying FATCA withholding on the net amounts paid or credited to the client account remains a major issue for Euroclear, as it will lead to undue withholding on many transactions. Indeed, for instructions that are input by our Participants, we have no information regarding the nature of the underlying transaction. While the instruction could be the result of a sale, it could also be the result of any other type of transaction between two participants; i.e. Euroclear is instructed to move securities and cash from Participant A to Participant B but have no knowledge of what precipitated the movements.

In the event that repurchase transactions (which have been estimated in the past to account for at least 50% of the instructions input directly by Euroclear Bank Participants) were subject to FATCA withholding, a point which we would like to receive your confirmation on, we would expect that the FATCA penalty would only apply on the remuneration component of the transaction, that is the difference in cash between the near leg (opening transaction) and the far leg (closing transaction). Under our current system design, the penalty would be withheld on the full cash amount, and in case neither party to the transaction is FATCA compliant, on both legs. In order to avoid overwithholding, we could request the market to identify such repo (or non-sale) transactions when instructing Euroclear. However, this would entail not only a substantial development cost for the entire market and for Euroclear, but could also lead to potential system abuse and partial avoidance of the FATCA tax: NPFFIs could themselves identify those instructions as not being subject to penalty.

Example - Undue withholding on a repo transaction.
A, a NPFFI, enters into a repurchase transaction with B, another NPFFI for an amount of EUR 1 million. Both parties instruct Euroclear to i) deliver 1 million of XYZ bonds (subject to FATCA withholding) against EUR 1 million cash from A to B for immediate settlement (near leg) and ii) deliver 1 million of XYZ bonds against EUR 1.1 million cash from B to A for settlement in 6 months (far leg). As Euroclear does not know the nature of the transaction, it will charge a 30% or EUR 300,000 penalty to A (on the

Post-trade made easy

near leg) and a 30% or EUR 330,000 penalty to B (on the far leg) while the penalty should have been of EUR 30,000 for B only (1.1 million minus 1 million at 30%, i.e. only on the remuneration of the repurchase transaction).

Because Euroclear has no knowledge of the facts giving rise to a client instruction, withholding on amounts paid or credited through Euroclear would bear no relationship to any reasonable FATCA liability. We therefore request to be exempted from FATCA withholding on gross proceeds of instructions settled through Euroclear. This could be considered as an exception under §1.1471-2 (a)(4)(i) (Exception to withholding if the withholding agent lacks control, custody or knowledge).

5. Reporting

5.1. The comments in this section refer to the following provision - page 364:

- §1.1474-1(d)(2)(ii): Liability for withheld tax – information returns for payment reporting - Transitional reporting rule for PFFIs to report non-US source FDAP.

We note the new obligation to report on the aggregate amount of all foreign FDAP income payments, and potentially other financial payments, made to NPFFIs. We understand that such data will be used to evaluate the potential benefits of introducing withholding on foreign passthru payments. However, we question the benefits of this new requirement, the implementation of which will be costly for Euroclear. Indeed, the amounts that will be reported to the IRS will be unreliable as: i) they will not be limited to the portion of US-source income (passthru payment percentage); and ii) they will not be limited to the intended classes of securities (i.e. securities issued by PFFIs).

5.2. With respect to §1.1471-4(d)(4)(iv)(B)(4), we request that Treasury and the IRS provide greater clarification as to what is considered to fall within the notion of "all other income paid or credited".

Post-trade made easy

6. Verification procedure

6.1. We welcome the departure from the external audit procedure found under the QI regime, which would clearly be unworkable under FATCA, in view of the large number of prospective FFIs that the IRS would have to oversee. Moving to a system with self-certification will reduce the costs and other administrative burdens that an external audit can bring. Clarity would be welcome, however, on whether the QI external audit regime (as distinct from FATCA) will continue to exist.

6.2. Another area in which there has been a departure from the existing rules relating to the QI regime has been in the frame of documentary evidence requirements. At present, the QI system, by operation of the attachment to a QI's Qualified Intermediary Agreement, draws on the AML and KYC rules applicable in the QI's own jurisidiction. We request that, contrary to some of the provisions in the draft regulations, the AML and KYC rules of the local jurisdiction should be applied as they are today. FATCA should not add another layer of requirements on top of existing AML and KYC rules. Examples would be: i) the need for an FFI to track expiry dates of documentary evidence, something that is not required by existing rules; and ii) the substantial ownership threshold, set at 10% rather than 25%.

6.3. In relation to the content of the certification that the responsible officer is to make, it would be desirable for the draft FFI agreement to be issued as soon as is possible, and for that draft to make as clear as possible the procedural requirements in that regard.

7. Data gathering

Euroclear, as a market infrastructure, operates highly automated systems to provide efficient wholesale services to major financial institutions. In this context, having access to standardised and automated data is a must.

7.1. In relation to material modifications to grandfathered obligations (§1.1471-2(b)(2)(iv) - page 142), we request that the regulations put the onus on the issuing community to identify and notify the market that a substantial modification has occurred.

Post-trade made easy

7.2. For identification of participating FFIs (§1.1471-3(d)(3)(i) - page 172), we would request that the regulations explicitly permit FFIs to rely on third party data providers to provide them with automated information on the FFI-EIN. Alternatively, we would request that an FFI-EIN list be made available by the IRS in such a way that it be possible for PFFIs to automate the verification process of the FFI-EIN against their internal records.

7.3. Should a withholding on foreign passthru payments be introduced, we would also request that regulations explicitly permit the withholding agents to rely on third party data providers to inform them of the passthru payment percentage to apply to their payments.

Conclusion

We appreciate being given the opportunity to comment on the Proposed Regulations. While we recognize and applaud the efforts that Treasury and the IRS have made to shape the FATCA legislation to make it more practically feasible, we are still faced with a number of major implementation issues.

Safekeeping and settlement in Europe is a complicated topic and we anticipate that you will have questions regarding the points raised in this letter. Given the central role that the Euroclear Group plays in the European securities post-trade infrastructure landscape, we hope you will be amenable to discussing our requests with you further. Sophie Biourge, Director, Product Management, who is in charge of our efforts regarding FATCA, will be taking contact with you to arrange for such discussion. (sophie.biourge@euroclear.com; +322 326 2863).

Yours faithfully,

Jo Van de Velde
Managing Director, Head of Product Management
Euroclear SA/NV
+322 326 2744
Jo.vandevelde@euroclear.com