ABA Tax Section
May Meeting, Washington, DC
May 6, 2011

International Tax Committees Current Developments

Government Commentators

Michael J. Caballero
International Tax Counsel
Department of the Treasury
Washington, DC

Theodore D. Setzer
Deputy Associate Chief Counsel (Int'l)
Internal Revenue Service
Washington, DC

Presenters

Paul J. Crispino
General Electric Company
Stamford, CT

Maureen Kerrigan
PricewaterhouseCoopers LLP
Washington, DC

Summer A. LePree
Holland & Knight LLP
Miami, FL

Gary M. Thomas
White & Case
Tokyo, Japan

Moderator

Danielle E. Rolfes
Ivins, Phillips & Barker
Washington, DC

Agenda

- FLF: Recent Developments in Japan
- FAUST
  - Aircraft Leasing Final Regulations
  - FTC Guidance
  - Section 956, Software Sales; Section 960(c)
  - International Budget Proposals
  - Partnership Blockers & PFIC/CFC Overlap
  - Loss CFCs & Section 267(f)
- Transfer Pricing
  - New LB&I Transfer Pricing Director
  - 2010 APA Annual Statutory Report
  - Canada Arbitration
  - Intangibles Developments
  - APAs, China and India
- USAFTT
  - EOI/OECD Update
  - FATCA: Notice 2011-34

Foreign Lawyers Forum

- Recent Developments in Japan
  - 2011 Tax Reform Process
  - Key items in proposed 2011 annual reforms
  - Path Forward for Japanese Tax Reform
  - Transfer Pricing Alert

Recent Developments in Japan

- 2011 Tax Reform Process
  - Delay in passage of proposed 2011 annual reforms
  - Transitional extension of certain measures
  - Special tax law for Great East Japan Earthquake
- Key items in proposed 2011 annual reforms:
  - Corporate tax rate reduction of approximately 5%, resulting in effective rate of about 35.6%
  - Limiting net operating loss (NOL) deduction in any year to 80% of taxable income, while lengthening carry-over period from seven to nine years for losses arising in tax years ending on or after April 1, 2008

Recent Developments in Japan (cont'd)

- Key items in proposed 2011 annual reforms:
  - Limiting use of accelerated depreciation
  - Limited bad debt deductions by 25% annually with complete abolishment by 2014
  - Lowering deductible donation expenses to 50% of existing level
  - In transfer pricing:
    - Eliminate priority among methods
    - Adopt "most appropriate method rule"
    - Clarify use of ranges, averages and other points in a range
    - Clarify use of secret comparables

Recent Developments in Japan (cont'd)

- Path Forward for Japanese Tax Reform – Measures under Consideration
  - Abandon 5% corporate tax rate deduction
  - Keep rate reduction but adopt temporary corporate tax rate increase
  - Increase consumption tax rate as disaster recovery measure
  - Increase income tax rates on individuals
- Transfer Pricing Alert: Use of "Donation" Taxation That Avoids Application of Arm's Length Principle
  - Denial of access to competent authority relief

Foreign Activities of U.S. Taxpayers

- Agenda
  - Aircraft Leasing Final Regulations
  - FTC Guidance, including two category final regulations and Notice 2007-58 on Financial Services Entity status
  - Section 956, Software Sales; Section 960(c)
  - International Budget Proposals
  - Partnership Blockers & PFIC/CFC Overlap
  - Loss CFCs & Section 267(f)

Aircraft Leasing Final Regulations

- On July 2, 2008, the IRS and Treasury issued final, temporary and proposed regulations on the treatment of certain income and assets related to the leasing of aircraft or vessels in foreign commerce under sections 367, 954 and 956.
  - The temporary regulations expire on July 1, 2011. Section 7805(e).
- The temporary regulations added a new marketing safe harbor for rents derived from leasing aircraft, vessels or engines in foreign commerce when active leasing expenses equal or exceed 10% – rather than 25% – of adjusted leasing profit. Temp. Treas. Reg. Section 1.954-2T(c)(2)(ii).
  - An aircraft or vessel is leased in foreign commerce if (i) it is used for the transportation of property or passengers between a port or airport in the U.S. and a foreign country or between foreign ports or airports (used in foreign commerce), and (ii) (a) more than 50% of the miles traversed during the taxable year are outside the U.S. or (b) it is located more than 50% of the time during the taxable year outside the U.S. (predominantly used outside the U.S.). Temp. Treas. Reg. Section 1.954-2T(c)(2)(v).
- The temporary regulations also provide that rents derived from certain acquired leases and from marketing finance leases are eligible for the active rents exception. Temp. Treas. Reg. Section 1.954-2T(c)(2)(vi), (vii).
  - Rent from an acquired lease is eligible for the active rents exception if following the acquisition, the lessor performs active and substantial management, operational, and remarketing functions with respect to the leased property.
- The 2011 final regulations adopt the proposed regulations with some changes.

FTC Guidance

- Final regulations on the reduction of section 904(d) separate categories from 8 to 2 issued on April 7, 2011. TD 9521.
  - Categories reduced in the American Jobs Creation Act of 2004, effective for taxable years beginning after December 31, 2006.
  - Temporary and proposed regulations issued on December 21, 2007, set forth transition rules and safe harbors, including the ability to either reconstruct pre-2007 earnings and taxes or apply safe harbor methods.
  - The final regulations adopt the proposed regulations with minor changes.
  - Safe Harbor Methods. Taxpayers elect a safe harbor method by employing it in determining their FTC limitation on a timely filed original or amended return or during the course of an audit.
  - Look-through for Partnership Interests. The final regulations apply to the sale of a partnership interest by any 25% owner, rather than just CFC 25% partners.
  - FSE Recapture Rules. The loss account of a financial services entity having a separate limitation loss of overall foreign loss in the pre-2007 high withholding tax interest category, but no excess taxes in that category, is allocated to the post-2006 general, rather than passive, category.

FTC Guidance (cont'd)

- Reconsidering Financial Services Entity (FSE) Status. Is anything happening with Notice 2007-58? The IRS and Treasury announced the intention to consider updating the financial services entity, financial services income and active financing income definitions to reflect two FTC categories and the possibility of worldwide interest allocation (since delayed until 2021). *See* Treas. Reg. §1.904-4(e).
  - Prior to the reduction in the FTC limitation categories, income of a financial services entity would have been assigned to a separate category; now it is assigned to the general category.
  - Concern about inappropriate use of FSE status.
  - A number of written comments were submitted.
  - Current law application of 80% test: mechanical? Modifications to reflect changes in the nature of financial services, e.g., operating lease income?

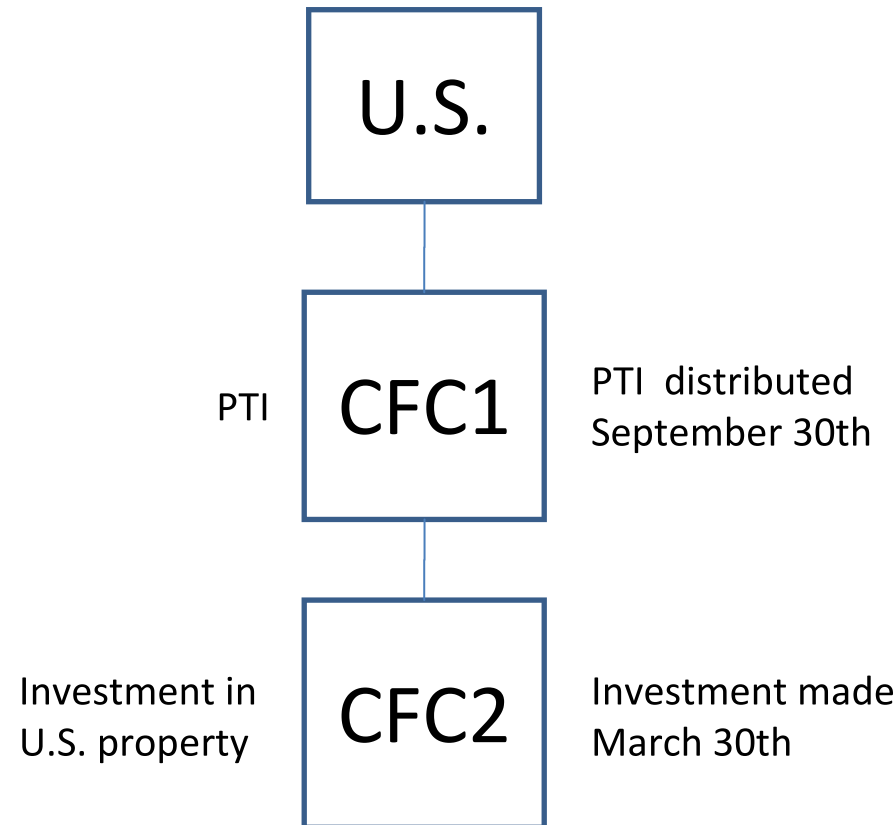
Section 956 Issues

- Intangibles Used in the United States
  - The IRS has held that a CFC's sales of software to U.S. customers does not give rise to an investment in U.S. property, although the CFC's acquisition or development of intangible property for use in the U.S. would give rise to an investment in United States property. CCA 201106007 (Oct. 13, 2010). See also PLR 200229030 (Apr. 17, 2002), revoked by PLR 200411016 (Nov. 24, 2003).
  - U.S. property includes any right to use in the U.S. a patent or copyright, an invention model or design, a secret formula or process, or any other similar property right, that a CFC acquires or develops for use in the United States. Section 956(c)(1)(D).
  - The CFC in question apparently obtained the right to distribute the software in the U.S. under a cost sharing arrangement with its U.S. parent, the distributor and developer of the software. It isn't clear why the CFC, rather than the U.S. parent, would have been granted the right to exploit the intangible in the United States.
  - No discussion of taxation at CFC level, subpart F, source, or related matters.
  - CCA questions whether the CFC had any tax basis in the intangible for purposes of calculating the CFC's investment in U.S. property.
  - CCA suggests having the right to use, without regard to actual use, is critical to finding an investment in U.S. property. But see Treas. Reg. §1.956-2(a)(1)(iv) (referencing actual use as indicative of having acquired or development IP for use in the U.S.).

Section 956 Issues

- Section 960(c)
  - Section 214 of the Education Jobs and Medicare Assistance Act of 2010 (Pub. L. No. 111-126) amended section 956 to limit the amount of FTCs deemed paid with respect to section 956 inclusions.
  - Section 960(c) provides that if there is a section 956 inclusion, the amount of any FTCs deemed to have been paid during the taxable year of the domestic shareholder under section 902 with respect to such inclusion cannot exceed the amount of the credits that would have been deemed to have been paid "if cash in an amount equal to the amount of such inclusion in gross income were distributed as a series of distributions (determined without regard to any foreign taxes which would be imposed on an actual distribution) through the chain of ownership which begins with such foreign corporation and ends with such domestic corporation."
  - Guidance expected, including clarifying mechanical issues for the hypothetical distribution concept.
  - Query whether the hypothetical distribution should be deemed to occur on the date the 956 investment is established, on each quarterly testing date or at year end. Is the taxpayer locked into the structure and attribute position of the CFC and the qualified group chain on the date of the investment in U.S. property?

Hypothetical Distribution Timing



In determining the hypothetical distribution, is the existence of PTI determined at the time of the initial investment in U.S. property, on each quarterly testing date or at year end?

Fiscal Year 2012 Revenue Proposals

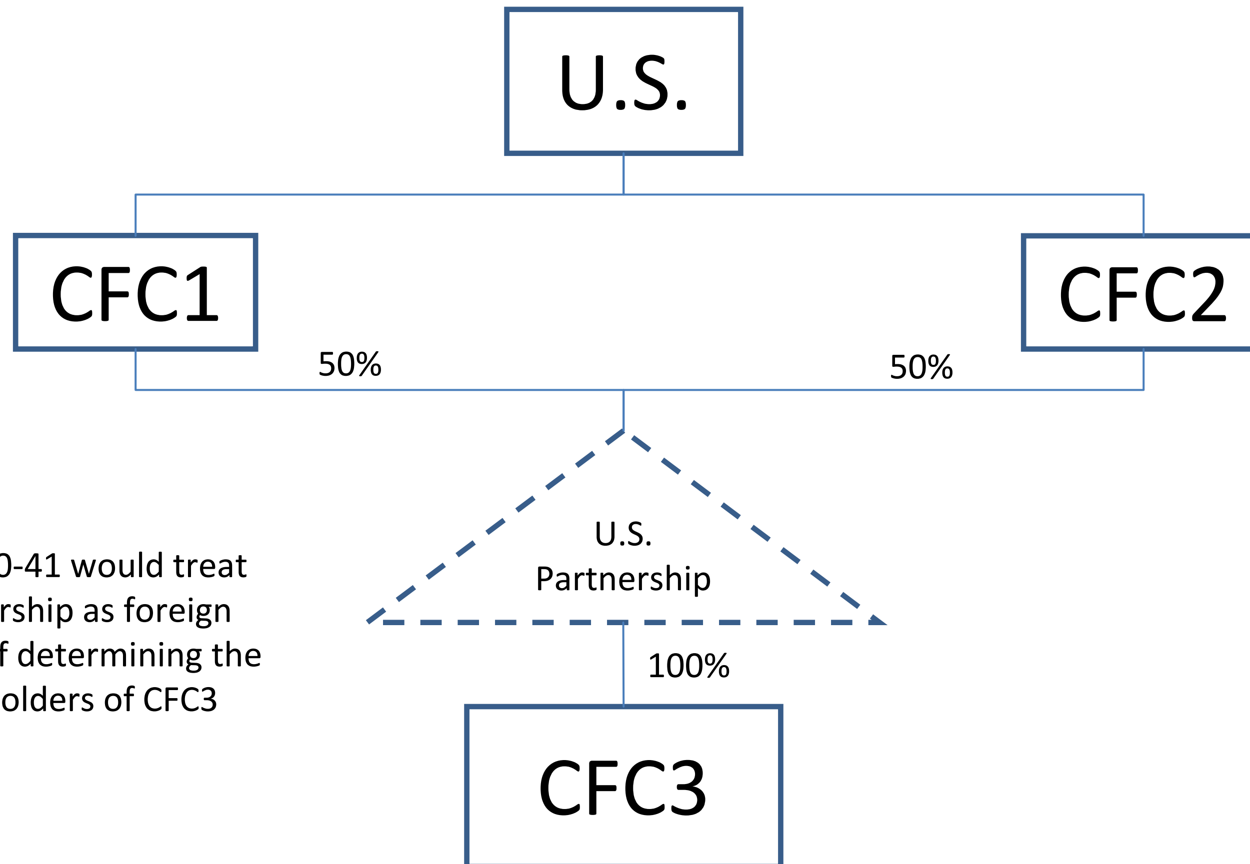
- On February 14, 2011, Treasury issued its Greenbook describing the Administration's fiscal year 2012 revenue proposals.
  - The international proposals essentially are carried over from the previous budget, including the proposals to deny interest expense deductions related to deferred income and determining FTCs on a pooled basis.
  - Excess Returns from Transferred Intangibles Taxed under Subpart F. This proposal has been modified to apply on a transactional basis, rather than an entity basis, and to clarify that the excess returns would be computed on a net basis after costs (other than taxes and interest) increased by a percentage mark-up. The proposal still would create a new category for this income (to limit cross crediting as other proposals also do but see 2004 Act's simplification aim) and would be triggered only if the excess returns are subject to a low foreign effective tax rate.
    - Need to determine what transactions are "connected with or benefitted from" the transferred intangibles.
    - How would the percentage mark-up be determined? Presumably transfer pricing methodology, e.g., comparables, would be used.
    - How would the effective tax rate be determined?

Partnership Blockers & PFIC/CFC Overlap

- In several PLRs, the IRS has held that the PFIC/CFC overlap rule of section 1297(d)(1) applies when a foreign corporation is owned directly or indirectly by a domestic partnership. See, e.g., PLR 201107004 (Nov. 8, 2010); PLR 201106003 (Nov. 8, 2010).
  - The partnership has a mix of U.S. partners, including individuals, domestic corporations and upper-tier domestic partnerships. The taxpayer represented that the so-called partnership blocker strategy described in Notice 2010-41, 2010-22 I.R.B. 715, did not apply to the partnership. See also Notice 2009-7, 2009-1 C.B. 312, identifying the partnership blocker structure as a transaction of interest. The ruling also provides that it doesn't apply if the U.S. person owns its interest through a CFC in a partnership blocker structure. Cf. 1.367(a)-9T(b) and 1.367(b)-4T(e)(2) (special rules apply when taxpayer takes certain positions).
  - In a partnership blocker strategy, a domestic partnership is inserted between CFCs. The U.S. taxpayers owning the upper-tier CFC take the position that because the domestic partnership is the U.S. shareholder with respect to the lower-tier CFC, the U.S. taxpayer does not have an income inclusion under section 951(a) with respect to the subpart F income of the lower-tier CFC.
  - Although it seems obvious that the overlap rule should apply when the U.S. owner of a foreign corporation is subject to both the PFIC and subpart F regimes, the ruling presumably suggests that a U.S. owner taking the position that the partnership blocker strategy precludes the application of subpart F is subject to the PFIC regime.

    Is this consistent with Notice 2010-41's recast?

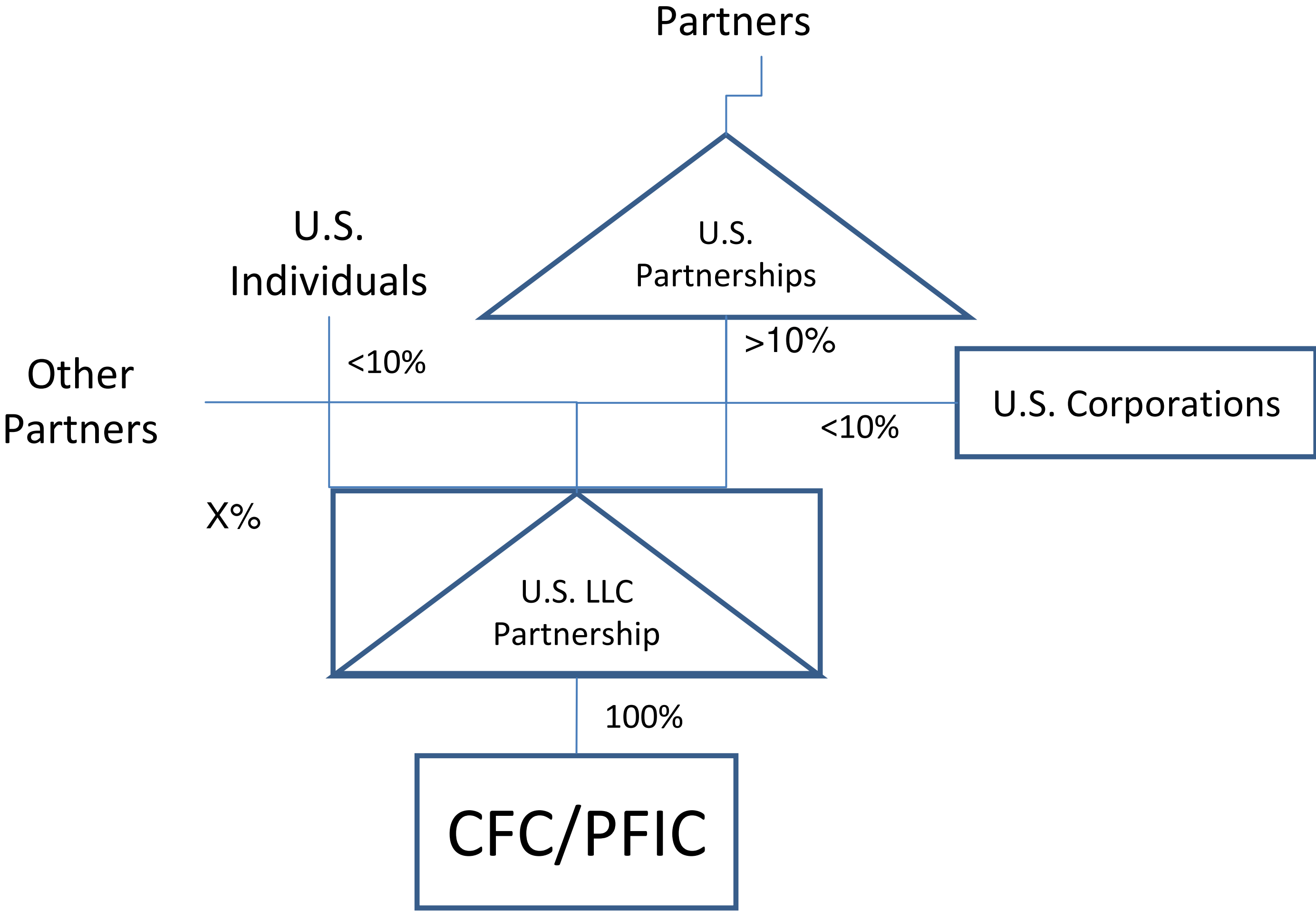
Partnership Blockers



Notice 2010-41 would treat U.S. partnership as foreign purposes of determining the U.S. shareholders of CFC3

Is there any timing on when the regulations implementing Notice 2010-41 would be issued?

Partnership Blockers & PFIC/CFC Overlap

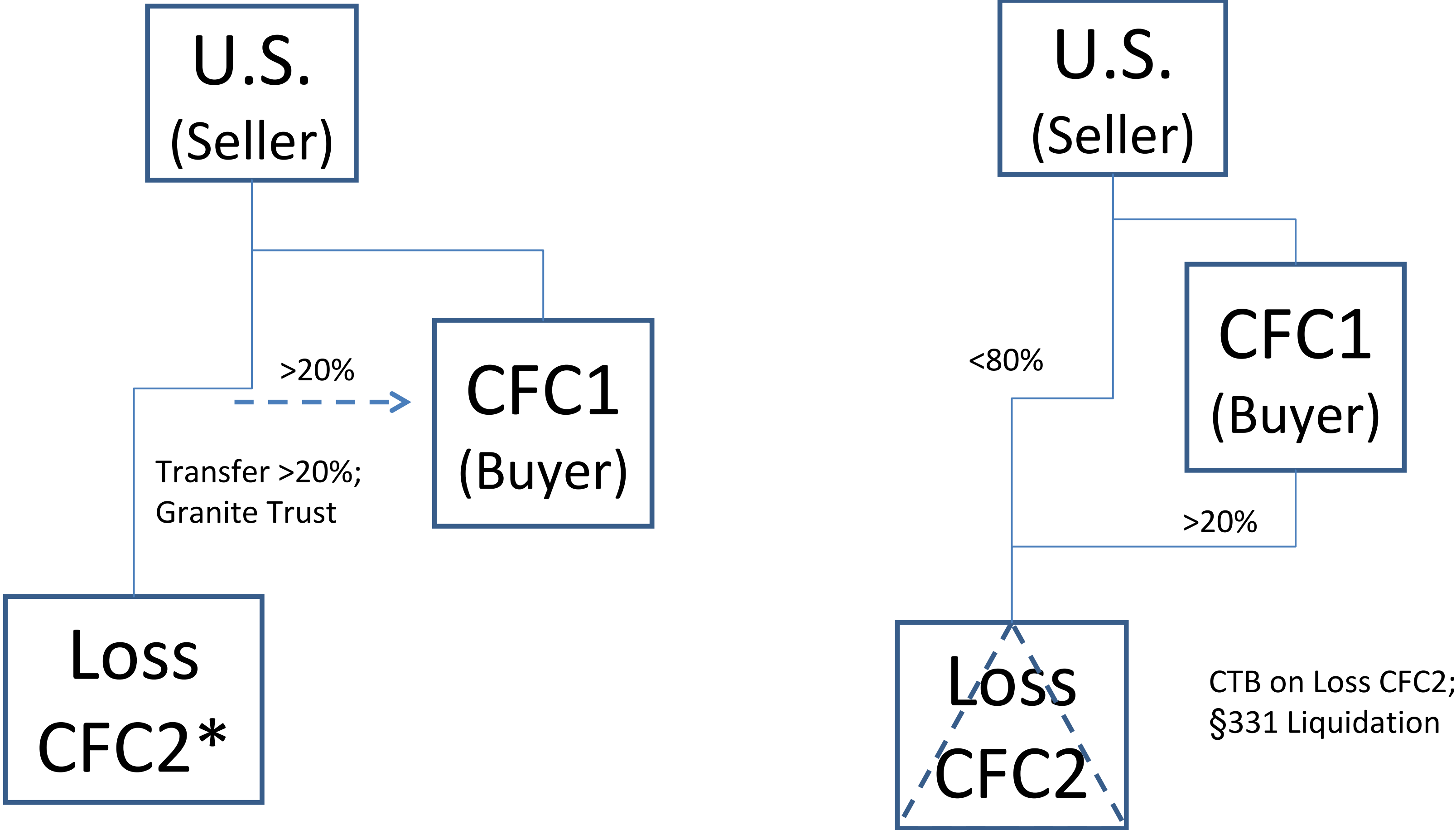


The PLRs hold that if Notice 2010-41 is not applicable, section 1297(d)'s PFIC/CFC overlap rule precludes the application of the PFIC regime to the U.S. shareholders.

Loss CFCs & Section 267(f)

- On April 21, 2011, IRS and Treasury issued proposed regulations under section 267(f) that would defer losses on transferred controlled group member shares, including shares of CFCs, until the buyer and seller are no longer related. The proposal would be effective for transfers occurring after the date the regulations are made final. See also CCA 201025046 (March 12, 2010).
- Proposal aimed at internal restructurings of loss companies, including CFCs, including through Granite Trust restructurings. See also budget proposal aimed at repealing section 351(g) (nonqualified preferred shares).
- Losses on transferred shares still would be available if shares transferred outside of the controlled group or if CFC is wholly worthless. Section 165; Rev. Rul. 2003-125.

Loss CFCs & Section 267(f)



PROPOSED REGULATIONS WOULD DEFER LOSS ON TRANSFERRED >20% INTEREST UNTIL SELLER AND BUYER ARE NO LONGER IN CONTROLLED GROUP RELATIONSHIP

* Loss CFC2 is not insolvent

Transfer Pricing

- Agenda
  - New LB&I Transfer Pricing Director
  - 2010 APA Annual Statutory Report
    - Pooling of Resources
  - Canada Arbitration
  - Intangibles Developments
    - Chief Counsel Advisory
    - OECD Project on Intangibles
  - APAs, China and India

New LB&I Transfer Pricing Director

- Sam Maruca, last week named new Transfer Pricing Director at the IRS, in LB&I
- Assume leadership of IRS's transfer pricing practice and the international practice network
- Expected to oversee development of a comprehensive transfer pricing strategy and training program at the IRS, add economists
- To join IRS on May 9

APA Annual Statutory Report

- Announcement 2011-28 (March 29, 2011),
  APA Program released its Annual Statutory Report regarding the APA Program's activities and structure for the calendar year 2010
- A record high number of APAs submissions for the third straight year, 144 applications were filed (127 submissions in 2009)

APA Annual Statutory Report

- APA Program executed 69 APAs in 2010, 49 bilateral and 20 unilateral (in 2009, 63 APAs were executed, 42 bilateral and 21 unilateral)
- Renewals, 32 executed in 2010 (28 in 2009)
- Pending requests for APAs, 350 in 2010 (321 in 2009)
- Median time to complete a bilateral/multilateral was 37.3 months in 2010 (40.6 months in 2009)
- Staff decreased from 39 at the end of 2009 to 35 at the end of 2010

Pooling

- Discussion of “pooling” of resources between the APA Program and U.S. Competent Authority
- Efforts have begun toward a pooling of resources and a better managing of their shared bilateral case load as a single inventory
- Pooling efforts remain at the initial stage
- One practice under consideration is assignment of a single APA team leader or CA analyst to work a bilateral case through, from inception to conclusion

Canada Arbitration

- About 80% of bilateral APAs in Canada involve the United States
- Growing APA caseload in Canada
- Canada APA statistics
  - Average time to complete a bilateral case during 2009-10 tax year was 48.8 months
  - Canada opened 2009-10 tax year with an active case inventory of 84 APAs and accepted 29 additional cases into the program; 16 APAs completed; 2 taxpayers withdrew; closing inventory of 95 APAs

Canada Arbitration

- Fifth Protocol to the US-Canada Treaty contained an arbitration procedure that became effective on December 15, 2010
- MOU and Arbitration Board Operating Guidelines released November 2010, providing detailed guidance concerning how the arbitration process would operate
- Cases eligible for arbitration under the MOU were APA cases, MAP cases, and Accelerated Competent Authority Procedure requests
- Provides for "baseball" style arbitration by a three-member board

Canada Arbitration

- Under the MOU, for an APA, arbitration begins two years after the earliest date on which the information necessary to undertake substantive consideration has been received by both parties
- Prevailing thought when the MOU was signed was that U.S. APAs with Canada would be under pressure to close

Canada Arbitration

- IRS cautious comments
- Michael Danilack,
  "[T]oo early to declare that arbitration is a success . . . We need to go through the whole process before we can make declarations about its success in the long run."
- IRS official recently said that since August the U.S. and Canada have closed 80 percent of the double tax cases that would have been eligible for arbitration by December 15

Intangibles: CCA

- On March 18, 2011, the IRS publicly released CCA 201111013 (dated June 25, 2010)
- Applies cost sharing concepts to a scenario where one party (Donor) provides a valuable intangible asset to a related party (Recipient) that must then further develop the intangible at its own expense before the intangible asset can be fully exploited
- Observes the principles of the income method as described in the temporary cost sharing regs may also be applicable to licenses and other intangible transactions that do not involve cost sharing

Intangibles: OECD

- On January 27, 2011, the OECD released a scoping paper with regard to a new project that will consider the various issues related to transfer pricing for intangibles
- Issues include framework, definitional aspects, specific categories of intangibles, intangible transfers, right of an enterprise to share in the return of an intangible it does not own, cost contribution arrangements, and valuation

Intangibles: OECD

- Result likely to be substantial revisions to Chapter VI (Special Considerations for Intangible Property)
- Plan to publish a discussion draft at the end of 2013
- Full OECD paper available at www.oecd.org/dataoecd/10/50/46987988.pdf

APA Report from China

- On December 30, 2010, China's State Administration of Taxation issued its first-ever report on APAs, the years from 2005-2009

Year	Unilateral	Bilateral	Total
2005	13	1	14
2006	10	0	10
2007	7	3	10
2008	6	1	7
2009	5	7	12
Total	**41**	**12**	**53**

APA Report from China

- Rise in the number of bilateral, with only one in 2005 and seven in 2009, and 2009 being the first year that the number of bilaterals exceeded the number of unilaterals
- Of the 12 bilateral APAs signed in 2009, nine were concluded with other countries in Asia, two with European countries, and one with North America
- Of the 53 completed APAs, all but two took two years or less to process, and more than half of those APAs (31 APAs) took one year or less

APAs: India

- Substantial backlog of transfer pricing cases in India
- Plans to provide for APAs. Features: arm's length price under any method, five years, binding on taxpayer and income tax authorities
- Will begin with unilateral agreements
- No specifics regarding the composition of the India APA Team
- U.S. and Indian CAs did resolve a significant number of transfer pricing cases in 2010

U.S. Activities of Foreigners & Tax Treaties

- Agenda
  - EOI/OECD Update
  - FATCA
    - Notice 2011-34

EOI/OECD Update

- Global Forum Peer Review
- Panama TIEA
- OECD/Council of Europe Multilateral Convention on Mutual Tax Assistance
- Joint Audits
- TRACE

FATCA

- "FATCA" signed into law March 18, 2010 (as part of HIRE Act)- IRC §§ 1471-1474
- Requires foreign banks and investment funds to report account information to IRS
- New withholding tax compliance regime
- Takes effect January 1, 2013

FATCA

- Automatic 30% W/H on “withholdable payments” to FFIs (foreign financial institutions) that fail to enter into agreement with IRS and certain payments to NFFEs (nonfinancial foreign entities)
- “Withholdable payments”
  - US source FDAP items
  - Proceeds from sale of property producing US-source interest or dividends

FATCA

- FFI defined- Section 1471(d)(4) and(5)
  - any foreign entity that
    - accepts deposits in the ordinary course of a banking or similar business,
    - as a *substantial* portion of its business, holds financial assets for the account of others, or
    - is engaged (or holding itself out as being engaged) *primarily* in the business of investing, reinvesting, or trading in securities (as defined in section 475(c)(2) without regard to the last sentence thereof), partnership interests, commodities (as defined in section 475(e)(2)), or any interest (including a futures or forward contract or option) in such securities, partnership interests, or commodities.
- What is “substantial”? What is “primarily”?

FATCA

- To avoid withholding, FFI must qualify as PFFI (participating FFI)
  - Enter FFI Agreement with IRS to:
    - Identify and disclose US owners of non-US bank or securities accounts
    - Withhold on payments to nonparticipating FFIs and recalcitrant account holders

FATCA

- Notice 2010-60 (August 27, 2010)
  - Exemptions and exclusions
  - Definitions
  - Information and identification requirements
  - Requested comments on various issues

Notice 2011-34

- April 8, 2011
- Items Covered:
  - Procedures for identifying preexisting accounts
  - Passthru payments- definitions and calculations
  - Deemed-compliant FFIs
  - Reporting requirements
  - Treatment of QIs
  - Expanded affiliated groups
- Does not adopt many commentator suggestions for additional exemptions and deemed-compliant status

Notice 2011-34

- Section I- Preexisting Individual Accounts
  - Notice 2010-60 identification procedures modified in response to comments
  - New provisions provided re: “private banking”
  - Six-step process for identifying accounts
  - Foreign PO boxes removed from list of US indicia
  - Requires completion certification by FFI’s “responsible officer,” including statement that FFI did not direct, encourage, or assist with avoidance

Section I. Preexisting Individual Accounts

- Substantially reduces compliance burdens to FFIs for preexisting accounts
- Now only private banking accounts and large accounts require both paper and electronic searches
- Other accounts only electronic review

Section I. Preexisting Individual Accounts

- Step 1: Account holders already documented as US persons are US account holders for FATCA
  - But not if account is depository, all owners are individuals, and balance not more than $50,000 on preceding 12/31
- Step 2: Exception for accounts with balance not more than $50,000
  - Many FFIs commented on limited utility of this provision for various reasons

Section I. Preexisting Individual Accounts

- Step 3: Private Banking Accounts
  - FFI must ensure, within 1 yr of FFI agreement, all private banking relationship managers:
    - Identify clients where actual knowledge of US status and request W-9
    - Perform diligent review of paper and electronic account files to identify accounts with US indicia
    - Request documentation from account holders where US indicia present (W-9 or W-8BEN)
    - Create and retain lists of existing US accounts, non-US accounts, and recalcitrant accounts
    - FFI must keep all written requests and responses for 10 years

Section I. Preexisting Individual Accounts

- Step 4: Accounts with US Indicia
  - FFI electronic search for US indicia
  - If so, FFI must request documentation within 1 year of FFI Agreement
  - Account holders must respond within 2 years of FFI Agreement effective date, or are classified as "recalcitrant" until documentation is received

Section I. Preexisting Individual Accounts

- Step 5: Large Accounts
  - If 12/31 balance was $500,000 or more, per se FFI diligent review of files to search for US indicia and request proof
  - If not produced within 2 years, recalcitrant status
  - More burdensome documentation required compared to prior Notice
  - But less burdensome for <$500K where no US indicia
- Step 6: Yearly Retesting
  - Beginning in year 3, FFI must apply Step 5 annually to accounts that did not meet the $500k threshold initially, but that do hold $500k as of 12/31 of the prior year

Section II. Passthru Payments

- PFFIs must deduct and withhold 30% of any "passthru payments" to recalcitrant owners and nonparticipating FFIs
  - Any withholdable payment or other amount to extent "attributable to" withholdable payment
  - Received comments suggesting limited definition
  - Also received comments suggesting broader definition using formulary approach
  - Adopted latter approach

Section II. Passthru Payments

- Deeming rule based on asset ratio
- A payment is a Passthru Payment to extent of
  1. Withholdable payments, plus
  2. Portion that is not a withholdable payment, multiplied by “passthru payment percentage” (PP%) of the payor FFI or issuer FFI (for custodial payments)

Section II. Passthru Payments

- PP% is based on FFI's assets:
  - FFI's US assets/FFI's total assets=PP%
  - Tested quarterly, and four most recent quarters averaged
  - Use gross assets as shown on financial statements, no reduction for liabilities
    - How does this apply to consolidated groups?
  - Assets in custodial accounts are not counted
  - Look-thru rule for lower-tier FFIs
  - FFI required to publish PP% quarterly
  - Failure to publish causes deemed PP% of 100% to apply

Passthru Payment Percentage

- Example:

  Fund A, a PFFI, is a fund of funds that elects to use book value for valuation purposes. Fund A's total assets are $100 million, broken down as follows:

  - Interest in Fund B, nonparticipating FFI ($20mm)
  - Interest in Fund C, PFFI with 50% PP% ($30 mm)
  - Interest in Fund D, PFFI with no PP% ($10 mm)
  - Interest in Fund E, domestic corp. ($40 mm)

Passthru Payment Percentage

- Example:

  A's PP% is 65%, calculated as follows:

  - A's US assets are $65 mm:
    - Fund B= $0 ($20mm * 0%) (the 0% prevents double withholding)
    - Fund C= $15mm ($30mm * 50%)
    - Fund D= $10mm ($10mm * 100%)
    - Fund E= $40mm ($40mm * 100%)
  - A's total assets are $100mm
  - $65mm/$100mm= 65%

Issues

- Potentially overreaching
- These amounts must be withheld on even if the accounts and owners have no connection to US and no US investments
- In cases of overwithholding, how is a refund obtained?
- How to identify nonparticipating FFIs?

Section III. Deemed-Compliant FFIs

- Three new categories of “deemed-compliant” FFIs:
  - Some local banks having only local affiliates;
  - Local FFI members of participating FFI groups; and
  - Certain investment vehicles and funds.
- To qualify, FFI must:
  - Apply to IRS for approval
  - Certify continued status every 3 years
  - Obtain an FFI-EIN

Deemed-Compliant FFIs

- Strictly Local Banks:
  - Each FFI in EAG licensed and regulated as bank; not fund;
  - Not engaged primarily in the business of investing, reinvesting, or trading in securities, etc.;
  - All members of EAG formed in same country;
  - No FFI solicits account holders outside home country;
  - Each member implements policies and procedures to ensure it does not open accounts for nonresidents, nonparticipating FFIs, and most NFFEs

Deemed-Compliant FFIs

- Strictly Local Banks:
  - Cannot have any significant contact with foreign persons
  - Can mortgage lenders use this exception? Is their primary business "investing" in mortgages?

Deemed-Compliant FFIs

- Local FFI Members of Participating Groups:
  - At least one member of group is a PFFI;
  - That local member has no operations outside its home country;
  - Does not solicit account holders outside home country;
  - Implements pre-existing account and customer ID procedures;
  - Agree with IRS that if any US accounts found, will either enter FFI agreement, transfer account to PFFI member (within *reasonable time*), or close account.

Deemed-Compliant FFIs

- Certain Investment Funds
  - All direct investors must be PFFIs or deemed-compliant FFIs holding on behalf of others, or certain excluded entities per 1471(f);
  - Fund must explicitly limit ownership to above persons;
  - Fund must certify it will calculate and publish PP% pursuant to the Notice

Deemed-Compliant FFIs

- Issues
  - Treatment of debt is still unclear
    - under 1471(d)(2)(C) debt is a “financial account” unless regularly traded on “established securities market”
  - Thus, if FFI has a foreign creditor, this could constitute foreign “financial account” that prevents the FFI from qualifying for deemed-compliant status
  - Need for guidance on what is “established securities market”
  - Need exceptions for short-term debt and commercial paper, regularly employed by U.S. businesses, etc.
  - This is also relevant to equity. When does interest in investment fund that’s not exchange-traded satisfy this test? What about a bank’s non-exchange-traded preferred stock?

Section IV. Reporting on US Accounts

- For reporting US account balances, FFIs may use year-end balances, rather than highest monthly balance
- Instead of gross receipts and withdrawals data, FFIs must provide annual data on
  - gross dividends paid or credited;
  - gross interest paid or credited;
  - gross other income paid or credited; and
  - gross proceeds from sale or redemption of property where FFI was custodian, broker, nominee, or other agent.

Section IV. Reporting on US Accounts

- Reporting interests in financial institutions:
  - Gross amount of all distributions, interest, and similar amounts;
  - Redemption payments
- US accounts closed or transferred
  - Report income paid/credited to closing date
  - Report amount or value withdrawn or transferred
  - Report account as closed or transferred
- Five year retention requirement if account statements retained in ordinary course of business and must provide to IRS on request

Section IV. Reporting on US Accounts

- Branch Reporting Election
  - IRS received comments that local privacy law prevents some FFIs from sharing information across jurisdictions
  - Response: FFIs may elect for each branch to report separately, rather than consolidate data
    - Election made with FFI Application

Section IV. Reporting on US Accounts

- Despite comments expressing concerns over duplicative reporting and substantial expense to FFIs, still no exception for US accounts where data is already automatically shared with IRS via treaty information exchange
  - E.g., Canada, UK

Section V. Qualified Intermediaries (QIs)

- QIs, foreign withholding partnerships, and foreign withholding trusts must consent to become PFFIs in their existing QI agreements unless qualify as deemed-compliant

- Notice (again) expresses intent to coordinate Chapter 3 and Chapter 4 withholding, and requests comments on the issue
  - How/when? Risk of overwithholding.

Section VI. EAG Provisions

- Each FFI in an EAG must be a PFFI or qualify as deemed compliant
- Notice sets out coordinated application process, where a lead FFI is appointed to apply for all members, though FFIs are still responsible for own obligations under the agreement
- Does an FFI EAG member that is not deemed compliant, but has no US accounts or US customers, have to sign an FFI agreement and comply with FATCA?
- Apparently so. Notice says continuing to study the issue.

This presentation does not constitute the provision of legal advice, accounting services, or written tax advice under Circular 230. The information provided herein is of a general nature and is not a substitute for consultation with legal or accounting advisers who have been provided with all pertinent facts.