INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÉRES

November 19, 2009

Representative Charles B. Rangel
Chair, House Ways and Means Committee
1102 Longworth House Office Building
Washington, DC 20515

Representative Richard E. Neal
House Ways and Means Select Revenue Measures Subcommittee Chairman
1102 Longworth House Office Building
Washington, DC 20515

Re: HR 3933: *Foreign Account Tax Compliance Act of 2009*

The Investment Industry Association of Canada (**IIAC**) would like to take this opportunity to submit comments to the House Ways and Means Select Revenue Measures Subcommittee with regard to the draft legislation impacting foreign financial institutions (**FFIs**) contained in HR 3933, the *Foreign Account Tax Compliance Act of 2009* (the **Act**) filed by Chairman Rangel on October 27, 2009. We would kindly ask that you consider these comments, and include them in the record for the hearing held on November 5, 2009.

BACKGROUND INFORMATION

The IIAC is Canada's equivalent to the Securities Industry and Financial Markets Association (**SIFMA**) in the United States, and represents over 200 investment dealers across Canada.

In June 2000, the Department of Finance Canada reported that there were 188 securities firms in Canada at the end of 1999 and that the 7 largest firms accounted for approximately 70% of the industry's capital. At that time, all but one of Canada's large, full-service securities firms were bank owned. The landscape of the Canadian securities industry has not changed significantly since that time.

In August 2001, the Department of Finance Canada estimated that banks accounted for approximately 70% of the total domestic assets held by the financial services sector, and that the six major domestic banks accounted for over 90% of the assets held in the banking industry.

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GENERAL CONCERNS REGARDING THE ACT

The IIAC understands the U.S. government's concerns regarding the use of offshore accounts and entities by certain persons to evade U.S. tax. This is a concern shared by the governments of many countries, and we have observed increased global efforts and inter-governmental cooperation through the inclusion of tax information exchange provisions in many new income tax treaties and protocols to existing treaties, as well as an increase in the number of tax information exchange agreements between countries that do not have income tax treaties in effect.

We recognize that an opportunity exists for the Internal Revenue Service (**IRS**) to use its influence over FFIs in the U.S. government's efforts to identify U.S. persons that may be evading U.S. taxation of income earned, directly or indirectly, through offshore accounts. Implementing the Act as proposed would allow the IRS to receive information automatically from FFIs and avoid having to make requests to foreign governments under tax information exchange agreements or under exchange of information provisions contained in income tax treaties. However, we believe that a more appropriate means to address tax evasion is by the use of international solutions developed through negotiations between governments, not through negotiations and agreements between the IRS and private entities.

We are extremely concerned that compliance with the Act will impose a significant level of additional cost and operational risk on FFIs that will be disproportionate to the amount of additional U.S. tax revenue generated. In particular, we are concerned that many FFIs will not find it economically feasible to enter into agreements with the IRS under proposed section 1471(b) **(FFI Agreements)** and to continue to operate as Qualified Intermediaries (**QIs**). It would be unfortunate to see foreign financial institutions forced to exit the QI regime into which they and the IRS have invested significant resources.

Foreign financial institutions will also need to consider the impact on their clients. It will be difficult to justify additional burdens and costs being placed on non-U.S. account holders with no investment in U.S. securities. Ultimately, this will likely have a detrimental impact on U.S. capital markets generally by creating disincentives for Canadians and other foreign investors to invest in the U.S. The "green shoots" of economic recovery in the U.S. could be stunted by the disproportionately onerous provisions of the Act. It could also result in a loss of opportunity for American investors by creating disincentives for U.S. persons to open accounts in Canada and elsewhere, disrupting the flow of global capital markets.

If the Act is enacted, it is critical that the Department of the Treasury (**Treasury**) and the IRS work closely with FFIs to ensure that the detailed requirements strike a reasonable balance between increasing U.S. tax revenue by identifying tax evasion by U.S. persons, and the additional financial burden and operational risks being imposed upon FFIs, in an effort to maximize the continued participation of such institutions in the QI regime and the number that enter into FFI Agreements with the IRS**.**

CONCERNS REGARDING SPECIFIC PROVISIONS OF THE ACT

Below we have summarized our concerns regarding specific provisions of the Act. Our comments are limited to the proposed new Chapter 4 of the Internal Revenue Code.

1. Effective Date

The Act provides that new Chapter 4 will generally apply to payments made after December 31, 2010.

We strongly believe that the implementation of the Act's requirements with respect to the identification and reporting of certain foreign accounts will require a substantially longer timeframe, especially given that much of the detail about implementation will be contained within regulations to be developed by Treasury, and within the FFI Agreements to be negotiated between FFIs and the IRS.

Once the Act is enacted, Treasury and the IRS will need to develop detailed regulations, model FFI Agreements, reporting forms, and other guidance. Until these details are finalized, an FFI will not be in a position to fully assess the costs and risks associated with compliance, and ensure that there are no legal or operational restrictions which would impede the FFI's ability to comply with the terms of the FFI Agreement. An FFI cannot make the business decision to enter into such an agreement without completing this internal review and analysis.

Once an FFI has confirmed that it can and will enter into an FFI Agreement with the Secretary, it needs time to make the necessary systems and operational changes to gather and record the additional information required for the purposes of identifying United States accounts, as well as accounts that are excluded from the requirements, and to modify systems to be able to produce the necessary reporting information. ***For most large FFIs, the minimum period required to make the necessary changes will be at least two years.***

If FFIs are not given enough time to make the changes necessary to be able to comply with the terms of the FFI Agreement, there is a risk that they will delay entering into such agreements until they are able to comply, even if this is after the effective date. If this results in the application of the 30% withholding on payments to the FFI in the interim, it could be extremely disruptive to the flow of U.S. withholdable payments and investment in the U.S. market.

Withholding agents will also need to identify their FFI clients and determine which ones have entered into FFI Agreements. Those FFIs that do not currently have the capability to withhold 30% tax on withholdable payments made to other FFIs or applicable non-financial foreign entities will need to implement the necessary changes. For many such FFIs, withholding on gross proceeds may present the greatest challenge.

Significant IRS resources will also be needed to process large numbers of FFI Agreements in a very short time period. A large affiliated group of FFIs could easily be operating in more than 50 countries and may have multiple legal entities within each of those countries that might enter into FFI Agreements. Whereas there are currently approximately 5,500 entities that have QI Agreements with the IRS, given the broad definition of FFI, there are potentially hundreds of thousands of entities that could be in position to enter into FFI Agreements with the IRS.

We recommend that the effective date of December 31, 2010 be removed from the Act and replaced with a provision giving power to the Secretary to devise a flexible or staggered effective date under the accompanying regulations. The effective date should be determined with regard to finalization of regulations, guidance and agreements.

2. Authority of the Secretary of the Treasury

The Act provides that the "Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the purposes of this chapter." Throughout proposed new Chapter 4, there are numerous provisions that give the Secretary the authority to define exceptions and exclusions from the requirements, as well as the detailed requirements.

However, there are certain additional areas where we would like to see greater authority given to the Secretary:

- Authority to define exceptions to the requirement in section 1471(b)(1)(A) to obtain information from each holder of each account maintained as is necessary to determine which accounts are "United States accounts".

  For example, it may be appropriate for the Secretary to provide exceptions for accounts existing on the effective date or accounts that are regarded as posing a low risk of tax evasion.

- Authority under section 1471(b)(1)(E)(ii) to provide alternatives to closing United States accounts for which the FFI is unable to obtain a valid and effective waiver under section 1471(b)(1)(E)(i) where foreign law prohibits the closing of such accounts.

- Authority to define the thresholds under which depository accounts for individuals are excluded from the definition of "United States account". See additional comments under point 5 below.

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3. <u>Information to be reported on United States Accounts</u>

Section 1471(c)(1) sets out very specific requirements with respect to the information to be reported on United States accounts, including the following:

- Name, address and TIN of each account holder that is a "specified United States person", and in the case of an account for a "United States owned foreign entity", the name, address and TIN of each "substantial United States owner" of the entity.

- Account number.

- Account balance or value (determined at such time and in such manner as the Secretary may provide).

- Gross receipts and gross withdrawals or payments from the account (determined for such period and in such manner as the Secretary may provide).

With respect to account balance or value, and gross receipts, withdrawals or payments, our understanding is that the Secretary only has the authority to determine the time or reporting period, and the manner in which such information is to be provided, but not whether or not such information must be reported.

There may be situations in which reporting such information may be extremely onerous and/or not particularly meaningful or useful to the IRS. For example, in some financial institutions, clients may have a depository account to hold cash and a custody account to hold securities. In such situations, purchases, sales and income transactions will be reported in both the depository account and the custody account. If both of these accounts report the proposed amounts, the information provided to the IRS will be overstated and misleading. We recommend that section 1471(c)(1) be amended to delete (D) and replace the current requirement under (C) with a more general requirement for such additional information and in such manner as the Secretary may provide.

4. <u>Reliance on Certification from Account Holders</u>

Although the Act does not set out specific requirements regarding the methods that an FFI is to employ for purposes of identifying its United States accounts, there is a degree of protection provided to the FFI in section 1471(c)(3), allowing them to rely on a certification from an account holder "if neither the financial institution nor any entity which is a member of the same expanded affiliated group as such financial institution knows, or has reason to know, that any information provided in such certification is incorrect."

Most FFIs that belong to an affiliated group will not be able to make use of the protection that this provision is intended to provide, primarily for the following reasons:

- Most affiliated groups of financial institutions do not have common operating systems or systems that have the ability to communicate with one another. In many cases, groups have grown and expanded through acquisitions, with each new acquisition bringing their legacy systems with them. Even within a single legal entity, there are frequently a number of different systems being used to support the diverse range of products and services that the FFI offers.

- In most jurisdictions, there are legal restrictions which prevent the sharing of information between separate legal entities without explicit client consent.

We recommend that section 1471(c)(3) be amended to limit the FFI's knowledge, or purported knowledge, that any information provided in a certification is incorrect to the information that the FFI has in its own electronic files. We understand the concern that an account holder could provide information to one entity within an affiliated group indicating that they are not a United States account holder, and they could also have an account with another member of the affiliated group that has information on file indicating that the account holder is a U.S. person. However, given that information about the account with the second affiliated entity would be reported to the IRS, the IRS is already being provided with adequate information regarding the U.S. person which could then be used to request additional information for this person under income tax treaties or tax information exchange agreements.

5. <u>Exception for Certain Accounts Held by Individuals</u>

The definition of "United States account" provides an exception for depository accounts held by natural persons where the aggregate value of all depository accounts held does not exceed $10,000, or $50,000 where all such account were already in existence on the date of enactment.

While we understand that this "*de minimis*" type exception was likely created with the intention of providing some relief to FFIs, the exception as currently drafted is operationally impractical, and would provide little or no relief to FFIs that would need to build the exception into their reporting systems. It would be extremely difficult and costly for an FFI to identify all accounts held by an individual, particularly where the individual only has a partial interest. In addition to the practical considerations, as discussed above under point 4, most jurisdictions impose legal restrictions which restrict the sharing of information between legal entities.

We recommend that the provision be amended to apply on an account by account basis and that authority be given to the Secretary to define the thresholds.

6. **Termination of the Agreement**

The Act provides that the FFI Agreement to be executed by the FFI and the Secretary may be terminated by the Secretary upon a determination that the FFI is out of compliance. A reciprocal provision should be added allowing the termination of the agreement by the FFI upon notice to the Secretary.

The IIAC appreciates the opportunity to provide you with this submission and would very much like to meet with your committees and staff to discuss our position and recommendations. To arrange a meeting, please contact the undersigned or Andrea Taylor, Assistant Director (416-687-5476 or ataylor@iiac.ca).

Yours sincerely,

"Ian Russell"

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