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

September 29, 2009

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Representative Charles B. Rangel
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Commissioner, Internal Revenue Service
1111 Constitution Avenue, NW
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Deputy Assistant Secretary, International Tax Affairs
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: The Administration's Fiscal Year 2010 Revenue Proposals (the "Proposals") Applicable to Qualified Intermediaries

The Investment Industry Association of Canada (**IIAC**) would like to take this opportunity to submit comments with regard to the Administration's proposals impacting Qualified Intermediaries (**QIs**) contained in the "Green Book", released in May 2009. Please note that throughout this submission, the term "**Proposals**" will be used to refer specifically to the Proposals being discussed herein, and not generally to all of the Green Book proposals.

The IIAC is committed to working with US lawmakers and the IRS to maintain a QI regime that is effective and efficient. We recognize that the Proposals are general outlines of proposed legislative changes and, in many cases, lack of detail has required that we make a number of assumptions. We hope that through future discussions, additional clarity will be provided, allowing us to provide further comments at a later date.

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. The IIAC QI Committee is responsible for reviewing and commenting on proposed amendments to QI legislation, regulation and policies, and develops positions on practical and conceptual matters surrounding US tax reporting requirements, including audits and QI forms.

Our members provide a variety of services including, but not limited to, the following:

- Full service brokerage
- Discount brokerage
- Discretionary investment management
- Institutional custody

Most of our larger members (based on number of account holders and assets under administration) are part of global groups of financial institutions that offer a diversified range of services worldwide. In most cases, it is primarily only those entities that offer custody services that have entered into QI Agreements. These services may represent a relatively small portion of the financial groups' overall activities.

The majority of our members' clients are Canadian residents and the majority of holdings in client accounts are Canadian securities. Based on an informal survey of some of our larger members, we provide the following estimates relating to Canadian retail brokerage accounts:

- Percentage of total accounts for identified US persons: < 1%
- Percentage of accounts under QI Agreement for Non-Qualified Intermediaries: < 1% (most of these accounts have only one underlying beneficial owner)
- US source income as a percentage of total income earned in client accounts: < 15%
- Percentage of total accounts owned by Canadian residents: > 98%
- Percentage of total accounts holding securities that generate US source reportable amounts: 10 to 15%

The QI regime has been operating for over nine years, and we believe that, as a result of the considerable resources that QIs have committed to the implementation and ongoing maintenance of the QI requirements, it is generally working well, and that QIs have demonstrated high levels of compliance with their QI Agreements. The GAO Report to the US Senate Committee on Finance – Tax Compliance (December 2007) found that "the QI program contains features that give the IRS some assurance that QIs are more likely to properly withhold and report tax on U.S. source income sent offshore than other withholding agents."

GENERAL CONCERNS REGARDING THE PROPOSALS

We have identified some of our general concerns related to the Proposals, listed below. Additional concerns regarding specific proposals are discussed in the attachment to this letter.

1. Unreasonable burden on foreign financial institutions to detect tax evasion by US persons

We understand the US government's concerns regarding the use of offshore accounts and entities by certain persons to evade US 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 IRS to use the QI regime to engage foreign financial institutions in the US government's efforts to identify US persons that may be evading US taxation of income earned, directly or indirectly, through offshore accounts. Implementing the Proposals as described in the Green Book would allow the IRS to receive information automatically from foreign financial institutions 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***.

We are extremely concerned that Proposals put forth in the Green Book will impose such a significant level of additional cost and operational risk on QIs that many will no longer find it economically feasible to continue to operate as QIs. QIs will also need to consider the impact on their clients. It may be difficult to justify additional burdens and costs being placed on non-US account holders with no investment in US securities.

It is unclear whether the amount of additional tax revenue that would actually be generated if the Proposals are enacted, particularly through QIs operating in high tax jurisdictions such as Canada, would justify the cost to QIs, their clients and the IRS. ***US persons that are tax residents in such jurisdictions or that have interests in foreign entities that are subject to tax in those jurisdictions are unlikely to have significant amounts of unpaid US tax after taking into account foreign tax credits and other deductions and credits.***

Although the Proposals create additional reporting obligations only with respect to those accounts that are for US persons or in which US persons indirectly have an interest (e.g., as a beneficial owner of an entity), QIs would still be required to review all accounts to confirm that there are no US accounts holders or US persons beneficially interested in the majority of their accounts.

We are also concerned that the Proposals require QIs to submit large volumes of additional information to the IRS which the IRS may not be able to efficiently process, making such information gathering redundant. It is not clear that the IRS is able to make full use of the information that it currently receives, especially with respect to the Forms 1042-S that are provided for non-US persons that are beneficial owners of foreign grantor or simple trusts, foreign partnerships or foreign non-qualified intermediary accounts.

It would be unfortunate to see foreign financial institutions forced to exit the QI regime into which they have invested significant resources. However, increasing costs with no increasing benefits makes this a very real possibility, particularly for the larger QIs that are part of a large diversified group of international companies. As a result, fewer foreign financial institutions (and particularly the larger ones) will be brought into the US information reporting and tax withholding system, and US persons may find alternative ways to avoid the onerous regime planned under the Proposals. This could include dealing with other countries with more reasonable and less costly tax reporting requirements, and choosing not to participate in US capital markets altogether or investing through alternative investment vehicles such as widely held funds that mirror direct investment in US securities.

2. Increased scope of the QI Agreement

The objective of the QI Agreement is set out in Revenue Procedure 2000-12 as follows:

> *The objective of the QI withholding agreement is to simplify withholding and reporting obligations for payments of income (including interest, dividends, royalties, and gross proceeds) made to an account holder through one or more foreign intermediaries.*

We believe that this objective has been met under the current QI regime.

Under the terms of the current QI Agreement, QIs that are not US payors (i.e., do not have a US parent) primarily only have documentation, withholding and reporting obligations with respect to US source reportable amounts paid to account holders, and in some circumstances, reporting of worldwide income and sales proceeds to US non-exempt recipients residing in the US. The Proposals seek to expand the scope of the Agreement considerably to include the following additional obligations:

- Review of all accounts (not just those receiving US source reportable amounts) to identify all accounts for US persons;
- Reporting of all sources of payments (including non-US) made to all accounts for US persons; and

- Identification of any underlying beneficial owner of a foreign entity that is a US person.

Contrary to the stated objective of the Agreement, the Proposals do not simplify withholding and reporting obligations for payments of income and they add information reporting that is not related to the reporting of US source income.

Currently, a foreign financial institution enters into a QI Agreement with the IRS and under section 1.01, a QI shall act in its capacity as a QI only for those accounts the QI has with a withholding agent that the QI has designated as accounts for which it acts as a QI by providing the withholding agent with a W-8IMY completed as a QI. ***Put simply, the QI is not required to act as a QI for accounts it has with all withholding agents, or even for all accounts it has with a particular withholding agent.***

Despite this, several of the Proposals make references that suggest that an entity that is a QI acts as a QI for all accounts and transactions, including the following:

- Proposals related to reporting of transfers of money or property to or from foreign financial institutions which vary depending upon whether the foreign financial institution is a QI or not a QI, rather than whether or not the transfer is to or from an account for which the foreign financial institution is acting as a QI and is subject to its QI Agreement.

- Proposals related to the negative presumption rules and FBAR reporting which are dependent upon whether or not the account is with a QI, again rather than whether or not the account is an account for which the QI is acting as a QI.

It is important that a foreign financial institution is able to clearly define the scope of transactions and accounts that are under its QI Agreement. The scope has a number of important implications:

- ***Activities over which the US courts have jurisdiction will concern many foreign financial institutions.*** Section 12.04 of the current QI Agreement (copied below) created significant concerns for many QIs when they originally entered into QI Agreements. The Proposals increase these concerns significantly, particularly if the scope is not clearly defined.

  Sec. 12.04 *This Agreement shall be governed by the laws of the United States. Any legal action brought under this Agreement shall be brought only in a United States court with jurisdiction to hear and resolve matters under the internal revenue laws of the United States. For this purpose, QI agrees to submit to the jurisdiction of such United States court.*

- ***Scope of transactions that are subject to the QI Audit.*** The IRS issued proposed audit procedures for the external QI auditors in Notice 2001-66. As indicated in the final audit guidance contained in Revenue Procedure 2002-55 with regards to "Scope of Audit Coverage", comments from the financial community stated that the scope of audit coverage required by the proposed audit guidance was "overly broad" and would prove to be "prohibitively expensive" for QIs. In response to those comments, the following changes were made:

> "The accounts subject to audit are changed from those that receive reportable payments (generally, reportable amounts plus certain broker proceeds and certain foreign source income) to those that receive reportable amounts (generally U.S. source fixed or determinable annual or periodical income). However, for accounts of U.S. non-exempt recipients that receive reportable amounts, the external auditor must take reportable payments into account when performing certain procedures. …".

The IRS accordingly adjusted and narrowed the scope of the transactions subject to QI audit, in response to industry feedback and concerns.

- ***Exposure to prohibitive costs remains an overriding concern***. The scope of the QI Audit not only impacts the direct cost of completing the audit, but also impacts the potential exposure to additional taxes, interest and penalties if any errors identified during the audit are extrapolated over the audit population.

3. Impact of Other Legal Restrictions on Proposals

QIs will need time to identify any restrictions that may exist under other laws (e.g., local privacy laws) and client contracts that may impact their ability to comply with the Proposals.

4. Effective Date of Proposals

The Green Book indicates that the Proposals would be effective beginning after December 31 of the year of enactment. We strongly believe that the implementation of the Proposals would require a substantially longer timeframe. The IRS would require time to develop specific rules and forms, requiring consultation with the financial services industry. After rules are finalized, reporting and withholding systems may require significant changes, existing accounts may need to be reviewed and (re)documented, policies and procedures would require revision.

Many QIs will be subject to QI audits for years during which new rules are being implemented and accounts are in transition. It will be important to ensure that QIs are given sufficient time to develop and implement changes before they are subject to review.

5. <u>Consultation and Negotiation with the Global QI Community</u>

Many foreign financial institutions and industry associations throughout the world have committed significant resources to the QI program, including working closely with the IRS and Treasury to negotiate the QI Agreement. This Agreement reflects compromises made on both sides in the interest of finalizing an Agreement by the announced effective date of January 1, 2001.

Perhaps one of the most significant compromises for foreign financial institutions is found in section 12.02 of the QI Agreement (copied below) which gives the IRS unilateral authority to amend the QI Agreement.

> *Sec. 12.02 This Agreement may be amended by the IRS if the IRS determines that such amendment is needed for the sound administration of the internal revenue laws or internal revenue regulations. The agreement may also be modified by either QI or the IRS upon mutual agreement. Such amendments or modifications shall be in writing.*

There are currently a number of outstanding issues impacting QIs, including proposed regulations related to section 302 transactions; amendments to the Agreement and Audit Guidance proposed by IRS Announcement 2008-98, the proposed implementation of cost basis reporting requirements, and now the Proposals in the Green Book. All of these are creating an environment of uncertainty for QIs with regards to the potential additional cost and risk associated with remaining in the QI program. The costs that have already been invested do not guarantee continued participation. ***If foreign financial institutions are concerned that costs will continue to escalate as a result of these and future changes, they may make financial decisions to terminate their Agreements. This would be an unfortunate outcome for the IRS, QIs, investors and US entities seeking to raise capital.***

It is important for US lawmakers to quickly initiate direct discussions with QIs to manage the uncertainty and take steps to preserve the QI regime. The concerns that were raised by foreign financial institutions during earlier discussions and negotiations are no less of a concern today, with exposure to cost and risk remaining in the forefront.

GENERAL RECOMMENDATIONS

In the attachment to this letter, we have provided some initial detailed recommendations in response to specific aspects of the Proposals. In addition, we provide the following general recommendations.

- Actively seek involvement and input from foreign financial institutions and government authorities to develop changes to the US reporting regime that would recognize and honour the balance of the QI regime.

- Not proceed with the requirement for all commonly controlled financial institutions of QIs to also be QIs and/or agree to certain reporting requirements. Alternatively, limit the requirement to only those commonly controlled entities or business units that provide full custody and related services in respect of investments in third party securities by clients.

- Focus on areas where the most significant tax revenue gains can be achieved at a reasonable cost. For example, focus on high value accounts, high risk jurisdictions or QIs that have a history of non-compliance.

- Utilize and leverage existing "know your customer" (KYC) and anti-money laundering (AML) requirements already established in each jurisdiction to identify US persons.

- Limit the scope of the QI Audit to US source reportable amounts.

- Ensure that effective dates provide sufficient time for QIs to implement changes. Staggered dates may be required if QIs are required to gather additional information for existing accounts.

- Include provisions to allow a QI to terminate its agreement with the IRS in a manner that creates minimum disruption for clients, paying agents, the IRS and the QI. It will be very disruptive if the rules that are finally implemented leave QIs with no option but to terminate their agreements before the new rules take effect. Paying agents would need to make adjustments to accounts to revise the amount of tax withheld at source going forward, as well as obtain new QI documentation and change coding on account types.

The IIAC appreciates the opportunity to provide you with these comments 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 Jack Rando, our Director of Capital Markets (416-687-5477 or jrando@iiac.ca).

Yours sincerely,

"Ian Russell"

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ATTACHMENT: DISCUSSION OF SELECTED PROPOSALS

PROPOSAL 1: REQUIRE GREATER REPORTING BY QUALIFIED INTERMEDIARIES REGARDING US ACCOUNT HOLDERS

> ***a) No foreign financial institution would qualify as a QI unless it identifies all of its account holders that are U.S. persons.***

This Proposal represents a significant increase in the scope of coverage of the QI Agreement to include all of the QI's accounts, and not just accounts receiving payments of US source income. As indicated earlier, our larger members estimate that only 10 to 15% of their total population of accounts earn US source income.

The Proposal is further complicated by the fact that it is very difficult to identify US persons, particularly those that are US citizens or green card holders that do not reside in the US and may have no apparent connections to the US. Many US citizens who have lived outside the US for many years, perhaps even since childhood, may not even realize that they have a US tax reporting obligation, particularly when they are resident for tax purposes in a foreign jurisdiction and are filing tax returns in that jurisdiction. The non-resident withholding tax liability for payments from most jurisdictions is based on residence of the taxpayer, and citizenship is not a consideration. Similarly, gathering of citizenship information is not necessarily a requirement under AML rules. Therefore, details regarding citizenship are frequently only relevant for purposes of identifying US persons for US tax purposes.

By changing account opening procedures to include specific questions related to US citizenship and visa status, QIs would be better able to identify new accounts for US persons. However, there is a concern that changes will be implemented to require QIs to identify *existing accounts* for US persons. When the QI regime was implemented, some QIs may have focused on documenting the small portion of their accounts receiving US source reportable amounts and those with indicia of US status. It could be extremely costly for some QIs to identify US persons in accounts opened prior to the effective date of any new requirements.

QIs will need to consider the implications of applicable privacy rules with respect to the use of information that is currently in their files. In Canada, for example, clients must generally be advised of the purpose for which private information is gathered. Such restrictions may limit the ability of the QI to use existing information for the purpose of identifying US persons for US tax purposes.

We recommend the following:

- The requirement to identify accounts for US persons that are currently outside the scope of the QI Agreement should be limited to new custody accounts opened after the new rules take effect. The effective date should allow sufficient time for QIs to implement the necessary changes to policies, procedures and recordkeeping systems.

- For existing accounts that do not receive US source reportable amounts, limit the requirement to identify accounts for US persons to accounts that meet certain conditions. For example:

    - accounts for which the QI has indicia of US connections on their electronic files (e.g., US address or phone number);
    - accounts over a certain size, measured in terms of income or assets; or
    - account holders resident in certain jurisdictions such as those that do not have income tax treaties or tax information exchange agreements with the US.

- Revise the W-8BEN to require individuals to indicate if they were born in the US and if they are a US citizen or green card holder and modify the instructions to include details about the client's responsibility as a US person.

- For new accounts that do not earn US source reportable amounts, allow the QI to rely on inquiry to determine whether or not an account holder is a US person. The QI would be required to obtain QI documentation only from account holders that indicate that they are US persons (i.e., a W-9 would be requested). Further documentation, over and above documentation that the QI is otherwise required to gather for AML purposes to verify the identity of the account holder, should not be required (i.e., a W-8BEN should not be required). The QI should be able to continue to rely on this information until such time as it receives information that would cause it to believe that the information is no longer correct, or the account receives US source reportable amounts.

- Continue to allow QIs to rely on documentation listed in the applicable KYC Attachment provided that the QI's account opening procedures include inquiry regarding whether or not the account holder is a US person.

- The focus of the QI audit should continue to be on ensuring that the correct amount of US tax has been applied to US source reportable amounts. The scope of the QI audit should continue to be limited to those accounts that received US source reportable amounts during the year subject to audit.

- Ensure that provisions to identify accounts for US persons do not conflict with other laws that may prohibit the QI from disclosing the identity of such persons.

> ***b) A QI would be required to report all reportable payments (for this purpose, treating the QI as a U.S. payor) received on behalf of all U.S. account holders. A QI would file Form 1099s with respect to payments to those U.S. account holders as though the QI were a U.S. financial institution.***

We are concerned that QIs that are not US payors will be expected to report on the same basis as US payors. Foreign financial institutions that have entered into QI Agreements have committed significant resources to becoming knowledgeable with regards to the very technical and complex rules applicable to QIs under the QI Agreement which are primarily contained in certain provisions of the Internal Revenue Code and related regulations. As indicated in Section 1.01 of the QI Agreement, "QI is a withholding agent under chapter 3 of the Code and a payor under chapter 61 and section 3406 of the Code for amounts that it pays to its account holders." ***QIs will need to assess the implications of being treated as a US payor and what additional reporting and withholding obligations this creates. QIs that are US payors typically receive technical and operational support from their US affiliates. Non-US payors do not generally have such resources available.***

The Proposal is likely to be very problematic for non-withholding QIs that currently rely on their US paying agents to issue Forms 1099 to their US account holders. Since it is unlikely that their non-US paying agents will assume backup withholding and Form 1099 reporting on their behalf, such QIs would be required to establish 1099 reporting systems at a great expense. They would also need sufficient time and resources to develop, test and implement such systems.

With increased obligations also comes increased risk associated with inadvertent failures that could occur. ***Some QIs have already indicated that they are not prepared to take on the additional cost and risk associated with the additional reporting requirements for US accounts holders and have publicly announced that they will no longer provide services to US persons. Making the reporting obligations too onerous and too difficult for QIs to comply with not only penalizes US persons living abroad (that need to maintain accounts with foreign financial institutions to manage not only their investments but their day-to-day finances), but could also result in the IRS receiving less rather than more information from independent third parties.***

Currently, the reasonableness of amounts reported by QIs on Forms 1042-S and Forms 1099 is assessed through the reconciliation process whereby the QI can compare the amounts reported to them on Forms 1042-S by their paying agents with those reported by the QI on Forms 1042-S and Forms 1099 that they issue, and analyzing any discrepancies. Since non-US securities are typically held through non-US custodians, there will be no similar information available for purposes of reconciling a QI's reporting and assessing reasonableness and completeness.

It is important to note that for most QIs, the majority of securities held in client accounts generate non-US source income. Therefore, the difficulty and cost related to reporting such amounts in accordance with US tax rules should not be underestimated, particularly given that for most QIs, US account holders represent a very small percentage of their total client base. We expect that for many QIs, the cost will be disproportionate to the amount of additional US tax revenue generated.

Consideration must also be given to the provisions contained in section 6.04 of QI Agreement that apply to an account for a US non-exempt recipient if the QI is prohibited by law, including contract, from disclosing the account holder's name, address and TIN to a withholding agent or the IRS. Under the current provisions, the QI is permitted such accounts, provided the account does not hold assets that generate, or could generate US source reportable payments. Although this may not be a significant issue for most Canadian QIs, it is nevertheless an issue that must be addressed. Transitional rules must be introduced to allow the QI to deal with such accounts without violating rules prohibiting disclosure.

We recommend the following:

- There should continue to be a distinction between QIs that are US and non-US payors.

- Reporting of non-US source income should be limited to accounts over a certain size measured by reference to income or assets.

- Simplified Form 1099 reporting should be introduced for non-US payors to report non-US source income. Amounts subject to reporting should be limited to transactions that the QI currently reports as part of its regular reporting. There should be no requirement for the QI to identify the nature of a payment in terms of US tax rules for purposes of assigning US income codes. The onus should be on the US person to reconcile the amount reported by the QI on Form 1099 to the amount reported by the taxpayer on their US tax return.

- The deadline for reporting of non-US source income should be extended beyond January 31st to allow the QI sufficient time to process the information.

- QIs should continue to have the option of not assuming backup withholding and Form 1099 reporting responsibility for US source payments, as well as for non-US source payments where their upstream paying agents agree to withhold and report.

- Backup withholding obligations should be limited to US source income payments, but if extended to non-US source payments as well, the obligation to withhold should be limited to cash payments.

- The scope of the QI audit should continue to be limited to accounts receiving US source reportable amounts and the review of reporting of non-US source payments should be limited to those accounts for US persons that are selected for testing during the audit.

> ***c) The Treasury Department would be authorized to issue regulations … including authority to require that for any financial institution to be a QI, commonly-controlled foreign financial institutions must meet certain reporting obligations with respect to account holders or that a financial institution may be a QI only if all commonly-controlled financial institutions are also QIs.***

We believe that placing the burden of becoming a QI upon all commonly controlled financial institutions is too onerous and would be too costly for most QIs and their related entities to bear. As discussed earlier, most of our larger members are part of global groups of financial institutions that offer a diversified range of services worldwide. These services could include banking, insurance, trustee services, investment management, retirement products, and investment funds, among many others. Even if the commonly controlled financial institutions do not become QIs, but agree to meet "certain reporting obligations", if these obligations are similar to those applicable to QIs with respect to identifying all account holders that are US persons and potentially those US persons that are beneficial owners of foreign entities, the cost for many organizations (some of whom may have in excess of 10 million accounts) would most likely far exceed any benefit derived from being a QI and being able to provide the benefits of reduced rates of withholding on US source income to non-US clients with custody accounts.

Concerns relate not only to the actual cost associated with the extra efforts required to identify and report accounts for US persons, but also include potential costs and risk if compliance will be subject to audit or review (similar to compliance with the QI Agreement) and potential assessment of penalties for incidents related to failure to comply.

It is highly likely that this Proposal will have the opposite of its intended effect. Instead of bringing more entities into the QI regime, this requirement may drive current QIs out of the regime, and in particular, the largest QIs that are part of a multinational group of financial institutions.

We recommend the following:

- As indicated earlier, we strongly recommend that this requirement either be removed entirely or as a minimum be limited to those entities (or portions of entities) that provide custody and related services in respect of investments in third party securities.

> ***d) The Treasury Department would be authorized to provide that for any financial institution to be a QI, it must collect information indicating the beneficial owners of foreign entity account holders and specifically report if a U.S. person is a beneficial owner.***

We are concerned that if the requirements to identify US persons that are beneficial owners of foreign entities are made too onerous and result in significant additional costs for QIs to administer, the additional burden will leave QIs with little choice but to terminate their QI Agreements. We are also concerned about the potential exposure to additional taxes, penalties and interest for failure to comply, as well as added audit costs if the IRS requires the auditor to perform additional testing with regards to these requirements.

The Canadian Anti-Money Laundering (**AML**) rules require a financial institution to identify and to verify the identity of the beneficial owners of an entity that own more than 25% of the shares. Similar requirements exist in many other jurisdictions. Under the Investment Industry Regulatory Organization of Canada's (**IIROC**) regulations, broker/dealers are subject to more stringent rules that require them to identify and to verify the identity of beneficial owners that own more than 10% of an entity's shares. There is generally a requirement for the financial institution to maintain and update this information.

We strongly believe that it would be too costly for most of our members to be able to identify all beneficial owners of non-US entities, and given that it is likely that most of these entities will not have US beneficial owners, the cost of confirming this absence of US beneficial owners would greatly outweigh the benefit achieved.

We recommend the following:

- The exceptions identified in Proposal 6 with respect to withholding on payments to foreign entities (discussed below) should also apply to this Proposal, specifically those that would exclude QIs from the requirement to identify US persons that are beneficial owners of certain types of foreign entities (e.g., publicly traded companies and their subsidiaries, foreign governments, pension funds, charities, or widely-held investment vehicles).

- The requirement to identify beneficial owners should be limited to the following:

  - new accounts opened after the new rules take effect, one that allows sufficient time for QIs to implement the necessary changes to policies and procedures, and which should be based on applicable AML/KYC requirements;
  - existing accounts that receive US source reportable amounts if certain conditions are met. For example:

  - accounts for which the QI has indicia of US connections on their electronic files (primarily US addresses and/or phone numbers);
  - accounts over a certain size, measured either in terms of income or assets;
  - account holders resident in certain jurisdictions, particularly those that don't have income tax treaties and/or tax information exchange agreements with the US;
  - accounts for which AML/KYC procedures have identified US beneficial owners, provided there are no other rules that restrict the use of the information for this purpose.

- The W-8BEN could be amended to require a foreign entity to provide information regarding any US ownership. However, if this approach is adopted, the QI should be permitted to assume that there are no US beneficial owners (unless the QI has other information that provides reason to know that there may be US beneficial owners) until such time as they request a revised W-8BEN from the entity. In the case of accounts meeting the acceptable KYC documentation requirements under the applicable country Attachment, the QI should only be required to seek information regarding US beneficial owners on the same frequency as the W-8BEN renewal, and as recommended above, such follow-up should only be required for accounts over a certain size.

- Reporting requirements should be limited to information reporting. The QI should not be required to make any attempt to allocate and report any portion of an entity's income to US persons with interests in the entity.

Additional comments and recommendations regarding the related Proposal to withhold on payments to foreign entities are discussed below.

e) Under section 6102 of the Code, the IRS may publish the list of QIs.

As discussed earlier, the QI is not required to act as a QI for accounts it has with all withholding agents, or even for all accounts it has with a particular withholding agent.

Although publishing a list of QIs may be useful, it is important that the purpose for which the list can be used be clearly identified. Currently, not all activities of a legal entity that has entered into a QI Agreement with the IRS are necessarily covered by the QI Agreement.

We recommend the following:

- We recommend that if a list of QIs is published, the purpose of the list should be clearly identified, specifying that inclusion on the list does not necessarily mean that all activities of the QI are necessarily covered under the QI Agreement.

PROPOSAL 2: REQUIRE WITHHOLDING ON PAYMENT OF FDAP INCOME MADE THROUGH NON-QUALIFIED INTERMEDIARIES

Any withholding agent making a payment of FDAP income to a nonqualified intermediary would be required to treat the payment as made to an unknown foreign person (and therefore to withhold tax at a rate of 30 percent). The Treasury Department would receive regulatory authority to provide exceptions, including exceptions for payments collected by nonqualified intermediaries for foreign government, central bank, foreign pension fund, and foreign insurance company payees, and other similar investors, and for payments that the Treasury Department concludes present a low risk of tax evasion. The rules will be designed so as not to disrupt ordinary and customary market transactions. Foreign persons that are subject to over-withholding as a result of this proposal would be permitted to apply for a refund of any excess tax withheld.

Although it is not clear from the comments in the Green Book, we assume that this Proposal is not intended to apply to flow-through entities that are non-US partnerships, or grantor or simple trusts. If this assumption is incorrect, we would have additional comments and recommendations.

While this Proposal may provide an incentive for some non-QIs (**NQIs**) to become QIs, we believe that the number of conversions may not be as great as anticipated. It is our view that NQIs have a role within the financial intermediary system, and that not every entity that is regarded as an intermediary should become a QI. Given the broad definition of “intermediary”, there are various types of NQIs, many of which are simply too small in size to have the dedicated resources required to maintain compliance with the QI Agreement, including technical knowledge and systems. Many NQIs are not in the flow of funds (e.g. nominees, investment managers, etc.), and are therefore generally not suited to becoming QIs. In many such cases, the NQI establishes individual accounts with the QI for each of their underlying account holders. Many QIs also limit the number and nature of NQIs that they will accept because of the additional administration related to these accounts, particularly if there are multiple underlying beneficial owners for a single account.

Although cumbersome, we believe that the current process whereby NQIs submit W-8IMYs with the beneficial owners’ Forms W-8 (or KYC documentation where acceptable) or W-9 and statements supporting the allocation of related income results in the correct withholding and reporting to indirect account holders.

If the Proposal to apply 30% withholding to all FDAP payments to an NQI is enacted, there could be a number of negative consequences, including, but not limited to, the following:

- Current investments in US securities (particularly interest-bearing instruments) may be sold and the proceeds reinvested in non-US securities in order to avoid the 30% withholding at source and the cost and delay of getting a refund.
- Investors residing in treaty countries may simply forego the benefit of a reduced rate of withholding tax on dividends. Investors residing in non-treaty countries will likely be indifferent.
- For most QIs, the majority of indirect account holders through NQIs are non-US persons. Therefore, the vast majority of the 30% tax withheld on interest payments to NQIs will be eligible for refund. This will potentially create a large administrative burden on the IRS and non-US persons investing in US securities.
- The IRS will receive less information regarding the account holders of NQIs than they do currently.

The Green Book indicates that the "proposal would discourage U.S. and foreign persons from attempting to avoid US tax or to obtain a lower rate of withholding tax by providing incorrect self-certification or otherwise relying on the lack of information reporting associated with using non-qualified intermediaries." It is our view that most persons providing W-8s do not intentionally provide incorrect forms for the purpose of avoiding US tax or obtaining a lower rate of withholding under a treaty. With regards to non-US persons, most accounts with QIs are holding non-US securities in addition to US securities. As a custodian, the QI is concerned with ensuring that account holders are properly identified and accounts are properly set up to apply the correct rate of foreign withholding tax, regardless of the country from which the income is derived, and therefore, QIs are not relying entirely on a W-8BEN for purposes of determining country of residence of the underlying account holder. Furthermore, it is our belief that US persons intentionally attempting to avoid US tax will search for alternatives.

The Proposal indicates that a payment to the NQI should be treated as a payment to an unknown foreign person. Although the proposal makes it clear that 30% NRA tax should be withheld, it does not make it clear whether the QI would still be expected to issue Form 1042-S in the name of "Unknown Recipient" (Box 13a) with the NQI identified as the intermediary in Box 17. If this is the case, under the current refund process, the NQI would need to issue Form 1042-S to each of the underlying beneficial owners to meet the supporting documentation requirements. In any event, QIs that currently collect underlying beneficial owner documentation and provide recipient specific reporting to the IRS will no longer have any reason to incur the cost of such procedures if all payments of US source income to NQIs are subject to 30% withholding. Although this simplifies the QI's reporting, given the concerns expressed about NQIs, it is unclear why it would be preferable for NQIs to issue Forms 1042-S and for less information to be provided to the IRS by a QI that has entered into an Agreement and is subject to regular audits.

We recommend the following:

- The Proposal should be more clearly defined, as we do not feel that the concerns relating to NQIs are applicable to all NQI situations. We recommend that rather than introduce a general proposal to withhold 30% with certain enumerated exceptions, the current process should be maintained for QIs, identifying certain exceptions that are subject to the 30% withholding.

  - **As a minimum, we suggest QIs be permitted to continue to follow the existing rules with respect to payments to NQIs in the following circumstances**:

    - Account holder of the NQI is a QI.
    - Accounts below a certain de minimus value based on amount of US source income or assets. As discussed above, some NQIs are not QIs because they are simply too small to have the resources to be able to comply with the requirements of the QI Agreement.
    - QI receives a copy of a W-9 or W-8 for the underlying account holder that contains a US ITIN and the QI reports the ITIN on the Forms 1042-S or 1099 that it issues to the indirect account holder at the end of the year.
    - QI is subject to AML/KYC rules or voluntarily implements internal policies that require the QI to identify the identity of both direct and indirect account holders.
    - QI reports a payment to the indirect account holder on a tax information statement in the country in which the QI, or a branch of the QI, is located, where the QI is required to file a copy of that statement with the tax authority of that country, and where that country has an income tax treaty in effect with the United States. This recommendation applies the procedures set out in section 5.10(B)(2)(ii) of the QI Agreement that can be used by a QI for purposes of establishing an account holder's status as "foreign" if the QI has a US mailing or permanent address.
    - NQI is an intermediary that is subject to AML/KYC rules that require it to identify and to verify the identity of its account holders, and where the AML/KYC rules governing the QI allow the QI to rely on the NQI to identify and to verify the identity of the indirect account holders.
    - QI receives the additional information for the indirect account holder that would be reported to the IRS if the indirect account holder were to file a claim for a refund of excess tax. The W-8BEN could be amended to include such additional information.
    - NQI is located in a jurisdiction with which the US has a tax information exchange agreement or payments that the Treasury Department concludes present a low risk of tax evasion. This is

consistent with Proposal 3 relating to withholding on gross proceeds paid to NQIs (discussed below).

For payments to NQIs that are subject to the 30% withholding, we also provide the following recommendations:

- There should be a suitable transition period to allow:

  - accounts that qualify for exemption to be identified;
  - accounts to take steps to otherwise qualify for exemption (e.g., obtaining a US ITIN, as recommended above);
  - NQIs that choose to become QIs to implement the necessary policies, procedures and systems changes to take on QI responsibilities; and
  - accounts to dispose of US securities.

- A streamlined refund process should be developed that does not require non-residents to file regular US income tax returns. Under the current process, an account holder must first wait to receive a Form 1042-S to submit as evidence of the tax withheld (which could be as long as 15 months after the tax was originally withheld), and then wait for the refund to be processed, which we understand is currently taking approximately 14 to 16 months. Increased reclaim volumes may significantly lengthen this time period if the process is not simplified.

- Any account holder that has submitted a claim for a refund in a previous period and has received such refund should be entitled to receive payments through an NQI subject to reduced rates of withholding at source in subsequent years.

- Similar to Proposal 3 discussed below (withholding on gross proceeds paid to NQIs), the NQI should be permitted to apply for a refund on behalf of its account holders.

PROPOSAL 3: REQUIRE WITHHOLDING ON GROSS PROCEEDS PAID TO CERTAIN NON-QUALIFIED INTERMEDIARIES

> ***A withholding agent would be required to withhold tax at a rate of 20 percent on gross proceeds from the sale of any security of a type that would be reported to a U.S. non-exempt payee, when paid by the withholding agent to a nonqualified intermediary that is located in a jurisdiction with which the United States does not have a comprehensive income tax treaty that includes a satisfactory exchange of information program.***
>
> ***The Treasury Department would receive regulatory authority to provide exceptions, including exceptions for payments collected by nonqualified intermediaries for foreign government, central bank, foreign pension fund, and foreign insurance company payees, and other similar investors; payments to nonqualified intermediaries located in jurisdictions with which the United States has a tax information exchange agreement; and payments that the Treasury Department concludes present a low risk of tax evasion. The rules will be designed so as not to disrupt ordinary and customary market transactions. Nonqualified intermediaries would be eligible to claim a refund on behalf of their direct account holders for any taxable year in which they identified all of their direct account holders that are U.S. persons and reported all reportable payments received on behalf of U.S. account holders. Foreign persons that are subject to withholding tax in excess of their income tax liability as a result of this proposal, and on whose behalf a refund claim is not made by a nonqualified intermediary, would be permitted to apply for a refund of any tax withheld.***

We find it interesting that Proposal 2 only provides for the refund claim to be submitted by the underlying beneficial owner, whereas this Proposal also permits the NQI to make a claim for a refund on behalf of its direct account holders, provided they have identified all their direct account holders that are US persons and reported all reportable payments received on behalf of those account holders. It is unclear why it would be preferable for the IRS to rely on NQIs to identify and report US persons rather than having QIs obtain documentation and report, given that the QIs are subject to periodic compliance audits. However, if the IRS is prepared to permit NQIs to request refunds of tax withheld on proceeds, it should also be reasonable for NQIs to request refunds of tax withheld on income payments (as recommended under Proposal 2 above).

Our comments and recommendations related to Proposal 2 (discussed above) generally apply equally to this Proposal.

PROPOSAL 4: REQUIRE THIRD-PARTY INFORMATION REPORTING REGARDING THE TRANSFER OF ASSETS TO FOREIGN FINANCIAL ACCOUNTS AND THE ESTABLISHMENT OF FOREIGN FINANCIAL ACCOUNTS

Any U.S. financial intermediary and any qualified intermediary that transfers money or property with a value of more than $10,000 to a foreign bank, brokerage, or other financial account on behalf of a U.S. person (or on behalf of any entity of which a U.S. person owns, actually or constructively, more than 50 percent of the ownership interest) would be required to file an information return regarding such transfer.

Any U.S. financial intermediary and any qualified intermediary that receives a transfer of money or property with a value of more than $10,000 from a foreign bank, brokerage, or other financial account on behalf of a U.S. person (or on behalf of any entity of which a U.S. person owns, actually or constructively, more than 50 percent of the ownership interest) would be required to file an information return regarding such transfer.

Any U.S. financial intermediary and any qualified intermediary that opens a foreign bank, brokerage, or other financial account on behalf of a U.S. person (or on behalf of any entity of which a U.S. person owns, actually or constructively, more than 50 percent of the ownership interest) would be required to file an information return with the IRS regarding such account, including reporting any amounts of money or property transferred by the financial intermediary to such account.

Exceptions to the reporting requirement would be provided for 1) accounts opened and amounts transferred to, from, or on behalf of, publicly traded companies and their subsidiaries, 2) accounts opened at and transfers made to qualified intermediaries on behalf of a U.S. person (or on behalf of any entity of which a U.S. person owns, actually or constructively, more than 50 percent of the ownership interest) or 3) transfers received by or on behalf of a U.S. person (or on behalf of any entity of which a U.S. person owns, actually or constructively, more than 50 percent of the ownership interest) from accounts held by a U.S. person at a qualified intermediary.

The Treasury Department would receive regulatory authority to provide additional exceptions to the reporting requirement, to require that certain additional information be reported, and to permit U.S. financial intermediaries and qualified intermediaries to report additional transfers of money or property to a foreign bank, brokerage, or other financial account on behalf of a U.S. person (or on behalf of an entity of which the U.S. person owns, actually or constructively, more than 50 percent of the ownership interest).

Implementing this Proposal would place a significant cost and administrative burden on QIs. We are also uncertain as to whether the additional information that the IRS would receive from QIs under this Proposal would provide new information that would be beneficial to the IRS, particularly if the requirement for QIs to report worldwide income and sales proceeds to the IRS under Proposal 1 is implemented.

We have not yet fully identified all the implications of this Proposal, but the following summarizes some of our concerns.

- Implementing the reporting required under this Proposal would likely require significant systems changes. Although there are requirements under the *Canadian Proceeds of Crime and Terrorist Financing Act* to report certain transfers of cash and securities out of Canada to the Canada Border Services Agency (which in turn reports to FINTRAC), the information gathered for these purposes of are contained in systems that are totally separate from tax reporting systems. Therefore, if this Proposal is introduced, QIs would need to make significant and costly systems enhancements to capture and report the applicable transactions for what will likely result in reporting for only a very low volume of transactions.

- The Proposal provides a number of exceptions to the reporting requirements. Identifying these exceptions would require complex filtering of data in order to find the transfers that are reportable. It is also not certain to what extent it will be possible to fully automate the identification of reportable transactions or whether significant levels of manual review and processing would be required. For example, determining whether a transfer is made to another QI or whether a US person has a 50% or more ownership interest make identification of reporting transfers difficult.

- QIs that currently have reporting obligations under anti-money laundering rules would need to research privacy issues related to providing similar information to the IRS.

- QIs will incur significant costs to implement changes to meet the reporting requirements set out under this Proposal, but it is uncertain that the IRS will in fact make effective use of the information that is provided.

We understand that the US Financial Crimes Enforcement Network released a report in 2006 which addressed the feasibility of reporting cross-border funds transfers for anti-money laundering and terrorist financing purposes and that the report identified the cost of implementing the reporting requirements as being a significant concern for both US financial institutions and the US government.

We recommend that reporting requirements under this Proposal not apply to QIs.

PROPOSAL 5: REQUIRE THIRD-PARTY INFORMATION REPORTING REGARDING THE ESTABLISHMENT OF OFFSHORE ENTITIES

Any U.S. person, or any qualified intermediary, that forms or acquires a foreign entity on behalf of a U.S. individual (or on behalf of any entity of which the individual owns, actually or constructively, more than 50 percent of the ownership interest) would be required to file an information return with the IRS regarding the foreign entity that is formed or acquired. The Treasury Department would receive regulatory authority to determine the information to be reported and to provide exceptions to the reporting requirement. In addition, the Treasury Department would receive regulatory authority to require, as necessary, withholding agents to collect additional information to determine whether a U.S. person is the beneficial owner of a foreign entity and specifically report if a U.S. person is a beneficial owner.

We are concerned that the cost that QIs would incur to implement this change would be excessive in relation to any potential benefit that the additional information would provide to the IRS. If a modified version of Proposal 1 is implemented (as recommended above), the IRS will receive significant information regarding accounts for foreign entities in which US persons have beneficial interests.

We recommend that reporting requirements under this Proposal not apply to QIs.

PROPOSAL 6: NEGATIVE PRESUMPTION REGARDING WITHHOLDING ON FDAP PAYMENTS TO CERTAIN FOREIGN ENTITIES

Any withholding agent making a payment of FDAP income to a foreign entity would be required to treat the payment as made to an unknown person (and therefore subject to 30 percent gross-basis withholding tax), unless the foreign entity provides documentation of the entity's beneficial owners. Exceptions would be provided for payments to publicly traded companies and their subsidiaries, foreign governments, and pension funds. In addition, the Treasury Department would receive regulatory authority to provide additional exceptions for payments to entities engaged in the active conduct of a trade or business in their country of residence, charities, widely-held investment vehicles, entities that enter into an agreement with the IRS to collect documentation for all owners and report all U.S. non-exempt owners to the IRS, and for any other payment that the Treasury Department concludes presents a low risk of tax evasion.

As noted in the GAO report, under current US tax law and regulations, corporations are taxpayers and the owners of their assets and income, regardless of the nationality and residency of the underlying beneficial owners of the corporation. Similar rules apply to trusts that qualify as complex trusts for US tax purposes. The entitlement to reduced rates of withholding under the portfolio interest exemption and under income tax treaties are determined at the entity level, even in those situations where the entity must satisfy LOB provisions with respect to beneficial ownership of the entity for purposes of qualifying for the benefits.

The Proposals do not change the entitlement of a foreign entity to earn US source income at reduced rates of withholding, but do add a significant administrative and economic burden to obtain the benefit of such reduced rates. In all likelihood this will result in very little additional tax revenue, but rather will identify US persons who may not be reporting interests in foreign entities or accounts.

If this Proposal is introduced, we expect that many foreign entities will simply divest themselves of securities that generate US source FDAP to avoid the requirement to either provide documentation for their beneficial owners or be subject to 30% withholding tax.

In addition, the Proposal is silent with respect to the ability of the foreign entity to claim a refund of excess tax withheld. As discussed above, given that the Proposal does not change the ultimate tax liability, it seems that only the entity itself should be able to file for a refund. In the case of a corporation, this would be done by filing Form 1120-F for which there is a simplified procedure if claiming a refund of excess tax withheld at source. Under the current procedures, there is no requirement for the entity to provide information regarding the beneficial owners of the entity.

Our comments and recommendations made earlier under Proposal 1 (d) and Proposal 2 generally apply to this Proposal as well.