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Submitted Via Electronic Mail

June 18, 2012

Mr. John Sweeney
Office of Associate Chief Counsel (International)
Internal Revenue Service
1111 Constitution Ave. NW
Washington, D.C. 20224

Re: Regulations Relating to Information Reporting by Foreign Financial Institutions and Withholding on Certain Payments to Foreign Financial Institutions and Other Foreign Entities; REG-121647-10; 77 Federal Register 9022 (February 15, 2012).

Dear Mr. Sweeney:

The American Bankers Association[1] (ABA) appreciates the opportunity to provide comments on Internal Revenue Service (Service) proposed regulations for the information reporting by foreign financial institutions (FFIs) with respect to U.S. accounts. The proposal implementing sections 1471 through 1474 of the Internal Revenue Code (Code)[2] requires FFIs and certain non-financial foreign entities (NFFE) to provide information to the Service through FFI Agreements, as well as impose due diligence procedures on withholding agents. Certain payments made to FFIs and NFFEs that do not participate in the required disclosures will be subject to a withholding tax.

In this letter, ABA comments solely on the effect of the proposal on foreign trusts with a U.S. corporate fiduciary, such as a bank, thrift, or trust company, acting as trustee.[3] Because this regulatory regime will affect our members that act as trustee to foreign trusts, we recommend that the Service—

- Explicitly exempt foreign trusts with U.S. corporate fiduciaries acting as trustee from the definition of foreign financial institution;
- Apply the material modification limitation only to grandfathered obligations that are funding-type transactions; and
- Define specified U.S. person, in the trust context, as a person with a beneficial interest in 10 percent or more of the distributable net income of such trust.

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[1] ABA represents banks of all sizes and charters and is the voice for the nation's $14 trillion banking industry and its two million employees.
[2] These provisions were originally introduced as part of the Foreign Account Tax Compliance Act of 2009 (FATCA), and enacted as part of the Hiring Incentives to Restore Employment Act of 2010 (HIRE Act).
[3] We reiterate the recommendations and requests made in our April 30, 2012, letter, which broadly commented on the proposal. Letter from ABA and The Clearing House to IRS and Department of the Treasury (Apr. 30, 2012), *available at* http://www.aba.com/NR/rdonlyres/DC65CE12-B1C7-11D4-AB4A-00508B95258D/76211/FATCAletter5212.pdf.

Foreign Trusts with U.S. Corporate Trustees
The Proposed Regulations make a number of references to foreign trusts that imply their designation as a FFI without making any explicit statements to this effect. This lack of clarity has led to considerable confusion about the treatment of foreign trusts and the responsibilities of the U.S. banks and trust companies that act as trustee for these trusts.

For a number of reasons, ABA strongly believes these foreign trusts should not be treated as foreign financial institutions but rather should be considered non-financial foreign entities. Foreign trusts do not hold themselves out as engaged in "the business of investing, reinvesting or trading in securities, partnership interests, commodities"[4] and are more akin to a NFFE than a FFI. The purpose of a trust is to hold legal title to trust assets on behalf of beneficiaries – not to pursue activities as a "business entity" as outlined in Regulations §301.7701-4.

The intentions and goals of FATCA may still be satisfied if foreign trusts with U.S. corporate trustees are designated NFFEs. In these circumstances, the U.S. corporate trustee already possesses and reports to the Service the information about the foreign trust's U.S. beneficiaries. The domestic bank or trust company submits this information to the Service in Form 3520-A or, in some circumstances, Form 1040-NR. In other words, the Service is currently receiving information about payments made to U.S. beneficiaries by these foreign trusts. No new opportunity for tax evasion is made available in this scenario. Treating a foreign trust with a U.S. corporate trustee as an FFI would only result in unnecessary duplicative reporting to the Service and unnecessary FFI Agreements with the Service entered into by the U.S. corporate trustee on behalf of the foreign trust.

Material Modification Rules for Grandfathered Obligations
Under the Proposed Regulation, a withholdable payment does not include any payment made under a grandfathered obligation or any gross proceeds from the disposition of such an obligation. The term obligation is defined as a legal agreement that produces or could produce a withholdable payment, other than an instrument that is treated as equity for U.S. tax purposes or that lacks a stated expiration or term. Under the Proposed Regulation, a "grandfathered obligation" is any obligation outstanding on January 1, 2013. For example, a debt instrument is outstanding on January 1, 2013, if it has an issue date, as determined under U.S. tax law, before January 1, 2013. ABA welcomes the relief for these grandfathered obligations; however we are very concerned about a significant limitation on this relief.

The Proposed Regulations introduce an additional requirement that is not contained in the FATCA legislation with regard to grandfathered obligations. Specifically, any material modification of an outstanding obligation will result in the obligation being treated as newly issued as of the date of the modification. In other words, if there is a material modification to a grandfathered obligation after December 31, 2012, the obligation will no longer be grandfathered. The Proposed Regulations define material modification as a "significant modification" of a debt instrument as defined in Regulation §1.1001-3.

[4] Proposed Rule 1471-5(e)(1).

Regulation §1.1001-3(e) defines whether a modification of a debt instrument is a significant modification. Under the general rule, a modification is significant if "based on all facts and circumstances, the legal rights or obligations that are altered and the degree to which they are altered is economically significant. In making a determination … [certain] modifications to the debt instrument … are considered collectively, so that a series of such modifications may be significant when considered together although each modification, if considered alone, would not be significant." In addition to this general rule, Regulation §1.1001-3(e) also provides specific modification rules for changes to the yield and the timing of payments, among other things.

ABA member institutions maintain on behalf of their clients millions of distinct debt instruments. The proposed limitation to the grandfathering provision would require an extremely elaborate and complex system in order to track these instruments and apply the complex significant modification rules contained in Regulation §1.1001-3. The accounting for these debt instruments becomes further complicated by the constant movement of securities into and out of client accounts maintained by our member institutions. A bank or broker may acquire these grandfathered instruments for the first time in a client account after January 1, 2013, but have *no* knowledge of whether the instrument had already been materially modified after December 31, 2012. The bank or broker would then have to research the instrument from January 1, 2013, through the date it was acquired in order to determine if it still maintains a grandfathered status.

It is our understanding that the grandfathering section of the FATCA legislation was designed to carve out obligations that were funding-type transactions, such as loan syndications and other loan facilities, repos, securities loans, swaps and other derivatives. The intent of the grandfather rule was to preserve the parties' expectations with respect to existing transactions and relationships and not to exempt all securities. However, when the FATCA was passed, Section 501 (d)(2) broadened the grandfathering provision to all existing obligations and not just those that were funding in nature.

Therefore, ABA believes that the material modification limitation contained in the Proposed Regulations should only apply to obligations that were funding-type transactions and not to all existing obligations. In particular, the material modification provisions should not apply to publicly-traded debt instruments for which significant modifications after December 31, 2012, cannot be properly or accurately tracked without elaborate and complex systems changes.

U.S. Owners of Foreign Trusts

ABA strongly urges the Service to define substantial United States owner as a U.S. person that has a beneficial interest greater than ten percent of the distributable net income of the foreign trust, as defined in Code Section 643(a)(6). Using this definition, the Service would capture information on those U.S. persons who are currently receiving withholdable payments from the foreign trust, while appropriately exempting from current information reporting remainder beneficiaries and other discretionary beneficiaries who may have no interest in the income of the foreign trust.

Conclusion
ABA appreciates this opportunity to offer comments on the proposed regulations. We urge the IRS to consider the implications of the proposal for foreign trusts that have U.S. corporate trustees. Should you have any questions or comments with respect to the issues raised in this letter, please do not hesitate to call the undersigned at (202) 663-5053.

Sincerely,

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