April 25, 2012

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


Ladies and Gentlemen:

These comments (“Comments”) are submitted on behalf of the International Tax Planning Committee (the “Committee”) of the Real Property, Trust and Estate Law Section (the “RPTE Section”) of the American Bar Association (the “ABA”) in response to the request by the Internal Revenue Service of the Department of the Treasury (the “Service”) for comments regarding the notice of proposed rulemaking and notice of public hearing for Regulations Relating to Information Reporting by Foreign Financial Institutions and Withholding on Certain Payments to Foreign Financial Institutions and Other Foreign Entities under chapter 4 of Subtitle A (sections 1471 through 1474) of the Internal Revenue Code of 1986 (“Code”) as promulgated under REG-121647-10 on February 8, 2012 (the “Proposed Treasury Regulations”). These Comments represent the views of the Committee and the RPTE Section only and have not been approved by the ABA’s House of Delegates or Board of Governors and therefore do not represent and should not be construed as representing the position of the ABA.

Michael A. Spielman, Chair of the International Tax Planning Committee, supervised the preparation of these comments and participated in their preparation. The principal drafting responsibility was exercised by Theodore C. Ahlgren and Scott A. Bowman, who also made substantive contributions along with Marianne R. Kayan,
Michael Rosen-Prinz, and J. Andrew P. Stone. These comments were further reviewed by Ellen K. Harrison on behalf of the RPTE Section’s Committee on Governmental Submissions.

Although the members of the Committee who participated in preparing these Comments on behalf of the RPTE Section have clients who may be affected by the federal tax principles and legal issues addressed herein, no such member (or firm or organization to which any such member belongs) has been engaged by a client to make a submission with respect to, or otherwise influence the development or outcome of, the specific subject matter of these Comments.

The Committee and the RPTE Section appreciate the opportunity to submit these Comments, and we respectfully request that the Service consider our recommendations. Members of the Committee and the RPTE Section are available to meet and discuss these matters with the Service and its staff and to respond to any questions. The principal contacts for discussion are listed below.

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Very truly yours,

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EXECUTIVE SUMMARY

On March 18, 2010, President Obama signed into law the Hiring Incentives to Restore Employment Act of 2010, Public Law 111-147 (the “HIRE Act”), including certain revenue offset provisions originally introduced as part of the Foreign Account Tax Compliance Act of 2009 (H.R. 3933) (“FATCA”). The FATCA withholding regime provisions were enacted into sections 1471 through 1474 of the Internal Revenue Code of 1986, as amended (the “Code”).

FATCA generally requires foreign financial institutions (“FFIs”) to provide information to the Service regarding their United States accounts (“U.S. Accounts”) by means of entering into an "FFI agreement" with the Service. FFIs that comply with these requirements are known as “participating FFIs.” FATCA also requires certain non-financial foreign entities (“NFFEs”) to provide information on their substantial United States owners (“substantial U.S. owners”) to withholding agents. FATCA imposes a withholding tax on certain payments to FFIs and NFFEs that do not participate in certain prescribed reporting and disclosure requirements.

On February 8, 2012, the Treasury Department and the Internal Revenue Service (the “Service”) issued Proposed Treasury Regulations and requested comments. Our Comments set forth the Committee’s recommendations with regard to the Proposed Treasury Regulations, insofar as these relate to trust and estate matters.
I. Introduction

A. Scope of Comments

On behalf of the RPTE Section, we expressly limit the scope of our comments to matters related to trusts, estates, and trustees, and in particular the compliance issues that may be imposed on foreign trusts and foreign trustees under FATCA. These comments have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and should not be construed as representing the position of the American Bar Association.

B. Basic Provisions of FATCA

FATCA imposes an obligation on “withholding agents” to withhold a 30 percent tax on “withholdable payments” to (i) foreign financial institutions (“FFIs”), as defined in section 1471(d)(5) and further discussed below, and (ii) certain non-financial foreign entities (“NFFEs”), defined in section 1472(d) as any foreign entity that is not a financial institution. Withholding is not required for payments to an FFI that has entered into an agreement with the Service to obtain and report information regarding its U.S. account holders or certifies that it has no U.S. account holders (a “Participating FFI”). Withholding is also not required for payments to an NFFE that certifies it has no substantial U.S. owners or identifies such owners. Under FATCA, an FFI is required to report the name, address, and taxpayer identification number of each specified U.S. owner of any U.S. account maintained by such FFI.

C. Definition of “Foreign Financial Institution”

Section 1471(d)(4) provides that an FFI is a “financial institution” that is a foreign entity. Section 1471(d)(5) defines the term “financial institution” to include any entity that:

(A) accepts deposits in the ordinary course of a banking or similar business;

(B) holds financial assets for the account of others as a substantial portion of its business; or

(C) is engaged (or holds itself out as being engaged) primarily in the business of investing, reinvesting or trading in securities,
partnership interests, commodities or any interest in such securities, partnership interests or commodities.

Proposed Treasury Regulation § 1.1471-5(e)(1) expands on the statutory definition and provides that the term “financial institution” includes any entity that:

(i) Accepts deposits in the ordinary course of a banking or similar business (as defined in paragraph (e)(2) of [Proposed Treasury Regulation § 1.1471-5]);

(ii) Holds, as a substantial portion of its business (as defined in paragraph (e)(3) of [Proposed Treasury Regulation § 1.1471-5]), financial assets for the account of others;

(iii) Is engaged (or holding itself out as being engaged) primarily (as defined in paragraph (e)(4) of [Proposed Treasury Regulation § 1.1471-5]) 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)), notional principal contracts (as defined in [Treasury Regulation §] 1.446-3(c)), insurance or annuity contracts, or any interest (including a futures or forward contract or option) in such security, partnership interest, commodity, notional principal contract, insurance contract, or annuity contract;

Proposed Treasury Regulation § 1.1471-5(e)(2)(i) states that an entity is considered to be engaged in a “banking or similar business” if, “in the ordinary course of its business with customers,” the entity engages in one or more of the following activities:

(A) Accepts deposits of funds;

(B) Makes personal, mortgage, industrial, or other loans;

(C) Purchases, sells, discounts, or negotiates accounts receivable, installment obligations, notes, drafts, checks, bills of exchange, acceptances, or other evidences of indebtedness;

(D) Issues letters of credit and negotiates drafts drawn thereunder;

(E) Provides trust or fiduciary services;

(F) Finances foreign exchange transactions;

(G) Enters into, purchases, or disposes of finance leases or leased assets; or

(H) Provides charge and credit card services.
Proposed Treasury Regulation § 1.1471-5(e)(2)(ii) states that “entities engaged in a banking or similar business include, but are not limited to, entities that would qualify as banks under section 585(a)(2) (including banks as defined in section 581 and any corporation to which section 581 would apply except for the fact that it is a foreign corporation).”

In defining whether a “substantial portion” of an entity’s business is holding financial assets for the accounts of other, Proposed Treasury Regulation § 1.1471-5(e)(3)(i) provides:

[a]n entity holds financial assets for the account of others as a substantial portion of its business if the entity’s gross income attributable to the holding of financial assets and related financial services equals or exceeds 20 percent of the entity’s gross income during the shorter of –

(A) The three-year period ending on December 31 of the year in which the determination is made; or

(B) The period during which the entity has been in existence.

With regard to the determination of whether an entity is “primarily engaged” in certain investment activities, Proposed Treasury Regulation § 1.1471-5(e)(4) states:

[a]n entity is primarily engaged in the business of investing, reinvesting, or trading if the entity’s gross income attributable to such activities equals or exceeds 50 percent of the entity’s gross income during the shorter of –

(A) The three-year period ending on December 31 of the year in which the determination is made; or

(B) The period during which the entity has been in existence.

D. Entities Excluded from the Definition of “Financial Institution”

Proposed Treasury Regulation § 1.1471-5(e)(5) excludes certain “excepted FFIs” from the definition of “financial institution.” Instead, Proposed Treasury Regulation § 1.1472-1(c)(1)(v) treats these entities as “excepted NFFEs.” As provided in Proposed Treasury Regulation § 1.1471-5(e)(5)(i), entities falling within this category include certain nonfinancial holding companies “substantially all of the activities of which is to own (in whole or in part) the outstanding stock of one or more subsidiaries that engage in trades or businesses, provided that no such subsidiary is a financial institution.” However, the exception does not include “certain
entities that function or hold themselves out as an investment fund, such as a private equity fund, venture capital fund, leveraged buyout fund or any investment vehicle whose purpose is to acquire or fund companies and then hold interests in those companies as capital assets for investment purposes.”

E. Definition of “Financial Account”

Proposed Treasury Regulation § 1.1471-5(b)(1) generally defines the term “financial account” to mean:

(i) Any depository account (as defined in paragraph (b)(3)(i) of [Proposed Treasury Regulation § 1.1471-5]) maintained by a financial institution (as defined in paragraph (e)(1) of [Proposed Treasury Regulation § 1.1471-5]);

(ii) Any custodial account (as defined in paragraph (b)(3)(ii) of [Proposed Treasury Regulation § 1.1471-5]) maintained by a financial institution (as defined in paragraph (e)(1) of [Proposed Treasury Regulation § 1.1471-5]);

(iii) Any equity or debt interest (other than interests that are regularly traded on an established securities market) in a financial institution that is described in paragraph (e)(1)(iii) of [Proposed Treasury Regulation § 1.1471-5] (and is not described in paragraph (e)(1)(i), (ii), or (iv) of [Proposed Treasury Regulation § 1.1471-5]);

Proposed Treasury Regulation § 1.1471-5(b)(3)(i) defines the term “depository account” to mean “a commercial, checking, savings, time or thrift account, or an account which is evidenced by a certificate of deposit, thrift certificate, investment certificate, certificate of indebtedness, or other similar instrument . . . .”

Proposed Treasury Regulation § 1.1471-5(b)(3)(ii) defines the term “custodial account” to mean:

an account for the benefit of another person that holds any financial instrument or contract held for investment (including, but not limited to a depository account, a share of stock in a corporation, a note, bond, debenture, or other evidence of indebtedness, a currency or commodity transaction, a credit default swap, a swap based upon a nonfinancial index, a notional principal contract as defined in [section] 1.466-3(c), an insurance or annuity contract, and any option or other derivative instrument).
Proposed Treasury Regulation § 1.1471-5(b)(3)(iii) defines the term “equity interest,” in the case of a trust that is a financial institution, to mean “either an interest held by a person treated as an owner of all or a portion of the trust under sections 671 through 679 or a person holding a beneficial interest in the trust that is described in [Proposed Treasury Regulation §] 1.1473-1(b)(3).” With regard to determining a person’s beneficial interest in a trust, Proposed Treasury Regulation § 1.1473-1(b)(3) provides that:

a specified U.S. person will be treated as directly or indirectly holding a beneficial interest in a foreign trust if such specified U.S. person has the right to receive directly or indirectly (for example, through a nominee) a mandatory distribution or may receive directly or indirectly, a discretionary distribution from the trust. Whether a person has a right to a mandatory distribution is determined taking into account all facts and circumstances.

II. Application to Trusts, Trust Companies, and Related Entities

A. Status of Trust Companies as FFIs

1. Discussion

On August 27, 2010, the Department of Treasury issued Notice 2010-60, 2010-37 I.R.B. 329 (“Notice 2010-60”), which was the first preliminary guidance on the status of trust companies as FFIs. Notice 2010-60 suggested that a trust company might be considered an FFI under section 1471(d)(5)(B), as an entity that, “as a substantial portion of its business, holds financial assets for the account of others.” Notice 2010-60 provided that “such entities may include, for example, broker-dealers, clearing organizations, trust companies, custodial banks, and entities acting as custodians with respect to the assets of employee benefit plans.” (Emphasis supplied).

Proposed Treasury Regulation § 1.1471-5(e)(3)(i) would therefore potentially include trust companies within the definition of a financial institution if a trust company’s gross income “attributable to the holding of financial assets and related financial services” equals or exceeds 20 percent of the trust company’s gross income.
We note that unless that trust company is also simultaneously engaged in a custodial or asset management business, a trust company’s income is typically not attributable to fees for holding financial assets, but rather to the performance of fiduciary services, in the form of an annual charge for performing certain administrative and recordkeeping functions. Although the trustee’s administrative and fiduciary function might include a certain degree of oversight over investment decisions in light of the fiduciary relationship, this function may not include any significant custodial function, and in many instances may wholly exclude custodial functions. For example, it is common for families to appoint trust companies as the fiduciary of family trusts for the simple purpose of establishing a trust in a particular jurisdiction for non-tax reasons or ensuring fiduciary continuity beyond the life of particular family members.

In these cases, the trust company will have minimal involvement in the investment of trust assets, which is instead commonly managed through a holding company, as further discussed below. In other cases, a trust company may perform financial services; however, these may or may not be related to holding financial assets. Therefore, it is not clear what the Proposed Treasury Regulations intend “holding” of financial assets to mean and what portion, if any, of a trustee’s fee could or should be considered “attributable” to the “holding” of financial assets. We request that the final regulations should include additional guidance clarifying when income is “attributable” to such activities.

Proposed Treasury Regulation § 1.1471-5(e)(2)(i)(E) states that an entity is considered to be engaged in a “banking or similar business” for the purposes of section 1471(d)(5)(A) if, in the ordinary course of its business with customers, it provides “trust or fiduciary services.” This definition could potentially be overbroad, as it could potentially treat certain entities that incidentally perform fiduciary services as FFIs, perhaps including some non-US law firms that also act as trustees. We note that such entities and organizations should not generally be considered engaged in a banking or similar business, and we respectfully suggest that the final regulations should limit the scope of the term “banking or similar business” to more narrowly focus the application of this provision. This might be accomplished, for example, by focusing on whether the entity “accepts deposits” and maintains a “financial account” on behalf of the trust, as discussed below.
We note that the Proposed Treasury Regulations appear to contemplate that any entity acting as a trustee in the ordinary course of its business generally would be considered an FFI because it “accepts deposits in the ordinary course of a banking or similar business” within the meaning of section 1475(d)(5)(A) and Proposed Treasury Regulation § 1.1471-5(e)(2).

The definition of “banking or similar business” in Proposed Treasury Regulation §§ 1.1471-5(e)(2)(i) through (iii), including by incorporation of the definition of “bank” under sections 581 and 585, appears to be broadly enough written to apply to many, if not all, institutional corporate trust companies, and as noted above perhaps even some entities that incidentally perform fiduciary services.

Nonetheless, ambiguity arises in applying the other prong of section 1471(d)(5)(A), namely that the entity in question “accepts deposits.” Trust companies may or may not accept deposits and maintain depository or custodial accounts. If trust companies do maintain such accounts, the application of the Proposed Treasury Regulations is sufficiently clear. However, many trust companies do not accept deposits and instead maintain accounts in their fiduciary capacity with banks or other traditional financial institutions that may or may not be related to the trust company. Such a trust company would be engaged in the performance of fiduciary services (and therefore under Proposed Treasury Regulation § 1.1471-5(e)(2)(i)(E) arguably would be engaged in a banking or similar business), but would not satisfy the definitional requirements to be considered an FFI under section 1471(d)(5)(A), as it would not “accept deposits.”

Additionally, we note that trust companies that do not maintain depository or custodial accounts are generally outside the chain of withholding payments, as ordinarily funds flow from payors to the trusts (as the beneficial owner of such payments), rather than through the trust company. Therefore, there is little apparent incentive (or justification to incur the related compliance costs) for such a trust company to enter into an FFI agreement. Moreover, because of the narrow definition of a “financial account” in Proposed Treasury Regulation § 1.1471-5(b)(1), which does not appear to include the fiduciary account of a trust company unless that trust company does maintain depository or custodial accounts, there would be little benefit to the Service in requiring such trust companies to enter into an FFI agreement. They would have no
“account holders” and therefore would not be subject to any reporting or withholding obligations with respect to the trusts for which that company acts as trustee.

The exclusion of trust companies that do not maintain depository or custodial accounts from this requirement would also be consistent with the elimination of duplicative reporting requirements under section 1471(d)(1)(C)(i), which excludes certain accounts and relationships from the definition “financial account” where “such account is held by another financial institution [that is a participating FFI]” and with the suggestion in Notice 2010-60 that where the same interest is a “financial account” of more than one FFI, reporting should generally be performed where possible by the FFI that is in a direct payment relationship with the account holder.

2. Recommendations

We recommend that final regulations clarify that while it is appropriate to treat broker-dealers, clearing organizations, and entities acting as a custodian with respect to financial assets as FFIs within this category, trustees and trust companies that do not also provide such custodial services with respect to financial assets generally should not be considered FFIs on this basis, as they generate fees primarily from fiduciary rather than custodial services.

Alternatively, if these recommendations are not acceptable to the Service, we recommend that the final regulations include a method for determining which proportion of a fiduciary’s fees are attributable (or deemed attributable) to charges for “holding financial assets” in order to determine whether such fees equal or exceed the 20 percent threshold.

We further recommend that final regulations exclude trust companies from the definition of FFIs entirely unless such trust companies separately maintain depository or custodial accounts on behalf of the trusts (unless, perhaps, they elect to assume withholding and reporting responsibility for the trusts for which they act as trustee, as suggested below). If the Service intends that trust companies that do not themselves maintain depository or custodial accounts should be treated as FFIs, then the final regulations should contain additional guidance and clarification as to what constitutes a “financial account” maintained by a trust company under such circumstances.
B. Status of Foreign Trusts as FFIs

1. Discussion

Although it does not specifically state that a foreign trust is an FFI, Notice 2010-60 can be interpreted as implying that a foreign trust might be considered an FFI under certain circumstances. The theory would appear to be that a trust might be an entity engaged primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interest in such securities, partnership interests, or commodities under section 1471(d)(5)(C). The Proposed Treasury Regulations do not explicitly state a rationale under which a foreign trust might be considered to be an FFI, yet they imply that certain trusts, depending on the level of their investment activities with respect to securities, partnership interests, and commodities, might be considered FFIs under section 1471(d)(5)(C).

We note that the Service received comments from various organizations in response to Notice 2010-60 criticizing the Service’s apparent position that foreign trusts should be treated as FFIs under FATCA when such foreign trust invests in securities, partnership interests, or commodities. Specifically, these comments suggested that foreign trusts should not be treated as FFIs because trusts are not “engaged in the business” of making investments on behalf of the beneficial owners of the trust. To the contrary, by definition under Treasury Regulation § 301.7701-4, a trust is an arrangement “for the purpose of protecting or conserving [property] for the beneficiaries.” The definition of an FFI under section 1471(d)(5)(C) is, by its very terms, antithetical to the definition of a trust as recognized for federal tax purposes. Accordingly, the Service has previously been encouraged to promulgate guidance to provide that foreign trusts that are properly classified as trusts, rather than business entities, under the entity classification rules in Treasury Regulation § 301.7701-4 should be classified as NFFEs, not as FFIs.

2. Recommendations

We share the views of previous commentators with respect to the broader point that trusts properly categorized as such under Treasury Regulation § 301.7701-4, rather than as business entities, by definition are not engaged in any business.
Trusts are employed for a number of reasons, including for family business succession planning, non-U.S. estate planning, and to address myriad other concerns unrelated to U.S. taxation. For example, citizens and residents of common law jurisdictions, such as the United Kingdom, regularly establish trusts for estate planning reasons exclusively related to their jurisdictions of domicile. If such a trust happens to include one or two beneficiaries who have become U.S. residents, the fulfillment of the trustee’s fiduciary obligation to preserve and protect the trust assets would appear to mean that under the Proposed Treasury Regulations, the trust is engaged in the “business” of investing should the trustee choose to invest in a portfolio of stocks, mutual funds, and bonds. We respectfully suggest that such a result is beyond the intended scope of FATCA, which was intended to regulate the financial and banking industries, not non-US families engaged in the preservation of family assets. We recommend that the Service promulgate final regulations that specify that trusts that are properly categorized as trusts under Treasury Regulation § 301.7701-4 would be treated as NFFEs rather than FFIs.

If the Service does not agree to this recommendation, we respectfully request that the final regulations provide additional clarity regarding the circumstances under which a trust should be considered to be engaged in the business of investing in securities, commodities, or partnership interests, and therefore treated as an FFI.

In recognition that these views have been expressed previously to the Service and the Proposed Treasury Regulations still suggest that certain foreign trusts will be treated as FFIs, the balance of our comments focus on the areas where further guidance in the final regulations might clarify and simplify the potential application of FATCA to foreign trusts and foreign trustees under the assumption that some foreign trusts may be treated as FFIs under the final regulations.

First, to avoid duplicative reporting, we recommend that if the trustee is a participating FFI, the trusts for which it acts as trustee should not be required to enter into a separate FFI agreement (if these trusts are, in fact, FFIs). Instead, such trusts should be treated as deemed compliant FFIs as provided in Proposed Treasury Regulation § 1.1471-5(f), provided that the FFI agreement signed by the trust company contains adequate safeguards to ensure that it will report and withhold with respect to the accounts it maintains for the trusts for which it acts as trustee. We think this provides adequate compliance mechanisms to ensure that the intent of FATCA is properly carried out. If a trust company maintains financial accounts, then it is in a position to
withhold and perform any necessary reporting sufficient to meet the intended goals of the legislation.

Additionally, we suggest that the Service consider and explore in collaboration with the professional tax and estate planning community a mechanism to permit trust companies, including those that do not maintain deposit or custodial accounts, to elect to conduct FFI compliance on behalf of foreign trusts. Such a mechanism would allow a trust company to interject itself in the chain of withholding payments, become a participating FFI, and assume responsibility for withholding and reporting on behalf of the foreign trusts for which it acts as trustee. This likely would require some mechanism under which the trust company would open a pooled or escrow account in its own name through which it could exercise control over the chain of payments. With control over the chain of payments, the trust company could then carry out its obligations as a participating FFI and satisfy any applicable withholding requirements. Not only would this reduce the reporting burden on foreign trusts, it would institutionalize the reporting obligation within the trust company itself, consistent with the broader goals of FATCA. We would be willing to provide more detailed comments on this issue, should the Service so desire, in collaboration with other interested professional organizations.

Alternatively, we recommend that the Service permit trust companies to treat the trusts of which it serves as a fiduciary as owner-documented FFIs under Proposed Treasury Regulation § 1.1471-5(f)(3) with regard to the depository and custodial accounts maintained by the trust company. If the trust company does not itself maintain deposit or custodial accounts, and instead maintains external accounts with another FFI, then the trust should be able to provide owner-documentation to that other FFI or withholding agent and be deemed compliant. Such a resolution would avoid unnecessary and duplicative compliance by trust companies.

Finally, we highlight three additional areas where we recommend the Service grant exceptions or exclusions from FFI status for certain foreign trusts.

First, we note that Proposed Treasury Regulation § 1.1471-5(e)(5)(i) provides excepted FFI status to certain holding companies substantially all of the activities of which is to own the stock in one or more subsidiaries that engage in trades or businesses, provided that no such subsidiary is itself an FFI. The theory appears to be that merely holding assets, including an equity interest in a subsidiary company, does not rise to the level of engaging in the business of
investing in securities. Under the same rationale, we recommend that a trust should not be considered to be engaged primarily in the business of investing in securities merely because it holds assets that include securities, commodities, or partnership interests. Such a conclusion is consistent with the well-established definition of a trust under Treasury Regulation § 301.7701-4. Alternatively, we request further clarification regarding what specific activities with respect to such assets constitute engaging in a trade or business with respect to these assets, as the notion of a trust engaged in a trade or business is novel within the traditional definition of a trust as recognized for federal tax purposes.

Second, we recommend that the Service provide an exception for trusts the trustee of which is not engaged in providing trust or fiduciary services in its ordinary course of business, such as an individual family member, a close family friend or business associate, an individual such as a lawyer or accountant, or an entity owned directly or indirectly by family members (i.e., a “private trust company”). Such an exception could take the form of permitting such family trusts to be treated as “excepted NFFEs” in accordance with Proposed Treasury Regulation § 1.1472-1(c) or in permitting such trusts to be deemed compliant FFIs as provided in Proposed Treasury Regulation § 1.1471-5(f).

As noted above, family trusts are regularly employed in the majority of common law jurisdictions for a number of non-tax reasons. In those situations where there is a small trust for the benefit of family members, it would be practically and administratively difficult for many trustees (particularly where these are individuals such as family members, friends, or trusted professional advisors such as accountants or attorneys) to satisfy the compliance burdens associated with entering into an FFI agreement. Although we recognize that the “owner-documented” FFI exception may, to some extent, alleviate the issue as to trusts that are FFIs, it remains unclear how many FFIs will be willing to assume withholding and reporting obligations on behalf of such small family trusts. Many banks and intermediaries may decide that assuming this compliance burden is not commercially justified and may refuse to open accounts on behalf of such small family trusts unless there is a bright line exception for such entities.

We recommend that the Service promulgate additional guidance in the final regulations with respect to a “small family trust” exception similar to the example provided in section II(B)(3) of Notice 2010-60. Specifically, we recommend that small family trusts that hold less
than US$2 million in gross assets, and of which the trustee is an individual, should be treated as an excepted NFFE.

Third, we note that Proposed Treasury Regulation § 1.1471-5(e)(5)(v) provides an exception for any foreign entity that is described in section 501(c). We recommend that the Service clarify that this exception would apply to any trust that qualifies for tax exempt status as a registered charitable trust or has analogous exempt status in the country of its governing law or principal place of administration.

C. Clarification of 10 Percent Test for Determining Substantial U.S. Owner

1. Discussion

If the Service will consider foreign trusts to be FFIs, further guidance is required with regard to what circumstances may cause a beneficiary of a foreign trust to be treated as a substantial U.S. owner. Under section 1473(2)(A)(iii), a substantial U.S. owner, in the case of a trust which is not a grantor trust, is any U.S. person who holds, directly or indirectly, more than 10 percent of the beneficial interests in such trust. However, section 1473(2)(B) provides that in the case of an FFI that is classified as such on account of being “engaged (or [holding] itself out as being engaged) primarily in the business of investing, reinvesting or trading in securities, partnership interests, commodities or any interest in such securities, partnership interests or commodities,” a special rule substitutes the 10 percent threshold for a zero percent threshold.

2. Recommendations

If foreign trusts are to be classified as FFIs on account of the Service’s position that trusts are engaged in the business of making investments on behalf of the beneficial owners of the trust, then we recommend that the Service provide guidance as to the meaning of the 10 percent beneficial interest test in determining whether a trust beneficiary is a substantial U.S. owner. Failure to do so would create significant ambiguity as to the relationship between section 1473(2)(A)(iii) and 1473(2)(B), and would seemingly conflict with the clear intention expressed in the statute that a 10 percent beneficial ownership test should apply. We recommend that if the Service maintains its position that foreign trusts are FFIs, it should promulgate guidance clarifying that the zero percent special rule otherwise applicable to certain investment funds does
not apply to “equity” interests in trusts. Doing so would preserve the statutory intent of section 1473(2)(A)(iii).

D. Avoidance of Duplicative Compliance and Centralization of Compliance Function Regarding Holding Companies Owned by Foreign Trusts

1. Discussion

It is common for families to have trusts that own and manage trust assets through one or more holding companies. Such subsidiary entities may invest in securities in such a manner that they also might be classified as FFIs under section 1471(d)(5)(C). In such a case, the position that a foreign trust that owns such holding companies is also an FFI, provided that the trust primarily invests in securities, would result in duplicative compliance.

As announced in Notice 2010-60, the Service has already provided for a centralized compliance and certification function with respect to members of an FFI’s expanded affiliated group. We think a similar procedure should apply in the case of a subsidiary that is majority owned by a participating or deemed-compliant FFI (a more than 50% owned subsidiary, to maintain consistency with the expanded affiliated group requirement) of a foreign trust where both the trust and the subsidiary are treated as FFIs.

2. Recommendation

To avoid duplicative reporting, we recommend that the Service provide for a centralized compliance and certification function for majority owned (more than 50% owned) subsidiaries of foreign trusts in the same way that the Service has done for an FFI’s expanded affiliated group. For example, a trust that is a participating FFI should be able to provide certifications on behalf of any of its subsidiaries that are also FFIs. To the extent that a trust company that is a participating FFI elects to assume withholding and reporting obligations on behalf of the trusts for which it acts as trustee, the trust company should also be able to provide certifications on behalf of these trusts.

We also recommend that subsidiaries that are 100% owned by one or more participating FFIs or FFIs that are themselves deemed compliant consistent with our recommendations and Proposed Treasury Regulation § 1.1471-5(f) should themselves be treated as participating FFIs or deemed compliant FFIs. This would be consistent with the approach taken toward certain
“qualified collective investment vehicles” in the fund context, and would still achieve the objectives of the Service as the reporting and disclosure obligations with respect to such subsidiaries would presumably be accomplished by the disclosure of any U.S. accounts maintained by the trust (or, where relevant, the disclosure of accounts maintained by a trust company that is an FFI or such other bank or FFI at which the trust’s accounts are maintained).