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Room 5205 www.regulations.gov (IRS-REG-121647-10)
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Dear Sirs/Madams:

Comments on the Proposed Foreign Account Tax Compliance Act
("FATCA") Regulations (the "Proposed Regulations")

We, The Hong Kong Federation of Insurers ("HKFI"), The Hong Kong Investment Funds Association ("HKIFA"), and The Hong Kong Trustees' Association ("HKTA"), have formed a joint industry FATCA working group (the "Working Group") in Hong Kong to share thoughts, provide education and work together to address concerns raised by financial institutions in Hong Kong with respect to FATCA. Hong Kong is a special administrative region of the People's Republic of China. The Working Group liaises with regulatory bodies in Hong Kong to solicit comment on FATCA. The Working Group's membership is extensive and further details on the members are outlined below.

The Working Group appreciates the opportunity to provide comments on the Proposed Regulations, and the attempt of the U.S. Department of Treasury ("Treasury") and the U.S. Internal Revenue Service ("IRS") to amend earlier guidelines and provide greater clarity through the Proposed Regulations. Through this submission, the Working Group wishes to provide some recommendations that we believe will lessen the burden of implementation, while still achieving the stated FATCA policy objectives.

Background

HKFI was established on 8 August 1988 and exists to promote insurance to the people of Hong Kong, as well as to build consumer confidence in the industry by encouraging the highest

standards of ethics and professionalism amongst its members. It enjoys recognition by the Government of the Hong Kong Special Administrative Region ("Government of the HKSAR") as the representative body of an important financial services industry in Hong Kong.

The insurance industry is one of the few industries in Hong Kong that enjoys a high degree of self-regulation complemented by the Government of HKSAR's prudent regulatory framework. While maintaining a frequent dialogue with the Commissioner of Insurance of Hong Kong on legislative issues affecting the industry, the HKFI actively promotes and perfects its self-regulatory regime with the aim of improving the professionalism of and strengthening public confidence in the insurance industry.

Currently, the HKFI has 90 General Insurance Members and 43 Life Insurance Members. 62,334 agents are currently registered with member firms. They combine to contribute more than 90% of the gross premiums written in the Hong Kong market. The life insurance sector represented over 10% of the GDP of Hong Kong with more than US$20 billion in revenue in 2010.

HKIFA is the professional body that represents the asset management industry in Hong Kong. Established in 1986, the HKIFA has two major roles, namely consultation and education. On consultation, it acts as the representative and consulting body for its members and the fund management industry generally in all dealings concerning the regulation of unit trusts, mutual funds, retirement funds and other funds of a similar nature. Towards this end, it reviews, promotes, supports or opposes legislative and other measures affecting the fund management industry in Hong Kong. Another very important task is to educate the public about the role of investment funds in retirement planning and other aspects of personal financial planning.

As of April 2012, HKIFA has 49 fund management companies as full/overseas members, managing about 1,270 Hong Kong Securities and Futures Commission authorized funds. Assets under management amounted to about US$1,000 billion as at the end of March 2012. In addition, HKIFA has 68 affiliate and associate members.

HKTA was established in 1991 by members of the trust and fiduciary services industry to represent the trust industry in Hong Kong, particularly in the areas of legislation and education. Organized as a not-for-profit company incorporated in Hong Kong, the HKTA has more than 90 members. It represents thousands of professionals primarily working in the trust, private banking, fund services, legal and accounting covering all Mandatory Provident Fund ("MPF") retirement plan trustees as well as corporate and individual trustees of Occupational Retirement Schemes Ordinance ("ORSO") retirement plans. All 16 active MPF trustees and many ORSO trustees are members of the HKTA.

HKTA works closely with various stakeholders of the pension and regulated funds industries to advance development of the industries' overall and to promote higher standards of

professionalism and pension or fund governance. HKTA has been active in raising FATCA awareness on the part of retirement plan trustees and other financial market participants in Hong Kong as well as providing education and updates where appropriate.

The Working Group Submission

We note that the key objective of the Treasury and IRS in the implementation of FATCA is to establish a regime that meets the goal of preventing evasion of U.S. taxes. We understand and recognise this objective. However, it is critically important that the Treasury and IRS achieve this objective through a workable and economical framework for the industries which are affected, which above all else, is consistent with local legal and regulatory regimes. In this regard, we attach the following submissions as Appendices to this letter voicing our members' concerns in greater detail which we would encourage you to consider.

Appendix I – Hong Kong Retirement Plans

Appendix II – Hong Kong Investment Funds

Appendix III – Hong Kong Insurance Companies

Appendix IV – Private Trusts

We once again thank you for the opportunity to provide these comments. In the meantime, if there is any further information we could provide or questions raised by our comments and suggestions that you would like addressed, please do not hesitate to contact us as follows:

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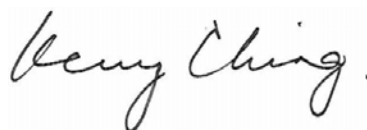
Sincerely yours,



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APPENDIX I

Comments on the FATCA Proposed Regulations
As Applied to Hong Kong Retirement Plans

In this Appendix I, we seek to provide you with information on how Hong Kong's retirement plans will have difficulty qualifying for the rules in the proposed regulations (the "Proposed Regulations") promulgated under Sections 1471 through 1474 of the Internal Revenue Code of 1986, as amended, on retirement and pension plans and accounts.[1] Those rules are the provisions on "certified deemed-compliant FFI" and "exempt beneficial owner" status for retirement plans under Proposed Treasury Regulations Sections 1.1471-5(f)(2)(ii)(A) and 1.1471-6(f)(1)(ii), respectively, and the exclusion of plan member accounts from being treated as "financial accounts" under Proposed Treasury Regulations Section 1.1471-5(b)(2)(i)(A) (collectively, the "Retirement Rules"). The principal Hong Kong retirement plans are Mandatory Provident Fund plans ("MPFs") and Occupational Retirement Schemes Ordinance plans ("ORSOs").

This Appendix I discusses the specific requirements within the Retirement Rules that Hong Kong's MPFs and ORSOs are finding it challenging to meet, and resulting recommendations for your consideration as you finalize the Proposed Regulations. We encourage you to consider broadening the Retirement Rules to accommodate the differing features of foreign retirement plans, including Hong Kong's MPFs and ORSOs. We summarize our recommendations on the Retirement Rules in the Exhibit to this Appendix.

In particular, as discussed in Section 2 below, we recommend that, where a foreign government has mandated that plan members participate in a retirement plan (or a retirement plan may be chosen by a plan member in lieu of a government-mandated plan), that retirement plan should qualify for a newly-added category of certified deemed-compliant FFIs. Hong Kong's MPFs and other government-mandated retirement/pension plans around the world (or plans in lieu thereof) have a range of terms and conditions tailored to the respective local jurisdictions' employment and retirement conditions. This new category of deemed-complaint FFI status would reflect the low risk of US tax evasion presented by foreign government-mandated

[1] The tax treaty-based rule for an exempt beneficial owner under Proposed Treasury Regulations Section 1.1471-6(f)(1)(i) is not available to retirement plans that are housed in entities organized in Hong Kong, which is the predominant portion of MPFs and ORSOs. Hong Kong does not have an income tax treaty with the US and is not viewed by the US as having residents who can qualify for the income tax treaty between the People's Republic of China and the US.

retirement plans. If this new category were added, MPFs in Hong Kong and ORSOs in lieu of MPFs could qualify for deemed-compliant FFI status.

1. Hong Kong Retirement Plan Industry

In order to participate in an MPF or ORSO, a plan member generally has to work in Hong Kong or have (or have had) an employment relationship involving Hong Kong. Hong Kong is a special administrative region within the People's Republic of China. This and the government mandate that MPF plan accounts be established for employees and self-employed persons ("SEPs") highlight the low risk that MPFs and ORSOs would be used by US taxpayers as a vehicle for US tax evasion.

The MPF retirement fund system in Hong Kong was created by the Hong Kong government as mandatory, privately managed, fully funded, defined contribution plans that were intended to assist the Hong Kong working population to accumulate retirement savings. The government of Hong Kong had studied the recommendation for this type of retirement plan made by the World Bank in a 1994 World Bank report entitled "Averting the Old-Age Crisis: Policies to Protect the Old and Promote Growth". In 1995, Hong Kong enacted the Mandatory Provident Fund Schemes Ordinance ("MPF Ordinance"). The MPF system began operating in 2000.

Before the implementation of the MPF system, a number of Hong Kong employers had elected to operate voluntary retirement plans to provide retirement benefits for their own employees. These employer-specific retirement plans, regulated under the Occupational Retirement Schemes Ordinance of 1993, have continued to operate in many cases.[2] Like MPFs, ORSOs are generally under the trusteeship of trustees.

Both MPFs and ORSOs are regulated and monitored under Hong Kong legislation. The Mandatory Provident Fund Schemes Authority ("MPFA") is the statutory body in Hong Kong that regulates and supervises the operation of MPF and MPF-exempted ORSO retirement plans. The MPF Ordinance authorized the establishment of MPFs, required them to register with the MPFA, created the MPFA as the regulator in Hong Kong for MPFs, and mandated the regulation of MPF trustees. The Hong Kong legal framework for ORSOs was established by the Occupational Retirement Schemes Ordinance. This law set up a registration and

[2] To tie in with the implementation in 2000 of the MPF system, ORSOs that fulfilled certain conditions could apply for an exemption from MPF requirements. Pre-existing members of an MPF-exempted ORSO had a one-off option to choose between the ORSO and an MPF, as do new members of such an ORSO.

regulation system for ORSOs.

Around 85% of Hong Kong's working population is now covered under MPFs, ORSOs or other pension funds. Hong Kong had 41 MPFs with aggregate assets under management of approximately HK$356 billion (US$ 46 billion) on December 31, 2011. The MPFs are served by 16 MPFA-approved MPF trustees, many of which are affiliated with major banking institutions or insurance companies.[3] On December 31, 2011, MPFs covered 2.5 million plan members and 252,000 employers. Hong Kong had 5,367 registered ORSOs with assets under management of HK$262 billion (US$34 billion) on December 31, 2011. On December 31, 2011, registered ORSOs covered 414,245 employees from 7,155 employers.

Features of MPFs and ORSOs

MPFs and ORSOs are both retirement protection plans set up for employees and SEPs. Almost all employees or SEPs, aged 18 to 64, who normally reside and work in Hong Kong are required to join an MPF. A single MPF may, in most cases, draw plan members from dozens of, or over a hundred, employers. Each of the employer and employee generally has to make a "mandatory contribution" each month to an MPF in an amount equal to the lower of (i) 5% of the employee's relevant monthly salary, and (ii) HK$1,000 (approximately US$130) (HK$1,250 or US$160 starting from June 2012).[4] The average MPF plan member had, as of December 31, 2011, approximately HK$142,400 (or US$18,370) held in MPF accounts. An MPF is permitted to make distributions to a plan member in connection with mandatory contributions only in specified, limited circumstances.[5] Employers can elect to make additional "voluntary contributions" to an MPF on behalf of their employees, and set the rules governing vesting and withdrawal of benefits derived from voluntary contributions made to the relevant MPF. Additional voluntary contributions can also be made by employees.

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[3] For a list of trustees, see http://www.mpfa.org.hk/english/reg_use/reg_use_amt/reg_use_amt.asp.

[4] Employers' contributions made to an MPF or MPF-exempted ORSO are generally tax deductible for Hong Kong tax purposes to the employers, to the extent that they do not exceed 15% of an employee's annual compensation. An employee's contributions made to an MPF or MPF-exempted ORSO are generally tax deductible up to a cap of HK$12,000 per year (HK$15,000 per year from June 2012).

MPFs typically invest in the equity of a number of investment funds that are generally themselves expected to be FFIs, as well as other assets. These underlying funds invest in equity, bonds, money market instruments and other assets. On September 30, 2011, North American assets represented approximately 12% of the total equity in lower-tier investment funds held by MPFs.

[5] Such MPF withdrawals are generally permitted upon the following limited events: retirement at the age of 65; early retirement at the age of 60; death; total incapacity of the employee; and permanent departure of the employee from Hong Kong.

ORSOs are retirement schemes set up voluntarily by Hong Kong employers. The features of ORSOs are governed by individual plan rules and determined by applicable employers. Contributions can be made solely by the employer or by both the employer and employee, depending on plan rules. On December 31, 2011, 89% of ORSOs were defined contribution plans and 11% were defined benefit plans.

2. Government-Mandated Retirement Plans Should Be Treated As A New Category of Deemed-Compliant FFIs

We recommend that, where a foreign government has mandated that plan members participate in a retirement plan, that retirement plan should be treated as a certified deemed-compliant FFI under a newly-added category of deemed-compliant FFI status. Under such a rule, MPFs in Hong Kong would qualify for certified deemed-compliant FFI status.

This rule should be added to the FATCA regulations because foreign governments' understanding of their jurisdictions' local employment and retirement practices should be deferred to, without a government-mandated retirement plan having to undergo detailed testing for its facts under the Retirement Rules as set forth in the Proposed Regulations. Government-mandated retirement plans in different jurisdictions have terms and conditions that cater to local features of the economy, labor force, norms for employment remuneration and retirement planning, social and cultural systems and other aspects. Introducing a new category of deemed-compliant FFIs for government-mandated retirement plans would recognize foreign governments' familiarity with relevant local features.

A government-mandated retirement plan has typically been subject to meaningful review and regulation by the applicable foreign government. That is the case for Hong Kong's MPFs, as discussed in Section 1 above. In many cases, government-mandated retirement plans have been the subject of legislation enacted by the foreign government setting forth key aspects of their terms and conditions and their operations. The MPF system was launched in Hong Kong in 2000, after considerable review by the government and after the enactment in 1995 of the MPF Ordinance.

Furthermore, we recommend that the proposed new category of certified deemed-compliant FFI status extend to any retirement plan which is registered with a foreign government and which may be chosen by a plan member in lieu of a government-mandated retirement plan. Under such a rule, MPF-exempted ORSOs in Hong Kong could qualify for certified

deemed-compliant FFI status.

3. Additional Comments on the Deemed-Compliant FFI Rule

We recommend that, if the new category of deemed-compliant FFIs recommended in Section 2 above were not adopted, adjustments set forth in this Section 3 be made to the certified deemed-compliant FFI rule for retirement plans set forth in Proposed Treasury Regulations Section 1.1471-5(f)(2)(ii) (the "Deemed-Compliant FFI Rule") and to related portions of other Retirement Rules. The adjustments in this Section 3 would modify such Deemed-Compliant FFI Rule to facilitate its coverage of Hong Kong's retirement plans. Further below in Section 4, we include other recommendations on the Retirement Rules and the Proposed Regulations.

A. The Requirement that Retirement Plan Contributions Be "Limited By Reference to Earned Income" Should Be Removed

MPFs and ORSOs are expected to be FFIs for FATCA purposes. A retirement plan can qualify as a certified deemed-compliant FFI under the Deemed-Compliant FFI Rule only if, among other things, contributions to the plan are "limited by reference to earned income" of the relevant plan member. An MPF cannot meet this requirement for reasons discussed below. This requirement also has to be met in order for an MPF to qualify as an exempt beneficial owner under Proposed Treasury Regulations Section 1.1471-6(f)(1)(ii) (the "Exempt Beneficial Owner Rule") and for an MPF account to be excluded from treatment as a financial account under Proposed Treasury Regulations Section 1.1471-5(b)(2)(i)(A) (the "Financial Account Rule").[6] Accordingly, it appears that the "limited by reference to earned income" requirement precludes all MPFs in Hong Kong from qualifying under the Retirement Rules of the Proposed Regulations.

"Mandatory contributions" by an employer and employee to an MPF are calculated based on the employee's monthly salary (and subject to an annual cap[7]). Besides mandatory contributions, "voluntary contributions" by the employer or employee can also be made under the MPF system. Voluntary contributions are intended by the Hong Kong government to encourage the working population to save amounts (in addition to those mandatorily required)

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[6] We note that the Financial Account Rule in Treasury Regulations Section 1.1471-5(b)(2)(i)(A)(2)(ii) is more restrictive in terms of the effect of its "limitation by reference to earned income" test. Such limitation has to be in place "under the law of the jurisdiction in which the account is maintained" and not merely pursuant to the terms and conditions of a particular retirement plan.

[7] See supra note 4.

in furtherance of sound retirement planning, and are a feature of every MPF in Hong Kong. While the vast majority of voluntary contributions are based on employees' salaries, certain voluntary contributions to MPFs are not limited by an employee's salary.

In the very limited scenarios where voluntary contributions made under the MPF system are not limited by reference to an employee's salary, they nonetheless present a low threat of US tax evasion because an individual has to have worked in Hong Kong, or have (or have had) an employment relationship involving Hong Kong, in order to participate in an MPF. In addition to causing MPF contributions to have difficulties meeting the "limited by reference to earned income" requirement in the Retirement Rules, voluntary contributions by an employee may prevent an MPF from meeting the test, in the Deemed-Compliant FFI Rule in Proposed Treasury Regulations Section 1.1471-5(f)(2)(ii)(A)(1)(iii) and the Exempt Beneficial Owner Rule in Proposed Treasury Regulations Section 1.1471-6(f)(1)(ii)(D), that a retirement fund receive 50% or more of its total contributions from the employer or the government.

Whether contributions to ORSOs are limited by reference to employees' earned income varies from ORSO to ORSO. In many instances, ORSOs will have contributions that meet this limitation.

Another set of scenarios that could cause an MPF or ORSO to not meet the "limited by reference to earned income" requirement for the Retirement Rules involves an employee who is not paid (or is paid on a reduced basis) by his employer for a certain period of time, but who nonetheless has the employer making contributions to the MPF or ORSO on his behalf. Depending on the terms and conditions of the particular MPF or ORSO, this potential challenge to meeting the "limited by reference to earned income" requirement could occur as a result of employer or employee contributions during periods when the employee is not paid (or is paid on a reduced basis), including, by way of illustration, upon the disability of an employee, an employee's sabbatical or leave of absence, or an employee's taking unpaid additional parental leave following the birth of a child or in order to care for an elderly or ailing family member.

Given the range of practical scenarios, as varied and textured as the fabric of employees' lives, where employees may have to (or want to) take some period of time off without receiving full pay, we recommend that consideration be given to whether the "limited by reference to earned income" requirement is too restrictive on retirement plans. We recommend that this

requirement be removed from the Proposed Regulations.

B. The "Limited By Reference to Earned Income" Requirement Is Also Difficult to Meet Because Permissible Contributions from Inter-Retirement Fund Transfers Are Restricted to Transfers from Retirement Plans that Qualify Under the Retirement Rules

For purposes of testing the amount of contributions to member accounts under the "limited by reference to earned income" requirement, the Retirement Rules carve out, from contribution amounts made to a transferee retirement plan ("Transferee Plan"), amounts transferred from another retirement plan ("Transferor Plan") only where the Transferor Plan (or the relevant account at the Transferor Plan) itself meets the Retirement Rules or the tax treaty-based exempt beneficial owner rule in Proposed Treasury Regulations Section 1.1471-6(f)(1)(i) for retirement plans.[8] It is not enough for this purpose that the Transferor Plan be, for instance, a participating FFI. Incoming transfers from Transferor Plans that do not meet the Retirement Rules are treated as contributions (presumably deemed made in the year of the transfers) to the Transferee Plan, so as to cause the Transferee Plan to potentially violate the "limited by reference to earned income" requirement and not qualify for the Retirement Rules.

As an example, consider an MPF that receives a transfer of a plan member's funds from an ORSO. Such a transfer may be required under the MPF Ordinance when an ORSO plan member leaves an ORSO. If the MPF receiving the transfer were seeking to qualify for the Retirement Rules, but the transferor ORSO did not, the transfer could potentially impact the MPF in the manner described above.

In addition, we note that the Retirement Rules do not appear to protect a Transferee Plan from being adversely affected if it had requested and received documentation (beyond the requirements of the Retirement Rules), and therefore believed, that the Transferor Plan qualified for the Retirement Rules at the time of the incoming transfer, but thereafter it were determined (whether by the Transferor Plan or by the United States Internal Revenue Service ("IRS")) that the Transferor Plan did not so qualify at the time of the transfer. Thus, even a Transferee Plan that proactively seeks to determine the FATCA status of a Transferor Plan prior to taking on an incoming transfer could be penalized by facts beyond the Transferee Plan's control.

From a practical perspective, transfers effected by plan members between retirement funds can

[8] See Prop. Treas. Reg. §§ 1.1471-5(b)(2)(i)(A)(2)(iii), 1.1471-5(f)(2)(ii)(A)(1)(i) and 1.1471-6(f)(1)(ii)(B).

be prompted by employees' changes in employment, desire to consolidate their retirement savings or desire to access better-performing retirement plans, among other factors. That the "limited by reference to earned income" requirement in the Retirement Rules hampers this type of transfer further confirms that such requirement should be removed.

C. Self-Employed Persons Should be Treated as "Employers", and Short-Term Workers As "Employees"

Where the prerequisites to the Retirement Rules turn on a plan member being an "employer" or "employee", the Proposed Regulations should be clarified to treat SEPs as "employers", as well as to treat as "employees" individuals who may have short-term jobs because of the industry for which they work or who may otherwise not be traditionally viewed as employees of a given single employer.

Under the MPF Ordinance, SEPs are required to participate in MPFs. As of December 31, 2011, 229,000 SEPs were enrolled in MPFs. All MPFs cover SEPs. These persons include individuals who work for themselves as sole proprietor, as well as partners in a business partnership. If there were to remain uncertainty, when the Proposed Regulations are finalized, regarding the ability of SEPs to qualify as "employers" (and there remained no guidance on alternatively treating SEPs as "employees"), MPFs could be rendered ineligible for the Retirement Rules.[9] The reason for this outcome is that, if an MPF had such individuals as plan members and they did not clearly constitute "employers" or "employees" within the meaning of the Retirement Rules, contributions to the MPF would not all be in the form of "government, employer, or employee contributions" as required by the Retirement Rules.

The MPF Ordinance allows "casual employees" to participate in some MPFs known as "industry schemes" when the worker operates in the construction industry[10] or catering industry. These industry-specific MPFs are tailored to the frequency with which workers move from job to job, or to the common practice of paying workers wages on a daily basis, in these two industries. Of the 41 MPFs in Hong Kong on December 31, 2011, two were industry schemes for casual employees.

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[9] See Prop. Treas. Reg. §§ 1.1471-5(b)(2)(i)(A)(2)(ii), 1.1471-5(f)(2)(ii)(A)(1)(i) and 1.1471-6(f)(1)(ii)(B).

[10] Hong Kong has high commercial and residential real estate prices, and the construction industry is a significant contributor to Hong Kong's economy.

The coverage by retirement plans of certain workers who may not fit the traditional notion of an "employee" is not unique to Hong Kong. Given the entrepreneurial contributions of individuals who choose to work for themselves, as well as the diversity of the industries in which retirees work in different parts of the world, we would appreciate it if you could consider how the Retirement Rules can accommodate these labor practices. Clarifying adjustments could be made to indicate that SEPs can be treated as "employers", and short-term workers as "employees", for purposes of the Retirement Rules.

In addition, and significantly for MPFs, we would appreciate a clarification or modification to the effect that the Retirement Rules can apply to a retirement fund covering employees from more than one employer.

D. ORSOs

In Hong Kong, ORSOs can have a range of terms and conditions that are determined by the employer that establishes the ORSO. Because variations from one ORSO to another can be relevant to the availability of the Retirement Rules, ORSOs as a retirement product are not amenable to being analyzed for FATCA purposes as a group and an ORSO-by-ORSO review will be required. Hence, efforts disproportionate to mitigation of perceived US tax evasion risks (if any) will be required for ORSOs to determine whether they meet the Retirement Rules. The Retirement Rules should be broadened and rendered them more flexible. As discussed in Section 2 above, we recommend that ORSOs be treated as certified deemed-compliant FFIs so long as they are in lieu of a government-mandated retirement plan.

In Hong Kong, smaller ORSOs may have a sufficiently limited number of plan members that they may not meet the requirement in the Deemed-Compliant FFI Rule in Proposed Treasury Regulations Section 1.1471-5(f)(2)(ii)(A)(1)(ii) that no single beneficiary of a retirement plan have a right to more than 5% of the FFI's assets. This requirement should be modified to indicate that either there is no greater-than-5% beneficiary or the retirement plan has collected from any such beneficiaries appropriate documentation on their status for FATCA purposes. There is a similar provision of the Exempt Beneficial Owner Rule in Proposed Treasury Regulations Section 1.1471-6(f)(1)(ii)(C) that should be correspondingly adjusted.

In addition, a retirement plan, including some ORSOs in Hong Kong, risks a scenario where the Deemed-Compliant FFI Rule or Exempt Beneficial Owner Rule is initially met for a plan

(or plan member accounts initially qualify for exclusion from financial account treatment), but later facts change in a manner that is beyond the retirement plan's control to make that treatment unavailable. An ORSO's ability to qualify for one of the Retirement Rules could be adversely affected over time by, for example, (i) the exit of plan members upon retirement benefits being paid out or in other limited scenarios,[11] (ii) the addition of plan members when they become employees of the employer that created the ORSO,[12] (iii) fluctuations in the value of investments held in plan members' respective accounts,[13] and (iv) changes in the residency of plan members.[14] We recommend that the Retirement Rules be revised to protect a retirement plan that initially qualifies for the Retirement Rules from losing its qualification through developments beyond the plan's control.

Moreover, where a retirement plan initially qualifies for one of the Retirement Rules, but later fails to continue to so qualify, we recommend that there be a transition window (e.g., nine months) accorded to the retirement plan within which to undertake FATCA readiness efforts, including, if applicable, customer due diligence. Without such a transition window, an ORSO or other retirement plan that initially qualifies for one of the Retirement Rules, but loses its qualification after January 1, 2014, could immediately become subject to the 30% withholding tax applicable on withholdable payments.

E. Effect of Hong Kong Tax Rules on the Retirement Rules

Some factual prerequisites to the Retirement Rules turn on local tax law. The Deemed-Compliant FFI Rule in Proposed Treasury Regulations Section 1.1471-5(f)(2)(ii)(A)(1)(iii) asks whether contributions to the retirement plan "that would otherwise be subject to tax" under relevant local law are deductible or excluded from gross income of the beneficiary, and also whether the taxation of investment income attributable to

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[11] See Prop. Treas. Reg. §§ 1.1471-5(f)(2)(ii)(A)(1)(ii) (no single beneficiary has a right to more than 5% of a plan's assets), 1.1471-5(f)(2)(ii)(A)(2)(iv) (participants that are not a resident of the country in which the plan is organized are not entitled to more than 20% of the plan's assets) and 1.1471-6(f)(1)(ii)(C) (no single beneficiary has a right to more 5% of a plan's assets).

[12] See Prop. Treas. Reg. § 1.1471-5(f)(2)(ii)(A)(2)(i) (plan has fewer than 20 participants) and 1.1471-5(f)(2)(ii)(A)(2)(iv) (participants that are not a resident of the country in which the plan is organized are not entitled to more than 20% of the plan's assets).

[13] See Prop. Treas. Reg. §§ 1.1471-5(f)(2)(ii)(A)(1)(ii), 1.1471-6(f)(1)(ii)(C) (no single beneficiary should have a right to more 5% of a plan's assets), 1.1471-5(f)(2)(ii)(A)(2)(iv) (participants that are not a resident of the country in which the plan is organized are not entitled to more than 20% of the plan's assets) and 1.1471-5(f)(2)(ii)(A)(2)(v) (no participant that is not a resident of the country in which the plan is organized is entitled to more than US$250,000).

[14] See Prop. Treas. Reg. §§ 1.1471-5(f)(2)(ii)(A)(2)(iv) (participants that are not a resident of the country in which the plan is organized are not entitled to more than 20% of the plan's assets) and 1.1471-5(f)(2)(ii)(A)(2)(v) (no participant that is not a resident of the country in which the plan is organized is entitled to more than US$250,000).

the beneficiary "is deferred" under such local law. In Hong Kong, contributions by an employee to an MPF (other than the employee's mandatory contributions), and contributions by an employee to an ORSO which exceed the mandatory contributions required to be made had such ORSO scheme been a MPF scheme, are not deducted or excluded from a plan member's gross income, causing the described test to not be met. We recommend that this test be made more flexible.

Also, investment income attributable to a plan member under an MPF or ORSO account is generally not subject to Hong Kong salaries tax or profits tax. This causes an MPF or ORSO to arguably not be able to meet the requirement that taxation of investment income is "deferred" to a plan member under Hong Kong tax law. We suggest that the Proposed Treasury Regulations Section 1.1471-5(f)(2)(ii)(A)(1)(iii) test be amended to ask whether, if investment income attributable to the beneficiary were otherwise taxed under local law, such taxation would be deferred.[15]

In addition, the Exempt Beneficial Owner Rule in Proposed Treasury Regulations Section 1.1471-6(f)(1)(ii)(D) asks whether a retirement plan is exempt from tax on investment income under relevant local law "due to its status as a retirement or pension plan". In Hong Kong, MPFs and ORSOs generally are not to be subject to Hong Kong profits tax. However, the reason for this outcome is not because MPFs and ORSOs are retirement plans, but because the plans tend not to be viewed by the Hong Kong Inland Revenue Department as carrying on a business in Hong Kong, which is a requirement to incur profits tax liability in Hong Kong. We recommend that Proposed Treasury Regulations Section 1.1471-6(f)(1)(ii)(D) be modified to ask whether, if a retirement plan would otherwise be subject to tax on investment income under relevant local law, such plan is exempt from tax due to its status as a retirement or pension plan.

F. Hong Kong As a Special Administrative Region

The Retirement Rules refer in various contexts to the "country" (i) under the laws of which a fund is established (or, in some cases, in which it operates), or (ii) under the laws of which a fund has to be exempt from tax on investment income.[16] As noted above, Hong Kong is a

[15] Similarly, we note that what constitutes a "tax-favored" account within the meaning of the Financial Account Rule in Treasury Regulations Section 1.1471-5(b)(2)(i)(A)(2)(i) should be clarified. For example, an account whose investment income is not taxed by a local jurisdiction because the local jurisdiction does not generally tax individuals on such income, regardless of whether or not such investment is received in the context of a retirement account, should not be precluded from being viewed as a tax-favored account for this purpose.

[16] See Prop. Treas. Reg. §§ 1.1471-5(f)(2)(ii)(A), 1.1471-5(f)(2)(ii)(A)(2)(iv) and (v), and 1.1471-6(f)(1)(ii)(A) and (D).

special administrative region within the People's Republic of China and is not a country. Hong Kong has laws relating to MPF and ORSOs that are not applicable elsewhere in the People's Republic of China. We believe that references in the Retirement Rules or elsewhere in the Proposed Regulations to the laws of a "country" should include references to the laws of a jurisdiction which may not be a country per se. We would appreciate a clarification or modification of the Proposed Regulations in this regard.

4. Additional Recommendations on the FATCA Proposed Regulations

G. Hong Kong Law Precludes MPFs From Becoming Participating FFIs If They Do Not Qualify for the Retirement Rules

The above-described proposed revisions to the Retirement Rules are significant to MPFs because Hong Kong law would preclude MPFs from disclosing information about MPF plan members to the IRS. The Proposed Regulations require a participating FFI to disclose to the IRS, among other things, certain information on US account holders and non-financial foreign entities with substantial US owners. However, Section 41 of the MPF Ordinance precludes the disclosure by MPFs and their trustees of MPF plan member information in this way.

Section 41 of the MPF Ordinance bars MPF member data from being disclosed by an MPF, the trustee of an MPF or any other party for purposes other than those necessary to perform their precise obligations under the MPF Ordinance.[17] This prohibition is viewed by the Hong Kong regulator for MPFs, the MPFA, as remaining in place in spite of any FATCA-specific consent for disclosure by the trustee that may be secured from an MPF plan member with respect to Section 41 of the MPF Ordinance. Accordingly, under Hong Kong law, MPFs that do not qualify under the Retirement Rules (which, based on the discussion above, appear to be all MPFs) are expected to have difficulty meeting the disclosure-related requirements under FATCA to become participating FFIs. As a result, under current Hong Kong law, all MPFs in Hong Kong risk not being able to comply with FATCA and to be withheld upon when they receive withholdable payments or, later, foreign passthru payments.

[17] Chapter 485, Section 41(1) of the MPF Ordinance states: "A person who obtains information in the exercise or performance of functions conferred or imposed by or under this Ordinance- (a) must not disclose the information to any other person, unless the disclosure is necessary in order to exercise or perform those functions; and (b) must not enable another person to have access to the information, except in so far as that access is necessary to allow that other person to exercise or perform functions under or for the purposes of this Ordinance." Our understanding is that Section 41(2) is not expected to alleviate the restrictiveness of Section 41(1) in the context of potential disclosure of plan member information to the IRS.

There is another impediment to an MPF's ability to become a participating FFI, if the MPF were to be unable to qualify under the Retirement Rules under the upcoming final regulations. Under FATCA, a participating FFI is generally required to withhold a 30% US withholding tax on certain payments the FFI makes to recalcitrant account holders or nonparticipating FFIs. The MPF Ordinance prohibits an MPF from reducing amounts it distributes to plan members by such US withholding tax, which is not contemplated under the MPF Ordinance. This reinforces our concern that, under current Hong Kong law, all MPFs in Hong Kong risk not being able to comply with FATCA. MPFs neither qualify for the Retirement Rules in the Proposed Regulations nor are able to meet the FATCA demands on a participating FFI.

H. Closing of MPF Plan Member Accounts Is Not Permitted

Outside of the Retirement Rules, the Proposed Regulations ask that a participating FFI contemplate closing the accounts of recalcitrant account holders. However, leaving aside the challenges to an MPF becoming a participating FFI in the first place (see Section 4.G above), it is impermissible under the MPF Ordinance for MPFs[18] to attempt to close a plan member account before the time that the MPF Ordinance indicates a payment should be made to a plan member. The significant impediments placed by the MPF system on closing MPF plan member accounts helped advance the policy objective of enhancing retirement protection in Hong Kong. The MPF Ordinance does not envisage (and, therefore, does not allow) the closing of the MPF accounts of holders who are recalcitrant account holders for FATCA purposes for no reason but such recalcitrance. It is difficult for many ORSOs to close plan member accounts as well.

I. US$50,000 Contribution Limitation Under the Financial Account Rule

We would appreciate your clarification on how the US$50,000 cap on annual contributions to a plan member's retirement account applies for purposes of the Financial Account Rule in Proposed Treasury Regulations Section 1.1471-5(b)(2)(i)(A)(2)(iii). The first part of this provision asks that annual contributions to the relevant account be capped at US$50,000. However, the second part of this provision asks that "limits or penalties" be in place under the law of the applicable jurisdiction on annual contributions in excess of US$50,000. We interpret the second part to mean that, despite the language in the first part of the provision, it is acceptable for annual contributions to exceed US$50,000, so long as, at that threshold or

[18] Section 7 of the MFP Ordinance generally requires an employer to ensure that its employees enroll and remain enrolled in an MPF.

above, there are limits or penalties imposed by the relevant jurisdiction's laws. We recommend an amendment of the language in this regard.

Moreover, clarification on what would constitute a limit or penalty for purposes of Proposed Treasury Regulations Section 1.1471-5(b)(2)(i)(A)(2)(iii) would be helpful. Language could be added that a penalty includes, without limitation, a local tax penalty, in the form of a contribution to a plan not being deductible from taxable income starting from a contribution level no higher than US$50,000 per year, but not necessarily starting at US$50,000 per year.

Proposed Treasury Regulations Section 1.1471-5(b)(2)(i)(A)(2)(iii) also requires that "limits or penalties" be in place under the law of the relevant local jurisdiction on "withdrawals made before reaching a specified retirement age". In the case of Hong Kong's MPFs, withdrawals in respect of "mandatory contributions" made to a plan member's account are permitted to be made only in limited situations as specified in Hong Kong law. The most likely withdrawal event is the attainment by the plan member of age 65. Because many retirement plans in various countries of the world are not triggered uniquely by the attainment by the plan member of a specified retirement age, consideration should be given to stating that, where alternative withdrawal conditions include but are not limited to the attainment of a certain age, the requirement that there be limits to withdrawals before a certain age would be treated as being satisfied.

J. Retirement Example of an "Investment Conduit"

Example 3 of Proposed Treasury Regulations Section 1.1471-6(f)(2) illustrates how the Exempt Beneficial Owner Rule is not available if a pension plan is acting as an "investment conduit". The example describes a foreign pension fund to which employees make contributions that get credited, along with "interest accrued on such contributions", to the employee's account. The retirement benefits to which a plan member is entitled are described as "reflect[ing]" the amounts credited to the relevant account. Example 3 concludes that the pension fund does not qualify for the Exempt Beneficial Owner Rule because it is an investment conduit. Consideration should be given to discussing in greater detail when a retirement fund would be treated as an investment conduit.

K. Certified Deemed-Compliant FFIs Should Be Permitted to Invest In a Qualified Collective Investment Vehicle

Under the Proposed Regulations, a retirement fund that is a certified deemed-compliant FFI is not a permitted investor for a qualified collective investment vehicle within the meaning of

Proposed Treasury Regulations Section 1.1471-5(f)(1)(i)(C). This provision indicates that, among other things, a qualified collective investment vehicle may only have direct equity holders that fall within specified categories for FATCA purposes. Registered deemed-compliant FFIs and exempt beneficial owners are among the permissible direct equity holders in such a vehicle. However, certified deemed-compliant FFIs, like retirement plans that meet the Deemed-Compliant FFI Rule in Treasury Regulations Section 1.1471-5(f)(2)(ii), are not. We recommend that retirement plans that meet such Deemed-Compliant FFI Rule, and the proposed new category of deemed-compliant FFIs for government-mandated retirement plans and retirement plans in lieu thereof (see Section 2 above), become permissible direct equity holders (and permissible debt holders and holders of other financial accounts) in a qualified collective investment vehicle.

L. Responsible Officer for an MPF or ORSO Unlikely to Be A Plan Employee or Officer

If an MPF or ORSO were to become a participating FFI, it would likely have no employees or officers of its own who could become the "responsible officer of the participating FFI" to certify to the IRS the MPF or ORSO's compliance with its FFI agreement and handle other responsibilities described in Proposed Treasury Regulations Section 1.1471-4(a)(6). The certifying party in lieu of a responsible officer at the MPF or ORSO, if the fund has no employees and officers of its own, may, as a practical matter, have to be a third party service provider such as the trustee to the MPF or ORSO. Given the technicalities relating to FATCA associated with being a responsible officer, a trustee may not be in a position to make the relevant FATCA certifications. We suggest that the Proposed Regulations be modified so that, where a participating FFI does not have employees of its own, a party that is certifying on behalf of the participating FFI could make required FATCA certifications only to that party's knowledge.

5. Concluding Observations on Hong Kong MPFs and ORSOs

We believe that our recommendations in this Appendix I on the Retirement Rules will make the rules more flexible to accommodate the differing features of foreign retirement plans, including Hong Kong's MPFs and ORSOs. We summarize the recommendations made in this Appendix I in the Exhibit hereto.

In particular, we recommend that, where a foreign government has mandated that plan members participate in a retirement plan (or a retirement plan may be chosen by a plan member in lieu of a government-mandated plan), that retirement plan should qualify for a newly-added category of certified deemed-compliant FFIs. If such a category were added, MPFs in Hong Kong and ORSOs in lieu of MPFs could qualify for deemed-compliant FFI status.

EXHIBIT TO APPENDIX I

Summary of Recommendations

Recommendation	Proposed Treasury Regulations Section	Appendix Section
Key Recommendation: Make a government-mandated retirement plan a new category of certified deemed-compliant FFI	Proposed new provision	2
Key Recommendation: Make a retirement plan which is registered with a foreign government and which may be chosen by a plan member in lieu of a government-mandated retirement plan, a new category of certified deemed-compliant FFI	Proposed new provision	2
Remove the "limited by reference to earned income" requirement from the Retirement Rules	1.1471-5(b)(2)(i)(A)(2)(ii), 1.1471-5(f)(2)(ii)(A)(1)(i), 1.1471-5(f)(2)(ii)(A)(2)(iii), 1.1471-6(f)(1)(ii)(B)	3.A
Allow amounts transferred in from another retirement plan to be more readily excluded from being treated as contributions to the transferee plan	1.1471-5(b)(2)(i)(A)(2)(iii), 1.1471-5(f)(2)(ii)(A)(1)(i), 1.1471-6(f)(1)(ii)(B)	3.B
Indicate that self-employed persons are treated as "employers", and short-term workers as "employees". Indicate that the Retirement Rules can apply to a retirement plan covering employees from more than one employer	1.1471-5(b)(2)(i)(A)(2)(ii), 1.1471-5(f)(2)(ii)(A)(1)(i), 1.1471-6(f)(1)(ii)(B)	3.C
Adjust the prohibition against a single retirement beneficiary having more than 5% of plan assets, to instead require documentation of FATCA status for any such large beneficiaries	1.1471-5(f)(2)(ii)(A)(1)(ii) 1.1471-6(f)(1)(ii)(C)	3.D

Recommendation	Proposed Treasury Regulations Section	Appendix Section
Protect a retirement plan that initially qualifies for the Retirement Rules from losing its qualification through factors beyond its control, including changes in plan member composition and in plan account asset values	Various provisions of the Retirement Rules	3.D
Make significant clarifications to how certain requirements on local tax law in the Retirement Rules apply	1.1471-5(b)(2)(i)(A)(2)(i), 1.1471-5(f)(2)(ii)(A)(1)(iii), 1.1471-6(f)(1)(ii)(D)	3.E
State that references to the laws of a "country" in the Retirement Rules include references to the law of a jurisdiction which may not be a country per se (e.g., Hong Kong)	1.1471-5(f)(2)(ii)(A), 1.1471-6(f)(1)(ii)(A) and (D)	3.F
Hong Kong laws on MPFs would prohibit the disclosure of MPF plan member information to the IRS, and preclude MPFs from being participating FFIs. See Section 2 for a recommended new category of deemed-compliant FFI	1.1471-4(d)	4.G
Hong Kong laws on MPFs would prohibit them from withholding under FATCA on distributions to plan members, and preclude MPFs from being participating FFIs. See Section 2 for a recommended new category of deemed-compliant FFI	1.1471-4(b)	4.G
MPFs cannot close plan member accounts under Hong Kong law. See Section 2 for a recommended new category of deemed-compliant FFI	N/A	4.H
Clarify what constitutes a "limit or penalty" for purposes of the Financial Account Rule, when annual contributions exceed US$50K or withdrawals are made before reaching retirement age	1.1471-5(b)(2)(i)(A)(2)(iii)	4.I
Clarify when a retirement fund can be treated as an "investment conduit" ineligible for the Exempt Beneficial Owner Rule	1.1471-6(f)(2)	4.J

Recommendation	Proposed Treasury Regulations Section	Appendix Section
Permit retirement plans that are certified deemed-compliant FFIs to be direct equity holders of a qualified collective investment vehicle	1.1471-5(f)(1)(i)(C)	4.K
Add a rule that, where a participating FFI does not have employees or officers, a party functioning as "responsible officer" can make certifications to his knowledge	1.1471-4(a)(6), 1.1471-4(c)(10)	4.L

APPENDIX II

Comments on the FATCA Proposed Regulations As Applied to Hong Kong Investment Funds

In this Appendix II, we seek to provide you with information on how Hong Kong's investment funds will face challenges in applying the requirements of the Foreign Account Tax Compliance Act ("FATCA"). We appreciate the opportunity to submit comments on the Proposed Regulations issued by the Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS") with respect to FATCA.

We note that the IRS and Treasury have provided guidance and responded to some of the many concerns raised by the financial industry. While this submission will focus on areas where we believe FATCA can be tailored to meet industry practice, we wish also to state our overall concern with the scope of FATCA. We unequivocally support the aim of combating tax evasion. Doubts abound, however, whether FATCA will be effective to that end. The costs of creating compliance systems to collect, retain and analyze information for FATCA are high. But such systems will have limited value if U.S. tax cheats provide false or misleading information about their U.S. indicia. The answer to this is not to increase FATCA's complexity: many institutions already will struggle with the costs of compliance with FATCA as currently drafted. Instead, we believe that a risk-based enforcement effort, coupled with robust intergovernmental cooperation, would be more likely to deliver efficient and effective results in the battle against U.S. tax evasion.

1. The Hong Kong Investment Funds Market

The Hong Kong investment funds market has several characteristics that complicate the implementation of FATCA. Hong Kong is a global financial center but has a population of only 7 million. As a result, few market participants (including fund sponsors and distributors) operate only in this jurisdiction. Over 90% of the funds offered to the general public in Hong Kong are domiciled in overseas jurisdictions (principally Luxembourg, Ireland and the United Kingdom). But such funds must be authorized by the Securities and Futures Commission before they are offered to the general public in Hong Kong. The Hong Kong dollar is pegged to the U.S. dollar, so many corporations and individuals use U.S. dollar-denominated products for saving and investment purposes. For example, around 30% of

deposits at licensed banks in Hong Kong are in U.S. dollars. Over 90% of funds are either denominated in U.S. dollars or have U.S. dollar share classes. Over 70% of funds are wholly or partially invested in U.S. equity, bond or money markets. Distribution is disaggregated and conducted on a regional basis, rather than local basis, because markets for investment products in Asia remain much smaller than in the United States. Because of the above factors, "business as usual" in Hong Kong involves cross-border offerings of investment products and significant use of U.S. dollar investments. As detailed here, these characteristics are occasionally treated in the Proposed Regulations as indicators of a heightened risk of U.S. tax evasion. We do not agree. Indeed, virtually all funds in Hong Kong have long prohibited sales to U.S. clients because of tax and legal considerations.

We suggest amendment of the Proposed Regulations in four areas:

1) Smaller Hong Kong banks and distributors cannot take advantage of the Local Bank and Restricted Distributor categories as proposed. We suggest changes to these categories to enable these smaller institutions to comply with FATCA.

2) Hong Kong investment funds may not fit under the Restricted Fund and Qualified Investment Vehicles categories as proposed. We suggest changes to these categories to allow for legitimate regional differences in how funds are organized and sold.

3) We propose several amendments to reduce the burdens associated with the due diligence process required under FATCA.

4) Finally, we suggest several amendments relating to the application of FATCA generally.

2. Distribution in Hong Kong

Funds in Hong Kong are distributed principally by third-party distributors, including local banks. The market is characterized by the presence of both sophisticated institutions that may have extensive direct dealing with U.S. taxpayers and small distributors that have no contact with the United States. The first category are likely to become participating FFIs. The second category of distributors may lack the resources to participate in FATCA initially

unless they can do so on a straightforward and efficient basis. But, as set forth in the Proposed Regulations, these distributors will not fall under the FATCA distribution categories that are designed for smaller distributors.

2.1 Restricted Distributors

Country of Operations. A Restricted Distributor is permitted to operate "solely in its country of incorporation or organization" and "must not have a fixed place of business outside that country". This restriction effectively discriminates against smaller markets. As noted above, Hong Kong has a population of only 7 million—few distributors, no matter how small, operate only in Hong Kong. In Asia, individual markets for investment funds remain small in comparison to markets in Europe or North America. As a result, many distributors in Asia must operate regionally if they are to be commercially viable. Such operations are not evidence of any intent to serve U.S. taxpayers. Furthermore, if the aim of FATCA is to catch U.S. tax evaders, operations outside of the United States, even in multiple jurisdictions, should not be relevant. We recommend that the requirement that a Restricted Distributor operate solely in its country of organization be amended to prohibit Restricted Distributors from operating in the United States. At a minimum, we would recommend that Restricted Distributors in Asia be permitted to operate regionally in APAC countries.

Size Thresholds. A Restricted Distributor is permitted to have "no more than [US]$175 million in assets and no more than [US]$7,000,000 in gross revenue on its income statement for the most recent accounting year." We note that these thresholds match thresholds used by the Small Business Administration ("SBA") to determine whether a U.S. brokerage house is a "small business." As used by the SBA, such thresholds have been carefully tailored for U.S. small businesses to determine whether a business may be eligible for government aid programs or exemptions from domestic regulation. Such thresholds were never intended to be used to determine the extraterritorial application of an extensive U.S. law such as FATCA. Unlike U.S. small businesses, brokers in Hong Kong must already comply with Hong Kong law and regulations. The costs of compliance with a foreign law, such as FATCA, are in addition to whatever local legal and compliance costs they already incur. We recommend that these thresholds be increased to US$2 billion in assets and no more than US$100 million in revenue.

Required Terms in Distribution Agreements. Restricted Distributors must perform a full review of pre-existing accounts with respect to sales made on or after December 31, 2011 if their distribution agreements did not contain restrictions on the sale of securities to U.S. entities or U.S. resident individuals. In Hong Kong, many fund distribution agreements do not contain such restrictions precisely because U.S. entities or U.S. resident individuals were never targeted: U.S. citizens account for less than one-third of one-percent of Hong Kong's population, after rounding up. Logically, many small distributors have viewed restrictions on U.S. investors as unnecessary boilerplate language and have been reluctant to amend their standard agreements. While it may be possible to convince distributors to include such language prior to FATCA's effective date, the distributors will have no incentive to do so, given that December 31, 2011 has already passed. We recommend that Restricted Distributors not be required to perform a section 1.1471-4(c) review of pre-existing accounts unless they have not adopted restrictions on the sale of securities to U.S. entities or U.S. resident individuals prior to December 31, 2013.

2.2 Local Banks

Country of Operations. Local Banks are also not permitted to have a fixed place of business outside of their country of organization or incorporation. Similar to Restricted Distributors, such a restriction does not reflect local market conditions in Hong Kong or Asia generally. Many banks in Hong Kong have regional operations. We do not believe that these cross-border activities indicate that such entities possess a greater capacity or willingness to assist U.S. tax evaders. We recommend that Local Banks be prohibited only from operating in the United States.

A Local Bank may operate a website as long as the website does not specifically state that nonresidents may open accounts. Again, while Hong Kong's international stature is important, its local market is relatively small. As a stable regional hub, it is unsurprising that Hong Kong banks may market to citizens of other Asian countries. Similarly, a Local Bank's website must not advertise the availability of U.S. dollar denominated deposit accounts. While non-local currency accounts are uncommon in the United States, this requirement ignores commercial reality in nearly all other markets. In many Asian jurisdictions, including Hong Kong, U.S. dollar accounts are held by local residents as a matter of course for a variety of reasons unconnected with U.S. tax evasion. Given the prevalent and legitimate

uses of U.S. dollar accounts outside the United States, we recommend that this requirement be removed.

Size Thresholds. A Local Bank may have no more than US$175 million in assets on its balance sheet. As with Restricted Distributors, we believe that the use of the SBA thresholds for institutions outside of the United States is inappropriate. In Hong Kong, we recommend that this threshold be increased to US$2 billion. We estimate that FFIs that are smaller than this threshold may find it challenging to pay for FATCA compliance costs.

Tax Reporting and Withholding. A Local Bank must be required by local law to perform either information reporting or tax withholding with respect to resident accounts. In Hong Kong, no such requirement exists because local tax authorities use a detailed, top-down tax assessment system, coupled with targeted audits of higher risk taxpayers. Because of the sophisticated structure of the Hong Kong tax regime, reporting and withholding by banks are not necessary. Furthermore, it is unclear how imposing local reporting and withholding requirements would support the goal of identifying U.S. tax evaders. Unless a local jurisdiction enters into a cooperation agreement with Treasury, any data collected under such information reporting or withholding regime would not be available to the IRS. Furthermore, such information would not be targeted at identifying U.S. taxpayers. In Hong Kong's case, significant changes would need to be made to local law before a reporting system could be implemented, and any such process is likely to be protracted. Accordingly, we recommend that this requirement be removed.

3 Deemed Compliant FFIs and Hong Kong Investment Funds

3.1 Restricted Funds

Permitted Distribution. A Restricted Fund may only be sold through certain specified channels. With the exception of local banks, certified deemed compliant FFIs are not permitted as either distributors or ultimate investors. We would recommend that a Restricted Fund be permitted to distribute through or sell to any deemed compliant FFI. We also believe that a Restricted Fund could be permitted to offer to a limited number of other types of investors without jeopardizing the value of the Restricted Fund category. Accordingly, we

recommend that a Restricted Fund be permitted to offer up to 10% of its interests to investors not listed in section 1.1471-5(f)(1)(i)(D)(2).

Definition of Distributor. In Hong Kong, there are a number of individuals and entities that facilitate fund distribution, but do not hold client money, perform account due diligence or invest directly in funds. We request clarification of the definition of distributor to confirm that these market participants (known locally as "independent financial advisors") would not be considered distributors for purposes of the Restricted Fund category and that client referrals from independent financial advisors would not preclude a fund from relying on the Restricted Fund category.

Redemption of Non-Qualifying Distributors. If a distributor ceases to be a qualifying distributor, the FFI must acquire or redeem all interests of the FFI issued through that distributor within six months of the distributor's change in status. In some cases, an FFI may not be able to dispose of portfolio holdings in an orderly manner within the required six-month period, and any redemption could harm remaining shareholders. This would have the unintended consequence of benefitting the non-qualifying distributor while harming the remaining FATCA-compliant entities. In Hong Kong, a fund trustee must act in the interests of *all* shareholders, consistent with the objective of the fund. Accordingly, a trustee could be prohibited by fiduciary duty from effecting the redemption if the harm to the fund from a disorderly disposition of assets outweighed the costs of FATCA non-compliance.

Furthermore, fund organizational documents do not always permit unilateral expulsion of shareholders. In such cases, funds would be required to solicit shareholder approval to change the organizational documents. Such approvals are not routine in Hong Kong and would involve considerable expense. Because a number of locally available funds are domiciled in other jurisdictions, approval of local regulators might also be required. It is unclear what a fund's options would be if shareholders or a regulator rejected any such change. As a result, we recommend that forced redemption should only be a requirement if it is permitted under an FFI's organizational documents and under the laws of the FFI's domicile. In addition, we believe the time period for forced redemption should be "six months, or, if longer, as soon as reasonably practicable, consistent with an orderly disposition of portfolio assets."

Review of Pre-Existing Accounts. A Restricted Fund is not required to conduct a full section 1.1471-4(c) review for any pre-existing individual investor who "purchased its interest at a time when all of the FFI's distribution agreements and its prospectus contained an explicit prohibition of the issuance of shares to U.S. entities and U.S. resident individuals." While most fund prospectuses in Hong Kong contain such prohibitions, many distribution agreements do not. This does not reflect an intent to market to U.S. persons—rather it reflects that U.S. persons do not constitute an appreciable part of the market for funds in Hong Kong. The costs associated with performing a one-time section 1.1471-4(c) review are significant and will undermine the ability of funds to comply with this category. We suggest that a Restricted Fund not be required to conduct a section 1.1471-4(c) review for a pre-existing account unless it still has non-compliant distribution agreements as of December 31, 2013. As an alternative, we suggest that a Restricted Fund be required to conduct a section 1.1471-4(c) review on only those distributors whose agreements do not contain the required restriction.

3.2 Qualified Investment Vehicles

Regulation as an Investment Fund. Certain funds may be deemed compliant if they meet the requirements of the Qualified Investment Vehicle category. A Qualified Investment Vehicle must be regulated in its country of incorporation or organization as a "collective investment vehicle." In some cases, however, investment funds that are sold in multiple jurisdictions are organized in a third-party jurisdiction where the entity is not regulated. This makes intuitive sense: if a fund must be regulated in each jurisdiction in which it is sold, additional regulation in its jurisdiction of incorporation is undesirable, decreases flexibility and increases costs to shareholders. But, if anything, certain multi-jurisdiction funds may be subject to *greater* scrutiny than a fund that is merely regulated in its country of organization. Accordingly, we recommend that the Qualified Investment Vehicle category require only that a fund be regulated as an investment fund under the laws of at least one jurisdiction. In addition, we request confirmation that the regulation of funds in jurisdictions such as the Cayman Islands, Hong Kong, Luxembourg and Ireland would meet this requirement.

De Minimis Investment. Subject to limited exceptions, each record holder of a Qualified Investment Vehicle must be a participating FFI, registered deemed compliant FFI, U.S. person described in any of section 1.1473-1(c)(1) through (12) or an exempt beneficial owner.

We would propose that Qualified Investment Vehicles be permitted to sell to all deemed compliant FFIs, as well as non-U.S. accounts (as defined in section 1.1471-5(a)). Further, we recommend that a Qualified Investment Vehicle be permitted to sell up to 10% of its interests (by value) to account holders that are not included in these categories. Without such an exception, funds will find their status under FATCA at risk because of non-compliance by parties that are outside of such funds' control.

4. The Due Diligence Process

The IRS and Treasury have attempted to respond to concerns by the financial services industry that the implementation of FATCA is costly. The Proposed Regulations state that the due diligence rules "rely extensively on an FFI's existing customer intake process." We believe, however, these statements miss the mark: the burden of FATCA comes not only from the data collected, but from the costly process of putting data to uses for which it was never intended. We believe that the Proposed Regulations underestimate the cost of building compliance systems for *existing* data. As detailed in this section, we recommend that FATCA be further tailored to the existing processes that FFIs currently use to analyze such customer intake information.

4.1 Use of Existing Definitions of U.S. Person

If FFIs are to "rely extensively" on their current investor intake process, they should be permitted to report data on "U.S. persons", as defined in the U.S. securities laws, in lieu of searching for U.S. indicia or reporting on U.S. taxpayers. We believe that the IRS, and not FFIs, will ultimately be in the best position to determine whether a U.S. person is a taxpayer. We believe that the Proposed Regulations underestimate the costs of searching for U.S. indicia to identify U.S. accounts. We are not confident that FFIs will be able rely extensively on their investor intake process to search for U.S. indicia. But if FFIs are permitted to report "U.S. person" information instead, such FFIs will have a greater capacity to become participating FFIs and to start reporting information to the IRS. The benefits of increased participation in FATCA outweigh the possibility that some fraction of U.S. taxpayers are not also U.S. persons.

4.2 Substantial U.S. Owners

Similarly, although the preamble to the Proposed Regulations states that "FFIs may generally rely on information collected for AML/KYC due diligence purposes to identify substantial U.S. owners", this is difficult to implement in practice. A substantial U.S. owner is generally a "specified U.S. person" that owns more than 10% of an entity. However, under Hong Kong's existing AML regulations, a financial institution is generally required to verify the identity of only beneficial owners that control 25% or more of an entity.[1] Data for 10% owners is required only in certain "high risk" situations. We understand that many jurisdictions have implemented the same 25% threshold. Accordingly, we believe that the definition of substantial U.S. owner should be modified to reflect this 25% threshold. We recommend that a 10% threshold apply only if it has been applied in accordance with local law.

4.3 Shareholder Response Rates and Requests for Waivers and Documentation

A number of sections in the Proposed Regulations require that account holders periodically provide either waivers (*e.g.*, of their privacy rights) or additional documentation. In Hong Kong, waivers will be required as a matter of course because funds are prohibited by local law from providing investor information to foreign governments. Proposed Regulations section 1.1471-3(c)(6)(ii) would also require the periodic update of documents establishing an investor's status under FATCA.

But a system that relies extensively on investor responses to requests for information faces significant practical challenges. In Hong Kong, **response rates from local investors range from 3-5%**. In practice, each request of information will result in a surge of "recalcitrant" accountholders. This will divert resources away from the more important task of identifying actual tax evaders. Elsewhere in the Proposed Regulations, Treasury and the IRS have acknowledged that the costs of updating account information may occasionally outweigh potential benefits (*e.g.*, with respect to pre-existing accounts). We recommend (a) that shareholders be permitted a longer period of time to respond to communications before they are considered to be recalcitrant (for example, a year or more) and (b) that documentary

[1] Anti-Money Laundering and Counter-Terrorist Financial (Financial Institutions) Ordinance (Cap. 615), Part 1, Schedule 2.

evidence remain valid in the absence of actual knowledge that a change of circumstances has made the information incorrect. Further, we support an intergovernmental effort with Hong Kong to eliminate the need for the privacy waivers described above.

4.4 U.S. Telephone Numbers Should Not Be U.S. Indicia

We note that the Proposed Regulations now include U.S. telephone numbers as "U.S. indicia" under section 1.1471-4(c)(4)(i)(A). There are practical difficulties to using U.S. telephone numbers as U.S. indicia. First, the United States does not have its own country code and instead shares the code "1" with a number of other nations. While many managers have the ability to isolate country codes, this requirement would force them to construct new data fields in order to capture and manipulate the additional codes. Second, this expense is unlikely to have any corresponding benefit: the use of SIM cards or disposable mobile phones effectively severs the link between a telephone number and a physical location. Those who travel internationally routinely purchase SIM cards with local numbers to avoid roaming charges. As a result, the presence of a U.S. phone number on an application form does not serve as a meaningful indicator of any U.S. status. We recommend that this U.S. indicia be removed in order to allow FFIs to focus on more meaningful U.S. indicia.

4.5 De Minimis Accounts

The Proposed Regulations exclude individual depository accounts with values of US$50,000 or less from the definition of U.S. accounts. It is unclear why this de minimis exception should apply only to depository accounts. Because of the cost associated with building a FATCA compliance framework, we recommend that this de minimis exception be expanded to all types of financial accounts.

5. General Concerns

5.1 Clarification of the Application of FATCA on Umbrella Structures

In Hong Kong, a significant majority of registered funds are organized in umbrella structures. The legal entity is the top-level umbrella fund. Under Luxembourg and Dublin laws (where many Hong Kong funds are domiciled), the law recognizes the separation of sub-funds and

their respective assets and liabilities. We note that sub-funds will invest in different types of securities and serve different groups of investors. Accordingly, we believe that FATCA's requirements should be applied at the sub-fund level, and we request confirmation of this point.

5.2 Timing of Responsible Officer Certifications

Proposed Regulations section 1.1471-4(c)(10) requires that a responsible officer of a participating FFI make certain certifications. In particular, the responsible officer is required to certify that the FFI did not have any formal or informal practices or procedures to assist account holders in the avoidance of FATCA during the period from August 6, 2011 through the date of the certification. This is difficult to implement. A responsible officer cannot certify that no policies existed to circumvent regulations that did not yet exist in final form. We recommend that the certification run instead from the effective date of the final FATCA regulations.

5.3 Exemption of Publicly Traded Funds

Despite improvement in the Proposed Regulations, publicly-traded funds ("PTFs") in some jurisdictions may face operational obstacles to complying with FATCA. In particular, some PTFs (other than ETFs) may struggle to meet the 10% turnover requirement for exception under section 1.1471-5(b)(3)(iv)(B). Clearly, substantial compliance difficulties are created if investors are admitted to a PTF in years when the turnover test is passed but turnover declines in later years. We would recommend that the turnover test be reduced to 5% and applied on an average basis over a period of years. Finally, we note that, despite the exemption of PTFs from most FATCA requirements, PTFs could still be required to withhold on non-participating FFIs. Given that the challenges of implementing this requirement with respect to non-participating FFIs are similar to the challenges that PTFs would face with respect to FATCA withholding generally, this requirement would be difficult to implement. We recommend that this requirement be eliminated.

5.4 General Application of FATCA to Hong Kong

We note that Hong Kong is a special administrative region within the People's Republic of China. As a result of this status, Hong Kong has its own tax and regulatory framework, but it is not a country. We request clarification that references to "country" in FATCA be replaced by "country or jurisdiction" as the context requires.

5.5 Timing

We estimate that FATCA compliance may require 18 months for many firms. While much of this work has already begun, some efforts must necessarily await the release of final regulations. We recommend that FATCA implementation be delayed for one calendar year after the year in which final regulations are issued. We believe that such a delay will allow FATCA to be implemented correctly and more cost-effectively.

6. Concluding Observations on Investment Funds in Hong Kong

We believe that our recommendations in this Appendix II will make FATCA more flexible in recognition of legitimate local market practices in Hong Kong and elsewhere. We summarize the principal recommendations made in this Appendix in the Exhibit hereto. In particular, we recommend that substantial revisions to the Restricted Fund and Qualified Investment Vehicle categories, as well as consideration of additional ways to reduce the burden of FATCA's due diligence requirements.

EXHIBIT to APPENDIX II

Summary of Recommendations

Recommendation	Proposed Treasury Regulations Section	Appendix Section
Permit Restricted Distributors to operate anywhere except the United States. At a minimum, permit Restricted Distributors in Asia to operate regionally in APAC countries.	1.1471-5(f)(4)(iii)	2.1
Increase permitted size of Restricted Distributors to up to US$2 billion in assets and no more than US$100 million in revenue.	1.1471-5(f)(4)(v)	2.1
Restricted Distributors should not be required to perform a Section 1.1471-4(c) review of pre-existing accounts unless they have not adopted restrictions on the sale of securities to U.S. entities or U.S. resident individuals prior to December 31, 2013.	1.1471-5(f)(4)(viii)	2.1
Permit Local Banks to operate anywhere except the United States.	1.1471-5(f)(2)(i)(B)	2.2
Remove the requirement that a Local Bank only operate a website if the website does not state that nonresidents may open accounts.	1.1471-5(f)(2)(i)(C)	2.2
Increase permitted size of Local Banks to US$2 billion.	1.1471-5(f)(2)(i)(D)	2.2
Remove the requirement that a Local Bank be required by law to perform either information reporting or tax withholding with respect to resident accounts.	1.1471-5(f)(2)(i)(E)	2.2

Recommendation	Proposed Treasury Regulations Section	Appendix Section
Permit a Restricted Fund to sell to all deemed compliant FFIs and up to 10% of its interests to investors not listed in Section 1.1471-5(f)(1)(i)(D)(2).	1.1471-5(f)(1)(i)(D)(1) 1.1471-5(f)(1)(i)(D)(2)	3.1
Exclude independent financial advisers from FATCA's distributor category.	1.1471-5(f)(1)(i)(D)(2)	3.1
Require forced redemption of distributors only if is permitted under an FFI's organizational documents, or extend the time period for such redemption.	1.1471-5(f)(1)(i)(D)(4)	3.1
Excuse Restricted Funds from complete FATCA account reviews if all of their distribution agreements contain prohibitions on U.S. investors as of December 31, 2013. Alternatively, a Restricted Fund should only be required to conduct a Section 1.1471-4(c) review on distributors whose agreements do not contain the required restriction.	1.1471-5(f)(1)(i)(D)(5)	3.1
Remove the requirement that Qualified Investment Vehicles be regulated as funds under the laws of their domicile jurisdiction.	1.1471-5(f)(1)(i)(C)(1)	3.2
Confirm that the regulation of funds in jurisdictions such as the Cayman Islands, Hong Kong, Luxembourg and Ireland meets this requirement.	1.1471-5(f)(1)(i)(C)(1)	3.2
Permit Qualified Investment Vehicles to sell up to 10% of their interests (by value) to any type of investor.	1.1471-5(f)(1)(i)(C)(2)	3.2

Recommendation	Proposed Treasury Regulations Section	Appendix Section
Permit the use of U.S. securities law definition of "U.S. person" on an ongoing basis.	1.1471-3 generally	4.1
Amend the definition of substantial U.S. owner to reflect 10% and 25% beneficial ownership reporting thresholds used by Hong Kong AML laws.	1.1473-1(b)(2)	4.2
Permit shareholders up to two years to respond to information or waiver requests.	1.1471-5(g)	4.3
Remove U.S. telephone numbers from the list of U.S. indicia.	1.1471-4(c)(4)(i)(A)(4)	4.4
Expand the scope of the US$50,000 de minimis exception to encompass all types of financial accounts.	1.1471-5(a)(4)(i)	4.5
Confirmation that FATCA's requirements should be applied at the sub-fund level.	Not applicable.	5.1
Change the start date of the period covered by the responsible officer certification from August 6, 2011 to the effective date of the final form of these regulations.	1.1471-4(c)(10)	5.2
Relax the requirements for securities to be considered to be "publicly traded" by reducing their required turnover from 10% annual to 5% on an average basis over a period of years.	1.1471-5(b)(3)(iv)(B)	5.3
Eliminate the requirement that PTFs to withhold on non-participating FFIs should be eliminated.	New Section	4.4

Recommendation	Proposed Treasury Regulations Section	Appendix Section
Delay the implementation of FATCA until one calendar year after the year in which final regulations are issued.		4.5

<u>**APPENDIX III**</u>

Comments on the FATCA Proposed Regulations
As Applied to Hong Kong Insurance Companies

In this Appendix III, we are pleased to provide you with comments on the challenges and concerns facing the Hong Kong insurance industry with regard to the proposed Foreign Account Tax Compliance Act ("FATCA") regulations.

It is the general view of Hong Kong insurance companies that the overwhelming majority of life insurance and annuity products pose a low risk of U.S. tax avoidance. This is largely due to insurance being a heavily regulated sector internationally and this limits the ability of insurers to solicit and sell life insurance policies and annuity contracts outside of the country of licensing and operation. Further, the long term nature of insurance products, the heavy cost of early termination to a policy holder and products' lack of portability when compared to bank deposits, do not make them ideal for U.S. tax avoidance. In addition, recent U.S. securities law requirements requiring enhanced disclosures to U.S. persons have acted as a further disincentive to sales into the U.S. This is corroborated by indicative statistics from member firms that the percentage of U.S. indicia relating to policies currently held is below 5%.

While the Proposed Regulations provide much needed relief in many areas, Hong Kong insurance companies continue to have significant concerns with certain provisions in the proposed regulations and welcome this opportunity to provide comment. The concern is due to the fact that insurance products are seen as posing a low risk for U.S tax avoidance, but the Proposed Regulations could lead to a high risk for FATCA non-compliance by insurance companies. In addition, the Proposed Regulations may also result in some unintended implications on the distribution model followed by the majority of Hong Kong insurance companies though their use of third party sales intermediaries on account of liabilities and penalties arising from possible FATCA non-compliance on the part of third party sales intermediaries.

Specifically, our comments focus on four key aspects:

- Recommend the creation of a new category of deemed compliant status for insurers, for which eligibility is determined by a set of criteria relevant to the insurance industry;
- Request that a number of the definitions that apply to life insurance or annuity contracts are revisited and, to the extent possible, follow local definitions rather than that of the Internal Revenue Code (Code);
- Bring to your attention that Hong Kong data protection laws and the Insurance Companies Ordinance pertaining to insurance contracts could prevent Hong Kong insurance companies from complying with many of the requirements that apply to pre-existing account holders. We therefore urge the IRS and U.S. Treasury to revise the definition of "grandfathered obligations" to apply to all life insurance and annuity contracts in existence on January 1, 2013;
- Recommend that aspects of the reporting obligations are amended to reflect the specific contractual and financial arrangements that are seen in the life insurance and annuity industry.

A. Deemed Compliance for Local Insurers

In line with the statement in the preamble to the Proposed Regulations that "[c]onsideration is being given … to providing a category of deemed-compliant FFIs for entities that issue certain insurance or annuity contracts that has requirements that are analogous to the requirements for local FFIs", we recommend that a new category of registered deemed compliant insurer is created along the lines of the following.

Whilst some justification for creating this new category can be drawn from the requirements that apply to local FFIs in the Proposed Regulations, life insurance is a specialised industry with unique characteristics that distinguish it from banks:

- Insurance is a highly regulated industry in which local licences and regulated permissions are required to operate. Local regulations normally require the insurer to obtain the requisite licenses and set up a local branch or subsidiary in the jurisdiction in which it wishes to sell policies. Consequently, many Hong Kong insurance companies operate in Hong Kong as a subsidiary or branch of a regional or global insurer, and in practice their market is local and they are prohibited under guidelines from selling insurance outside of Hong Kong.

- Most Hong Kong insurance companies rarely solicit business outside of Hong Kong because of other governmental regulatory restrictions (for example the U.S. securities laws referred to above), complying with foreign "know your customer" ("KYC") and anti-money laundering ("AML") regulations, corporate tax disincentives in the foreign jurisdictions, and the economic need to apply relevant actuarial data by geographic location.
- Policyholders may not transfer existing contracts to new providers in the same way that bank account holders can transfer bank deposits. This restriction also applies to insurers within the same corporate group. Therefore a pre-existing U.S. policyholder would be unable to transfer their contract to a non-Hong Kong branch or subsidiary of that insurer (or a competitor) to avoid complying with FATCA

Recommendation

We therefore propose that, to qualify as a registered deemed compliant insurer, the insurer would be required to register with the IRS to declare its status as deemed-compliant and to attest to the IRS that it satisfies certain procedural requirements which are outlined below:

- The insurer be licensed and regulated by the Office of the Commissioner of Insurance in Hong Kong;
- The solicitation of policyholders does not take place outside of Hong Kong;
- The insurer does not open accounts for U.S. persons who are not residents of Hong Kong.

A few additional comments are required to clarify the above requirements:

i) As noted above, a number of insurers operating in Hong Kong have branches and/or subsidiaries outside of Hong Kong. For the purposes of their deemed compliant status, having a business outside Hong Kong should not preclude them from being considered deemed compliant. Key is that the Hong Kong regulated operation only solicits life insurance and annuity contracts in Hong Kong. To the extent that an overseas branch of the Hong Kong operation is regulated by the insurance regulators in that territory outside of Hong Kong and it only solicits policyholders in that jurisdiction, it too should qualify for deemed compliant status.

ii) Should a resident of Hong Kong subsequently become resident in the U.S., the insurer should not be required to terminate the life insurance or annuity contract. As noted earlier, an insurance product is a long term relationship and the costs associated with termination would harm the insured and could push up the cost of any new insurance for the insured.

B. Transitional relief

The Proposed Regulations provide for transitional relief for a member of an expanded affiliated group (EAG) who is unable to comply with the requirements of FATCA generally due to restrictions imposed by local law. However, such transitional relief only runs until January 1, 2016. Thereafter, all members of the EAG must be participating FFIs, deemed compliant or exempt FFIs.

Prior to January 1, 2016, there are a significant number of local law issues for insurers to overcome in order to comply with the Proposed Regulations, particularly around reporting and dealing with recalcitrant policyholders. Many Hong Kong life insurers could therefore be subject to withholding as non-participating FFIs as a result of an entity within their EAG failing to comply unless those that are unable to comply are treated as deemed compliant FFIs.

Recommendation

We therefore propose that provided recommendation **A** above is adopted, any insurer falling within such criteria shall continue to be deemed compliant regardless of the position of the EAG. Alternatively, consideration should be given to at least a certain percentage of the EAG being substantially compliant participating FFIs, deemed compliant or exempt entities by January 1, 2016, and if that percentage is met, the EAG maintains its compliant status. We recommend a percentage of 90% of the lower of i) the number of entities within the EAG or ii) the total assets of the EAG.

C. Definitions - Clarity and/or extending exceptions/exemptions

Several of the definitions applicable to life insurance or annuity contracts are too restrictive or too difficult for non-US persons to comprehend. In order to provide needed clarity to insurers to enhance compliance and ensure that the definitions can be more easily understood so as to properly balance the administrative burden on insurers with the goals of FATCA, those definitions should be revised.

In general, we propose that where a definition is contained under the local insurance law, regulation or commercial practice of the place of operation of the insurer, that such local definition should be adopted. Recourse should only be had to definitions in the Proposed Regulations where no local definition exists.

There are a number of specific definitions where we would like to propose changes to the Proposed Regulations and they are noted below.

The definitions of "life insurance contracts" and "annuity contracts" should be simplified.

The definition of "life insurance contracts" is derived from a number of separate sections of the Code. The majority of Hong Kong insurance companies would find it challenging to interpret such provisions when they are not engaged in the U.S. insurance market.

For "annuity contracts" the definition is even less clear.

Our recommendation

The lack of clear definitions and the use of an unfamiliar Code increase the risk of unintended non-compliance for Hong Kong insurance companies. We recommend that the Proposed Regulations be amended so that the definition for both types of contract is the definition provided under the relevant local law, regulation or commercial practice of the operation of the insurer. We request that this is stated explicitly in the final regulations to make it simpler for Hong Kong insurance companies to comply.

For example, in Hong Kong, insurers would look to the Insurance Companies Ordinance (Cap.41), which prescribes, in Part 2 of the First Schedule, the different classes of insurance business. Long term business (i.e. life business) includes:

i) Class A is for "Life and annuity" which describes the nature of business as "effecting and carrying out contracts of insurance on human life or contracts to pay annuities on human life, but excluding (in each case) contracts within Class C below".

ii) Class C is for "Linked long term" which describes the nature of business as "effecting and carrying out contracts of insurance on human life or contracts to pay annuities on human life where the benefits are wholly or partly to be determined by reference to the value of, or the income from, property of any description (whether or not specified in the contracts) or by reference to fluctuations in, or in an index of, the value of property of any description (whether or not so specified)."

The exception to the definition of "cash value insurance contracts" for premium refunds on non-life insurance contracts

Proposed Regulation §1.1471-5(b)(3)(v)(C)(2) excludes from the definition of cash value refunds of premiums on non-life insurance and non-annuity contracts due to "policy cancellation." Some Hong Kong insurance companies write health, sickness, or disability insurance policies that provide for premium refunds upon the occurrence of certain events. Those events include both a surrender of the contract under certain circumstances and a termination of the contract because of, for example, the death of the policyholder. As a technical matter, it appears that a covered refund under the Proposed Regulations (which requires a policy "cancellation") may arise only in the first case, as the term "cancellation" implies that the policy in question has been cancelled by the policyholder.

Our recommendation

We believe that the exception also should apply in the event of the termination of the contract. Accordingly, we request that the words "or termination" be inserted after the word "cancellation" in sub-clause (C)(2).

A further point to note under this comment is that disability insurance is classified as a life product in Hong Kong. This highlights the need for local classifications and definitions to be used as requested above.

An exception should be added to the definition of "cash value insurance contracts" for low-cash value life insurance and annuity contracts

While the Proposed Regulations exempt individual depository accounts of US$50,000 or less from the definition of U.S. accounts, no such exemptions exists for cash value life insurance and annuity contracts. As such contracts have relatively high surrender costs, the risk of tax evasion is considered less than for normal depository businesses.

Our recommendation

The current exemption in the Proposed Regulations should be extended to cover life insurance and annuity contracts the cash value of which is $50,000 or less.

D. Hong Kong law restrictions

Hong Kong insurance companies are prevented from complying with a number of the key requirements for reporting on, and terminating contracts of, pre-existing customers by Hong Kong law. This could therefore force them to be non participating FFIs and they will incur the associated penalties.

- *Data privacy*
  The Insurance Companies Ordinance has restrictions on the disclosure of individual policyholder data to an overseas authority and the Hong Kong SAR Personal Data (Protection) Ordinance requires life insurers to obtain consent from the policyholder to transfer data cross-border. As the Personal Data Ordinance only came into force on 20 December 1996 and the fact that many contracts were in place pre-the Personal Data Ordinance, many Hong Kong insurance companies' policy documents do not contain clauses that reserve the right for cross-border data transfer. Furthermore, the data privacy law in Hong Kong also requires the usage of data to be determined at the time of data collection. It is generally not expected that current pre-existing insurance

contracts allow for the policyholders' data to be used for U.S. tax reporting or related data transfer. As such, written consent must be obtained from policyholders to allow transfer. Interaction with insurance customers is far less frequent banks. In some instances, it may only be through the issuance of annual statements. This makes it extremely difficult, if not impossible to collect the information necessary to facilitate FATCA reporting.

- *Contract*

  An insurance contract represents a binding legal agreement between the policyholder and the insurer. Where recalcitrant policyholders are identified, it is questionable whether an insurer can unilaterally terminate an insurance policy under law without suffering any form of penalty themselves. Further, it is unlikely that a recalcitrant policyholder would choose to terminate their insurance contract, as any termination on their part would require they pay significant levels of compensation. In addition, the contracts could prohibit the application of withholding taxes where the tax is not levied within Hong Kong but by a foreign jurisdiction.

Our recommendation

We therefore recommend the grandfathering of all life insurance and annuity contracts in existence on January 1, 2013.

E.1 Reporting – "payments made"

Hong Kong insurance companies believe that the Proposed Regulations require reporting on amounts that could never give rise to tax avoidance by U.S. persons. Life insurance and annuity contracts are not the same as bank accounts as the policyholder is unable to access the 'funds' until the insured event occurs and payment is triggered. Additionally, determining the value of the account may be difficult until the contract reaches maturity. The actual benefits due to the policyholder until the payment is triggered are nil.

Our recommendation

The reporting that is required with respect to life policies and annuities should be limited to amounts actually paid to policyholders.

E.2 Reporting - Updating of data

There are specific challenges to insurers in meeting monitoring and reporting obligations as a result of the relationship insurers typically have with their policyholders. Typically, in the context of long terms insurance products, insurers would only have physical contact with policyholders if there was a triggering event, for example, actions such as top ups, change of address, or change of beneficiary, or a replacement of the product initiated by the insurer. Otherwise contact with policyholders is usually not required. The terms of the contract are agreed at inception and premiums calculated on the basis of the risk profile of the individual at the time. Records are therefore not maintained in the same way as by other financial institutions, e.g. a bank. In addition, many of the records maintained by life insurers are scanned documents. This will make it extremely challenging to identify and report on customers with U.S. indicia.

Our recommendation

We recommend that documentation obtained by an insurer should not be required to be renewed unless the insurer identifies U.S. indicia through the course of its normal business dealings with a policyholder. For example a policyholder updates his personal information to include a U.S. postal address.

E.3 Reporting Beneficiary information

Proposed Treasury Regulation §1.1471-5(a)(3)(v) outlines two rules for identifying the true holder of life insurance and annuity contracts that constitute financial accounts. From our reading of the first rule, it would appear that at maturity of a life insurance or annuity contract, the beneficiary of the contract is considered the holder of the contract for FATCA purposes. We therefore understand this to mean that an insurer must obtain account identification information for each beneficiary of a matured insurance or annuity contract prior to making payment. This rule places a far greater burden on insurers than required of other FFIs.
A failure on the part of an insurer to pay a beneficiary due to the beneficiary not being willing to provide the requisite account identification information due to privacy concerns may well not be enforceable given the beneficiary is not a party to the insurance contract.

Our recommendation

The requirement for insurers to report on beneficiaries in addition to the policyholder should be removed.

EXHIBIT to APPENDIX III

Summary of Recommendations

Recommendation	Proposed Treasury Regulations Section	Appendix Section
Create a new category of certified deemed-compliant FFI for local insurers	Proposed new provision	A
Provided recommendation A above is adopted, any insurer falling within such criteria shall continue to be deemed compliant regardless of the position of the expanded affiliated group (EAG). Or Consideration should be given to at least a certain percentage of the EAG being substantially complaint participating FFIs, deemed compliant or exempt entities by January 1, 2016, and if that percentage is met, the EAG maintains its compliant status. We recommend a percentage of 90%.	1.1471-4(e) Or Proposed new provision	B
Use local definitions for insurance unless local law is silent.	General point	C
The definition of "life insurance contracts" and "annuity contracts" should be the definition provided under the relevant local law, regulation or commercial practice of the operation of the insurer. We request that this is stated explicitly in the final regulations to make it simpler for Hong Kong insurance companies to comply.	Life insurance: 1.1471-1(b)(35) ref. sections 7702, 101(f) and 817(h) Annuity contracts: 1.1471-1(b)(4) 1.72-2(a)(1)	C
With reference to 'cash value insurance contracts', insert the words "or termination' after the word 'cancellation' in sub clause ©(2)	1.1471-5(b)(3)(v)(C)(2)	C

Recommendation	Proposed Treasury Regulations Section	Appendix Section
An exception should be added to the definition of "cash value insurance contracts" for low-cash value life insurance and annuity contracts. The current exemption in the Proposed Regulations should be extended to cover life insurance and annuity contracts the cash value of which is $50,000 or less.	1.1471-5(b)(3)(v)	C
Grandfathering of all life insurance and annuity contracts in existence on January 1, 2013.	1.1471-2(b)(2)(i) and (ii) 1.1471-2(b)(2)(ii)(C) and (D)	D
The reporting that is required with respect to life policies and annuities should be limited to amounts actually paid to policyholders.	General point	E.1
We recommend that documentation obtained by an insurer should not be required to be renewed unless the insurer identifies U.S. indicia through the course of its normal business dealings with a policyholder.	1.1471-4(a)	E.2
The requirement for insurers to report on beneficiaries in addition to the policyholder should be removed.	1.1471-5(a)(3)(v)	E.3

APPENDIX IV

Comments on the FATCA Proposed Regulations

As Applied to Private Trusts

In this Appendix IV, we are pleased to provide the following comments regarding the concerns of non-US trustees following the issuance of proposed regulations pursuant to the Foreign Account Tax Compliance Act ("FATCA").[1]

We greatly appreciate the provisions in the proposed regulations ("Proposed Regulations") issued on February 15, 2012,[2] that modified some of the more onerous requirements of FATCA. Having said that, we - like other industry groups – believe that the Proposed Regulations do not go far enough to address the reasonable concerns of non-US financial institutions regarding the complexity and related compliance costs of FATCA.

As you know, trusts are extremely common vehicles used by persons all around the world, serving important functions, including the transfer of assets from one generation to the next. Private trusts range widely from very large to very small in monetary value. Settlors and trustees range from highly sophisticated to very unsophisticated.

At the broadest level, we are concerned that, unless certain provisions of the Proposed Regulations are clarified and / or modified: (1) there will be many FATCA-related "traps for the unwary"; and (2) use of trusts outside the US - even where families have no US connections - may become uneconomical due to FATCA-created compliance costs and/or risks of dispute.

We respectfully request that further amendments and clarifications be made so that FATCA and its application to private trusts are more clear, less onerous, and permit the practical administration of private trusts.

[1] Public Law 111-147.
[2] Federal Register Vol. 77 N0. 31 at 9022-9109.

1. Clarifying that the "Payee" and "Payor" are the Private Trust, Not the Trustee

The proposed regulations provide that, in general, the payee is the person to whom a withholdable payment is made, regardless of whether such person is the beneficial owner.[3] In the case of a payment to a trustee of a trust, it is not entirely clear whether the "payee" and/or "payor" is the trust company or the trust itself or both (and, if so, why). In general, it appears that the Proposed Regulations treat the payee and payor as the private trust rather than the trustee. However, this should be made unambiguous.

We recommend that it be clarified that the private trust, not the trustee, shall be treated as the payee and payor for FATCA purposes.

It appears that under the Proposed Regulations that a payment made to an underlying holding company that is a disregarded entity will be treated as made to the trust rather than to the disregarded entity. This is sensible and appropriate.

Where payment is made to a trust that is a flow-through entity, such as a grantor trust, certain aspects of the Proposed Regulations are unclear. Some read the Proposed Regulations as requiring withholding unless the trust is a PFFI or deemed-compliant FFI even if the withholding agent has documentation to show that the trust is a grantor trust owned by a nonresident alien. This would be an unreasonable rule.

2. Treatment of Grantor Trusts (e.g. a Revocable Trust Settled by a Non-US Person)

US income tax rules treat the grantor of a grantor trust as the owner of the income and assets of the trust, and for consistency and administrability FATCA should also follow that approach.

We recommend that it be clarified that if the withholding agent has documentation to show that the trust is a grantor trust owned by a non-resident alien, that the "payee" be treated as that non-resident alien and the withholding rules follow accordingly.

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[3] Prop. Reg. §1.1471-3(a)(1).

We note that Prop.Reg. §1.1473-1(d), regarding withholding agents, reads:
"(3) Grantor trusts as withholding agents. The term withholding agent includes a grantor trust with respect to a withholdable payment or a passthru payment (in the case of a grantor trust that is a participating FFI) made to a person treated as an owner of the trust under sections 671 through 679. For purposes of determining when a payment is treated as made to such owner of a trust, see §1.1473-1(a)(5)(v)."

This rule is inconsistent with the general US income tax principles under which grantor trusts are not treated as separate from their owners and transactions between the grantor trust and the owner are disregarded. Furthermore this provision would result in unnecessary FATCA withholding burdens on trustees of grantor trusts and additional costs.

We recommend that this provision be removed from the final version of the regulations.

3. Clarification of Points Related to the Application of Owner Documented FFI Rules in the Context of Private Trusts

The proposed regulations are helpful in defining when a beneficiary of a trust is a substantial US owner. As you know, the definition of substantial US owner and the reporting and withholding obligations under FATCA are different depending upon whether the trust is classified as a foreign financial institution ("FFI") or as a non-financial foreign entity ("NFFE").

The "Owner Documented FFI" category of deemed-compliant FFIs should be helpful to many trusts to manage compliance with FATCA although trustees are concerned about the complexity and related costs (including professional fees) of satisfying the requirements of the proposed regulations.

We are very concerned about certain requirements and obstacles to qualifying for this category. An owner-documented FFI is treated as a deemed-compliant FFI only with respect to payments made by a withholding agent who has agreed to undertake additional due

diligence and reporting obligations.[4] Furthermore, there are a number of potential obstacles to a trust becoming an owner-documented FFI.

An FFI is not able to be treated as deemed-compliant with respect to a payment or account for which it acts as an intermediary.[5] If a trust is a simple trust or a grantor trust, it is not clear whether it can be a deemed-compliant owner-documented FFI.

We recommend clarification that a simple trust or a grantor trust can be a deemed-complaint owner-documented FFI.

As you know, to be an owner-documented FFI, the following requirements apply –

1. The FFI must be only a type (iii) FFI;
2. The FFI must not be affiliated with an other FFI that is a type (i), (ii) or (iv) FFI;[6]
3. The FFI must not maintain financial account for any non-participating FFI or issue debt which constitutes a financial account to any person in excess of $50,000;[7]
4. The FFI must provide the designated withholding agent that is either a US financial institution or a PFFI with all of the documentation required in §1.1471-3(d)(7); and
5. The withholding agent must agree to report to the IRS all of the information described in §1.1474-1(i) with respect to any of the owner-documented FFIs's direct or indirect owners that are US persons.[8]

We recommend clarification that (1) the affiliation restriction would not make a trust which has a trust company as the trustee ineligible to be an owner - documented FFI; and (2) if a trust funds a 100% owned holding company with debt (as is the case for a variety of reasons in many existing trusts), such indebtedness would not make the trust ineligible to be an owner-documented FFI.

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4 Prop. Reg. §1.1471-5(f)(3).

5 Under Treas. Reg. §1.1441-1(c)(13), an intermediary is a person who acts as an agent for another person, regardless of whether such other person is the beneficial owner of the payment, a flow-through entity, or another intermediary. This definition is adopted for purposes of FATCA. Prop. Reg. §1.1471-1(b)(34). Although the definition does not mention simple and grantor trusts, such entities do file W-8IMY – an intermediary form -- which suggests that they may be intermediaries which would make them unable to use the owner-documented FFI rule.

6 Query whether the affiliation restriction makes a trust which has a trust company as the trustee ineligible to be an owner-documented FFI - if the trust is "affiliated" with the trustee, and the trust company is a type (i) FFI.

7 Many existing trusts have funded an underlying holding company with what is purported to be debt. It is unclear whether this would make the trust ineligible to be an owner-documented FFI.

8 Prop. Reg. §1.1471-5(f)(3)(ii).

As you know, a withholding agent can treat a payee as an owner-documented FFI if

1. The agent has a withholding certificate identifying the payee as an owner-documented FFI that is not an intermediary;
2. The agent agrees to treat the payee as an owner-documented FFI;
3. The payee submits annually an FFI owner statement;
4. The payee submits valid documentation for each US person, owner-documented FFI, exempt beneficial owner or NFFE that holds an interest, directly or indirectly, in the payee;
5. The agent does not know or have reason to know that the payee maintains a financial account for a nonparticipating FFI or issues debt constituting a financial account to any person in excess of $50,000; and
6. The agent does not know or have reason to know that the payee is affiliated with any other FFI other than an FFI that is also treated as an owner-documented FFI.[9]

The contents of the owner reporting statement are detailed in proposed regulation §1.1471-3(d)(7)(iv). These regulations provide that a partnership, simple trust or grantor trust may provide the owner reporting statement with a withholding statement described in Treas. Reg. §1.1441-5(e)(5)(iv). This indicates that a trust that is a simple trust or a grantor trust is in fact eligible to be treated as an owner-documented FFI even though it is treated as an intermediary for chapter 3 purposes.

The owner reporting statement must include the name, address, TIN, entity tax classification and a W-9 or W-8 or other documentary evident "for every person that owns an equity interest in the payee, and must indicate such person's chapter 4 status." The report must indicate each person's percentage ownership.

Proposed regulation §1.1471-3(d)(7)(i) and (iv) are inconsistent regarding the need to document non-US owners. Paragraph (i) requires documentation of U.S. owners, owner-documented FFI, exempt beneficial owner or NFFE that holds an interest in the payee, but paragraph (iv) requires documentation for "every person" that owns an equity interest in the

[9] Prop. Reg. §1.1471-3(d)(7).

payee. This may be an error because proposed regulation §1.1474-1(i) requires the withholding agent to report only the identity of each US person who has a direct or indirect interest in the owner-documented FFI.

It is also not clear whether the rules of proposed regulation §1.1473-1(b)(3) for determining when a person has a beneficial interest in a trust and the value of such interest apply for purposes of the owner report required in proposed regulation §1.1471-3(d)(7).

We recommend that, in order to make this rule administrable, clarification be provided that the deemed ownership rules of §1.1473-1(b)(3) are applicable. In such case, then a beneficiary of a wholly discretionary trust who did not receive a distribution in the prior year would not be included on the owners report.

If a discretionary non-grantor trust invests through an underlying holding company, the holding company can become owner-documented only if the trustee identifies ownership shares based on a facts and circumstances test – a very unworkable rule.

We recommend that the owner reporting rules for owner-documented FFIs be modified so disclosure of owners should be limited to beneficiaries who are US persons and who (i) are treated as the owner of a portion of the trust, (ii) have the right to current mandatory distributions (i.e., omitting remainder and contingent beneficiaries) and/or (iii) actually receive distributions in the prior year.

Such information is all that is necessary to enforce compliance by US persons with their tax payment obligations because a beneficiary who is not the owner of a trust, who does not have the right to a distribution, and who does not receive a distribution is not subject to US tax.

4. Election to File Information Returns as if the Trust Were a US Person

Another way to satisfy the FATCA requirements is for the trust to make the election to file information returns as if it were a US person. This would be very expensive and onerous for most non-US trusts. Where it would be a viable approach, it would be unreasonable to require, as is done in proposed regulation §1.1471-4(d)(5)(ii), reporting above and beyond what a US institution is required to do.

We recommend that if a non-US trust were to elect to file information returns as if it were a US person, it should not be required to report more than what is required of a US institution.

5. Application of *De Minimis* Rule

Proposed regulation §1.1473-1(b)(4) provides that if a person who has only a discretionary interest in a trust did not receive more than $5,000 in the prior year, that person will not be treated as a substantial US owner. A person whose mandatory interest has a value not in excess of $50,000 will not be treated as a substantial US owner.

There appear to be different views regarding whether the *de minimis* rule applies to a trust that is an FFI although the better reading appears to be that it does. There also is some confusion as to whether the *de minimis* rule is applicable to the reporting obligations of an owner-documented FFI, although the better reading appears to be that it does.

We recommend clarification that the *de minimis* rule applies to a trust that is an FFI, and that the *de minimis* rule is applicable to the reporting obligations of an owner-documented FFI.

6. Clarification and Simplification of Rules for Determining Beneficial Interests in a Holding Company Wholly Owned, Directly or Indirectly, by a Private Trust

The vast majority of private trusts in Asia own 100% of the shares of a corporate entity which in turn owns assets, including investments. We are concerned that the Proposed Regulations give rise to unnecessary complexity and traps for the unwary under this common fact pattern, as well as under structures where a trust owns more than one corporate entity, directly or indirectly, which is also a common fact pattern.

By way of background, a trust will be a US-owned foreign entity only if the trust has a "substantial US owner." A substantial US owner means a person who owns more than ten percent of a trust that is classified as an NFFE or more than zero percent in the case of a trust

that is classified as an FFI.[10] However, the trust will be a US-owned foreign entity if a US person is treated as the owner of any portion of the foreign trust, however small.

If a trust owns a beneficial interest in another entity, whether another trust or an underlying holding company, the beneficial owners of the foreign trust (either the deemed owners under sections 671-679 or the beneficiaries) are deemed to beneficially own a share of the other entity.[11] *Except as provided in Proposed Regulation §1.1473-1(b)(3)*, ownership is attributed proportionately to beneficiaries of a nongrantor trust based on all relevant facts and circumstances.[12] The preamble clarifies that the indirect ownership rules are based on the controlled foreign corporation regulations in Treasury Regulation §1.958-1.[13] These rules are problematic for discretionary trusts because it is very difficult to determine ownership percentages.

Arguably, the phrase "except as provided in Proposed Regulation §1.1473-1(b((3)" implies that the rules for determining beneficial interests in the trust also control the determination of ownership of an underlying holding company owned by such trust or another trust in which the trust holds a beneficial interest.

However, it is also possible that this language only refers to the determination of a beneficiary's beneficial interest in another trust and not to the determination of a beneficiary's interest in an underlying holding company. This would be undesirable because of the difficulty of applying a facts and circumstances test to determine beneficial ownership in the case of a discretionary trust. It also would lead to the result that a beneficiary may have a smaller interest in a trust than the beneficiary has in an underlying holding company owned by such trust. This would result from applying different standards for determining direct and indirect ownership, which would be unnecessarily complex, and create a trap for the unwary. While a beneficiary or owner of a foreign trust is not attributed ownership under the indirect ownership rules if the foreign trust is a "participating FFI" (a "PFFI") or a deemed-compliant FFI, if the underlying holding company is classified as a corporation, as most are, then the indirect ownership rules will apply if the trust is a deemed-compliant FFI as an owner-documented FFI.

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[10] Prop. Reg. §§1.1473-1(b)(1)(iii); 1.1473-1(b)(5).
[11] Prop. Reg. §1.1473-1(b)(2).
[12] Prop. Reg. §1.1473-1(b)(2)(v)
[13] Federal Register Vol. 77, No. 31 at 9038.

Accordingly, the beneficiaries or owners (under Code §§671-679) of a trust that owns shares in an underlying entity would be deemed to own an interest in the underlying entity applying a facts and circumstances test except as otherwise provided in Proposed Regulation §1.1473-1(b)(3) unless the trust is a PFFI or a deemed-compliant FFI. Under Code §958, the person who is the owner of the trust under the grantor trust rules is deemed to own all of the shares of an underlying holding company. In the case of an underlying holding company that is classified as a corporation, attribution of ownership of a non-grantor trust will be required if the trust is an owner-documented FFI. This is the category of deemed-compliant FFIs that is most likely to be useful to a foreign trust.

A trust which directly holds investments in securities would appear to be a type (iii) FFI. However, if a trust holds its investments through a holding company, which most foreign trusts do, it is not clear whether the trust would be a type (iii) FFI or an NFFE, although the holding company clearly would be a type (iii) FFI.[14] As discussed above, the beneficiaries of the trust would be treated as the indirect owners of the underlying holding company based on all relevant facts and circumstances (not based on distributions).[15] The indirect ownership rules apply equally to an FFI and an NFFE. In the case of a wholly owned company that is treated as a disregarded entity, presumably the trust will be treated as actually owning the investments owned by the company so that the trust itself would be classified as an FFI.

To avoid complicated and duplicative reporting and traps for the unwary, it would be useful if, for FATCA purposes, a company that is 100% owned by a trust, directly or indirectly, ("Company Wholly Owned by a Trust") would be able to make an election for a payment to the Company Wholly Owned by a Trust to be treated under FATCA as being paid to the shareholder/ trust. That is, the Company Wholly Owned by a Trust could elect to be treated as a disregarded entity for purposes of FATCA, whether or not a check-the-box election is made. This would avoid the difficulties of the indirect ownership rules and would enable ownership of the shares to be based on the same method used to determine beneficial ownership of the trust.

[14] If the holding company made distributions to the trust, the gross income test to meet the definition of type (iii) FFI would be met.

[15] Prop. Reg. §1.1473-1(b)(2).

Accordingly, we recommend that to avoid complicated and duplicative reporting and traps for the unwary, a company that is 100% owned by a trust, directly or indirectly, should be allowed to make an election such that a payment to such company would be treated under FATCA as being a payment made to the shareholder/ trust.

* * *

We believe these recommendations would help to make the application of FATCA to trusts more clear and less onerous, and would facilitate the practical administration of trusts.

EXHIBIT to APPENDIX IV

Summary of Recommendations

Recommendation	Proposed Treasury Regulations Section	Comment Letter Section
Clarify that the private trust, not the trustee, shall be treated as the payee and payor for FATCA purposes.	Prop. Reg. §1.1471-3(a)(1). Prop. Reg. §1.1471-3(a)(3). Prop. Reg. §1.1471-3(b)(2). Prop. Reg. §1.1471-3(c)(6).	1
Clarify that if the withholding agent has documentation to show that the trust is a grantor trust owned by a non-resident alien, that the "payee" be treated as that non-resident alien and the withholding rules follow accordingly.	Prop. Reg. §1.1473-1(d). Prop. Reg. §1.1473-1(d)(2). Prop. Reg. §1.1473-1(d)(3).	2
Remove Prop. Reg. §1.1473-1(d)(3) from the final version of the regulations.	*Removal of* Prop. Reg. §1.1473-1(d)(3).	*2*
Clarify that a simple trust or a grantor trust can be a deemed-complaint owner-documented FFI.	Prop. Reg. §1.1471-5(f)(3)(ii).	3
Clarify that (1) the affiliation restriction would not make a trust which has a trust company as the trustee ineligible to be an owner - documented FFI; and (2) if a trust funds a 100% owned holding company with debt (as is the case for a variety of reasons in many existing trusts), such indebtedness would not make the trust ineligible to be an owner-documented FFI.	Prop. Reg. §1.1471-5(f)(3)(ii)(B). Prop. Reg. §1.1471-5(f)(3)(ii)(C).	3
Clarify that the deemed ownership rules of Prop. Reg. §1.1473-1(b)(3) are applicable to the rules under Prop. Reg. §1.1471-3(d)(7) for identification of owner-documented FFIs.	Prop. Reg. §1.1471-3(d)(7). Prop. Reg. §1.1473-1(b)(3).	3

Recommendation	Proposed Treasury Regulations Section	Comment Letter Section
Modify owner-documented FFI rules so that disclosure of owners is limited to beneficiaries who are US persons and who (i) are treated as the owner of a portion of the trust, (ii) have the right to current mandatory distributions (i.e., omitting remainder and contingent beneficiaries) and/or (iii) actually receive distributions in the prior year.	Prop. Reg. §1.1474-1(i).	3
If a non-US trust were to elect to file information returns as if it were a US person, it should not be required to report more than what is required of a US institution.	Prop. Reg. §1.1471-4(d)(5)(ii).	4
Clarify that the *de minimis* rule of Prop. Reg. §1.1473-1(b)(4) applies to a trust that is an FFI, and that the *de minimis* rule is applicable to the reporting obligations of an owner-documented FFI.	Prop. Reg. §1.1473-1(b)(4).	5
A company that is 100% owned by a trust, directly or indirectly, should be allowed to make an election such that a payment to such company would be treated under FATCA as being a payment made to the shareholder/ trust.	Prop. Reg. §1.1473-1(b)(2).	6