INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE

INTERNATIONAL REPORTING AND WITHHOLDING SUBGROUP REPORT

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Foreign Account Tax Compliance Act (FATCA)

IRPAC has worked closely with the IRS and Treasury regarding the implementation of the Foreign Account Tax Compliance provisions of Subtitle A of Title V of the HIRE Act (commonly referred to as FATCA). IRPAC has engaged in an ongoing dialogue with the IRS and Treasury regarding the regulations implementing FATCA that were issued on January 17, 2013 and the draft Forms W-8, Withholding Certificate), 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, and 8957, Foreign Account Tax Compliance Act (FATCA) Registration. IRPAC intends to continue this dialogue and provide input with regard to the regulations, associated forms, and the foreign financial institution (FFI) registration process.

Following is a summary of the principal issues that have been discussed.

A. Notice 2013-43

Recommendation

IRPAC recommends that the IRS continue to take into account the time needed by withholding agents and their customers to implement FATCA in an orderly manner. Notice 2013-43 provides for a postponement in the imposition of FATCA withholding until July 1, 2014. Due to the delay in the issuance of final guidance, IRPAC recommends that the IRS provide for an additional postponement until January 1, 2015 in order for withholding agents to complete the steps necessary to fulfill their obligations under FATCA.

Discussion

The implementation of FATCA is an enormous task. Notice 2013-43 acknowledges the practical problems faced by both U.S. withholding agents and foreign financial institutions (FFIs) in complying with FATCA. IRPAC applauds the IRS for its decision to release Notice 2013-43 to announce the delay of the effective date for the implementation of FATCA until July 1, 2014.

Withholding agents have devoted substantial resources to the design of systems based on the final regulations and the associated draft forms. It is important to note that substantial work remains to be done and can only be undertaken after final and comprehensive guidance is issued. The systems development process involves a series of steps. The remaining steps include refining the scope of the project, development and documentation of technical requirements, design and coding of program changes, testing to ensure compliance with technical requirements, finalization of programming changes, and scheduling the release of systems changes. Each of these steps requires a substantial commitment of time and resources and must be undertaken <u>sequentially</u>. Although preliminary scoping and initial deign work has been largely completed based on guidance issued to date, the completion of design, programming and testing can only be accomplished after the IRS has released comprehensive final guidance.

IRPAC understand that the IRS intends to issue additional regulations that will provide guidance under Chapter 4, and make changes to the regulations under Chapter 3 and Chapter 61. The IRS has also issued substantially revised draft versions of Forms W-8, 1042 and 1042-S. Withholding agents cannot make the necessary changes to on-boarding procedures or their reporting and withholding systems until the final versions of these forms and their instructions are released.

The implementation of FATCA is further complicated by the negotiation of Intergovernmental Agreements (IGAs) between Treasury and foreign governments. The IGAs are meant to address local privacy concerns by providing a separate set of rules for financial institutions located in an IGA country. Financial institutions with branches and subsidiaries located in multiple countries will have to implement varying IGA requirements in the many jurisdictions expected to enter into IGAs. Thus, financial institutions are faced with the prospect of programming systems to comply with the FATCA regulations and then reprogramming systems and revising procedures for individual countries when an IGA becomes effective.

Due to the delay in the issuance of final guidance, IRPAC recommends that the IRS provide a postponement of the requirement to impose Chapter 4 withholding until January 1, 2015 (with corresponding changes to other effective dates under the Chapter 4 regulations).

B. Treatment of Expiring Chapter 3 Documentation

Recommendation

IRPAC recommends that withholding certificates (Forms W-8) and documentary evidence that would otherwise expire on December 31, 2013 should be considered valid until December 31, 2014.

Discussion

Notice 2013-43 provides that withholding certificate and documentary evidence that would otherwise expire on December 31, 2013 will expire instead on June 30, 2014, unless a change in circumstances occurs that would otherwise render the withholding certificate or documentary evidence incorrect or unreliable. This extension of the validity period of such documentation is consistent with the delay in the imposition of FATCA withholding until July 1, 2014.

The extension of the validity period from December 31, 2013 until June 30, 2014 is only relevant for obligations or accounts that are considered preexisting obligations under the Chapter 4 regulations. The extension of the validity period is of limited benefit because withholding agents would need to solicit a new Form W-8 before July 1, 2014. A new Form W-8 received before July 1, 2014 would generally not include Chapter 4 status information. Withholding agents would need to resolicit Forms W-8 for many preexisting accounts after July 1, 2014 and before December 31, 2014 in order to obtain necessary Chapter 4 status information.

IRPAC recommends that tax documentation that would otherwise expire on December 31, 2013 be treated as valid until December 31, 2014.

C. Electronic Transmission of Tax Documentation

Recommendation

IRPAC recommends that the electronic transmission provisions of Chapters 3 and 4 be modified to provide that a withholding agent may accept tax documentation (withholding certificates, written statements, withholding statements, documentary evidence) that has been transmitted via e-mail or facsimile, except in the case the withholding agent knows such documentation has been transmitted by a person who does not have the authority to transmit such documentation and, in the case of documentary evidence, the documentary evidence appears to have been altered from its original form. We recommend that all the other authentication requirements with respect to faxed and e-mailed documentation be eliminated.

Discussion

Treasury Reg. § 1.1471-3(c)(6)(iii)(iv) provides that a withholding certificate may be accepted by facsimile for Chapter 4 purposes if the withholding agent confirms that the individual or entity furnishing the form is the individual or entity named on the form. In the case of a withholding certificate that is transmitted via e-mail, the even more stringent authentication requirements of Treasury Reg. § 1.1441-1(e)(4)(iv) apply for Chapter 4 purposes. We believe that these authentication requirements with respect to faxed or e-mailed documentation do little, if anything, to identify documentation which has been signed by an unauthorized person. Such requirements, on the other hand, are costly for withholding agents to administer.

There should be no requirement that the person who furnishes a faxed or e-mailed form be the person named on the form. There is no such requirement in the case of a form placed in an envelope and sent via physical mail. No distinction should be made for this purpose between physical mail and e-mail or facsimile. Consider, for example, a person, such as an administrative assistant, who is not authorized to sign a Form W-8, but who, as part of his normal duties at work, transmits the form on behalf the person authorized to sign the form. Under current rules, such person is permitted to put the form in an envelope and then send the envelope via physical mail. In contrast, such person cannot transmit the form via e-mail or facsimile. The disparate treatment of forms sent via physical mail and e-mail or facsimile is irreconcilable.

Withholding agents generally request and collect documentation within a short timeframe. We posit that the probability of a withholding agent receiving documentation during this timeframe from a person other than the intended person is remote. An imposter would need to know when a particular withholding agent is expecting documentation from a particular account holder. Further, the withholding agent would have had to receive no documentation from the actual account holder. Had the withholding agent received documentation from the account holder, the withholding agent would almost certainly have notified the account holder of the two sets of documentation and eventually identified the authorized documentation. This combination of imposter knowledge and no documentation from the account holder is improbable.

The current electronic transmission requirements are also inconsistent with the fact that documents transmitted via e-mail and facsimile are generally presumed to be transmitted from an authorized person for purposes other than US withholding tax. E-mailed and faxed documents are commonly accepted in business, and the practice is generally devoid of authentication requirements.

In summary, the benefits, if any, of the current electronic transmission requirements applicable to documentation transmitted via e-mail or fax clearly outweigh the costs of compliance. Therefore, IRPAC recommends that the Chapter 3 and Chapter 4 regulations be revised to permit a withholding agent to rely on otherwise valid documentation which has been transmitted via e-mail or facsimile, except in the narrow case the withholding agent knows the documentation has been transmitted by a person who does not have the authority to transmit the information.

D. Presumption Rules for Certain Exempt Recipients

Recommendation

IRPAC recommends that an entity that may be treated as an exempt recipient without the need for furnishing a Form W-9, Request for Taxpayer Identification Number and Certification (an “eyeball exempt recipient”) should not be presumed foreign unless there are indicia of foreign status associated with the entity’s account.

Discussion

Treasury Reg. § 1.1471-3(f)(3)(ii) provides that certain entities that have been historically treated as U.S. exempt recipients (*e.g.* corporations, financial institutions, and brokers) under the eyeball test will be presumed foreign entities if the withholding agent has not received a Form W-9 or other documentary evidence from the recipient. This represents a change from long standing rules under Chapter 3 and Chapter 61. The rationale for this change is unclear. IRPAC believes that in the absence of foreign indicia associated with an account of an eyeball exempt recipient, there should not be a presumption of foreign status.

For purposes of Chapter 3, Treasury Reg. § 1.1441-1(b)(3)(iii)(A) provides that an eyeball exempt recipient is presumed to be a foreign person only if:

(1) the withholding agent has actual knowledge of the payee’s employer identification number and the number begins with the two digits “98”; or

(2) the withholding agent’s communications with the payee are mailed to an address in a foreign country; or

(3) the name of the payee indicates that it is a type of entity on the per se list of foreign corporations; or

(4) payment is made outside the U.S.

IRPAC believes that the above indicia of foreign status should also apply for purposes of presuming the foreign status of an eyeball exempt recipient for Chapter 4 purposes.

If the IRS concludes that the change made to the presumption rules under the Chapter 4 regulations should be retained and incorporated into the Chapter 3 regulations, IRPAC recommends that this change should not apply to preexisting obligations or accounts. It would require a tremendous amount of time and expense for withholding agents to solicit Forms W-9 for millions of preexisting accounts or obtain or locate documentary evidence for such accounts. IRPAC believes that such an effort would be wasteful and take strained resources away from the implementation of FATCA.

E. Treatment of Foreign Branches Located in IGA Countries

Recommendation

IRPAC recommends that foreign branches of U.S. financial institutions (USFIs) and controlled foreign corporations of USFIs located in an IGA country should be subject only to the IGA with respect to documentation standards and Chapter 4 withholding and reporting requirements.

Discussion

Foreign branches of USFIs are subject to the provisions of an Intergovernmental Agreement (IGA) if the USFI's branch is located in an IGA partner country. Such branches are treated as Reporting Financial Institutions under the provisions of Model I and Model II IGAs, and are subject to the requirements imposed by the IGA. USFI's controlled foreign corporations (CFCs) are also subject to the provisions of an IGA if the CFC is resident in that jurisdiction.

A separate set of rules and procedures for documenting, withholding and reporting with respect to accounts maintained by a Reporting Financial Institution are provided for in the IGAs. One of the primary goals of these rules is to address privacy concerns in a number of jurisdictions that would make it difficult or impossible to comply with FATCA. The Chapter 4 regulations do not appear to apply to a CFC of a USFI resident in an IGA jurisdiction; rather, only the account documentation and Chapter 4 withholding rules provided in the IGA apply.

The requirements are less clear with regard to branches of USFIs. The regulations do not specifically address whether the IGA documentation standards or the standards set forth in the Chapter 4 regulations apply to such foreign branches. It would appear that a customer may be required to provide a Form W-8 or other documentation when transacting with a Reporting Financial Institution that is a branch of a USFI, but would not be required to produce such documentation when transacting with other Reporting Financial Institutions. This distinction seems arbitrary. Foreign branches of USFIs would be at a competitive disadvantage if they are required to comply with the documentation rules contained in the regulations (e.g., a Form W-8) rather than the rules in the IGAs (e.g., reliance on client relationship, regulatory, or publically available information). IGA partner jurisdictions expect that customers of Reporting Financial Institutions only be required to provide the types of documentation described in the IGAs. If USFI foreign branch customers are required to provide a Form W-8, it is likely those customers will choose to do business with other Reporting Financial Institutions that are not subject to that documentation standard.

IRPAC recommends that the regulations be clarified to provide that accounts maintained at a USFI foreign branch located in an IGA jurisdiction (Model I or II) are subject to the documentation standards provided in the IGAs, and not those in the regulations, for purposes of compliance with Chapter 4.

In addition, IRPAC recommends that USFI foreign branches and CFCs located in IGA jurisdictions be subject only to the Chapter 4 withholding requirements applicable to Reporting Financial Institutions resident in the IGA jurisdiction. Treasury Reg. § 1.1471-2(a)(2)(v) requires that a USFI foreign branch located in a Model I IGA withhold in accordance with the rules in the regulations under Section 1471 and, presumably, also in accordance with the rules in a Model I IGA. For the same competitive reasons described above concerning documentation standards, IRPAC recommends that the regulations be amended so that the same Chapter 4 withholding obligations apply to all Reporting Financial Institutions subject to an IGA.

F. Reason to Know Standards Under Chapters 3 and 4

Recommendation

IRPAC recommends that the “reason to know” standard provided in Chapter 4 (and Chapter 3), be modified to permit additional time to review both documentation obtained at the time the account is opened and the results of a know-your-customer review conducted at or following the opening of the account. Additionally, corresponding regulations should be issued to provide that if the result of such review indicates that the tax documentation is unreliable or incorrect, the withholding agent is not obligated to impose withholding tax with respect to payments that occurred during the review period.

Discussion

Under existing regulations, a withholding agent that opens an account for a non-U.S. person is obligated to collect and review a withholding certificate, written statement or documentary evidence to support such person's claim of Chapter 4 status. However, such documentation is considered unreliable or incorrect to the extent that there is information in the withholding agent's files that conflicts with the person's claim. It is expected that withholding agents will now be required to compare a variety of information to the documentation provided to establish such person's Chapter 4 status. In many instances such review will not occur contemporaneously with account opening. Although not all on-boarding functions are organized in the same way, such a review would generally require the coordination of personnel that conduct a review of the withholding certificate or other documentary evidence with personnel that perform the local KYC/AML (Know Your Customer/Anti-money Laundering) review. IRPAC believes that thirty days is a reasonable period of time to permit withholding agents to accomplish this type of review.

During this thirty-day period, the account may be permitted to engage in certain transactions without the risk that the withholding agent would be obligated to impose withholding tax with respect to a withholdable payment. To the extent that the review does result in a determination that the tax documentation is unreliable or incorrect, withholding tax should be imposed only prospectively to withholdable payments and a withholding agent should not be obligated to impose withholding tax on withholdable payments that were paid during the thirty-day review period.

G. Coordinated Account System Rules

Recommendation

IRPAC recommends that the final regulations under Chapter 4 be modified to more clearly define, and expand, the circumstances under which a withholding agent, or members of its expanded affiliated group, may rely on shared tax-related documentation furnished by an accountholder or customer for multiple obligations or accounts. IRPAC also recommends that the corresponding regulations under Chapter 3 be similarly modified so that documentation requirements for both purposes are coordinated as closely as possible.

Discussion

Current tax documentation requirements under Chapter 3 and Chapter 4 each provide that, with specified limited exceptions discussed below, a withholding agent generally must obtain withholding certificates, written statements, or documentary evidence from a payee on an obligation-by-obligation (or on an account-by-account) basis. This essentially requires withholding agents with clients that establish multiple accounts, particularly when such accounts cross several distinct lines of business, to solicit and obtain separate tax documentation for each account. This documentation effort is voluminous and duplicative, often resulting in significant (and largely avoidable) costs and customer service issues.

The final regulations under Chapters 3 and 4 also provide specified instances in which a withholding agent may rely on a single withholding certificate, written statement, or documentary evidence furnished by a payee for one obligation or account to establish the payee's tax status with respect to other accounts or obligations. Unfortunately, the procedural provisions contained in these regulations are not clear in all cases and, for a number of reasons, including the uncertainties and complexities of the various technical requirements that must be met, offer limited relief to most withholding agents.

For example, Treasury Reg. § 1.1471-3(c)(8) makes numerous references to a "branch location" of the withholding agent, or a branch location of a member of the expanded affiliated group, which may be interpreted to include only distinct business operations that are separated geographically. There is no mention of separate lines of business that may exist within the same withholding agent, or separate lines of business that may exist among member organizations of an expanded affiliated group. Specific references to branch locations do not contemplate the scope or variety of distinct businesses and organizational structures of today's financial institutions. In addition, Treasury Reg. § 1.1471-3(c)(8) refers solely to "accounts" of a withholding agent, and makes no reference to "obligations" as that term is used elsewhere in the Chapter 4 regulations.

IRPAC recommended changes to Treasury Reg. § 1.1471-3(c)(8) that should simplify and clarify the existing account-by-account documentation exception rules, expand the application of these exceptions to better accommodate today's financial services environment, and include illustrative examples that explain the application of the modified rules. Finally, IRPAC also recommends that the corresponding regulations under Chapter 3, namely Treasury Reg. § 1.1441-1(e)(4)(ix), be modified so that documentation requirements for both purposes are coordinated as closely as possible.

These changes should enable withholding agents to share tax documentation in many more cases. This will be especially important as FATCA rules are gradually implemented over the coming years, and large populations of clients with preexisting accounts either establish new accounts, or need to be re-documented for Chapter 4 purposes.

H. New Forms W-8, W-9, 1042 and 1042-S

Recommendations

IRPAC reviewed and discussed with the IRS the May 2013 draft version of the new Form W-8BEN-E, Certificate of Status of Beneficial Owner for United States Tax Withholding and Reporting. IRPAC recommends that the IRS make modifications to terminology and formatting on the face of the form in order to prevent a high level of errors by those completing the form and, therefore, decrease the number of invalid

Forms W-8BEN-E submitted to withholding agents. IRPAC also recommends that the IRS publish instructions to Form W-8BEN-E—as well as the forms and instructions for other forms in the W-8 series—as soon as possible in order to provide withholding agents with the necessary time to update their documentation, withholding and reporting systems, and that the instructions provide withholding agents with explicit guidance on how to validate the new Forms W-8 for purposes of both Chapter 3 and Chapter 4 requirements.

Discussion

IRPAC is pleased that in the May 2013 release of draft Form W-8BEN-E, the IRS adopted recommendations in the 2012 IRPAC Annual Report to clarify who should use the form and to streamline the overall amount of information collected and submitted. However, given the complexity of the FATCA regulations, the Form W-8BEN-E remains long and complicated. IRPAC is concerned that many people will be confused by the terminology used on the form which, combined with the length and complexity of the form, will lead to a high rate of errors on forms being submitted to withholding agents.

IRPAC discussed with the IRS a number of specific changes to the May 2013 draft Form W-8BEN-E, including:

- Remove “Chapter 3” on Line 3 and “Chapter 4” on Line 4, because references will be meaningless to persons completing the form who are unfamiliar with U.S. tax law nomenclature;
- Remove or clarify the last check box on Line 5 (“Not receiving withholdable/pass-thru payment”) because it is unclear what this status refers to and will likely be the subject of substantial misuse; and,
- Remove the “do not abbreviate” language from Lines 2, 6 and 7.

IRPAC also made a number of suggestions regarding the validation rules for financial institutions when reviewing and validating new Forms W-8, including:

- Allow a tolerance—based on a “reasonable person” standard—for the use of country abbreviations on Lines 2, 5 and 6;
- Allow entities to use a P.O. Box or In-Care-Of address on lines 6 and 12 if the entity does not have a physical address; and,
- Allow the withholding agent to accept and retain on its systems only the specific pages of the Form W-8 that pertain to the particular payee.

In addition, IRPAC made a number of suggestions regarding how to provide clarity in the Form W-8 series instructions in order to prevent high error rates, including:

- Provide explicit instructions on how to determine a Chapter 4 status if not readily known (including how to contact IRS for assistance);

- Clearly indicate who should complete the form—for example, should a foreign branch of a USFI located in a Model I IGA jurisdiction complete a Form W-9 or the IGA Partner FI documentation standard?;

- Clarify which lines on the Form W-8BEN-E need to be completed if the form is being used solely for Chapter 3 purposes, or solely for proving foreign status; and,

- Provide clarification in the withholding agent Requester Instructions—or in some other formal guidance—on validation rules for determining if a form is valid for both Chapter 3 and Chapter 4 purposes. For example, which specific status code combinations are required for the form to be valid?

IRPAC reviewed and discussed with the IRS the May 2013 draft version of the Form W-9. IRPAC recommended that the IRS provide additional clarity, by way of revised instructions or some other formal guidance, concerning the inclusion of the new exemption codes. Specifically, the IRS should notify withholding agents that all existing Forms W-9 on file (that do not include such exemption codes) remain valid going forward, and that withholding agents are not required to validate the new exemption codes.

IRPAC raised concerns that the inclusion of new exemption codes for (1) “Exempt payee code (if any)”, and (2) “Exemption from FATCA reporting code (if any)”, on the May 2013 draft Form W-9 appear to provide withholding agents with additional form validation obligations, as well as to indicate the need for withholding agents to re-paper all existing account holders with Forms W-9 on file in order to similarly validate and report on such codes. IRPAC stressed to the IRS the need for clarification due to the significant amount of effort that may be required to meet such requirements for withholding agents with large populations of U.S. account holders. IRPAC advised the IRS that withholding agents should not be required to re-paper their existing population of account holders with Forms W-9 on file, and that for new accounts, withholding agents should not be required to validate the specific exemption claimed by the account holder (assuming the name and TIN requirements were met).

IRPAC also emphasized to the IRS the need for clear instructions on who should complete the FATCA exemption code, and state explicitly that the FATCA exemption code is not relevant for accounts maintained in the U.S. In addition, IRPAC recommended that the Instructions for the Requestor of Form W-9 make it clear that the “exempt payee code” and “exemption from FATCA reporting code” only affect reporting and do not affect whether a payee is subject to backup withholding or FATCA withholding, regardless of how such codes are completed.

The IRS released the final version of Form W-9 and the Instructions to Requester in August, 2013. IRPAC notes that none of the recommendations we discussed with the IRS are reflected in the final Form W-9. We continue to believe those recommendations are important and urge the IRS to consider them. IRPAC also recommends that the IRS issue guidance that the new Form W-9 is not required to be used before July 1, 2014. In addition, IRPAC recommends that a substitute Form W-9 should not be required to include the certification that the payee is exempt from FATCA reporting, if the account is maintained in the U.S.

IRPAC reviewed and discussed with the IRS the April 2013 draft versions of Forms 1042 and 1042-S. With respect to the Form 1042, IRPAC recommends that the IRS remove Section 2, “Reconciliation of Payments of U.S. Source FDAP Income” because the information captured within this schedule is not pertinent to the withholding agent’s U.S. account or NRA reporting obligations under Chapter 3 or Chapter 4, and capturing such information will create a significant burden on withholding agents.

IRPAC recommends that the IRS provide withholding agents with explicit instructions regarding which data fields on the Form 1042-S are required for purposes of reporting under Chapter 3, or Chapter 4, or for combined reporting under Chapter 3 and 4. IRPAC also recommends that the IRS modify the numbering sequence for the Chapter 3 status codes—which essentially replace the recipient code on the current Form 1042-S—so that they mirror the existing recipient codes for retained statuses such as individuals, corporations etc. Modifications to the existing numbering sequence will force all U.S. withholding agents to change their systems, even those only required to report under Chapter 3, thereby creating an unnecessary additional programming and systems development burden. Codes for all new Chapter 3 statuses should be appended to the existing numbering scheme.

IRPAC emphasized to the IRS the importance of providing withholding agents with clear guidance in the instructions regarding how to complete the forms, whether solely for purposes of Chapter 3 reporting, or Chapter 4 reporting, or for a withholding agent completing the form for combined Chapter 3 and 4 reporting. For example, for combined reporting, guidance is required for identifying acceptable Chapter 3 and Chapter 4 status and exemption codes. Without clear guidance, both withholding agents and the IRS will find it difficult to determine from the Form 1042-S if the withholding and reporting was done correctly. This may prove particularly troublesome under future IRS examinations of the withholding agent’s Form 1042.

IRPAC also noted that the draft Form 1042-S omits a box for the recipient’s GIIN, and advised that the recipient GIIN should be added to the final version of the form.

I. Reporting Obligations With Respect to Foreign Investment Funds

Recommendation

IRPAC recommends that the Chapter 61 obligations of a “U.S. payer” of distributions and redemptions made by a foreign investment fund which is either classified as a partnership for U.S. federal income tax purposes or treated as a passive foreign investment company under IRC § 1297 be eliminated in the case the FATCA reporting requirements of such investment fund are satisfied.

Discussion

A U.S. payer of distributions and redemptions made by a foreign investment fund – typically, a transfer agent with a U.S. parentage as the foreign fund itself would generally not be a U.S. payer – must currently generally issue Forms 1099 on such distributions and redemptions. (In the case of a fund that is treated as a partnership, such Forms 1099 are only required in the case the Form 1065, U.S. Return of Partnership Income, and Schedules K-1, filing requirements of the fund are not satisfied (see Treasury Reg. §§ 1.6041-3(f) and 1.6045-1(c)(3)(5)).) Such Forms 1099 are misleading to both taxpayers and the IRS. In the case of a fund that is a partnership, such forms are misleading because partnership distributions are not items of income, i.e., income is recognizable each year, regardless of any distribution, while the Forms 1099 are based on cash movements. In the case of a fund that is a Passive Foreign Investment Company (PFIC), such forms are misleading because, similar to a partnership, the PFIC rules generally result in the recognition of income each year, regardless of whether distributions are made. Further, the characterization of the distributions as reported on Forms 1099 (for example, as dividends in the case of a PFIC) is generally not the proper characterization for U.S. income tax purposes. In short, the information reported on the Forms 1099 is incompatible with the manner in which the distributions must be treated for U.S. income tax purposes.

In the case of a fund that is a partnership and that is not required to issue a Form 1065 or Schedules K-1 pursuant to Treasury Reg. §§ 1.6031(a)-1(b) and 1.6031(b)-1T, the fund may provide "pro-forma" K-1s to its US investors, if any, in order to assist such investors in completing their U.S. tax returns. In the case of a fund that is a PFIC, the fund may provide a PFIC statement (showing ordinary earnings and net long term capital gains) to its US investors, if any, in order to assist them in completing their U.S. tax returns. This reporting, which is not a regulatory requirement, unlike the Form 1099 reporting, is usable by taxpayers. FATCA will require the funds (partnerships and PFICs) to file a FATCA report with respect to reportable US investors showing the account balance and "the gross amounts paid or credited to the account holder during the calendar year including payments in redemptions (in whole or part) of the account" (see Treasury Reg. § 1.1471-4(d)(4)(iv), and the corresponding language at Article 2.2.a.7 of the Model 1 IGA). This requirement to report "gross amounts paid" is more appropriate with respect to such investment funds as, unlike Forms 1099, this reporting does not specify or imply the [generally incorrect] income tax characterization of a payment.

In summary, the pro-forma K-1s and PFIC statements, if any, and the FATCA reports provided by a PFIC or foreign partnership are sufficient and effective reporting. In contrast, the Forms 1099 issued with respect to distributions and redemptions by a PFIC or foreign partnership are unnecessary and misleading. Accordingly, we recommend that the requirement to issue such Forms 1099 be eliminated.