ISDA® Safe, Efficient Markets

Mr. Jesse Eggert
Associate International Tax Counsel
United States Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

June 11, 2013

Dear Mr. Eggert:

The International Swaps and Derivatives Association, Inc. ("ISDA") appreciates the opportunity to comment on the practical implications of a particular provision of the Model Intergovernmental Agreement to Improve Tax Compliance and to Implement FATCA (the "Model 1 IGA") relating to implementation of the Foreign Accounting Tax Compliance Act ("FATCA").

Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 60 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

Background

Model 1 IGA Article 4(1)

Article 4, section 1 of the Model 1 IGA provides:

> Treatment of Reporting [FATCA Partner] Financial Institutions. Subject to the provisions of paragraph 2 of Article 5, each Reporting [FATCA Partner] Financial Institution will be treated as complying with, and not subject to withholding under, section 1471 of the U.S. Internal Revenue Code if [FATCA Partner] complies with its obligations under Articles 2 and 3 with respect to such Reporting [FATCA Partner] Financial Institution and the Reporting [FATCA Partner] Financial Institution:

> . . .
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> d) to the extent that a Reporting [FATCA Partner] Financial Institution is . . . acting as a qualified intermediary (for purposes of section 1441 of the U.S. Internal Revenue Code) that has elected to assume primary withholding responsibility under chapter 3 of subtitle A of the U.S. Internal Revenue Code, . . . withholds 30 percent of any U.S. Source Withholdable Payment to any Nonparticipating Financial Institution; and
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> e) in the case of a Reporting [FATCA Partner] Financial Institution that is not described in subparagraph (1)(d) of this Article, and that makes a payment of, or acts as an intermediary with respect to, a U.S. Source Withholdable Payment to any Nonparticipating Financial Institution, the Reporting [FATCA Partner] Financial Institution provides to any immediate payor of such U.S. Source Withholdable Payment the information required for withholding and reporting to occur with respect to such payment.

This provision of the Model 1 IGA has been instituted in bilateral agreements with Norway, Spain, Ireland, Mexico, Denmark and the United Kingdom.

Although not entirely clear from the face of Article 4, we understand the intent is that a Reporting FATCA Partner Financial Institution has no FATCA withholding obligations with respect to U.S. Source Withholdable Payments that it makes in a principal capacity.

Typical Transaction

Many U.S. and non-U.S. financial institutions have dealer affiliates in the U.K. These dealer affiliates are foreign financial institutions ("FFIs"), and frequently are qualified intermediaries ("QIs"). As dealers, these FFIs continuously enter into swap and other transactions with unrelated parties. In a typical swap transaction, the dealer's counterparty (the "Counterparty") will be required to post collateral to the dealer. The collateral often consists of U.S. Treasury securities or other securities that generate U.S. source income. Under a standard ISDA Credit Support Annex, the dealer is permitted at its option to (i) hold the collateral and pay any income received from the collateral to the Counterparty or (ii) to sell or lend the posted collateral to a third party. In the latter case, the dealer is required to make substitute income payments to the Counterparty equal in amount to the income received on the collateral.

Although the law is not entirely settled in this area, market participants generally view the Counterparty as the owner of the posted collateral for U.S. tax purposes where the dealer retains the collateral, with the result that the dealer is making payments as agent. Where the dealer lends or sells the collateral, market participants generally view the Counterparty as having made a securities loan to the dealer with the result that the dealer is making payments as principal. In general, there is no U.S. tax significance to characterizing the arrangement between the dealer and the Counterparty in either manner. However, under Article 4 of the Model 1 IGA a dealer would be required to identify whether the dealer is making the payment to its counterparty in its capacity as principal (with no FATCA withholding required) or whether it is making the payment to its counterparty in an intermediary capacity (with FATCA withholding potentially required).[1]

A significant practical problem arises because it is common practice for dealers to place similar assets received as collateral (typically fixed income securities) from all Counterparties into a single pooled account. These accounts do not allow for specific assets to be linked to a particular Counterparty. Without a way to track the assets, the dealer will not know whether it is making payments to the Counterparty of income with respect to assets held on the Counterparty's behalf or of substitute payments with respect to securities that the dealer has borrowed from the Counterparty. Accordingly, if the Counterparty is a non-participating FFI, the dealer will not have any way of determining whether it is acting as an intermediary or whether it is acting as a principal, and in turn whether or not FATCA withholding is required.[2]

Proposal

We propose that the Treasury Department in administering an IGA, that like the IGA with the U.K., follows the Model 1 IGA create an exception under which no FATCA withholding would be required with respect to payments of withholdable amounts, where the payments relate to assets that were posted as collateral to the Reporting FATCA Partner Financial Institution in connection with a transaction in the ordinary course of the Reporting FATCA Partner Financial Institution's business as a dealer in securities.

We believe that the well intentioned provisions of Article 4(1) of the Model 1 IGA insofar as they relate to Reporting FATCA Partner Financial Institutions were set forth and implemented in bilateral agreements without complete awareness of the manner in which those Reporting FATCA Partner Financial Institutions' business and systems currently operate. It does not appear that the intention of those provisions was to require significant alteration of the manner of doing business in order to take advantage of the negotiated relief for certain Reporting FATCA Partner Financial Institutions. Moreover, we do not see any principled reason to base

[1] Note that this issue is present regardless of whether or not the dealer is a QI, and if it is a QI, whether or not it has assumed primary withholding responsibility. If the dealer is a QI that has assumed primary withholding responsibility, it would have to make this determination in order to know whether or not to withhold under FATCA on payments to a non-participating FFI. If the dealer is not a QI or is a QI that has not assumed primary withholding responsibility, it would have to make the determination in order to inform the party that is paying the relevant amount to the dealer, so that the party making the payment can withhold as required.

[2] A similar issue may arise in connection with assets held in margin accounts and other circumstances, which we do not address in this letter.

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the requirement of FATCA withholding on whether or not the Reporting FATCA Partner Financial Institution has in fact borrowed U.S. securities posted as collateral. We believe that the suggested exception is consistent with the intention of the language of the Model 1 IGA and would not create any undue opportunity for abuse or avoidance of the purposes of FATCA.

On behalf of ISDA, I wish to thank you for your consideration of this issue.

With best regards.

Sincerely yours,

Thomas Prevost

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