MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

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**Via Electronic Mail: Notice.Comments@irscounsel.treas.gov**

Honorable Michael Mundaca
Assistant Secretary for Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Honorable Douglas Shulman
Commissioner
Internal Revenue Service
Room 5203
P.O. Box 7604, Ben Franklin Station
Washington, D.C. 20224

**Re: MFA Comments on Advance Notice 2010-60**

Dear Assistant Secretary Mundaca and Commissioner Shulman:

Managed Funds Association ("MFA")[1] welcomes this opportunity to provide its comments in response to Notice 2010-60 (the "Notice")[2], which provides preliminary guidance for public comment on priority issues arising in connection with the implementation of information reporting, withholding and documentation requirements of sections 1471-1474 of the Internal Revenue Code of 1986, as amended (the "Code").[3] These provisions were enacted under the Foreign Account Tax Compliance ("FATCA") section 501 of the Hiring Incentives to Restore Employment Act of 2010[4] and generally will take effect with respect to certain payments made after December 31, 2012.

MFA supports the broad anti-tax evasion objectives underlying FATCA and we encourage Treasury and the Internal Revenue Service (the "Service") to establish an appropriate regime under which the information needed for U.S. tax enforcement purposes is obtained in a manner that does not impose unnecessary administrative burdens, particularly on those foreign financial institutions ("FFIs") that present little or no opportunity for U.S. taxpayers to evade their U.S. tax obligations. Consistent with this

[1] MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $1.5 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

[2] 2010-37 IRB 1 (August 27, 2010).

[3] Except as otherwise specifically stated, all references in this letter to "section" and "sections" are to sections of the Code.

[4] Public Law 111-147 (March 18, 2010).

view, MFA believes that Treasury and the Service should, in considering when and how to exercise their discretionary authority under section 1471(b), adhere to several broad principles in developing guidance under FATCA with respect to private investment funds, including hedge funds.

A. General Principles for Foreign Investors, including Private Investment Funds

FATCA was enacted to reduce evasion of U.S. taxes by U.S. taxpayers. To achieve this objective, section 1471(a) provides for the imposition of a 30 percent withholding tax on "withholdable payments" to an FFI that does not comply with section 1471(b), which in turn requires such an institution to enter into an agreement under which it will be obligated to undertake certain reporting, due diligence and withholding responsibilities. Similar rules also apply to certain non-financial foreign entities (an "NFFE"). Recognizing the breadth of the reporting regime it mandated, Congress wisely granted Treasury and the Service authority in section 1471(b) to exempt certain FFIs wholly or partially from those requirements. In considering whether private investment funds should be subject to these reporting requirements, we believe that Treasury and the Service should consider the following factors.

First, appropriate recognition should be given to the important and positive role played by foreign investors, including private investment funds, in the U.S. capital markets. If the FATCA provisions are applied in a manner that is too onerous (*e.g.,* impose burdens that funds classified as FFIs cannot be certain they can administer and comply with), non-U.S. persons that invest in the U.S. through such funds may conclude that they should invest their assets elsewhere and not risk the imposition of a 30 percent withholding tax as the result of an inadvertent violation. In this regard, MFA notes that some fund investors are already seeking undertakings of FATCA compliance from fund sponsors and, in such cases, those sponsors will be particularly acute in assessing their ability to ensure compliance on a cost effective basis. If they conclude they cannot and must, therefore, invest elsewhere, the U.S. capital markets will be unnecessarily harmed.

Second, private investment funds are unlikely to present substantial opportunities for tax evasion by U.S. taxpayers. In order to ensure compliance with the U.S. securities laws and other regulatory requirements, most private investment funds do not engage in public offerings or other broad distributions of interests in their funds. The nature of the limited offering and the tax structure of offshore private investment funds, make it unlikely that a U.S. person, other than a pension fund or other tax-exempt entity, would be an investor in such a fund, as taxable U.S. persons would not derive any advantage from investing in such a fund.[5] As a result, the overwhelming majority of investors in non-U.S. private investment funds are either non-U.S. persons or U.S. tax-exempt entities. Moreover, most non-U.S. private investment funds elect to be treated as "corporations" for U.S. tax purposes in order to accommodate their non-U.S. investors and other provisions of the Code, most notably those dealing with passive foreign investment companies ("PFICs"). We note that other provisions of FATCA require U.S. persons holding shares of a PFIC to file reports with the Service.

Third, many non-U.S. private investment funds are organized in low tax jurisdictions because the investors are subject to tax in their home countries and want to avoid the risk of double taxation. Many of these jurisdictions, however, are not tax secrecy jurisdictions. For example, the Cayman Islands has a

[5] One circumstance when a U.S. taxable person may invest in an offshore private investment fund is when the U.S.-based manager of a non-U.S. fund invests in the fund to better align its interests with the interests of the investors in the fund. In these circumstances, however, the U.S. manager is fully subject to U.S. reporting and taxes and is in no way seeking to evade U.S. tax laws.

robust anti-money laundering regime requiring procedures for client identification and other matters.[6] In addition, the Cayman Islands has recently entered into tax information exchange agreements with the United States and other governments, thus demonstrating a willingness to assist governments in curbing tax evasion.[7] Because many offshore private investment funds are domiciled in the Cayman Islands and other jurisdictions with similar characteristics, there is not a significant risk of tax evasion simply because the fund is domiciled outside of the United States.

Fourth, virtually all non-U.S. private investment funds impose documentary requirements and obtain representations in subscription agreements with respect to client identity. Included among the typical representations made by investors in these subscription agreements are representations as to whether they are U.S. persons and, if so, whether they are tax-exempt entities. In certain circumstances, entity investors are required to make specific representations about underlying beneficial owners of the entity investor In addition to the representations made in the subscription documents, many private investment funds require investor information in connection with "know your customer" provisions in anti-money laundering policies. These representations and documentary requirements further reduce the risk of tax evasion by investors in private investment funds.

B. Deemed Compliance under Section 1471(b).

Section 1471(d)(4) defines an FFI as any financial institution which is a foreign entity and section 1471(d)(5)(C) provides that, except as otherwise provided by the Treasury and the Service, the term "financial institution" includes any entity that is engaged primarily in the business of investing, reinvesting or trading in securities (as defined), partnership interests, commodities (as defined), or any interest, such as a futures or forward contract or option in any of the foregoing. The Notice states that this category generally includes, but is not limited to:

> "mutual funds (or their foreign equivalent), funds of funds (and other similar investments), exchange-traded funds, hedge funds, private equity and venture capital funds, other managed funds, commodity pools, and other investment vehicles."

As noted above, Congress wisely recognized that not all entities classified as FFIs need to undertake all of the activities mandated by section 1471(b). Section 1471(b)(2)(A) provided Treasury and the Service with authority to treat an FFI as meeting the requirements of section 1471(b) if:

> "(A) such institution –
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> (i) complies with such procedures as the Secretary may prescribe to ensure that such institution does not maintain U.S. accounts, and

[6] A description of the Cayman Islands anti-money laundering rules and guidance can be found on the Cayman Monetary Authority's website, available at: http://www.cimoney.com.ky/aml_cft/default.aspx?id=136.

[7] A list of these agreements is available at: http://www.oecd.org/document/55/0,3343,en_21571361_43854757_44261367_1_1_1_1,00.html.

> (ii) meets such other requirements as the Secretary may prescribe with respect to accounts of other foreign financial institutions maintained by such institution, or
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> (B) such institution is a member of a class of institutions with respect to which the Secretary has determined that the application of this section [1471] is not necessary to carry out the purposes of this section."

In explaining the grant of exemptive authority provided in section 1471(b)(2)(B) with respect to FFIs that do not present a significant risk of U.S. tax evasion, the staff of the Joint Committee on Taxation stated that:

> "it is anticipated that the Secretary may provide rules that would permit certain classes of widely held collective investment vehicles, and to the limited extent necessary to implement these rules, the entities providing administration, distribution, and payment services on behalf of those vehicles, to be deemed to meet the requirements of this provision."[8]

As discussed above, many offshore private investment funds do not have U.S. taxable persons as investors. As noted, many funds have specific eligibility requirements in their offering documents to which potential investors must attest compliance. Investors are also subject to various regulations, including anti-money laundering rules, which we believe are well designed to prevent U.S. taxable persons from becoming investors in these funds. As such, MFA recommends that Treasury and the Service exercise their authority under section 1471(b)(2)(A) by issuing guidance applicable to private investment funds, which are FFIs and which are operated in a manner consistent with the principles set out in section A. above, would be deemed to meet the requirements of section 1471(b). For this purpose, we believe that a fund should be permitted to rely on representations it receives from investors unless it knows or has reason to know that a representation is not correct.

Granting such an exemption pursuant to section 1471(b)(2)(A) is consistent with the intended purpose of the statute as it would apply only to those private investment funds that do not present a significant risk of tax evasion. Such an exemption would also enable a fund that opts not to admit U.S. persons as investors (other than tax-exempt institutions) to provide greater certainty to its investors that the fund is in compliance with FATCA. Private investment funds can therefore continue to actively participate in, and provide capital and liquidity to, the U.S. financial markets without risk that the investors may be subject to the special 30 percent U.S. withholding tax.

Alternatively, MFA believes that, consistent with the statement by the Joint Committee on Taxation, certain widely held collective investment funds, including private investment funds, should be deemed compliant pursuant to section 1471(b)(2)(B) even if they do have U.S. persons as investors, provided that such funds disclose to the Service any U.S. accounts (as defined in FATCA) when they have direct privity with the ultimate beneficial owner of the account (including through a known nominee or agent of the beneficial owner).[9] Such an approach would be justified on the grounds that (a)

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[8] See "Joint Committee on Taxation, Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3310, the 'Hiring Incentives to Restore Employment Act,' Under Consideration by the Senate (JCX-4-10), February 23, 2010" ("JCT Report"), at 41

[9] We note that this recommendation is similar to one made by the Alternative Investment Management Association ("AIMA") in its comment letter of June 29, 2010.

information as to the identity of indirect investors is often in the possession of transfer agents or other intermediaries (which are in a better position to report relevant information to the Service or Treasury); (b) the investor base is subject to frequent change; (c) indirect investors would use FFIs such as banks to transfer funds to and receive funds from the fund and these FFIs will be subject to FATCA reporting requirements with respect to those investors who are specified U.S. persons (as defined in the statute) ; (d) in many instances there are pre-existing prohibitions on actively marketing these funds to U.S. persons in order to avoid application of U.S. securities laws to the funds; and (e) many of these funds have in place "know your client" and anti-money laundering procedures.

C. Tailored reporting agreements.

To the extent that Treasury and the Service choose not to use their authority to grant exemptions to private investment funds pursuant to section 1471(b)(2)(A) or (B), MFA encourages Treasury and the Service to consider providing certain private investment funds with the opportunity to comply with FATCA through a tailored agreement that would be deemed to meet the requirements of section 1471(b). We believe that Treasury and the Service should also consider a tailored reporting agreement for private investment funds that cannot meet the conditions of any exemption that is granted. We believe that private investment funds should be eligible to use the tailored agreement if they meet certain requirements intended to ensure that they did not provide meaningful opportunities for tax evasion by U.S. persons. For example, the tailored agreement option could be limited to funds that are organized in jurisdictions that have entered into a tax information exchange agreement with the United States or that have robust anti-money laundering policies and procedures. The tailored agreement available to funds that meet such criteria would contain provisions intended to facilitate compliance by the fund without burdens and costs that are disproportionate to the ability of U.S. persons to use the fund as a vehicle for tax evasion. For example, such an agreement might enable the fund to rely on representations received from investors, including FFIs and entities, unless the fund knows or has reason to know that a representation is not correct.[10]

MFA believes that the use of such an approach will enable most private investment funds, including those that do not prohibit U.S. accounts, to comply with the FATCA requirements without undue administrative burdens, while still ensuring that Treasury and the Service receive the necessary tax enforcement information. Such an approach will also help ensure that private investment funds have sufficient certainty of being compliant that they can continue to participate in the U.S. capital markets, without risk of imposition of the special withholding tax as the result of an inadvertent violation or a violation as the result of their inability to comply with FATCA requirements because of local law constraints or otherwise. In considering the framework for a tailored reporting agreement, we encourage Treasury and the Service to consider two issues in particular, the appropriate treatment of entity investors in offshore private investment funds and the ability of such funds to use records that are obtained for anti-money laundering purposes for purposes of complying with FATCA.

1. Accounts of Entities. Section 1471 requires reports to be made with respect to United States Owned Foreign Entities, which include, pursuant to section 1471(d)(3) any foreign entity that has one or more "substantial United States owners." MFA believes that verifying ownership through multiple tiers of entities will prove to be wholly impractical without some reliance on representations and recommends that the Treasury and the Service give particular attention to the burdens that such a requirement will impose. For example, in those cases where the investor of record is itself an FFI that is subject to section

[10] MFA intends to make a supplemental, and more detailed, submission with respect to the scope of the proposed tailored agreement option.

1471 with respect to its U.S. account holders, imposing a due diligence requirement on the fund to identify the customers of the FFI will be both costly, conducive to errors and possibly result in the filing of duplicative reports with the Service.

2. Use of Existing Records. Most if not all private investment funds have "know your client," anti-money laundering and anti-terrorism financing mechanisms in place. MFA recommends that the Treasury and the Service permit funds and other FFIs to rely on the data produced by those records unless the fund knows or has reason to know that the data is not correct.

D. Other Issues

1. Passthru Payments. If it is determined that private investment funds will be required to withhold on passthru payments as defined under section 1471(d)(7), then we recommend that an accounting approach be provided which is administrable and equitable. The private investment fund should be permitted to use any reasonable method of attributing a payment to a withholdable payment as long as that method is used consistently by the private investment fund with the exception for payments that are directly traceable. We do not believe it is necessary for the accounting approach to be precise in order for the intended effect of withholding on passthru payments to be obtained. However, it should only affect actual distributions to recalcitrant account holders, and prevent withholding upon compliant account holders. One approach to consider is the use of a rolling weighted average percentage based upon actual receipts and dispositions computed by the investment fund. This percentage would be provided as necessary to, and applied by: the investment fund or its paying agent to cash distributions which were made directly by it to recalcitrant account holders; or, in the case of indirect owners, applied by the final nominee to cash payments made to recalcitrant account holders. Overwithholding may occur, and special provision should also be made for the recovery of any such overwithholding.

2. Refunds of Withheld Amounts. The JCT Report[11] states that credits and refunds with respect to specified financial institution payments, as defined in section 1474(b)(2)(B), generally are not allowed. It further states that refunds and credits are allowed if, with respect to the payment, the foreign financial institution is entitled to an exemption or a reduced rate of tax by reason of any treaty obligation of the United States, and that a reduced rate of tax is only allowed to the extent provided under such treaty. We understand that one of the reasons for this provision is to force compliance from the outset of the effective date, rather than apply for refunds after amounts have been withheld. We believe, in certain circumstances, there should be the ability of FFIs receiving specified financial institution payments to receive refunds or credits, even if domiciled in a country without a treaty with the United States. As outlined in the passthru payment example, there are different ways of calculating the amount of tax to withhold on a withholdable payment. We think refunds or credits should be allowed, to all FFIs regardless of domicile, in cases where there is an overwithholding due to a calculation error by the withholding agent. Additionally, we think refunds or credits should be allowed in cases where the FFI has properly and timely entered into an FFI agreement, but the withholding agent does not have the FFI agreement properly documented, such as due to administrative oversight. In these types of circumstances, we believe the FFI should be able to claim a refund or credit for all withholdable payments, including gross proceeds.

3. Treatment of Deferred Fees. Fees which are payable by an investment fund to any of its service providers, and which are outstanding on March 18, 2012, should be treated as grandfathered obligations under section 501(d)(2) of the HIRE Act. As such, these fees payable would not be subject to

[11] JCT Report at 48.

withholding under chapter 4. The payables which we believe should be included as grandfathered obligations have a definite payment term, and are not treated as equity.

4. Defining "Business of Investing." The term "business of investing" as used in section 1471(d)(5)(C) is not defined directly in the Internal Revenue Code or guidance issued thereunder. The term "business of investing" as defined under the Investment Company Act of 1940 is almost exactly the same as that used for purposes of section 1471(d)(5)(C). In addition, it is impliedly referred to in part I of subchapter M of the Internal Revenue Code for purposes of defining corporations which qualify as regulated investment companies. The more extensive body of law provided by the Investment Company Act of 1940 underlying the term "business of investing" seems to provide a better approach for purposes of this defining this term than the creation of an entirely new definition for chapter 4. Thus, we recommend that the term "business of investing" be defined by reference to the Investment Company Act of 1940.

5. Closing Accounts. Section 1471(b)(1)(F)(ii) states that in cases where an FFI is unable to obtain a waiver of secrecy from certain account holders, that the FFI must close the account within a reasonable period of time. We believe that a reasonable period of time to close account with regard to a fund would be at least as long as an account lock-up, as defined and provided by the fund's legal documents signed by such account holder. This timeframe would prevent investors from using this provision to their benefit to try and exit a fund interest, which could negatively affect other fund investors.

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**Conclusion**

MFA supports the broad anti-tax evasion objectives underlying FATCA and we encourage Treasury and the Service to establish an appropriate regime for private investment funds, which present little or no opportunity for U.S. taxpayers to evade their U.S. tax obligations. Specifically, we encourage Treasury and the Service to consider funds that are operated in a manner consistent with the principles set out in section A of this letter to be deemed compliant with section 1471(b) of FATCA. To the extent that Treasury and the Service choose not to grant such an exemption, we encourage them to develop a tailored reporting agreement for private investment funds that achieves the goals of FATCA while not imposing overly burdensome requirements that could unduly limit these funds from continuing to act as important participants in U.S. capital markets. MFA and its members would be happy to discuss with you or your staff any of the issues discussed in this letter as you move forward in the rulemaking process.

If you have any questions regarding any of these comments, or if we can provide further information with respect to these or other regulatory issues, please do not hesitate to contact Stuart J. Kaswell or me at (202) 367-1140.

Respectfully submitted,

/s/ Richard H. Baker

Richard H. Baker

President and CEO