EBF_022576

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Brussels, 26 August 2016

Subject: Comments regarding the implementation of Section 871(m) and related QDD program

Dear Mr Stack, dear Mr Sweeney,

I am writing to you as Chief Executive of the European Banking Federation (EBF) which is the voice of the European banking sector and uniting 32 national banking associations in Europe that together represent some 4,500 banks – large and small, wholesale and retail, local and international – employing about 2.5 million people.

The present letter expresses our views and concerns about several aspects of regulations issued by the U.S. Department of the Treasury and the U.S. Internal Revenue Service on 17 September 2015 under Section 871(m) of the U.S. Internal Revenue Code[1] as well as related provisions set out in IRS Notice 2016-42 pertaining to the Proposed Qualify Intermediary Agreement (these regulations and provisions are hereinafter collectively referred to as the "Regulations"). The present letter notably elaborates on certain open issues regarding the treatment of dividend equivalent payments under applicable income tax treaties and related legal issues that may arise from the perspective of non-U.S. withholding agents under their respective domestic legislation. This letter also offers some high-level comments with respect to the timeframe currently contemplated for the implementation of the Regulations and the flow of information required for the correct application of the related withholding tax by withholding agents along with suggested ways to accommodate the resulting challenges in a more effective way while still meeting the policy objectives of the Regulations. Additional technical comments related to IRS Notice 2016-42 will be submitted in a separate letter. These shall not detract from the representations made in the present letter.

As you know, the Regulations provide rules for withholding on "dividend equivalent payments" on certain equity-linked instruments, such as equity derivatives, equity-linked notes and convertible debt instruments, referencing U.S. securities and made to non-U.S. persons. It is

[1] https://www.irs.gov/irb/2015-41_IRB/ar07.html

understood that withholding will be imposed on payments derived from eligible instruments issued after 2016. We note that this publication also includes temporary (and proposed) regulations that provide new rules for determining whether certain complex derivatives are subject to withholding under Section 871(m) and for payments by certain dealers.

Implementing Section 871(m) from the perspective of non-U-S. financial institutions

As a preliminary remark, we would like to underline the fact that for non-U.S. financial institutions, the Regulations represent a comprehensive set of highly sophisticated and complex rules which raise many challenges.

One major aspect is the contemplated starting date of the foreseen provisions, as it would impose an accelerated timeline for numerous players, whereas many stakeholders are still struggling to properly comprehend and understand in depth all the implications of the Regulations. Experience with FATCA has demonstrated that financial institutions face an uphill struggle to be ready in time. By way of example, FATCA came into force on 1 July 2014. While the IRS had released detailed Regulations, they however continued to publish FAQs and other guidance on their website in a bid to ease implementation of the US Regulation by impacted FIs. In this context, we note that Competent Authority Agreements signed with Partner Jurisdictions provided for a two-year transition period for remediation and enforcement with a view to ease implementation.

Implementing the Regulations under Section 871(m) poses the same types of operational issues. Implementing extremely sophisticated foreign rules requires reasonable deadlines and any IT development will also necessitate many months of work as from the date when the final rules are known. We understand and acknowledge that a lot of (but not all) the Regulations are now in final version, however we would urge the U.S. authorities to consider certain helpful changes. We also note that the rules developed under Section 871(m) generally cannot be implemented on an isolated basis but need to be coordinated with market participants on an industry-wide basis but also, perhaps most crucially, with foreign jurisdictions in which relevant institutions operate, as further detailed below.

Open issues under income tax treaties and domestic legislation

Several legal issues still require clarifications from the perspective of non-U.S. financial institutions and international investors.

There is still a lot of legal uncertainty about the treatment of dividend equivalent payments under income tax treaties concluded by the United States. It is understood that the Regulations provide that a dividend equivalent shall be treated as a dividend from sources within the United States for purposes of any provision regarding dividends in any such treaties, thus presumably allowing for a withholding under Section 871(m) equal to the rate which would have been applied to a dividend under the applicable treaty. Whether the United States may validly assert the authority to treat dividend equivalent payments between non-U.S. parties as dividends for the purpose of the applicable U.S. income tax treaty has, to the best of our knowledge, not been discussed and certainly not been agreed by treaty partners[2].

[2] In accordance with the OECD Model Convention, double tax treaties usually define dividends as "*income from shares* […] *or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which*

Moreover, one may argue that the Regulations' broad definition of "payment" violates the non-discrimination provisions foreseen in applicable income tax treaties. These provisions generally prohibit the United States from imposing a more burdensome tax on residents of the other signatory state than it imposes on U.S. residents. Now, it is understood that the United States do not tax U.S. residents on implicit dividends with respect to price return only contracts. These uncertainties may almost inevitably translate into situations of double taxation for investors, as it is not clear how the Section 871(m) withholding suffered by an investor may be creditable against any tax due in his/her jurisdiction of residence absent an agreed treatment on the legitimacy of such withholding under the applicable U.S. income tax treaty.

Another concern relates to the proposed Qualified Derivatives Dealer ("QDD") status, with respect to which no final regulations have yet been enacted. This new status would impose new requirements on withholding agents of eligible products, such as endorsing a primary withholding agent status for the purposes of Section 871(m) provisions, undertaking liability to tax for each non-QDD intermediary, etc. Assuming primary withholding responsibility for the first time as a QI will be quite challenging in many jurisdictions where that status has been the exception rather than the norm. Furthermore, it is unclear if it would be at all possible for QDDs under their domestic legislation to deduct withholding tax and remit it to the IRS under Section 871(m) to the extent that the taxable income at hand may have no U.S. nexus at all. It is understood that, for instance, a total return swap between a UK bank and a French bank, neither of which has a presence in the United States, which references a U.S. equity will be in scope of these rules and therefore a proportion of the swap income will be subject to U.S. tax. In other words, the Regulations would require non-U.S. institutions to withhold and pay to the IRS a U.S. tax on payments which were not previously treated as U.S. sourced. Whether foreign jurisdictions would agree to such reallocation of tax revenues to the benefits of the U.S. Treasury remains to our view highly questionable. We note that comparable questions arose in the context of FATCA and could be only solved by the entry into intergovernmental agreements with a sizeable number of jurisdictions globally.

- ***We believe that any issues arising from Section 871(m) regulations under applicable income tax treaties and/or international law should be cleared with relevant jurisdictions before the implementation of the Regulations. Finally, sufficient lead-time is required by member institutions to discuss any related domestic legal impediments with their home authorities.***

More time is required for the QI application process in 2017

Additional entities will need to become Qualified Intermediaries so they may elect to become Qualifies Derivatives Dealers. Additional time will be necessary for such entities to assess the impact and suitability of the new QDD status before eventually going through the application process for the first time. The proposed Qualified Intermediary Agreement has been issued very recently and is currently subject to a comment period before being issued final. To put it simply, there will not be enough time for all existing entities to re-apply to be QIs let alone trying to get new entities through the application process by 31 March 2017 and we would like

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is subject to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is resident." The view developed by the United States for the purpose of Section 871(m) thus appears to be inconsistent with the provisions of applicable income tax treaties to the extent that dividend equivalent payments do not result from an equity investment and/or are not made by a company resident in the United States.

to think that the anticipated flow of new applications may also mobilize some resources within the IRS.

- ***Without prejudice to the other representations below, we would welcome an extension of the deadline for renewal of, or, as the case may be, application for, the QI status in 2017 to 30 June 2017. We further submit that any successful application for QI status lodged within the said deadline should be deemed effective as of 1 January 2017.***

Efficient data dissemination is a prerequisite to Section 871(m) withholding

The Regulations provide that each determining party be able by 1 January 2017:

- to identify as from the issuance of whether a product is eligible to the Section 871(m) requirements,
- to identify during the whole life-time of a product of the portion corresponding to a dividend from a directly or indirectly underlying share.

Typically, such information will only be known to a withholding agent if the issuer/determining party provides it. Efficient data dissemination, bringing together the knowledge of the product and that of the client tax eligibility, is therefore an essential prerequisite to the correct application of any withholding under Section 871(m) globally. In this context, issuers should play an instrumental role in the transmission of the relevant information to other financial institutions. Failing this, withholding agents could, to our view, be hardly held liable of any under-withholding or, as the case may be, incorrect withholding.

- ***We submit that the IRS should define a set of mandatory information to be made available by issuers and adapt the provisions relating to withholding tax liability so that a withholding agent shall not be held liable if the information required for the correct application of any applicable Section 871(m) withholding was not available.***

- *For any product with underlying U.S. securities that is either listed or held by a clearing agent, issuers should be required to inform financial data providers and, where applicable, international central securities depositories (ICSDs) whether the product at hand is in scope or out scope of Section 871(m). Where the product at hand is in scope, the following information should be made available:*

  - *whether the product at hand is a simple contract or a complex contract;*
  - *delta or substantial equivalence, whether any reference index is a qualified index;*
  - *the amount of any dividend equivalent payment;*
  - *the timing (record date, execution date, payment date) of any dividend equivalent payment subject to withholding.*

- *Finally, it would be useful if the IRS issued and kept up-to-date a list of indexes regarded as qualified (outside the scope of Section 871(m) provisions), and/or gave the opportunity for players to ask whether such or such indexes are qualified (by means of a FAQ or a dedicated portal).*

Since data providers will need to work on technical specifications as to how the information should be communicated, withholding agents will only be able to adapt their systems once these final specifications are released**.**

A postponement of the implementation date of Section 871(m) Regulation to 1 January 2018 is highly advisable

No final regulations have yet been enacted with respect to the proposed QDD status. In this context, it is important to stress that withholding agents will only be able to put in place or adapt internal procedures and systems upon release of the final set of regulations, which, we anticipate, would be only available by the end of 2016. This situation is at risk of creating significant bottlenecks within member institutions, some of their teams being already working under great pressure within an already overloaded agenda on many other concurring projects such as the implementation of the new international standard developed by the OECD, known as the Common Reporting Standard, whereas the implementation of FATCA rules is still an on-going process. All of these being massive and resource-absorbing pieces of legislation.

In view of this background and considering the numerous yet-unresolved issues stated above:

- ***We respectfully request a postponement of the implementation date of Section 871(m) Regulations to 1 January 2018 coupled with the granting of an appropriate transition period until 31 December 2018 for purposes of enforcement and administration of related obligations of QDDs.*** *During the said period, mutual dialogue should be favoured in order to solve any identified issue. This would provide member institutions across Europe some much-needed breathing room while implementation projects would continue to deploy expeditiously. Considering this background and the precedent of FATCA, non-US financial institutions can only be required to implement these new regulations on a best effort basis as a first step.*

- ***Finally, QDDs should be allowed during the transitional period suggested above to make use of the escrow procedure and therefore should not be required to deposit the tax withheld until it is certain that the payment is subject to withholding under Section 871(m)****.*

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We appreciate your consideration of our comments and concerns, and would be happy to further discuss the issues in this submission with you and your teams. Please do not hesitate to contact us at r.kaiser@ebf.eu.

Yours sincerely,

Wim MIJS
Chief Executive