



INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

Barbara Amsden
Director, Capital Markets
Tel: (416) 687-5476
E-mail: bamsden@iiac.ca

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CC:PA:LPD:PR (REG-140206-06)
Room 5203
Internal Revenue Service (IRS)
PO Box 7604, Ben Franklin Station
Washington, DC 20044 U.S.A.
www.regulations.gov (IRS REG-140206-06)

Dear Sir or Madam:

Re: IIAC Comments on Proposed Regulations (REG-140206-06): Notice of Proposed Rulemaking (NPR) and Notice of Public Hearing Withholding Procedures under Section 1441 for Certain Distributions to Which Section 302 Applies

The Investment Industry Association of Canada (IIAC) is taking this opportunity to present the concerns and recommendations of the Canadian investment dealer Qualified Intermediary (QI) community on proposed regulations identified above, released October 16, 2007, regarding the procedures to be followed for distributions to which section 302 of the Internal Revenue Code (IRC) applies.

We have several concerns with the proposed regulations, the following three being the most critical.

1. Proposed Certification Process

We strongly recommend that the certification process set out in the proposed regulations be eliminated.

From our members' discussions with several U.S. advisors, it would appear that the majority of distributions subject to section 302 qualify to be treated as payments in exchange for stock. In these cases, the certification process set out in the proposed regulations is unreasonably complex and costly to administer given that very few, if any, events will have beneficial owners for which dividend treatment will apply. The extremely complex and costly certification process outlined in REG-140206-06 would, we suspect, yield much less in the way of new revenue than it costs the financial community to administer.

2. Proposed Escrow Procedures

We request that withholding QIs be permitted to adopt the same escrow procedures as U.S. withholding agents.

Although we understand that the majority of QIs in other jurisdictions have not assumed primary non-resident alien (NRA) withholding responsibility, 75 per cent of U.S. source

payments made by the Canadian Depository for Securities (CDS) are made to QIs that have assumed such responsibility. Not allowing QIs to apply the escrow procedures set out in the proposed regulations has a significant impact on a withholding QI's ability to effectively and efficiently perform its obligations under its QI Agreement. It also places a significant and unnecessary burden on the U.S. withholding agent that would have to implement non-standard processing procedures to withhold on selected payments to a QI that would otherwise receive payments on a gross basis.

It is unclear why the escrow procedure has not been made available to withholding QIs. We have discussed this issue with members of the IRS QI Team and Treasury, and external consultants, none of whom could offer any explanation as to why the escrow process has not been made available to QIs.

3. Implementation of Proposed Regulations Before Enactment

We wish to express our concerns in regards to the decision of several U.S. withholding agents, including the largest American depository, to implement the procedures set out in the proposed regulations before they are enacted and prior to the proposed effective date, particularly given that there will be a public hearing to discuss these proposals.

Should comments submitted lead to changes to the regulations, QIs will have incurred unnecessary costs and created confusion associated with implementing manual processes and procedures that will need to be amended again. Systems changes to automate processes cannot reasonably be made until the proposed regulations are final.

Withholding QIs and their U.S. withholding agents will incur added costs related to the transfer of the withholding responsibility from the QI to the U.S. withholding agent for selected transactions.

As well, a number of U.S. withholding agents have indicated that charges will be applied to all elections to which section 302 applies as of January 1, 2008, adding another unnecessary cost to the QI that has been forced to relinquish its withholding responsibility.

In addition, we strongly support the Information Reporting Program Advisory Committee's (IRPAC's) observations, submitted on October 24, 2007, that more focus needs to be placed on emerging legislation that, if enacted, would significantly impact the information reporting community. QIs must be considered as part of this community. We also support IRPAC's observation that sufficient lead time must be provided for the implementation of processes to administer new or amended requirements. Based on the fact that the Canadian QI community was not notified directly of the proposed changes, coupled with the fact that many U.S. paying agents are immediately implementing proposed procedures at a cost to the QIs, we respectfully submit that the Canadian QI community has received neither of these considerations.

Please see the attached appendix for additional comments.

Because of our members' serious concerns regarding REG-140206-06, we also intend to appear at February 6 hearings on the regulations. We would be pleased to discuss any questions or concerns that you may have regarding our comments and hope to see our recommended changes reflected in the final regulations.

Yours truly,



Cc: IRS Reports Clearance Officer

**Investment Industry Association of Canada Comments on Proposed Regulations:
Notice of Proposed Rulemaking (NPR) and Notice of Public Hearing Withholding
Procedures under Section 1441 for Certain Distributions to which Section 302 Applies
(REG-140206-06)**

The proposed regulations provide for an escrow procedure (which will not be available to QIs, regardless of whether or not they have assumed primary withholding responsibility) for U.S. withholding agents to apply when determining whether a distribution in redemption of stock is treated as a dividend or a distribution in part or full payment in exchange for stock. Under this procedure, a U.S. financial institution may establish an escrow account and will withhold 30 per cent (or the applicable dividend rate provided under a treaty) of the payment, which it will hold in the escrow account while making the determination under section 302 as to whether the distribution should be treated as a dividend or a payment in exchange for stock. The beneficial owner must provide a written certification to the financial institution within 60 days as to whether the distribution is either a dividend or a payment in exchange for stock.

We are providing the following additional comments on the proposed regulations and related legislation.

1. Certification procedures

As it would appear that the majority of distributions subject to section 302 qualify as payments in exchange for stock and that very few, if any, events will have beneficial owners for which dividend treatment will apply, the certification process set out in the proposed regulations is unreasonably complex and costly to administer. Moreover, we suspect it will yield much less in the way of new revenue than it costs the financial community to administer.

Preliminary research indicates a significant discrepancy between NPR and withholding agent estimates of the number of events that may be subject to section 302. Each event could require that thousands of investors be contacted and required to provide responses within a very short period of time. The complexity of the certification (two pages and three or more pages of instructions) required to comply with the certification process set out in the proposed regulations is significant and excessive given that it is expected that the majority of these transactions will result in the distribution being treated as a payment in exchange for stock and hence not subject to withholding.

To alleviate this excessive amount of paperwork for investors, and U.S. and foreign intermediaries, we recommend that the following amendments to the proposed regulations or other existing legislation be considered.

- a) Treat accountholders with minimal ownership in publicly traded corporations as having had a proportionate decrease in their interest, and thereby entitled to capital gains treatment, by allowing for such distributions to which section 302 applies to be a payment in exchange for stock where a shareholder holds five per cent (or some other appropriate amount) or less of any class of outstanding stock in the company.
- b) For accountholders holding in excess of five per cent (or such other percentage determined to be appropriate), allow the custodian or other intermediary in possession of information regarding the accountholder's position (e.g., portfolio manager or investment advisor) the

option of calculating the accountholder's change in percentage holdings for purposes of determining whether the distribution qualifies as a payment in exchange for stock.

If the current proposals regarding the certification process are not amended as recommended above, we request the following additional revisions:

- a) Given the short time period during which certificates must be gathered, QIs should be permitted to rely on their regulator-approved methods of receiving such information from clients without a signature.
- b) The requirement for a QI that has assumed primary backup withholding and Form 1099 reporting responsibility to pass additional documentation related to U.S. non-exempt recipients to a U.S. paying agent should be removed.
- c) In the case of shares held by a flow-through entity (i.e., a partnership, grantor or simple trust, or similar arrangement) for U.S. tax purposes, where income is allocated and reported to the underlying beneficial owners, the underlying beneficial owner does not generally own a divided interest in any of the assets of the flow-through entity. The determination of the nature of the payments to which section 302 applies must be made at the flow-through entity level and not at the beneficial owner level. In such situations, the certification should be provided by persons authorized to sign on behalf of the flow-through entity (e.g., general partner, trustee, etc.) and not by the underlying beneficial owner.

2. Escrow procedures

Under the QI Agreement, a QI can choose to assume primary NRA withholding responsibility. In so doing, the QI has agreed to be responsible for the U.S. NRA withholding and reporting requirements under Chapter 3 of the Internal Revenue Code. Although gains from the sale of property are excluded from fixed or determinable annual or periodical income (FDAP), a QI would still have to determine whether the payments to which section 302 applies are FDAP or not, as required under the QI Agreement.

Following this, it is not clear why the availability of the escrow account has not been extended to withholding QIs and yet the proposed regulations allow QIs to make adjustments for related under- and over-withholding in accordance with the terms of the QI Agreement. It would be reasonable for the QI to be permitted to deduct and withhold the initial tax and remit it to the IRS, as required. U.S. financial institutions should be able to pay all amounts on a gross basis to a QI provided the QI has given them a W-8IMY indicating that it is a withholding QI for the applicable accounts. The processing of transactions would be much more streamlined where a withholding QI maintains responsibility for withholding and remitting NRA withholding tax and where the QI does not have to pass additional documentation up to the U.S. paying agent. This change would yield a substantial improvement in the burden on our members and their clients, as well as for the upstream withholding agent and the IRS itself. ***We request that QIs assuming primary withholding responsibility be allowed to follow the same rules as U.S. financial institutions.***

3. Reporting

Under the proposed regulations, where the payment is treated as a payment in exchange for stock, the entire amount will have to be reported to the QI on Form 1042-S as "capital gains". The QI then reports the amount on a Form 1042-S as "capital gains" or on a Form 1099. While the U.S. paying agent and/or QI will know the amount of the sales proceeds, neither will know the portion that constitutes gains. Therefore, ***if Form 1042-S reporting is going to be required, there should be a new income code that more correctly identifies the type of payment as proceeds instead of a capital gain.***