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Delivered via email

Re: Request for Delay in Application of Final Section 871(m) Regulations

The Investment Industry Association of Canada (IIAC)¹ is writing to follow up on previous submissions made in 2014 (February 20, March 12) in response to proposed regulations under Internal Revenue Code section 871(m) (the “Regulations”), to respectfully request that Treasury and the IRS consider further extension of the Regulations’ effective date. Specifically, we request that:

1) the final Regulations apply to treat payments made pursuant to a Notional Principal Contract (NPC) or Equity Linked Instrument (ELI) on or after **January 1, 2017** (and that references the payment of a dividend from an underlying security on that date) as a “dividend equivalent”; and

¹The Investment Industry Association of Canada (IIAC) is the national association representing the investment industry’s position on securities regulation, public policy and industry issues on behalf of our 160 IIROC-regulated investment dealer Member firms in the Canadian securities industry. These dealer firms are the key intermediaries in Canadian capital markets, accounting for the vast majority of financial advisory services, securities trading and underwriting in public and private markets for governments and corporations.

2) the final Regulations apply to any “delta one” NPC or ELI that is either an over-the-counter derivative or a single stock future, only if entered into or issued on or after **July 1, 2016**, and to any other NPCs or ELIs only if entered into or issued on or after **January 1, 2017**.

As stated in our previous submissions, the technical complexities of correctly identifying, reporting and withholding on transactions under the proposed Regulations will make implementation of the section 871(m) requirements extremely difficult from an operational perspective for financial institutions, even with the simplified definitions and tests contained in the proposed Regulations published last year. Currently, the infrastructure does not exist in the marketplace to support delta test determination and the corresponding taxation for derivative products of this nature for institutional clients, let alone for the vastly more numerous and disparate retail clients. We reiterate our previous comments about the scale of the systems development that will need to be undertaken by securities dealers and withholding agents to implement section 871(m) requirements under the proposed Regulations.

There are significant operational challenges to calculating “delta” (not once, but twice) and linking the capital markets areas of financial institutions to tax information reporting and withholding systems. These systems and linkages do not currently exist and would need to be built and tested, and both traders and back office personnel would require extensive training to understand the complex requirements. Where the number of transactions involved is not on a scale that makes system development a feasible option for an FI, calculation and transmission of information may require manual implementation, which comes with its own set of resourcing burdens. Section 871(m) implementation for foreign intermediaries is particularly burdensome as it is happening concurrently with interconnected implementation requirements for FATCA (including areas where it impacts current requirements under Chapters 3, 61 and Section 3406), cost basis reporting, and the expected OECD Common Reporting Standard (CRS).

While we greatly appreciated the communication from Treasury and the IRS in Notice 2014-14, clarifying the intention to limit “specified ELIs to ELIs issued on or after 90 days after the date of publication of the final regulations”, which temporarily alleviated industry concerns about the original application date of the proposed delta test, we believe that further extensions are necessary in light of the delay in publication of further revised or finalized Regulations. As FIs and withholding agents work towards all of these timelines concurrently, we believe that Treasury and the IRS should reconsider the proposed effective dates of the Regulations, on a later, more phased-in basis (as outlined above) that would allow FIs and withholding agents to focus first on the implementation of already finalized regulations for FATCA and cost basis reporting, and to understand the impact on the capital markets before layering additional requirements on top of existing regimes. We also note that the extended timelines proposed above are based on the assumption that final Regulations will be published shortly, and if there are significant delays or further consultation on the Regulations, commensurate extensions to the effective dates would be required.

If you have any questions with respect to the foregoing, we kindly ask that you contact the undersigned at ataylor@iiac.ca or 416-364-2754.

Yours sincerely,

“Andrea Taylor”

Andrea Taylor
Managing Director
Investment Industry Association of Canada