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***Delivered via email***

***Re: Proposed Regulations (REG-140206-06): Proposed Withholding Procedures Under Section 1441 for Certain Distributions to Which Section 302 Applies (the "Proposed Regulations")***

The Investment Industry Association of Canada (IIAC) [1] is writing to follow up on previous recommendations made with respect to the Proposed Regulations[2]. We genuinely appreciate the consideration the IRS has given to these concerns in the past, given the number of competing items on the regulatory agenda. However, we strongly believe that the IRS should prioritize re-evaluating these Proposed Regulations in 2017, particularly in light of the fact that they have been in proposed format for over eight years, and because the industry has been able to identify a number of serious challenges while using best efforts to comply with the unclear requirements contained within the Proposed Regulations. This letter contains specific examples of these challenges that our industry members have documented since our last meeting with the IRS on this matter in December 2015.

As we articulated in our letter to the IRS dated October 17, 2015, the lack of published, finalized rules created a great deal of regulatory uncertainty for Canadian Qualified Intermediaries (QI) with respect to the certification process required to release the escrowed amounts. The lack of final rules has also caused uncertainty and confusion among clients, who are required to execute complex calculations, sometimes without adequate or consistent information from issuers, and complete a certification that requires some understanding of complicated U.S. tax law concepts (such as what constitutes a "meaningful reduction" in ownership). The absence of final rules and applicability dates from the IRS, meant that many decisions about the implementation of the proposed escrow procedure, both in terms of timing and administration, were left primarily to U.S. withholding agents. Where gaps and uncertainty exist in the Proposed Regulations and in the interpretation of jurisprudence relevant to section 302 itself, U.S. withholding agents, brokers and clients have been forced to make assumptions, which results in well-intended, but often inconsistent, approaches to compliance. As explained in this letter, the greatest challenges to compliance have arisen because the Proposed Regulations do not place adequate responsibility on issuers to provide timely and consistent disclosure with respect to transactions subject to section 302 (and section 304, where applicable).

**A Simplified Approach**

We believe the IRS should re-consider the Proposed Regulations in light of what we understand to be the intent of section 302 (to provide a mechanism to prevent controlling shareholders from using these types of transactions to withdraw funds from a corporation without incurring dividend treatment), and re-propose these Regulations in a way which balances the need to prevent evasive behaviour, with the reality that the vast majority of shareholders currently required to comply with the incredibly complex section 302 certifications should not in fact be impacted by section 302 at all.

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[1] The 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 132 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] IIAC letters to IRS dated January 16, 2008, October 17, 2015; IIAC remarks at IRS public hearing held February 6, 2008.

As such, our primary recommendation is for a more practical approach to eliminate the certification requirement as set out in the Proposed Regulations for beneficial shareholders who:

(a) hold these shares in accounts that are tax exempt under the relevant tax treaty (i.e. in Canada, are held in Canadian RRSP accounts); or

(b) hold less than 1% of the shares of the issuer after the transaction (as calculated by the intermediary based on the knowledge of client's holdings at its own institution), and have confirmed with their financial institution that they do not hold shares of the issuer at another financial institution or constructively own shares of the issuer.

Such confirmation could be provided to the financial institution electronically, or verbally, as long as the financial institution keeps a record of the confirmation. Furthermore, if the distribution is with respect to a transaction potentially subject to section 304, a full certification should not be required where the beneficial owner similarly confirms to their financial institution that they do not hold shares of both the target and acquiring corporations (either at another financial institution or constructively).

Similarly, the IRS should eliminate the certification requirement where the issuer has fully redeemed all of the outstanding shares as there is no need for the beneficial owner to certify that their interest has been completely terminated. In this case, the need for confirmation of other holdings would also be unnecessary, as all share holdings, whether held at another financial institution or constructively, would have been redeemed.

Clients with *de minimis* holdings in the issuer of less than 1% after the transaction, and clients whose holdings of the issuer are held in registered tax-exempt retirement savings arrangements (such as Registered Retirement Savings Plans (RRSPs)) that are recognized in the Canada – U.S. Convention, should not be required to complete the certification. It makes sense, given the intent of section 302, and the IRS rulings relating to the "meaningful reduction" test, to automatically deem *de minimis* beneficial shareholders to have experienced a meaningful reduction.[3] It also makes sense to automatically exclude beneficial owners with shares in tax exempt savings accounts, because these shareholders would automatically qualify for 0% withholding on the payment regardless of how the certification is completed, or whether it is completed at all.

For clients who hold more than the *de mimimis* amount of shares outside of a treaty defined tax-exempt account, and confirm that they do not hold other shares of the issuer, either directly or constructively, the intermediaries could calculate the change in ownership (based on its own knowledge of the client's full holdings at their institution) to determine if the client has experienced a "meaningful reduction", rather than administer a complex certificate to the client. Only clients that

[3] IRS Letter Ruling 200552007, December 30, 2005: "In most instances, a shareholder in a publicly traded corporation is unlikely to control the corporation even through attribution. Likewise, any reduction in the interest of such a shareholder is likely to be meaningful."

do not meet the tests outlined above and do not certify as to their holdings (or certify that they do own additional shares of the issuer other than those held by the intermediary) will receive the full certification form, and will be required to complete their own calculations.

This simplified process will significantly reduce the number of clients who will receive and need to complete the certification, and hopefully reduce the number of cases where clients are erroneously withheld upon because they complete the certification after the 60-day escrow period has expired, or because they ultimately do not understand and do not complete the certification.

***Challenges for Compliance***

Regardless of whether the simplified approach described above is adopted, we believe it is important for the IRS to understand the administrative challenges we have identified, and must be addressed before the Proposed Regulations are finalized. These challenges were identified by reviewing more than 130 transactions logged by the IIAC as being subject to section 302 and 304 in 2016 (as of the date of this letter). According to data collected by our members, we believe that the number of transactions requiring section 302/304 processing is increasing substantially, year-over-year, which highlights the urgency of our request to simplify and improve the requirements.

*Lack of clarity around identification of section 302/304 transactions*

As per §1.1441-3(c)(5)(iii)(I)(1) of the Proposed Regulations, the U.S. withholding agent "shall provide the information and instructions described in paragraph (c)(5)(iii)(C) of [the Proposed Regulations] to the QI". Canadian QIs are currently receiving notifications from U.S. withholding agents announcing upcoming section 302 and 304 distributions, however, QIs do not have a clear understanding of how U.S. withholding agents are identifying potential section 302 and 304 distributions. Some transactions are announced months in advance, some with only a few days' notice, and some notifications seem to have been issued after the redemption date has passed.

Presumably U.S. withholding agents are identifying section 302 and 304 transactions by reviewing publicly available information provided by the issuer – a process that must consume a significant amount of resources; however, we note that some section 302 and 304 transactions have been announced by U.S. withholding agents where the issuer has not, to our knowledge, publicly disclosed the transactions as such (for example, the proxy circular may include language disclosing a merger as potentially subject to section 302, but the U.S. withholding agent may have announced the merger as subject to section 302 and/or section 304). There have also been situations where the issuer has published additional disclosure affecting the transaction's status as potentially subject to section 302 or 304 on its website or elsewhere after the distribution date (during the escrow period). This has caused a great deal of confusion among QIs and their clients in determining which certifications must be completed, and often reduces the amount of time the client actually has to complete the certification during the escrow period. Furthermore, as there are no requirements in the Proposed Regulations mandating consistent and timely disclosure from the issuer as to whether a transaction is potentially subject to section 302 or 304, the burden of identifying these transactions seems to

have inappropriately fallen onto the shoulders of U.S. withholding agents, who in addition to reviewing publicly filed documents, are often making additional inquiries of the issuer. The issuer should be required by law to provide publicly available notification of section 302 and 304 transactions, and the disclosure published relating to these transactions should be consistent and clearly explain (1) why these transactions may be subject to section 302 or 304; and (2) the certification process that must be completed by financial institutions and beneficial owners to determine the treatment of the distribution. There must be a consistency to the identification and notification process.

*Lack of consistent and timely information from issuers and U.S. withholding agents within the escrow period*

Similarly, the Proposed Regulations lack provisions placing responsibility on issuers and U.S. withholding agents to provide QIs with information about transactions and distributions on a consistent and timely basis once the distribution has occurred and the escrow period has started. Paragraph (c)(5)(iii)(C) of the Proposed Regulations require the U.S. withholding agent to provide the total number of the distributing corporation's shares outstanding before and after the distribution to the beneficial owner (or to the QI, who will forward this information to the beneficial owner). Without this information, it is impossible for beneficial owners to complete the required section 302 and 304 certifications and return them to the QIs within the 60-day escrow period. Furthermore, we note that in order to complete the necessary calculations for a merger that is subject to section 302, the beneficial owner must also receive information in order to determine their "potential interest" in the acquiring corporation, by assuming that all of the target corporation shareholders had exchanged all of their outstanding shares for shares of the acquiring corporation. In order to determine this, the U.S. withholding agent must also complete calculations requiring information about the FMV of the acquiring corporation's shares immediately before the transaction, and, where there are options for target shareholders, information about how many shareholders chose each option.

During 2016, there were numerous examples where this information was not made available on a timely basis by the issuer to the U.S. withholding agent (and ultimately the Canadian QIs and the beneficial owners). In some instances, information may have been made available close to the end of the 60-day escrow period, and in others, it was not made available at all, leaving either the U.S. withholding agent and/or the QI to use approximations gleaned from issuer news releases or third-party information services. In many of these cases, both the U.S. withholding agent and QIs made repeated requests of the issuers to provide the necessary information. Issuers often did not seem to understand the reasons for the information requests, and as a result did not provide enough detailed information for the required calculations. U.S. withholding agents do not have the authority under the Proposed Regulations to provide addition time to QIs and beneficial owners to complete the certifications. If the escrow period runs out, the amount held in escrow is remitted by the U.S. withholding agent to the IRS, the QI is therefore unable to rely upon its own set-off procedures under the QI agreement to reimburse the beneficial owner once the certification is received confirming that the distribution should not have been subject to withholding, and the beneficial owner is left with little choice except to initiate a refund claim with the IRS. This seems an unfair and inappropriate

result, penalizing the beneficial owner rather than the issuer who was delinquent in providing the necessary information.

Therefore, issuers must be required by law to provide the information necessary for the beneficial owner to determine whether there has been a meaningful reduction in ownership. This information is critical to the certification process. Ideally, the issuer should be required to upload this information to one consolidated publicly available repository, rather than on individual issuer websites, within a reasonable timeframe for the certification process to be completed. Additionally, any escrow period should not begin until this information has been made available by the U.S. withholding agent to the QI, and should be extended from 60 to 90 days, to ensure that beneficial owners have enough time to receive, complete and return the certification to the QI, and for the QI to provide the U.S. withholding agent with a withholding statement to release the amount from escrow.

Regarding the imposition of an escrow period generally, Canadian QIs are understandably concerned about the requirement to hold any portion of the distribution (that would normally be paid to a withholding QI at 100%) in escrow by a U.S. withholding agent, as they are generally the closest financial institution to the beneficial owner, and, as we have learned from experience with section 302 and 304, any delay in the information flow can create a significant withholding liability for the beneficial owner. This is particularly true for transactions subject to section 304, where 30% of the value of the total number of shares that are to be issued are held in escrow, which can be a significant amount. As we have stated in previous submissions, if the IRS can consider and address the information flow challenges identified above, it would alleviate the need for what many of our withholding QI members believe is an inefficient and unnecessary escrow procedure on the part of U.S. withholding agents. If QIs can receive or access information from the issuer on a timely basis, the distributions to QIs from the U.S. withholding agent could be made at 100%, and then QIs could be allowed to either impose a 60-day “escrow” procedure themselves or just administer the certification process and use the provisions already applicable under the QI agreement to apply the correct amount of withholding.

However, if the IRS determines that the escrow period is necessary and U.S. withholding agents must carry out the withholding, there must be additional requirements in place for U.S. withholding agents to provide the information received from the issuers in a consistent format, to all of their participants, and to make available a consolidated list of all section 302 and 304 transactions and the information necessary for the beneficial owner to complete the certification.

*Lack of standardization for certifications*

The Canadian industry has worked together to develop consistent section 302 and 304 certification forms, and has attempted to simplify instructions as much as possible for beneficial shareholders. However, this may not be the case in other jurisdictions. While we recommend a flexible approach that allows financial institutions to customize format and provide plain language instructions, it may be helpful for industry to work with the IRS to develop adequate and clear instructions that can be provided to beneficial owners in making the determination whether the distribution they received

meets the tests outlined in section 302(b). Financial institutions cannot provide tax or legal advice to their account holders, and as mentioned above, the timeframe within which the beneficial owner will have to complete the certification may be too short for them to obtain advice.

We would also appreciate confirmation in final regulations that the certifications can be electronically provided, as is now the standard for Forms W-8 received from beneficial owners. Receiving the certifications electronically has become a necessity given the extremely short deadlines provided to beneficial owners when information has not been provided by the issuer and U.S. withholding agent in a timely manner.

We hope that the IRS can consider these comments and work with our association to improve this process. We have seen the approaches taken with respect to the proposed regulations for section 305(c) to better the facilitate the information transfer process, and urge the IRS to go farther in making issuers accountable for providing information required to accurately and efficiently apply U.S. withholding tax to these distributions. We would appreciate meeting with you to discuss our recommendations above, and would be happy to do so in person or via teleconference. You may contact me directly via email at **ataylor@iiac.ca** or by phone at 416-687-5476.

Yours sincerely,

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