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Delivered via email

Re: Supplementary Comments of the Investment Industry Association of Canada (IIAC) on Notice 2016-42: Proposed Qualified Intermediary Agreement (the "Proposed QI Agreement")

As indicated in our preliminary written submission dated August 17, 2016, the IIAC[1] is writing to provide supplementary comments on the Proposed QI Agreement published on July 1, 2016. Our overall recommendation with respect to implementation has not changed since the submission of our preliminary letter: we believe it makes practical sense to grant (1) a general one-year delay in the implementation date of both section 871(m) (to January 1, 2018) and the Proposed QI Agreement (by extending the validity of the current QI Agreement to December 31, 2017); and (2) to provide a one or two-year transitional period during which a QI acting as QDD who is using best efforts to comply will not be deemed to have triggered an event of default, and will not be assessed penalties

[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 138 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.

or sanctioned for non-compliance. We will continue to follow up on this primary recommendation and the other recommendations made in our previous submission; however, this letter will focus primarily on our concerns about other substantive changes proposed for the QI compliance procedures, the Qualified Derivatives Dealer (QDD) regime, and other revisions made to the Proposed QI Agreement that will have an impact on the current operations and processes of QIs and may require further consideration.

Compliance Procedures

1) ***Clarification with respect to the independence of external reviewers for periodic review***. Section 10.04(A)(3) of the Proposed QI Agreement states that "*the external reviewer cannot be reviewing systems, policies, or procedures or the results thereof that it was involved in designing, implementing, or maintaining*." We understand the need for an external reviewer to be independent; however, there are concerns that the broad language used in this section could significantly limit the choice of external reviewers for many QIs, especially given the dearth of U.S. tax expertise outside of the United States. Concerns have also been raised that this may disproportionately impact small firms who do not have in-house expertise and must seek assistance in design and implementation from outside counsel. It will also impact larger bank-owned dealers who have historically aligned the choice of QI auditors and general bank auditor; how this section is to be interpreted, and if it is interpreted narrowly, will greatly impact the decisions of all QIs engaging outside counsel to assist with design and implementation. We agree that there should be a standard of independence for external reviewers, but this should be balanced with the need of a QI to be able to engage the necessary outside expertise. This is a situation that we will continue to monitor, and if necessary, may provide additional recommendations for guidance at a later date.

2) ***Clarification as to when projection of underwithholding is required and recommendation for a threshold approach with respect to projection***. Section 10.05 of the Proposed QI Agreement states that "*if the reviewer used a sampling method for its review, see Appendix II to this Agreement for an allowance in certain cases to use a projection method to determine the amount of underwithholding*" (emphasis added). However, in Section 3.D of Appendix II, it states that "*if the reviewer has determined that underwithholding has occurred with respect to the sample…then the reviewer will determine the total amount of underwithheld tax by utilizing a projection method…*". While the language in section 10.05 states that projection will be required only in certain cases, the language in Appendix II seems to indicate that projection is automatic and mandatory if any underwithholding is found within the sample. Historically, we understand that projection of underwithholding has not been automatically applied, and generally only required by the IRS after conducting follow-up fact-finding with the QI, and where the error rate was above a certain threshold percentage of the sampled accounts (i.e. above 3-4%). If the IRS does indeed intend to require automatic projection of underwithholding in a sample across the QI's account population, this could result in very large, and potentially unfair, tax assessments being imposed on a QI. As such, we would appreciate clarification that automatic projection of underwithholding is not required, and

recommend a return to the historic model of requiring projection only in certain cases where error rates are higher than a reasonable threshold (such 3-4%), in line with the language proposed in section 10.05.

3) ***Certification with respect to application of QI's policies, procedures and processes to branches of the QI.*** We note that new section 10.03(A)(6) of the Proposed QI Agreement requires the QI's RO to certify that the "*QI's policies, procedures, and processes <u>are applied consistently to all branches</u> covered by the QI Agreement (except as otherwise required by a jurisdiction's AML/KYC procedures, as applicable*" (emphasis added). It is unclear what is meant by the term "applied consistently", or how that could be implemented or assessed, as many foreign branches may use different systems, and have different types of clients, requiring the branch to establish policies, procedures and processes that are different from each other, and from the QI's head office. We recommend that this language be revised to allow the RO to certify that "branches covered by the Agreement have policies, procedures and processes that are consistently applied", rather than certifying that the branches have consistently applied the same policies, procedures and processes.

4) ***Clarification with respect to segregation of accounts into strata for periodic review.*** In Appendix II of the Proposed QI Agreement, section 2.C provides guidance for QIs on how to segregate accounts into strata for the purposes of the periodic review. In particular, we note the language in 2.C.(a), which states that "*if QI makes payment to a single account that result in the account meeting the qualifications for more than one stratum, the account should be treated as multiple accounts, with each newly redefined account consisting of the payments received for each stratum*". However, this seems to contradict the language used in subsections 2.C.(a)(2) through (5), which each refer to a "*stratum of accounts not included in a previously defined stratum*", which suggests that an account should only be included in one stratum. We would appreciate further clarification to resolve this apparent contradiction.

   Section 2.C of Appendix II also includes strata of accounts held by recalcitrant account holders and non-participating FFIs. In the case of QIs that are Registered-Deemed Compliant Model 1 IGA FFIs, where the local IGA may provide that accounts should be reported as "U.S. reportable accounts" rather than as "recalcitrant accounts" for FATCA purposes, further clarification should be provided regarding in which stratum such accounts should be included, if at all. These comments also apply to subsection 2.C.(b)(1) for QDD accounts and 2.C.(c)(1) for accounts receiving substitute interest payments.

5) ***Further clarification with respect to selection of accounts for periodic review***. Section 2.G of Appendix II seems to require additional clarification, particularly the references in the second paragraph with respect to sample size of 20 accounts or less, which seem to contradict previous sections which refer to a minimum sample size of 50 accounts. It would be helpful if clear examples could be provided.

6) ***Reduction in number of accounts subject to periodic review – spot checks***. We note that the "spot check" procedure, recognized by the IRS as a reliable indicator of compliance under the previous audit guidance in Revenue Procedure 2002-55, is no longer available. We believe that the rationale is still applicable, and as such, the number of sample accounts subject to pooling, withholding and reporting review should be reduced.

Qualified Derivatives Dealer (QDD) Regime

1) ***Requirement to obtain waivers/information from U.S. non-exempt recipients***. Section 8.03(C) of the Agreement requires a QI acting as a QDD to obtain waivers from U.S. non-exempt recipients to whom the QI/QDD makes a qualifying dividend equivalent offsetting payment, allowing the QI to disclose the name, address, and TIN to the IRS upon request. If the QI/QDD does not obtain the waiver from or does not collect and maintain the required information for the U.S. non-exempt recipient receiving the payment, the payment will not be a qualifying dividend equivalent offsetting payment (this exception is also reiterated in the definition of "Qualifying Dividend Equivalent Offsetting Payment in section 2.70). Ultimately, if these payments do not qualify, this will affect the calculation of the section 871(m) amount and will increase the QDD's Tax Liability.

   First, the requirement for QIs to obtain waivers from account holders, particularly from pre-existing account holders who have already been validly documented for QI purposes, will be extremely challenging from an operational and client service perspective. Additionally, it is not clear what purpose this waiver serves, or what form it must take, given that QIs are already required to collect the name, address and TIN from the U.S. non-exempt recipient on a valid Form W-9 under section 5.09 of the Proposed QI Agreement, for the purpose of filing information returns, including to the IRS (as clearly indicated in the General Instructions to the Form W-9). Since sections 8.03(C) and 2.70 of the Proposed QI Agreement make reference to the term "waiver" and not to the Form W-9, it seems as though what is required is a separate document waiving "*any prohibition on disclosure of such information to the IRS*". We would appreciate an explanation why such a waiver is necessary for the payments to be included as qualifying dividend equivalent offsetting payments, and ask the IRS to reconsider this approach, given the difficulties that QIs will have in obtaining these waivers. If this approach is necessary, we believe that any accounts already documented with a valid Form W-9 should be grandfathered, and thus the payments to those account holders would be qualifying dividend equivalent offsetting payments. Furthermore, if this approach is necessary, the IRS should clarify what form such a waiver should take, and consider incorporating it into the Form W-9. Limiting the number of requests made by a QI to obtain additional information from an account holder, and reducing the number of forms an account holder must complete will minimize the potential for non-compliance.

   Second, we note that this approach seems to reverse the principles of standard backup withholding rules, shifting the tax liability from the undocumented payee to the payor. We are also concerned that where a TIN is not provided by a U.S. non-exempt recipient receiving

a qualifying dividend equivalent offsetting payment that is a reportable payment, it would be subject to backup withholding (as required of the QI/QDD under section 3.05(D)), and it would also increase the QDD's tax liability, because it would be excluded from the QDD's qualifying dividend equivalent offsetting payments. We urge Treasury and the IRS to consider this analysis, and if there is agreement that there is the potential for double tax liability with respect to the same payment, to address this before finalizing the Agreement. We suggest that it is more appropriate for any tax liability or penalty to apply to the account holder who does not provide the QI with the requested information, as it is the account holder who requires the incentive to comply, not the QI. It makes little sense to require a QI/QDD to incur additional tax liability when they have no means of ensuring compliance on the part of the account holder, beyond making the request for information.

2) ***Deferral of periodic review and RO certification for QDD accounts***. As mentioned above, we would prefer to see a delay in the general implementation of section 871(m) and the QDD regime. Even if no relief is provided with respect to the implementation dates of section 871(m) and the Proposed QI Agreement, the provisions in the Agreement which require a QDD to use 2017 (the first year of implementation) as the year for its periodic review during the initial certification period is extremely unreasonable, especially since the Proposed QI Agreement will likely not be finalized until the final quarter of 2016. A deferral of the periodic review and RO certification for QDD accounts until the next full three-year certification period would be greatly appreciated.

3) ***Clarification regarding use of different calendar years for QI and QDD periodic review.*** Section 10.05 of the Proposed QI Agreement states that "*QI is required to arrange for the performance of one review for the certification period to evaluate QI's documentation, withholding, and reporting practices. If QI is acting as a QDD, this should also include a review of its determination as to whether transactions are section 871(m) transactions, its computations and determinations of dividend equivalent amounts and qualifying dividend equivalent offsetting payments, and its calculation of its QDD tax liability*". It is unclear whether the QI-related review and the QDD review can be conducted for different calendar years within the certification period. We would appreciate clarification from the IRS to confirm that different calendar years can be selected.

Other comments

1) ***Clarification with respect to pooled reporting for accounts to which the joint account option has been applied.*** We note that Section 4.05(B)(3) of the Proposed QI Agreement (which modifies the obligations for QIs with respect to accounts to which joint account treatment has been applied) has been amended, but still appears to allow amounts paid to the direct partners, beneficiaries, or owners of these partnerships and trusts to be included in the QI's chapter 3 reporting pools as described in section 8.03(B). However, section 8.02(E) of the Proposed QI Agreement states that "*QI must file a separate Form 1042-S for each account holder of QI that is a partnership or trust to which QI applies the joint account*

option that receives from QI an amount subject to chapter 3 withholding, and is allocable to such entity's chapter 3 reporting pools" (emphasis added). As these provisions seem to conflict, we would appreciate further clarification regarding these requirements.

Additionally, we note that Parts 1.2 and 1.3 of Appendix I to the Proposed QI Agreement require the QI to provide the names and addresses of partnerships or trusts to which QI has applied the agency or joint account options. We are unaware of the policy rationale behind this change, as section 8.02(D) of the Agreement already requires recipient specific reporting to each partnership or trust to which QI applies the agency option. It is not clear what additional value providing this information in the RO certification provides to the IRS and recommend that QI instead be required to provide such information upon request.

2) ***Clarification for QIs that are Registered Deemed-Compliant Model 1 IGA FFIs.*** We note that in some provisions of the Proposed QI Agreement, references are made to U.S. Treasury Regulations which do not apply to QIs that are Registered Deemed-Compliant Model 1 IGA FFIs, who are required to follow the provisions of the local IGA. For example, the new provision in section 8.02(I) requires a QI to "*file a separate Form 1042-S for each direct account holder that establishes its status as a passive NFFE but fails to provide the information regarding its owners as required under §1.1471-3(d)(12)(iii) unless such information was reported by the withholding agent*". We note that the regulation cited refers to "substantial U.S. owners". It is not clear if this provision is also intended to apply in the case of a passive NFFE that fails to identify controlling persons – if so, this provision should be amended accordingly.

We greatly appreciate the ongoing work and dialogue with the industry on these matters. 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,

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