September 22nd, 2017

By Electronic Submission via the Federal eRulemaking Portal (www.regulations.gov)

The Honorable Steven T. Mnuchin
Secretary
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: Executive Order 13777 (Enforcing the Regulatory Reform Agenda) and Section 871(m)

Dear Secretary Mnuchin:

The Investment Industry Association of Canada (“IIAC”) is writing in response to the Department of the Treasury’s (“Treasury”) Request for Information (82 FR 27217) of June 14, 2017, in part, to identify regulations that impose costs that exceed their benefit and should be modified or eliminated pursuant to Executive Order 13777. The IIAC represents 130 IIROC-regulated investment dealer member firms in the Canadian securities industry¹ and we appreciate the opportunity to encourage Treasury and the IRS to review and consider amendments to the Section 871(m) Final Rules² based on the policy goals of Executive Order 13777.

The IIAC supports the policy objectives behind the Section 871(m) regulations. The Final Rules, however, are complex and burdensome, despite the lack of clear evidence that certain aspects of the regulations meaningfully prevent tax avoidance as originally intended by Congress. The IIAC has previously expressed our concerns regarding aspects of the Final Rules in several submissions to Treasury and the IRS, including a May 24, 2017 submission³. IIAC members do appreciate the delayed implementation of certain aspects

¹ The IIAC is the national association representing the investment industry’s position on securities regulation, public policy and industry issues on behalf of our 130 IIROC-regulated investment dealer members in the Canadian securities industry. These dealer firms are the key intermediaries in the Canadian capital markets, accounting for the vast majority of financial advisory services, securities trading and underwriting in the public and private markets for government and corporations.

² Final Rules refers to the Internal Revenue Code Section 871(m) Treasury Regulations published September 18, 2015 and further revised in a final rule published in the Federal Register on January 24, 2017.

of the regulations provided by Treasury and the IRS’ pursuant to the August 4, 2017 Notice 2017-42, however, many troublesome aspects of the Final Rules were not addressed and remain outstanding. We outline our concerns below.

Section 871(m)
We are in agreement with the Securities Industry and Financial Markets Association (“SIFMA”); the German Banking Industry Committee; the German Derivatives Association; and the European Banking Federation recommendations\(^4\) that the cost of complying with the Final Rules exceed the potential benefits and the Final Rules should be withdrawn or substantially modified. We believe that the objectives of the Section 871(m) regulations can be achieved if the current status quo under the Final Rules (the 2017 phase in status) become permanent, with some additional rule modifications which we discuss further. The scope of the phase in rules currently in place, covering delta one transactions and the general anti-abuse rule will have the desired impact of preventing tax avoidance without the additional costs and complexities required under a full implementation of the Final Rules.

Qualified Securities Lending Regime
We believe that qualified securities lending (“QSL”) regime should be maintained indefinitely. Notice 2017-42 did not extend the QSL regime, which is scheduled to lapse December 31, 2017 and therefore this recommendation is a high priority. The QSL regime has been working effectively within the securities lending industry and the IRS has not provided policy rationale as to why it is not being continued. The qualified derivatives dealer (QDD) regime was not designed for securities lending and is far more onerous in terms of its requirements on participants. Additionally, we have outlined in previous submissions to both Treasury and IRS our concerns regarding cascading tax implications for QDDs and therefore requiring QSLs to become QDDs will unnecessarily expose those firms to these risks and complexities.

If Treasury does not accept this recommendation, we request the QSL regime be extended until at least December 31, 2019. If the QSL regime is not extended, current QSLs will need additional time to apply to become Qualified Intermediaries (QIs) and QDDs. For those QSLs that already have QI status and have renewed their QI Agreements effective January 1, 2017, there is no mechanism to apply now for QDD status using the QI portal\(^5\). These QIs will no longer be able to rely on QSL status as of January 1, 2018, and yet there is no path towards obtaining QDD status.

Assuming that the issue of obtaining QDD status is remedied, and that such status may be obtained effective January 1, 2017, participants in securities lending transactions will need additional time in order to fully understand the participants in securities lending transactions, redocument all counterparties and determine withholding and reporting responsibilities. The potential for cascading withholding deserves careful consideration and securities lending participants may need to reconfigure certain transactions.

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\(^5\) The Qualified Intermediary, Withholding Foreign Partnership and Withholding Foreign Trust Application and Account Management System
Physical Securities
The Final Rules expanded the scope of liability on QDDs by requiring them to be liable for tax on dividends received on physical securities which increases the potential for overwithholding. As we highlighted in our May 24, 2017 submission to the IRS, this requirement goes against the very purpose of the QDD regime - which was to reduce the potential for duplicative or cascading taxation where the QDD is not realizing the economic benefit of dividends received. The Final Rules instead favour hedging through derivative transactions as the QDD would be exempt from withholding on the equivalent payments. The Final Rules may result in a distortion of market practices if firms restructure in order to avoid punitive rules.

With respect to any concern regarding tax avoidance, QIs have already have self-reporting tax obligations to the IRS and if there is additional tax liability in a transaction where a client has hedged using a physical security, the QI must self-assess and remit. The current regime is sufficient to capture appropriate withholding of tax in these circumstances.

If Treasury and the IRS do not exempt dividends received on physical securities from the scope of the Final Rules, we believe it is necessary for the IRS to create a “credit forward system” to ensure that QIs receive offsetting credits for the tax withheld on the dividend equivalents against the amounts withheld on the actual dividends.

Combination Rules
The combination rules are extremely complex and industry participants have not received guidance from the IRS making it very difficult for firms to determine how to build systems to comply with the requirements. While the simplified combination rules under the phase in period greatly reduce the burden on short party withholding agents, there has been no relief for long party participants. The result has been an inequitable shifting of the combination rule burden to non-US custodians and other long party agents who have, effective January 1, 2017, been operating under the requirement to identify all potential transactions, including listed products, that could be combined to delta one despite a complete lack of specificity with respect to how these rules should be applied.

The complexity of this undertaking and the cost of building and implementing systems capable of handling the combination rules are astronomical. For example, the ordering rules require parties to combine transactions in the manner that results in the most transactions with a delta of 0.80 or higher (delta 1 for 2017 and 2018). The Managed Fund Association noted in their July 31, 2017 submission that “a literal application of this provision with respect to an investor that trades 50 option trades on a single name in a single day could lead to both parties having to test the more than 1 quadrillion unique combinations that could theoretically be formed.”

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**Listed Options and Futures**

We recommend that listed options and futures be explicitly excluded from the scope of the Section 871(m) regulations. Removing listed products would substantially ease the burden for industry participants as those securities are the transactions that involve the most cumbersome combination determinations. Further, these transactions do not present the types of tax abuse scenarios that Section 871(m) was designed to address. Based on anecdotal evidence from industry participants, the occurrence of combinations in the listed option space is not common and has produced minimal withholding thus far in 2017. Excluding listed products from Section 871(m) would enable the Treasury to achieve its objectives with respect to tax avoidance while also achieving the objectives of Executive Order 13777 of reducing the compliance burden.

If the Treasury and the IRS do not agree to exclude listed options and futures, additional guidance for combination rules must be provided to ensure equal treatment across the industry and to prevent operational builds that could be unnecessary or unintentionally fail to meet future guidance issued by the IRS. At minimum, the safe harbor rules applicable to short parties should be extended to long party participants. There should be consistent treatment for all parties.

**Partnerships**

Additionally, the Final Rules are unclear in how to calculate withholding amounts on dividend equivalents payments arising from partnerships. The Managed Funds Association in their July 31, 2017 submission also outlined their concerns on this matter. Industry participants would generally be unable to determine the exact amount to withhold until the Schedule K-1 is provided by the partnership and even then there are complexities in how to treat the information. Consequently, industry participants may be undertaking different methodologies when attempting to comply with the requirements resulting in inconsistent treatment.

Guidance for market participants is required; in particular, with respect to how participants can manage the timing mismatch between when information is provided from partnerships and when withholding is required. We recommend that the effect of the Final Rules on partnerships is postponed until guidance is provided given the difficulty level for market participants to properly comply at this time.

**International Implications**

The scope of the Final Rules and their application to non-U.S. firms, and particularly QIs, is unclear and this should be taken into consideration as Treasury and the IRS determine how best to move forward. The United Kingdom, France, Spain, Italy and Germany have raised jurisdictional concerns as to whether or not the U.S. has the authority to impose dividend withholding tax on dividend equivalent payments between foreign counterparties outside of the U.S. The Canada Revenue Agency has not publicly commented on this specific issue at this time. However, Canadian QIs could potentially be in the position where they need to decide if they are going to be compliant with local tax laws or their QI Agreement. If Canadian QIs withhold on payments of dividend equivalent amounts, but local authorities have determined that these amounts are not subject to withholding at source, clients would be penalized as they would be taxed according to U.S. laws and yet not able to receive any tax credits under the treaty. This will result in contradictory treatment of similar payments across jurisdictions and will create an
unlevel playing field within the securities industry depending on how various countries respond to the jurisdictional question.

Conclusion

We appreciate the opportunity to provide comments on the section 871(m) Final Rules and how we believe they can be improved to achieve both its objectives and the Executive Order 13777 goals. We strongly encourage Treasury and the IRS to review all industry submissions, including SIFMA’s, as there are some universal concerns regarding fundamental aspects of the Final Rules. We believe that the Final Rules are overly complicated, and the uncertainty in how to operationalize the Final Rules will result in increased costs to both financial institutions and for individual taxpayers.

We reiterate our recommendations that the status quo of the phase-in of the Final Rules should become permanent (delta one transactions), the QSL regime should be maintained indefinitely, and listed options and futures should be excluded from the scope of Section 871(m).

We greatly appreciate the ongoing work and dialogue with the industry on the Section 871(m) Regulations. If you have any questions with respect to the foregoing, we kindly ask that you contact the undersigned at awalrath@iiac.ca or 416-687-5472. Thank you.

Yours sincerely,

“Adrian Walrath”
Assistant Director

cc: The Honorable David J. Kautter, Assistant Secretary for Tax Policy, Department of the Treasury
The Honorable John A. Koskinen, Commissioner, Internal Revenue Service
The Honorable Neomi Rao, Administrator, Office of Information and Regulatory Affairs