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

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1111 Constitution Avenue, NW
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www.regulations.gov (IRS REG-140206-06)

Dear Sir or Madam:

Re: IIAC Comments on Proposed Tender Offer Changes

I am writing for the members of the Investment Industry Association of Canada (IIAC) regarding the estimated cost of implementing 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 (*Internal Revenue Bulletin 2007-46 (November 13, 2007)). We wish to draw your attention to the detrimental impacts that we believe will arise should the rule proceed as drafted. Henry M. Paulson, Jr. said that his goal as the Treasury Secretary "… is to promote the conditions for American prosperity and economic growth – and maintaining the competitiveness of [U.S.] capital markets is central to that goal." Capital markets and tax systems are connected. We believe that over-regulation in the tax system can have a negative impact on capital markets' competitiveness and efficiency similar to the over-regulation of capital markets that is currently of concern in the U.S. This is particularly likely in the case of the proposed regulations, which:

- Require extremely costly and onerous withholding and paper-based certification procedures that may not generate more in tax revenue than the associated administration costs (NPR and withholding agent estimates of the number of events subject to section 302 vary significantly and, in any event, payments appear likely to predominantly qualify as proceeds)
- Do not permit Qualified Intermediaries (QIs) that have assumed withholding responsibility to fully undertake that responsibility for distributions to which section 302 would apply – it is not clear why QIs were specifically excluded under the proposed regulations from assuming withholding responsibility for these distributions and it appears contrary to the principles of the QI Agreement
- Do not allow QIs to use the same escrow procedures as U.S. withholding agents
- Have been rushed to implementation by a number of large custodians, including the largest U.S. depository, prior to finalization, even though outstanding questions of interpretation

remain. This means greater likelihood of confusion and cost for investors and intermediaries, particularly if the proposed regulations are not enacted in their current form.

We do not understand how the data used in the costing for REG-140206-06 was obtained or the estimate of the burden was calculated. Also, this new measure is only one of many government-related burdens that domestic or foreign businesses must bear, especially as the number of shareholders that have distributions treated as dividends rather than proceeds appears, based on preliminary research, to be small. To better achieve IRS objectives at a more reasonable cost, we recommend that the IRS:

1. Eliminate the certification process or, at the very least, significantly simplify it

2. Permit withholding QIs to adopt the same escrow procedures as U.S. withholding agents

3. Rescind permission to use the proposed procedures until the effective date, which should accommodate necessary operational and systems changes to implement the proposed procedures.

If the proposed regulations are not withdrawn, we believe that extending the escrow procedures to QIs (with other simplifications recommended in the attached) is not only a more effective alternative, but is consistent with:

- the IRS *Declaration of Taxpayer Rights*, which requires that taxpayers pay only the right amount of tax – withholding on transactions that are withholding-exempt, even if followed by reimbursement, is contrary to this right
- efforts by the Department of the U.S. Treasury and Finance Canada to advance freer trade in securities between our two countries
- the recent signing of the fifth Protocol to the Canada-United States Income Tax Convention, which we believe implies a spirit of continuing co-operation between Canada and the U.S. as taxing jurisdictions that is reflected in the QI Agreements.

Attached as Appendices 1 and 2 are our more detailed comments. Our submission to the IRS, which includes other suggestions for simplifying the proposed regulations and related legislation, is also appended.

We would be pleased to answer any questions that you may have and hope to see our recommended changes reflected in the final regulations.

Yours sincerely,

Cc: David Nason, Assistant Secretary for Financial Institutions, Department of the Treasury
Robert Steel, Treasury Under Secretary for Domestic Finance, Department of the Treasury
Internal Revenue Service
Securities and Exchange Commission
Finance Canada/Canadian Embassy (Washington)
Canada Revenue Agency
Securities and Exchange Commission

IIAC COMMENTS ON PROPOSED REGULATIONS:
***NOTICE OF PROPOSED RULEMAKING AND NOTICE OF PUBLIC HEARING WITHHOLDING PROCEDURES UNDER SECTION 1441 FOR CERTAIN DISTRIBUTIONS TO WHICH SECTION 302 APPLIES* (REG-140206-06)**

U.S. withholding agents must apply the escrow procedures to comply with withholding and reporting obligations in the case of a distribution made by a publicly traded corporation to which section 302 applies. The presumption is that the payments are dividends subject to a 30-per-cent withholding tax (or the applicable dividend rate provided under a treaty) unless proper certifications are received from beneficial owners or QIs to confirm that the payment should be treated as proceeds. Below are our views on the questions of particular interest to the OIRA as per Internal Revenue Bulletin 2007-46:

1. **Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility**

   The benefits from the rule change are absent from the NPR. The NPR specifies that the NPR is not a "significant regulatory action". However, we suspect that the benefits are small, because we anticipate the majority of section 302 transactions will likely result in the distribution being treated as a payment in exchange for stock rather than as a dividend.

   Moreover, the measure may accelerate and unfairly increase receipt of money by the IRS, which is contrary to the IRS *Declaration of Taxpayer Rights*, section V., which states that taxpayers "… are responsible for paying only the correct amount of tax due under the law – no more, no less." In fact, shareholders will pay too much, for example, if they do not return certifications and therefore do not receive proceeds treatment to which they may be entitled – many shareholders, we suspect, may not complete the certifications because they will not understand them.

2. **The accuracy of the estimated burden associated with the proposed collection of information**

   We believe that the estimated burden provided in the proposed regulations significantly underestimates the costs to withholding agents, intermediaries and shareholders. We would be pleased to walk a representative of your office through the process to see first-hand the workload that we believe is involved for the withholding agent, the intermediary's back office, the investment advisors that have to deal with investors and the investors themselves. We are preparing a cost assessment (to follow). We also believe that there may be other negative (although unquantified) impacts for the U.S. (refer ***Appendix 2***).

3. **How the quality, utility and clarity of the information to be collected may be enhanced**

   Do not allow the elective application by U.S. withholding agents of the specific procedures prior to the effective date of the final regulations. One U.S. withholding agent has elected to implement the escrow procedures as of January 1, 2008 and others have also while there are still unresolved issues. Differences in the interpretation of the applicability of the proposed regulations and section 302 relative to certain types of transactions will almost certainly mean inconsistency of application, multiple refunds, errors and needless compliance problems. Rushed implementations increase costs and the risk of mistakes.

4. **How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology**

   Given the magnitude of the problems we have itemized, our preferred solution is an amendment of the proposed regulations to allow issuers, custodians and/or withholding agents, including QIs, to identify in a straightforward, up-front manner whether distributions are to be treated as proceeds or dividends.

   If this is not possible, we recommend the measures outlined in our attached response to the IRS on the NPR. Please note, in terms of automation and use of information technology, regulatory organizations accept e-mail, phone calls and fax to replace paper. These are increasingly the common forms for communication of instructions these days.

5. **Estimates of capital or start-up costs and costs of operation, maintenance and purchase of service to provide information**

   See 2. above

Appendix 2

UNQUANTIFIED DETRIMENTAL COSTS OF IMPLEMENTING REG-140206-06

- ***Negative impact on U.S. securities markets – intermediaries and issuers:*** The Interim Report of the Committee on Capital Markets Competitiveness and the McKinsey Report on New York Competitiveness pointed to the importance of a proactive approach to maintaining, and to some extent restoring, the United States' capital markets. While the main focus of the reports was securities regulation, we believe that in the United States, as in Canada, the taxation system is an increasingly important consideration for investors and investment advisors considering the purchase of securities of a particular country. It is arguable that there may be a reduction in orders passed to U.S. intermediaries as some investment advisors may choose to reduce the risk of subjecting themselves and their clients to the burden of additional paperwork. In the event a certificate is not completed and returned, the tax withheld will be at a higher rate than it should be, requiring the investor to request a refund. It is also possible to foresee some tax-related impediments to raising capital, redemptions and restructuring efforts as intermediaries take steps to avoid the related workload.

- ***Negative impact on U.S. tax revenues and the U.S. economy:*** Overlooking the costs of compliance on a case-by-case basis may be possible, but in aggregate there is a tipping point when the cost of tax regulations – which provide no direct economic benefit to the intermediaries themselves – will, in fact, lead to less tax revenue overall as investors (or their advisors) either opt for investment alternatives from other countries or take steps that will avoid the possible creation of dividends.

- ***Negative impact on retirees:*** Withholding tax up front, and only repaying it some days or months afterwards, if at all, will negatively affect cash flows for investors, in particular, for people in retirement who are living on a fixed income and rely on these payments for their day-to-day expenses.

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January 16, 2008

CC:PA:LPD:PR (REG-140206-06)
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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.***