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Re: Further Comments of the Investment Industry Association of Canada (IIAC) on Final and Temporary Regulations and Proposed Rulemaking on Dividend Equivalents from Sources Within the United States (REG-127895-14) (the "Regulations")

The Investment Industry Association of Canada (IIAC)[1] is writing to follow up on our previous submissions dated November 6, 2015 and December 17, 2015, in response to the Regulations published by Treasury and the IRS relating to Internal Revenue Code section 871(m). We appreciate the considerable efforts of Treasury and the IRS to implement these provisions, including engaging in dialogue with the financial services industry to understand the practical impediments to implementation of the Regulations.

As outlined in our previous submissions, the technical complexities of correctly identifying, reporting and withholding on transactions under the Regulations will make full implementation of the section 871(m) requirements extremely difficult from an operational perspective for brokers and custodians. In addition to the significant operational challenges to calculating, tracking and storing the information required to determine whether transactions are "in scope" for section 871(m), and linking systems to enable tax reporting and withholding for dividend equivalent payments made with respect to those transactions, we are concerned that the industry is lacking sufficient regulatory guidance necessary to implement the requirements of the Regulations in a consistent fashion by January 1, 2017 – a date which is now less than seven months away. Some of the regulatory gaps for which additional guidance is necessary have only

[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 135 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.

been identified by industry over time as they attempt to design systems and operational requirements to implement the Regulations.

For this reason, we believe that it is reasonable for Treasury and the IRS to issue a written notice allowing for a general extension of the applicability date of the Regulations to **January 1, 2018**, conditional upon the publishing of additional required guidance by no later than January 1, 2017. An additional twelve months would allow industry more time to understand and consistently apply the complex requirements of the Regulations. In particular, withholding agents and Qualified Intermediaries (QIs) require adequate time to understand the overall changing scope of their compliance requirements, of which the Regulations are only one inter-connected part.

Specifically, with respect to the Regulations, we highlight the following areas in which our members have identified implementation issues and/or are awaiting additional guidance:

1) ***Complex Contracts/Substantial Equivalence Test***: Given that Treasury and the IRS have not yet published final rules relating to the use of the substantial equivalence test for complex contracts, we reiterate our previous recommendation that Treasury and the IRS consider a further delay on the applicability dates for complex contracts (at a minimum, if no extension is provided for the Regulations generally, as requested above), so that the industry has adequate time to digest and understand the concepts, and to adjust internal procedures and systems. The industry is currently attempting to build these procedures and systems based on the draft guidance; however, as with other areas of the Regulations, there are a number of outstanding questions which are not addressed in the draft guidance. For example, we concur with the recommendations made by the Securities Industry and Financial Markets Association (SIFMA) in its March 31, 2016 submission relating to complex contracts and the substantial equivalence test, in particular those relating to the combination of contracts.

   We remain concerned that if the substantial equivalence test is developed and implemented too quickly, it could create a great deal of uncertainty in the market for complex products, with unknown impact on the capital markets generally. As such, we would prefer to see a phased in approach, with applicability to complex contracts occurring no sooner than **January 1, 2018**, provided that adequate guidance with respect to identifying complex contracts subject to section 871(m) is finalized by no later than January 1, 2017.

2) ***Listed Options:*** We ask that the IRS and Treasury confirm as soon as possible the use of an "end of day" calculation of delta which could then be applied to the next day's trades. We reiterate the point made in our previous submissions that there is currently no source of real-time or intraday delta information with respect to these transactions, and market data providers we have consulted with have indicated that they will not be able to provide this information in time to meet the January 1, 2017 implementation date, or potentially at all. Even if dealers and withholding agents have the access to the information necessary to calculate real-time delta themselves (which they do not), it would be practically impossible for them to carry out this complex task. Again, we concur with the recommendations made by our colleagues in the U.S. securities industry that the Regulations should be clarified to (a) require the clearinghouse for the

listed option to compute and provide the end-of-day delta for the option to the broker or custodian, (b) provide additional comfort to the broker or custodian that they may rely upon this delta calculation; and (c) reduce the requirements for such a clearinghouse to record the inputs for the delta calculation, as a long as information is available to demonstrate a compliant methodology. This is another area where the uncertainty about how to implement the Regulations, the lack of timely, definitive guidance about the calculation and provision of delta information, and the sheer size of the network of systems that would require updating to accommodate the transfer of additional information, supports our recommendation to delay the applicability until **January 1, 2018**.

3) ***Qualified Derivatives Dealer (QDD) Regime***: Given the significant delays in publishing of revisions to the QI Agreement, which we anticipate will provide additional guidance about the proposed QDD regime, we are very concerned that industry will not have sufficient time to review, provide comment and implement changes that may result from the revisions. In particular, it is not clear how these amendments could be finalized and implemented by January 1, 2017. Since the implementation of the QDD regime and the Regulations should take place at the same time, we believe this provides further reason to delay the general applicability of the Regulations (and the QDD regime) until **January 1, 2018**.

   Our members who are currently acting as withholding QIs remain concerned about the issues we raised in our December 17, 2015 submission relating to the limits of eligibility for QDD status and to the types of payments covered by the QDD regime, and hope to see closer alignment with the current QSL regime in future published guidance.

4) ***Combined Transactions***: Numerous issues and questions have been raised by industry with respect to the application of the rules requiring the combining of transactions. We will not duplicate the questions and recommendations already enumerated by the submissions made by other organizations, but we would like to add our support for these recommendations, and would appreciate further guidance from Treasury and the IRS, in particular, clarity around how these rules should be applied by withholding agents and QIs, who may not have actual knowledge necessary to apply the combination rules as currently drafted. If these rules are not clarified and significantly simplified, it may be extremely difficult for these withholding agents and QIs to apply these standards at all, and particularly by January 1, 2017.

5) ***Provision/Transfer of Information:*** We strongly concur with recommendations suggested by our colleagues at SIFMA that additional guidance should be issued with respect to structured notes, particularly that the issuer of a structured note be required to compute section 871(m) information (i.e. whether it meets the substantial equivalence test), and provide this information to the financial institution required to withhold on the payments. Similarly, issuers of convertible debt instruments should be required to calculate delta for embedded options.

   Also, we note that the Regulations do not address the transfer of securities between financial institutions acting as withholding agents that are “in scope” for section 871(m). For example, if there is a change in the primary withholding agent, the receiving financial institution will require certain information to meet withholding obligations on dividend equivalent payments made with

respect to the contract. This information could include: date and time of original issuance; delta at the time of issuance recorded by the transferring financial institution; substantial equivalence test results with respect to the contract; and information about combined transactions. However, we believe that receiving financial institutions should be able to rely on the delta/substantial equivalence information provided by the transferring financial institution without receiving information about the underlying calculations or methodology used by the transferring financial institution to determine whether the transaction is in scope for section 871(m). First, the transferring financial institution may in turn have received the information from the issuer or another party to the transaction, and thus would not have the underlying calculation information. Second, financial institutions are understandably wary of providing potentially sensitive and competitive information to other financial institutions. We believe that in order to facilitate continued withholding obligations, the basic information listed above should be sufficient. We also note that as necessary guidance addressing this matter would not likely be published until late in the second half of 2016, transferring and receiving financial institutions may require additional time to phase in this process, not unlike the phase-in period provided by the IRS with respect to cost basis transfer statements.

6) ***Implications for Domestic Tax Reporting Requirements***: Our members are currently considering the complications that compliance with section 871(m) withholding and reporting requirements will cause for Canadian tax reporting requirements, and whether there will be tax filing challenges faced by our clients and counterparties due to inconsistent characterization of payments subject to section 871(m) under the Canadian and U.S. tax rules. In particular, we are concerned about the serious potential for double taxation for non-U.S. persons. We may follow up with additional comments on this subject after consulting with the Canada Revenue Agency.

We greatly appreciate the ongoing work and dialogue with the industry on the Regulations. 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"

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