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Re: Comments of the Investment Industry Association of Canada (IIAC) with respect to Revenue Procedure 2017-15, TD 9808, and REG-134247-16

The Investment Industry Association of Canada (IIAC)[1] is writing to respond on behalf of Canadian Qualified Intermediaries (QIs) to the announced changes to portions of the Internal Revenue Code and other documents governing the withholding and reporting of tax on U.S. source income paid to foreign persons and the QI regime. Some of these changes have already been published in final form, and some are still proposed. Almost all the IIAC's large and medium sized members are QIs, most of which have assumed primary non-resident alien (NRA) withholding and primary Form 1099 reporting and backup withholding responsibility under their QI Agreements. Some of these QIs also belong to financial groups whose members may be applying for QI and/or QDD status through the QI, Withholding Foreign Partnership (WP), and Withholding Foreign Trust

[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 130 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.

(WT) Application and Account Management System (the "System"). In this letter, we reiterate our concerns[2] around the process by which IRS published new and proposed regulations and the amended QI Agreement, and lack of guidance and support for the System, as well as outlining our concerns with respect to specific issued raised in the content of the published material.

Background

(1) On December 30, 2016 (one day before its effective date of January 1, 2017), the final revised QI Agreement was published as part of Revenue Procedure 2017-15 (the "2017 QI Agreement").

(2) On December 30, 2016, the System was made available for QI and QDD applications and renewals.

(3) On January 6, 2017, final, temporary and proposed regulations regarding withholding of tax on certain U.S. source income paid to foreign persons, information reporting and backup withholding on payments made to certain U.S. persons and portfolio interest treatment under chapters 3 and 61 and sections 871, 3406 and 6402 of the Internal Revenue Code were published (for simplicity, this package will be referred to collectively as the "withholding regulations").

(4) On January 6, 2017, final, temporary and proposed regulations relating to information reporting by foreign financial institutions (FFIs) and withholding on certain payments to FFIs and other foreign entities under chapter 4 were published (the "chapter 4 regulations"). This letter generally will not focus on the chapter 4 regulations because of Canada's status as a Model 1 IGA jurisdiction.

(5) On January 19, 2017, final, temporary and proposed regulations under Internal Revenue Code section 871(m) were published (for simplicity, this package will be referred to as the "section 871(m) regulations").

Process and Consultation

As outlined previously in our letter dated August 17, 2016, we have noted a pattern of compressed timelines for consultation for many proposed U.S. tax reporting and withholding requirements, and in some cases, no opportunity for consultation with affected QIs and withholding agents. While we appreciate that the IRS did provide a period for comment with respect to some of the withholding regulations published on January 6, there were significant aspects of those requirements and the 2017 QI Agreement which were amended without

[2] Letters from the IIAC to the IRS dated August 17, 2016, August 31, 2016, December 12, 2016 and March 6, 2017.

consultation. For example, the introduction of a three-year validity period for treaty statements associated with documentary evidence was not published in Notice 2016-42 (the proposed QI agreement) for consultation by the IRS prior to final publication in Rev Proc 2017-15. Similarly, the removal of references to the QI Attachments in the 2017 QI Agreement were not part of the draft QI Agreement previously published for comment in Notice 2016-42. It is unclear why such significant changes were made without any industry consultation, and as such, although the 2017 QI Agreement has now been effective since January 1, 2017, we believe it is important to comment on these amendments, describe the potential impact on QIs in Canada, ask the IRS to provide additional clarification about why these amendments were adopted without consultation, and recommend that the IRS effectively reinstate the requirements from the previous version of the QI Agreement (see comments below).

We appreciate the recent notification from the IRS, allowing renewing QIs and new QIs applying for Qualified Derivative Dealer (QDD) status an additional two months (until May 31, 2017) to complete the online application process on the QI System. However, we note that since this extension was received on March 31 (the original due date for completion), many renewing and prospective QIs had already completed and submitted their applications, and would not be able to benefit from the extension of time nor from any additional guidance or FAQs published by the IRS between March 31 and May 31. It is now unclear how this application process will proceed, as some QIs/QDDs may have left certain fields blank (with the expectation that the IRS will follow up if more information is required), and others may use the additional time (or will receive additional guidance) which will allow them to complete those fields. It is not known how or when the IRS will follow up with applicants, or how long it may take for a QI/QDD renewal/application to be fully processed, and status granted. It would be very helpful if the IRS could publish an FAQ or some other kind of document clearly outlining the steps and the anticipated timeframe for the QI/QDD renewal/application process. This information should be made available to all QIs on the IRS website to ensure equal distribution of this important information.

Risk of Cascading Withholding Tax for QDDs and Taxpayers

In our letter dated December 12, 2016, we outlined our industry's concerns with respect to the proposed changes to the QI and QDD regimes described in IRS Notice 2016-76 (published December 2, 2016). We highlighted the Canadian industry's primary concern: the announcement that Treasury and the IRS intended to revise the section 871(m) regulations to provide that a QDD will be subject to withholding under chapters 3 and 4 on all actual dividends received. The 2017 QI Agreement confirmed that a QDD would remain liable for the tax on dividends (including deemed dividends) received on physical shares, but delayed the implementation of this provision until January 1, 2018. The commentary to the 2017 QI Agreement requested comments on approaches for alleviating any overwithholding that might occur when withholding on dividends begins in 2018, acknowledging that this is a possible result of making such a change.

Since it was announced in Notice 2016-76, we have viewed this change as a fundamental shift in principle which could potentially undermine what we understood to be one of the primary purposes behind the QDD regime – to reduce the potential for duplicative or cascading taxation where the QDD is not realizing the economic benefit of the dividends received. It may not have been the intent of the IRS to compel foreign dealers to hedge contracts using derivatives, or to restructure their businesses, but this is likely to be the result - a distortion of market behavior that could have unintended and unknown consequences for the global marketplace. We do not have an issue with QDDs calculating the correct amount of tax to be withheld with respect to QDD tax liability and actual dividends received that are not offset by dividend equivalent payments; we do have an issue with the double taxation that will be possible starting in January 2018, when withholding will be applied to both the actual dividends and the dividend equivalent payments. There are prospective Canadian QDDs who will be holding physical shares offshore to facilitate hedging, and we do not think that the restructuring of their businesses or business practices was the intended goal or an appropriate result of section 871(m).

To this end, we believe that it is necessary for the IRS at a minimum to provide for a "credit forward system", offsetting the withholding tax on the dividend equivalent payments against the amounts already withheld on actual dividends. However, even if the IRS intends to implement a credit forward system, concerns remain that this would place the initial up-front burden of the withholding tax squarely upon the shoulders of the QDD, a somewhat ironic result for regulations that were created to facilitate withholding on dividend equivalent payments. QDDs would still potentially be required to revise the terms of their contracts with counterparties, and even then, this could be further complicated if a QDD and a counterparty are subject to different rates of withholding. Therefore, we believe the most efficient approach is for QDDs to be allowed to act as the true intermediaries that they are, and to be allowed to self-assess, and remit any withholding tax liable with respect to actual dividends received for physical securities hedging transactions not subject to section 871(m) withholding.

Three-Year Validity Period for Treaty Statements and Documentary Evidence

The preamble to the 2017 QI Agreement announced that the chapter 3 regulations would also be amended "to provide that treaty statements associated with documentary evidence for establishing residence in a treaty country have a three-year validity period, consistent with the validity period for withholding certificates that contain a claim for treaty benefits". The 2017 QI Agreement did not change the existing rule for the validity period of documentary evidence, however, it was noted in the preamble (and in the proposed withholding regulations) that Treasury and the IRS would be considering applying the same three-year validity period to documentary evidence obtained by QIs to align with the validity period of the treaty statement.

As noted above, this new three-year validity period for treaty statements associated with documentary evidence was not published in Notice 2016-42 (the proposed QI Agreement) for consultation prior to final publication in Rev Proc 2017-15. This change, and the proposed change to apply the three-year validity period to documentary evidence, represent a significant and fundamental change to the documentation requirements of QIs. These changes seem to require QIs to develop new processes and procedures to re-document account holders in instances where (a) the documentary evidence in question has not expired, or may never expire (as in the case of a constating document of an entity); or (b) the residence of the account holder is unlikely to change over a three-year period, particularly in a country like Canada where individual account holders are more likely to move residence within Canada than outside of Canada. Furthermore, we question the necessity for this change when account holders are required to provide QIs with updated information within 30 days of a change in circumstances. It is inefficient and makes little sense for a QI to request documentation from an account holder when the documentary evidence on file has not changed or has not expired.

It is not clear from the published materials whether the IRS intended to apply the three-year validity for documentary evidence only to entities, as the language in the preamble to the 2017 QI Agreement refers to "alignment" with the expiration of treaty statements, which would seem only to apply to entities. However, the actual amendments to the chapter 3 withholding regulations (in §1.1441-1T(e)(4)(ii)(A)(2)) do not seem to limit the three-year validity to entities, as it refers to "documentary evidence described in §1.1441-6(c)(3) or (4)", which includes documentary evidence establishing residence for individuals. Although we recommend that the IRS reconsider and eliminate the concept of three-year validity for treaty statements and documentary evidence for *all account holders*, at a minimum, it should not be extended to individual account holders. Furthermore, it is not clear if the exception in §1.1441-1(e)(4)(ii)(B)(11), providing indefinite validity for documentary evidence that is "generally not renewed or amended", still applies, given the language in (B) that the exception in (11) does not "apply to documentary evidence…furnished prior to July 1, 2014." Additional guidance on this point, confirming the indefinite validity for non-expiring documentary evidence, would be appreciated.

Status of Negotiated QI Attachments

We have noted that throughout the 2017 QI Agreement, references to the "QI Attachment" have been removed from the following sections:

- Section 2.03 (definition of "Agreement")
- Section 2.20 (definition of "Documentary Evidence")
- Section 2.45 (definition of "know-your-customer")

- Section 4.05(B) (Joint Account Treatment – Modification of Obligations for QIs)
- Section 5.01(A) (General Documentation Requirements)
- Section 11.04 (Significant Change in Circumstances)
- Section 11.06 (Event of Default).

In each of these instances, the sections in question now only refer to "applicable/appropriate know-your-customer rules". We are concerned about the potential impact of removing these references, because in addition to setting out the applicable Canadian laws and regulations governing account documentation, and the list of acceptable documentary evidence, the Canadian QI Attachment also contains the following negotiated provision:

> *5.(iv)(b) For accounts opened prior to January 1, 2001, if QI was not required under its know-your-customer rules to maintain originals or copies of documentation, QI may rely on its account information if it has complied with all other aspects of its know-your-customer rules regarding establishment of an account holder's identity, it has a record that the documentation required under the know-your-customer rules was actually examined by an employee of QI, an employee of an affiliate of QI, a correspondent bank of QI, in accordance with the know-your-customer rules, and it has no information in its possession that would require QI to treat the documentation as invalid under the rules of section 5.10(B) of this Agreement.*

Our concern is that by removing the references to the QI Attachment from certain definitions in the 2017 QI Agreement, the IRS may have inadvertently removed the QI Attachment from forming part of the Agreement, and along with it, the negotiated grandfathering provision noted above. We believe that if this removal were intentional, the IRS would have provided adequate notice of its possible removal, with a suitable comment period for the Canadian industry to respond. At the very least, it would have been mentioned as a significant change to the Agreement, rather than as a "minor correction", deleted only because "printed and signed agreements are no longer used". *We would appreciate immediate confirmation in writing from the IRS that the QI Attachments in their current form still constitute part of the QI Agreement, followed by an amendment in the next version of the Agreement, reinstating the previous version of the definition of "Agreement", including the QI Attachments*. We would also expect the IRS to make any other necessary amendments ensuring that the QI Attachment is referred to in the appropriate sections of the Agreement, to avoid any future confusion.

We appreciate the opportunity to provide you with these comments. 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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