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Submitted via email

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Re: Final Regulations under section 1446(f)

Dear Sirs and Mesdames:

The Investment Industry Association of Canada (the "IIAC") is the national association representing the investment industry's position on securities regulations, public policy and industry issues on behalf of our 115 IIROC-regulated investment dealer members in the Canadian securities industry.[1]

The IIAC has made several submissions[2] with respect to section 1446(f) relating to transfers of interests in publicly traded partnerships ("PTPs") by foreign persons, and we appreciate the responsiveness of the Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS") to the financial industry's concerns with respect to how to implement these complex requirements. While the revisions made to the Final Regulations under 1446(f)[3] will improve clarity and has provided increased flexibility for Qualified Intermediaries ("QIs") with respect to withholding and reporting requirements, there remain a number of outstanding questions that impact financial institutions ("FIs") ability to operationalize these requirements.

I. Clarification regarding the scope of section 1446(f)

In particular, as the IIAC represents Canadian QIs and FIs, a pressing concern is the ambiguity with respect to the scope of section 1446(f), and its potential application to non-U.S. PTPs. We request that the Treasury and IRS provide written guidance that:

1. there is a presumption for brokers that an entity which offers flow-through features and limited liability to the members, and that is organized outside the U.S. is not a PTP, absent knowledge to the contrary, such as the broker receiving a qualified notice from the entity; and

2. there is a presumption that a non-U.S. PTP does not have U.S. effectively connected income ("ECI"), absent the entity publishing a qualified notice to the contrary.

Absent an entity publishing a qualified notice, IIAC Members note it will be very onerous for brokers to try and ascertain if an entity should be classified as a PTP for purposes of section 1446(f). IIAC Members expect that most Canadian limited partnerships publicly traded on the Toronto Stock Exchange (for example) that do not engage in U.S. trade or business should not be classified as PTPs under U.S. tax classification rules. It is logical to assume that many Canadian entities operate locally, or only engage with other non-U.S. countries as a result of their business models. However, without the requested presumption, it would be overly burdensome for brokers to demonstrate that the publicly traded non-U.S. entity is not a PTP.

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[1] For more information visit, **http://www.iiac.ca**

[2] IIAC Submissions: **https://iiac.ca/wp-content/uploads/IIAC-Priority-Recommendations-on-Proposed-Regulations-under-section-1446f.pdf**; and **https://iiac.ca/wp-content/uploads/Submission-to-IRS_Withholding-of-Tax-and-Information-Reporting-with-Respect-to-Interests-in-Partnerships-Engaged-in-the-Conduct-of-a-US-Trade-or-Business_July-12-2019.pdf**

[3] Withholding of Tax and Information Reporting With Respect to Interests in Partnerships Engaged in a U.S. Trade or Business, 85 FED. REG. 76910 (Nov. 30, 2020).

Canadian QIs are concerned that if there is a presumption that non-U.S. PTPs are in scope of section 1446(f), then without a qualified notice, they will have to withhold on transfers by non-U.S. persons with respect to their interest in the entity as it is not clear what other type of evidence could be used to demonstrate their compliance with the requirements under section 1446(f). This is a potentially harsh result on a transfer of interests in Canadian (and other foreign) publicly traded limited partnerships that have no ties to the U.S. and therefore no reason to issue qualified notices.

Further, we do not believe it is fair to impose this type of withholding requirement with respect to non-U.S. PTPs without knowledge that there is U.S. ECI. To have a U.S. trade or business is a matter of fact, not something that can be presumed or assumed. For example, section 864(c)(1)(B): in the case of a nonresident alien individual or a foreign corporation not engaged in trade or business within the United States during the taxable year, no income, gain, or loss shall be treated as effectively connected with the conduct of a trade or business within the United States. The IIAC is not aware of any other disposition under the U.S. tax code, or case law that makes such a presumption. In addition, IIAC Members concur with SIFMA[4] in their 2021 submission, and we expect only a small subset of Canadian (non-U.S.) PTPs to have U.S. ECI. Consequently, we believe our requested presumptions are needed to avoid inappropriate overwithholding on the sale of these partnerships interests.

The IIAC would like to outline how the relationship between sections 864(c)(8) and 1446(f), supports our request for a presumption that a non-U.S. PTP does not have U.S. ECI, absent the entity publishing a qualified notice to the contrary. Section 864(c)(8) provides the rule that a gain or loss resulting from the sale of an interest in a partnership engaged in a U.S. trade or business is treated as ECI. This rule applies to both U.S. and non-U.S. partnerships that have foreign partners. Logically, a non-U.S. partnership that has foreign partners and is not engaged in a U.S. trade or business is excluded from this rule. Second, section 1446(f) prescribes a withholding tax of 10% applicable on the amount realized which is equal to the gross proceeds from the disposition of an interest in a partnership treated under section 864(c)(8) as effectively connected with the conduct of a trade or business within the U.S. The rule under section 1446(f) refers to the rule under section 864(c)(8), which includes in scope only partnerships with foreign partners that are engaged with the conduct of a trade or business within the U.S.. As a result, a non-U.S. partnership not engaged with the conduct of a trade or business within the U.S., should *ipso facto* be excluded from the rule under section 1446(f), and, therefore, no withholding should apply.

The IIAC also echoes SIFMA's concerns that the converse presumption that a non-U.S. PTP has U.S. effectively connected income, despite any published qualified notice to indicate this, represents a significant international reach. The U.S. does not have the right to impose taxation on non-U.S. persons that do not have a connection with the U.S. Further, it would require substantial adjustments to securities processing and trading systems worldwide in order to classify non-U.S. securities, most of which will not be PTPs nor have U.S. ECI.

[4] See SIFMA's February 24, 2021 submission: **https://www.sifma.org/resources/submissions/final-regulations-of-section-1446f-relating-to-transfers-of-interests-in-publicly-traded-partnerships/**

II. Request to delay the Effective Date

While we greatly appreciate the additional implementation time provided in Final Regulations under section 1446(f) in comparison to the originally proposed 60 days, FIs still need additional time to work through outstanding implementation questions, and develop new system builds. The IIAC believes an effective date of January 1, 2023 would provide the financial industry sufficient time to undertake and complete the significant system builds required to comply with the requirements.

As noted in our 2019 and 2020 submissions, non-U.S. withholding agents have identified the following operational challenges:

- implementing a system and process to review Qualified Notices, or source reliable data for Qualified Notices;

- implementing a system and process to track and withhold on gross proceeds for non-U.S. account holders, which was previously only tracked and withheld on for certain U.S. account holders.

Further, there are additional significant changes for QIs. Final regulations state that a QI that assumes withholding responsibilities on any portion of a distribution from a PTP will be required to assume withholding responsibilities for the entire distribution for purposes of chapter 3 (including sections 1446(a), 1446(f), and chapter 4), or not assume withholding responsibilities for any of these purposes. While the final regulations intend to be flexible, due to the number of account holders and transactions QIs process on a daily basis, it is not operationally feasible for many QIs to assume withholding on a payment-by-payment basis, or pass withholding rate pools to an upstream withholding agent, so these QIs must opt to be full withholding QIs under chapter 3. Certain U.S. clearing organizations have also stated that they will require their withholding QI participants to assume withholding responsibility under all of chapter 3 (including 1446(a) and 1446(f)). Consequently, many QIs are forced to undertake chapter 3 withholding responsibilities for all distributions, or be a non-withholding QI for all distributions with these U.S. clearing organizations. As a result, despite any flexibility allowed in the regulations, many QIs will be forced to perform both 1446(f) and 1446(a) withholding. Prior to 1446(f) rules, 1446(a) was only allowed to be performed by U.S. withholding agents, and not QIs. Therefore, in addition to the section 1446(f) related builds, QIs are now required to review 1446(a) requirements, and implement new systems and processes to withhold and report under section 1446(a), which relies on different withholding rates and logic from FDAP income. Section 1446(a) poses a significant challenge to operationalize by January 1, 2022 in addition to new requirements under section 1446(f).

There also remain outstanding questions that impact QIs/FIs ability to comply with the requirements. For example, the revised Qualified Intermediary Agreement has not yet been released. The Forms W-8 and instructions will also have to be amended. It is not clear when we can expect to see this Agreement and Forms. Firms cannot finalize their processes or update documentation and downstream withholding and reporting systems without having these documents in final form.

If our request to delay the effective date to January 1, 2023 is rejected, the IIAC requests that withholding be delayed until July 1, 2022.

III. Clarification that section 1446(f) does not apply to securities lending transactions and collateral arrangements

The IIAC would like to voice our support for SIFMA's statement "that securities lending transactions, as well as the posting, return and rehypothecation of collateral under securities lending or other transactions, are not subject to withholding under section 1446(f)". While we would have appreciated a clear exception stating this, confirmation that section 1446(f) does not apply to securities lending transactions and collateral arrangements will ensure that these markets are not unnecessarily disrupted as a result of the current uncertainty.

We would like highlight the following points from the 2018 and 2021 SIFMA letters that we believe support this position:

> "…Neither securities loans of PTPs nor the posting, return or rehypothecation of PTPs as collateral should result in a disposition with gross proceeds that is subject to withholding under section 1446(f), provided the transaction substantially conforms to section 1058. Section 1058(a) describes nonrecognition with respect to a transfer of securities under an applicable agreement in "exchange…for an obligation under such agreement, or on the exchange of rights under such agreement by that taxpayer for securities identical to the securities transferred by that taxpayer." Such an exception would preserve the withholding obligation when the PTP interest is eventually sold."
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> Further, "…the definition of "amount realized" in Treas. Reg. section 1.1446(f)-4(c)(2), which cross-references the definition of "gross proceeds" in Treas. Reg. section 1.6045-1(d)(5), should apply only to cash proceeds (see Treas. Reg. section 1.6045-1(a)(9)), and therefore a securities loan (or similar transaction) and securities posted as collateral should not generate an "amount realized" as defined for section 1446(f) purposes. The securities lender receives only a promise to receive back identical securities at a later date, which should not be considered "gross proceeds" that would be subject to withholding tax. Any cash received by the securities lender is mere collateral, which also should not be treated as "gross proceeds." In addition, any collateral returned by the security lender upon the security borrower returning the borrowed security is clearly not, and should not be treated as, "gross proceeds."

Lastly, exclusion from section 1446(f) withholding is consistent with application of the QDD regime under section 871(m) for securities lending and other collateral arrangements.

IV. Modification of delivery versus payment rule

The IIAC requests that the IRS and Treasury modify the section 1446(f) regulations (e.g., Treas. Reg. sec. 1.1446(f)-4(a)(2)(ii))) to provide that a broker that executes a sale of an interest in a PTP delivery versus payment is not required to withhold under section 1446(f) and is not required to obtain documentation for the receiving custodian if the executing broker knows the seller is a U.S. person.

The forgoing should be applicable when the seller has instructed, and provided their Form W-9 directly to the executing broker, as well as when the executing broker has obtained a Form W-9 for the seller or a certification that the seller is a U.S. person from a second broker that acts as an agent for the seller, such as an investment manager, pursuant to Treas. Reg. sec. 1.1446(f)-4(b)(2). It would be an unnecessary burden for executing brokers to collect documentation for receiving custodians when such brokers know the seller is a U.S. person and thus, no section 864(c)(8) tax is due. A broker in Canada is less likely to have such knowledge in comparison to the seller's executing broker and it may be more difficult to obtain the documentation from the seller in this specific scenario.

V. Clarification on QI procedures for disclosing and nominee reporting under section 6031 for Disclosing QIs

While IIAC Members appreciate the flexibility provided in the final regulations regarding QIs assuming withholding responsibilities, there are some concerns that the reporting may still be burdensome for QIs, who are nominees. We understand that the QI Agreement will be modified to include instructions related to the process. The IIAC supports SIFMA's requests for specific notes clarifying the process in the QI Agreement to reduce the burden on QIs for nominee reporting.

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We appreciate the ongoing consultation with financial industry participants as our members have a vested interest in fully understanding and being able to comply with these final regulations. If you need any clarification or have questions regarding this letter, we kindly ask that you contact the undersigned at **awalrath@iiac.ca**. Thank you.

Sincerely,

"Adrian Walrath"

Adrian Walrath
Director
Investment Industry Association of Canada