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Submitted via the Federal eRulemaking Portal
Internal Revenue Service
Attn: CC:PA:LPD:PR (REG-105476-18)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Proposed Regulations—Section 1446(f) "Withholding of Tax and Information Reporting with Respect to Interests in Partnerships Engaged in the Conduct of a U.S. Trade or Business"

Dear Sirs and Mesdames:

The Investment Industry Association of Canada (IIAC) is writing to the Department of Treasury (the Treasury) and the Internal Revenue Service (the IRS) to raise concerns regarding the proposed regulations to section 1446(f) "Withholding of Tax and Information Reporting with Respect to Interests in Partnerships Engaged in the Conduct of a U.S. Trade or Business" ("the proposed regulations"). We are requesting guidance and/or relief regarding the seven issues that are outlined below.

The IIAC is the national association representing the investment industry's position on securities regulation, public policy and industry issues on behalf of our IIROC-regulated investment dealer members in the Canadian securities industry. A working group comprised of IIAC Members active on U.S. tax matters assisted in our review of the proposed regulations and the drafting of this response. We appreciate the opportunity to provide comments and can provide any additional information necessary to help support the content of this submission.

General Comments

1. Additional time is required to modify systems, software and other administrative and technical issues.

As currently drafted, the proposed regulations would be effective beginning 60 days after the finalization date. However, withholding agents will need significantly more time in order to implement the new requirements.

In the past, the IRS has been made aware of the challenges of implementing changes to withholding and reporting systems and the need for at least 18 months for firms to update their systems. Many firms are required to submit budget proposals for development projects during the prior fiscal year for approval. Once the project is approved, stakeholders are consulted to confirm requirements. This includes engaging Enterprise Taxation teams and external consultants for regulatory requirements; liaising with IT/development teams to update documentation, withholding and reporting systems; engaging Operations and multiple business lines for procedure changes; training front-end employees; and educating account holders on products, documentation and tax implications.

In particular, we have concerns that the proposed timeline does not take into account the additional work required by Qualified Intermediaries (QIs). QIs must review and implement the anticipated required revisions to the QI Agreement, as well as changes to W-8 series and 1042-S/1042 forms, for impacts on systems, policies and procedures which often require the time and attentions of the same personnel focusing on section 1446 specific changes. The proposed regulations under section 1446(f) will also require QIs to update withholding and reporting systems (whether primary withholding responsibility is assumed or not) to account for gross proceeds on the disposition of publicly-traded partnership units paid to non-U.S. account holders. ,QIs have not historically been required to withhold and report U.S. sourced gross proceeds for non-U.S. account holders so this is a significant departure from current operations and will require careful consideration when QIs change systems. New processes will need to be designed as QIs are also not currently required to review Qualified Notices with regards to gross proceeds. QIs will also need time to assess whether they wish to assume primary withholding responsibilities under section 1446 which can only be properly determined once legislation is finalized and anticipated changes to the QI Agreement and affected forms (such as W-8 series forms and Forms 1042-1042-S) are announced.

Due to the complexity of implementation and the reasons set out above, 60 days is not sufficient to make the necessary system and process changes required to comply with these new requirements. We request that the IRS take into consideration the burden involved for QIs to apply section 1446 withholding and reporting and provide sufficient time to digest and implement required changes, and that the effective date be deferred until at least 18 months after the finalization of not only the proposed section 1446(f) regulations, but also the finalization of the related changes to the QI Agreement and impacted reporting forms and returns.

2. Significant changes to current QI reporting processes will be required, necessitating cumbersome systems modifications

Payments allocated to direct account holders

The current regulations state that “any person that withholds or is required to withhold an amount under … §1.1446-4(a) (applicable to publicly traded partnerships required to pay tax under section 1446 on distributions) must file a form 1042-S for the payment”. In addition, “a Form 1042-S shall be prepared for each recipient of an amount subject to reporting and for each single type of income payment” [§1.1461-1(c)(1)(i)]. Under Sec. 8.01 of the current Qualified Intermediary Agreement, “except as otherwise provided in section 8.02 …, QI is not required to file forms 1042-S for amounts paid to each separate account holder for whom such reporting would otherwise be required. Instead, QI shall file a Form 1042-S reporting the pools of income (reporting pools) as determined in section 8.03 of this Agreement”.

Section 8.02 of the QI agreement addresses recipient specific reporting, and in general terms requires QIs to file recipient specific 1042-S in the case of FDAP payments made to flow-through entities (see 8.02(B) and (C)).

For purposes of 1042-S reporting, the proposed regulations extend the definition of "recipient" to include "a partner (including a foreign partnership) receiving a distribution from a publicly traded partnership subject to withholding under section 1446(a) and §1.1446-4 on distributions of effectively connected income, and a partner (including a foreign partnership) receiving an amount realized from a transfer of a publicly traded partnership interest subject to withholding under section 1446(f)(1) and §1.1446(f)-4." The amounts subject to reporting under the proposed regulations include "the amount of any distribution made by a publicly traded partnership … that is paid to a qualified intermediary that assumes primary withholding responsibility for the payment".

The proposed regulations and accompanying commentary seem to indicate that payments allocated by a QI to direct account holders under section 1446(a) and §1.1446-4 are subject to recipient specific Form 1042-S reporting. It is not clear if QIs will be permitted to pool report such payments as allowed under existing Section 8.01 of the QI Agreement. The availability of pooled reporting is one of the main benefits of QI status and is of particular importance as it reduces the burden of 1042-S reporting and generally provides for non-U.S. accountholder privacy. As such we request that the final regulations and new QI agreement support the pooled reporting of such payments to direct account holders as provided under the QI Agreement. In the event such recommendation is not adopted, QIs will need significant time to revise reporting operations in order to operationalize a parallel reporting system, as different payment types allocated to the same account will need to be reported separately and using opposing methodologies.

<u>Payments allocated to a foreign partnership</u>

§ 1.1461-1(c)(1)(ii)(A)(8) of the proposed regulations amends the definition of "recipient" for purposes of 1042-S reporting in the context of payments related to section 1446(a) and §1.1446-4. Commentary indicates that modifying the definition of 'recipient' to include a foreign partnership that receives section 1446 payments would allow the foreign partnership to claim a credit on tax withheld. The proposed regulations indicate that QIs would be required to issue Forms 1042-S to such partnerships.

Section 8.02(G) of the QI agreement requires QIs to "look through" partnerships (or other flow-through entities) and provide payee specific Forms 1042-S for each foreign account holder (or interest holder) of the partnership (or other flow-through entity) that is receiving amounts subject to chapter 3 reporting and/or withholding. The proposed regulations require QIs to implement a reporting mechanism that runs counter to the reporting required under the QI Agreement for all other types of Chapter 3 income.

This difference in treatment of (non-withholding) foreign partnerships will certainly be a challenge for QIs and withholding agents as systems and processes will need to be updated to identify cases where a payment of FDAP requires the QI to file partner/beneficial owner specific Form 1042-S reporting, vs payments related to section 1446, resulting in the issuance of a Form 1042-S to the partnership.

The challenges noted above reinforce the need to increase the time for implementation to a minimum of 18 months post finalization of the regulations, the amendments to the QI agreement and related forms and publications

3. The Qualified Notices system places undue burden on industry participants

We appreciate that proposed §1.1446-4(b)(4) includes several changes to the existing qualified notice rules used to inform brokers of effectively connected income distributions and, now, effectively connected gain including:

- the inclusion of sufficient detail to determine the types of income distributed and the appropriate withholding rates or information that an exception to withholding applies; and

- the posting of notices in a readily accessible format in an area of the primary public website of the publicly traded partnership (PTP)

On the second point above, the existing challenge with how a broker will know where and when to look for these notices will be further exacerbated by these new requirements .

It would be very helpful if there was a central public website where all publicly traded partnerships would post their qualified notices. If this is not possible, brokers would likely have to engage an outside service provider in order to reliably obtain this required information. This would result in a further and ongoing increase to the already significant costs that will be incurred to comply with the new section 1446(f) requirements.

4. Uncertainty exists regarding the type of "Treaty claim" available to payees

The proposed regulations provide five exceptions to the 10% withholding that will apply to the transfer of a PTP interest. One of the exceptions is when a transferor states that it is not subject to tax on any gains from the transfer pursuant to an income tax treaty in effect between the United States and a foreign country. The transferor is required to submit a valid Form W-8 with the information necessary to support the claim.

We are concerned as to what is considered necessary information required on a transferor's Form W-8 when claiming treaty benefits pursuant to section 1446(f). We recommend that the IRS clarify whether a statement confirming that the transferor is not subject to the tax pursuant to a particular tax treaty on a Form W-8 is the only necessary information required to support the claim.

We understand that there is generally an article in U.S. income tax treaties addressing taxation of gains derived by a resident of a contracting state. For example, Article XIII of the United States and Canada Income Tax Convention (the "Canadian Treaty") addresses the treatment of gains derived by a Canadian resident from the alienation of different types of property in the United States. However, the Canadian Treaty does not provide specific information regarding the treatment of gains derived from the sale or exchange of an interest in a partnership that is engaged in the conduct of a trade or business within the United States.

Absent specific or identifiable guidance, it will be difficult for transferors to determine whether they are entitled to treaty benefits. We recommend that the IRS provide more information regarding the applicability or availability of reduced or eliminated withholding under US income tax treaties.

5. More guidance is required regarding the ability to assume primary withholding responsibility for section 1446 payments, and the application where multiple parties to the transaction are QIs and/or brokers

QIs' assumption of primary withholding responsibility

Sec. 2.06 of the QI Agreement defines "primary withholding responsibility", whereby QIs may assume primary chapter 3 and 4 withholding responsibility with respect to payments of U.S. source FDAP income or assume primary Form 1099 reporting and backup withholding responsibility. A QI that assumes primary withholding responsibility assumes the primary responsibility for deducting, withholding and depositing the appropriate amount of payment. QIs have the option to assume primary withholding responsibility for payments of substitute interest. A QI certifies its primary withholding status by providing a W-8IMY with the appropriate certifications.

Under proposed §1.1446(f)-4(a)(2)(i), a broker that pays the amount realized to a foreign broker is required to withhold unless the foreign broker is either a U.S. branch treated as a U.S. person, or a QI that assumes primary withholding responsibility for the payment. Commentary issued with the regulations states that the Treasury and the IRS intend to modify the QI agreement to allow QIs to assume primary withholding responsibility on section 1446 amounts.

Commentary and proposed regulations do not specify if this primary withholding responsibility will be part of the "general" primary withholding responsibility in respect of FDAP withholding. Or, if instead, QIs will have the option to have primary withholding responsibility only in respect of the payments listed in the proposed regulations, similarly to the option of assuming (or not) primary withholding responsibility on substitute interest.

We recommend that QIs have the option to choose whether to assume primary withholding responsibility for purposes of the proposed regulations independently from their withholding status in respect of FDAP under Chapters 3 and 4.

Clarification on withholding responsibility and delivery versus payment (DVP) arrangements

Regarding the broker obligations to withhold, the commentary further provides:

> for example, when a transfer of a PTP interest occurs through a cash on delivery account, a delivery versus payment account, or other similar account or transactions, this definition would include a broker that receives an amount realized from the sale against delivery of the PTP interest and any other that receives an amount realized from that broker. Therefore, the withholding obligation under proposed §1.1446(f)-4 is generally limited to brokers that receive proceeds from the sale and act on behalf of the transferor.

Bringing DVP arrangements in-scope creates significant complexity for brokers. In Canadian financial institutions, DVP accounts are typically not set up for withholding because a custodian will be holding the security in an account in the name of the customer/client and be responsible for the withholding of U.S. source income (e.g. FDAP).

Requiring brokers with DVP-only arrangements to withhold under the proposed regulations would cause failed trades and an undue burden as it would require expensive system builds and also impose documentation requirements that would be impossible to apply within normal market trading deadlines (such as collecting withholding certificates) that would not otherwise ultimately result in better or more complete report.

We recommend that DVP arrangements from accounts that are subject to these regulations be excluded from the final regulations and the withholding responsibility be transferred to the custodian holding the security on behalf of the beneficial owner. This proposed modification would align the final regulations with the current requirements related to withholding on payments of U.S. source FDAP.

6. The regulations in current form create substantial additional burdens for industry participants, and especially for QIs and other withholding agents.

The proposed regulations provide specific information on estimated costs for each broker that has responsibilities under section 1446(f). In particular, it is stated that the estimated total annual cost per respondent is $26, the estimated number of respondents per broker is 76,000 and the estimated total annual monetized cost per broker is $1,827,938.

The estimated total annual monetized cost of approximately $1.8 million is a significant expense that may not readily be passed on to customers. For smaller brokers in particular, this additional expense may drive participation away from US markets, as the costs would outweigh any perceived investment benefit.

The proposed regulations also indicate a substantial change to current QI operations. QIs will be required to review and implement the anticipated revised QI Agreement (generally with the assistance of outside advisors at additional cost); modify documentation, data capturing and storage, tax withholding, tax reporting and associated systems and tools within a very short period of time; and review and operationalize anticipated revised Forms W-8 and instructions. QIs will also need to communicate the new requirements to their customers and to collect new documentation and/or treaty claims.

Brokers will need to incur costs to deal with these responsibilities regardless of the number of respondents or transactions. This creates heavy financial and non-financial burdens. As mentioned earlier, it is unlikely that they can recover these costs from clients.

We recommend that the IRS simplify the requirements in order to minimize these onerous burdens.

7. The ability to eliminate withholding on U.S. underlying owners of a partnership should be extended to other types of flow-through entities.

The Proposed Regulations provides that brokers are allowed to rely on a certification from a non-U.S. partnership to modify the amount realized (and therefor subject to withholding) based on the portion of the payment that is attributable to U.S. persons.

It is unclear why this special rule only applies to non-withholding foreign partnerships (NWFPs) and not to non-withholding foreign trusts (NWFTs) or nonqualified intermediaries (NQIs). For Chapter 3 withholding purposes, a broker that is a full withholding QI is required to follow the same documentation, withholding and reporting requirements and process when they pay U.S. source income to NWFPs, NWFTs and NQIs. We are concerned about the challenges especially from an operational perspective that brokers will have if different rules apply to NWFPs, NWFTs and NQIs under section 1446(f). We recommend that the IRS allow this special rule to apply to NWFTs and NQIs.

Closing

We appreciate the consultation with industry participants as our members have a vested interest to fully understand and be able to comply with these proposed regulations. If you need any clarification or have questions regarding this submission, we kindly ask that you contact the undersigned.

Yours sincerely,

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