

THE ASSOCIATION OF GLOBAL CUSTODIANS

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December 9, 2015

Via E-Mail

The Honorable Mark Mazur
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Re: Section 1441 Withholding Procedures for Certain Distributions to Which Section 302 Applies
(REG-140206-06)

Gentlemen:

This letter is submitted on behalf of the Association of Global Custodians ("Association" or "AGC")¹ and its member banks in order to seek guidance with respect to the Section 1441 withholding procedures for certain distributions to which Section 302 applies.

¹ The Association is an informal group of 11 member banks that provide securities safekeeping and asset serving functions to cross-border institutional investors worldwide. Members provide custody-related services to most types of institutional investors, including investment funds, pension funds, and insurance companies.

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On November 13, 2007, Treasury issued a Notice of Proposed Rulemaking concerning withholding procedures under Section 1441 for distributions in redemption of publicly traded stock to which Section 302 applies [REG-140206-06]. Those proposed regulations were intended to clarify the responsibilities of withholding agents when such distributions occur, and also introduced an “escrow procedure” under which the deposit of tax withheld in such cases could be delayed for a period of up to sixty days. While the AGC appreciates both the availability of the escrow procedure and the effort to clarify what is expected of a withholding agent with regard to such distributions, some questions remain.

More than eight years have passed since their proposal, yet these regulations have not been finalized. During that time, other significant regulatory changes have occurred, such as the introduction of regulations implementing Chapter 4, and those coordinating the FATCA regulations with the Chapter 3 and Chapter 61 rules. No corresponding changes have been made to the proposed rules under §1.1441-3 governing withholding on Section 302 distributions on publicly traded stock. The members of the Association find themselves, therefore, in need of guidance in several areas. The areas on which guidance is sought are outlined in the attached Annex.

* * * * *

The Association members very much appreciate your willingness to consider the views expressed in this letter. They would be pleased to provide further information upon request in relation to the concerns they have raised.

Sincerely yours on behalf of the Association,



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ANNEX

Transactions Involving Taxable Stock Consideration –

Several large corporate actions were completed this year in which participating shareholders received shares of stock which, in the opinion of the issuer, represented a distribution potentially subject to U.S. withholding tax. In one case, Medtronic Inc. (a U.S. corporation) simultaneously acquired Covidien plc (a foreign corporation) and merged into Medtronic plc, a newly formed Irish holding company. Shareholders of “old” Medtronic received a combination of “new” Medtronic plc shares and cash. In the company’s opinion, Section 304 applied and the total consideration received (including the value of the “new” Medtronic plc shares) constituted a Section 302 payment subject to withholding. In a second case, Mylan Inc. (a U.S. corporation) merged into Mylan N.V. (a newly formed Netherlands holding company) while simultaneously acquiring certain business assets from Abbott Laboratories (another U.S. corporation) in exchange for 110,000,000 new Mylan N.V. ordinary shares. While “old” Mylan Inc. holders received only “new” Mylan N.V. shares in the transaction, in the company’s opinion Section 304 applied and the receipt of the “new” Mylan N.V. shares was a public Section 302 distribution potentially subject to withholding.

Such transactions pose significant problems for both shareholders and withholding agents. The rules would seem to require that 30% (or lesser treaty rate) be withheld from payments made to the non-U.S. recipients, even if there is no payment of cash received. What, then, is the withholding agent to do? If an amount of cash equal to 30% of the fair market value of the shares is deducted from the client’s account, a negative balance will result. The fact is that many withholding agents have not elected to apply the permitted escrow procedure to Section 302 payments because of the operational complexities involved in putting monies in a suspense account. Those that have not implemented the escrow procedure have two choices, the first being to immediately make a tax deposit using cash that neither they nor their client have received. This can lead to overdrafts, the expenses of which either the client or the withholding agent would have to bear. The other option would be to sell a sufficient quantity of the shares received to cover the necessary tax deposit. If that second method were followed, the inevitable fluctuation in the stock price during the period following payment would create problems. If the share price rose during the 60-day period that followed the Section 302 payment, the refund processed when the client provided the required certifications would not be sufficient to repurchase the number of shares to which they were originally entitled. While share prices obviously can move in either direction, the introduction of such discrepancies is unacceptable given that the vast majority of beneficial owners are eligible for, and ultimately provide the supporting certifications and receive, a refund of the tax initially withheld.

We would ask, therefore, that guidance be provided as to what is required in such cases. In the case of the Medtronic and Mylan transactions cited above, withholding agents withheld millions of dollars that merger participants had never actually received in cash. Those clients (or the withholding agents themselves) suffered the effects of those overdrafts until such time as the Section 302 payment

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certifications could be collected. Such fact patterns were presumably not anticipated when the proposed rules were written. Ideally, no cash would need to be withheld from the recipient until such time as the 60-day escrow period lapsed or the shareholder provided a Section 302 payment certification indicating that dividend treatment was applicable.

Acquisitions of U.S Corporations by Foreign Corporations –

Apart from the “corporate inversions” described above, there are many instances where a U.S. corporation is acquired by a non-U.S. corporation in exchange for a combination of cash and stock in a transaction that is tax-free with respect to the shares of acquirer stock received. While the Section 302 tests might apply to determine the character of any gain realized by a U.S. holder in such a transaction, we would ask that guidance be provided confirming that any deemed dividend received in such a non-Section 7874 transaction would be non-U.S. sourced. As such, there should be no need to collect Section 302 payment certifications or to withhold U.S. tax with respect to such transactions.

Acceptable Manner of Receiving Section 302 Payment Certifications –

It has long been permissible for withholding agents to accept Forms W-9 provided by fax. With respect to Forms W-8, the coordinating regulations [T.D.9658] published March 24, 2014 provide that a “...withholding agent may generally rely upon an otherwise valid Form W-8 (or documentary evidence) received by facsimile or a form or document scanned and received electronically, such as, for example, an image embedded in an email or as a Portable Document Format (.pdf) attached to an email” [see §1.1441-1T(e)(4)(iv)(C)]. By extension, it would seem reasonable that withholding agents should be able to accept Section 302 payment certifications provided in the same fashion. We would ask that the Service clarify, by regulation or other written authority, that Section 302 payment certifications received in this manner may in fact be relied upon.

Signor Capacity –

The proposed regulations require that a Section 302 payment certification contain a penalties of perjury statement, the signature of the beneficial owner, and the date of signature. The certification in Part XXIX of Form W-8BEN-E (Rev. February 2014) has a capacity checkbox beneath the penalties of perjury statement and signature/date line. We are asking for guidance whether a Section 302 payment certification for a beneficial owner should include a signor’s capacity checkbox, with similar language to what is included on the Form W-8BEN-E.

Refunds of Withholding After the Escrow Period –

We would request that guidance be provided that clearly permits a withholding agent to treat as erroneous and refund any withholding should the recipient provide a valid Section 302 payment certification after the end of the 60-day escrow period. One might assume that such refunds would be

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permissible using the general reimbursement or set-off procedures, but a clear statement to that effect would be most helpful.

Potential Penalties –

There may be instances where the withholding agent is not aware at the time of payment that Section 302 should apply to a particular transaction. We would ask that guidance be provided confirming that a withholding agent that is late in placing such withholding in escrow will not be subject to any penalty so long as any withholding due is deposited by day 61.