

THE ASSOCIATION OF GLOBAL CUSTODIANS

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SKANDINAVISKA ENSKILDA BANKEN
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March 29, 2012

HAND DELIVERY

Messrs. Mark E. Erwin and D. Peter Merkel
Office of the Associate Chief Counsel (International)
CC:PA:LPD:PR (REG-120282-10)
Courier's Desk
Internal Revenue Service
1111 Constitution Avenue NW
Washington, D.C. 20224

Re: Comments on Temporary Dividend Equivalent Regulations under Section 871(m) of the Internal Revenue Code

Dear Sirs:

The Association of Global Custodians (the "Association" or "AGC")¹ is pleased to provide the U.S. Department of the Treasury ("Treasury") and Internal Revenue Service ("IRS") with comments on proposed and temporary regulations under Section 871(m) of the U.S. Internal Revenue Code of 1986, as amended (the "Code"), enacted as part of the Foreign Account Tax Compliance Act provisions of the Hiring Incentives to Restore Employment Act. We appreciate the IRS' and Treasury's openness to feedback from industry participants on these regulations, as well as on other provisions of FATCA.

On January 23, 2012, Treasury and IRS published proposed (Fed. Reg. Vol. 77, No. 14, p. 3202. (REG-120282-10)) and temporary regulations (T.D. 9572, Jan. 23, 2012), which provide guidance on when a derivative contract such as a swap or sale-repurchase transaction (repo) that provides for a payment contingent upon, or determined by reference to, a U.S. source dividend ("dividend equivalent") is considered a "specified notional principal contract" ("SNPC") for purposes of Section 871(m) of the Code. Under Section 871(m), dividend

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. Association members are listed on the letterhead above.

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equivalents on SNPCs are treated as U.S. source dividends, subject to withholding under Chapters 3 and 4 of the Code when paid or credited to a non-U.S. person. The temporary regulations ("Temporary Regulations") extend the statutory definition of a SNPC through December 31, 2012, and clarify the application of the rules to dividend equivalents, including details around withholding. The proposed regulations ("Proposed Regulations") propose rules that will be applicable as of January 1, 2013, including expanding the definition of a SNPC.

Section 1.1441-7T(a)(2) of the Temporary Regulations addresses the question of who may be a withholding agent with respect to dividend equivalent payments, as follows: **"Each person that is a party to any contract or arrangement that provides for the payment of a dividend equivalent, as defined in section 871(m), shall be treated as having control and custody of such payment."** The substance of this provision is illustrated by Example 6 of Temp. Reg. § 1.1441-7T(a)(3). However, we believe that while the language is clear with respect to the withholding responsibility of the parties to a transaction, the regulation does not clearly address whether intermediaries or custodians could also be a withholding agent for purposes of these rules.

The language of Temp. Reg. § 1.1441-7T(a)(2) closely tracks the statutory language of Section 871(m)(7).² The AGC had requested clarification of this provision by letter dated September 8, 2010, a copy of which is attached hereto for your reference. For the reasons stated in the attached letter, and consistent with Treas. Reg. § 1.1441-2(d) (regarding withholding agents that lack knowledge of the facts giving rise to a payment), we believe that guidance on this issue is appropriate, and respectfully request that Treasury and IRS clarify that financial intermediaries which are not a counterparty to a derivatives transaction should not be considered the withholding agent for purposes of new Code Section 871(m). To this end, we would suggest that Treasury and IRS consider adding new Examples 7 and 8 to Temp. Reg. § 1.1441-7T(a)(3), as follows:

Example 7. Same facts as in *Example 6* above, except that Bank Y, a U.S. financial institution, acts as a custodian for FC with respect to FC's global investments. Bank X makes net payments under the NPC to FC's account at Bank Y, and FC may have payments related to NPC transactions wired out of its account maintained by Bank Y to FC's NPC counterparties. Bank Y is generally treated as a withholding agent with respect to U.S. source payments that it collects on behalf of FC, for purposes of Chapters 3 and 4. However, because Bank Y is not a party to the contract, and is only acting as an intermediary with respect to the dividend equivalent payments, Bank Y does not have sufficient information about the terms of the NPC to know whether it is a specified NPC for purposes of Section 871(m). Similarly, Bank Y would not readily be able to track the amount of any payment attributable to a dividend versus a price return. Accordingly, Bank Y is not treated as a withholding agent with respect to the NPC payments.

² Section 871(m)(7) of the Code provides: "For purposes of chapters 3 and 4, each person that is a party to any contract or other arrangement that provides for the payment of a dividend equivalent shall be treated as having control of such payment."

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Example 8. Same facts as in *Example 7* above, except that Bank Y is a non-U.S. financial institution. For the reasons set forth in *Example 7* above, Bank Y is not treated as a withholding agent with respect to the NPC.

Published guidance is urgently needed on this issue as the effective date of the Temporary Regulations is January 23, 2012.

The AGC greatly appreciates the opportunity to provide the comments set forth above. If you have questions concerning this letter or would like additional information, please contact the undersigned. Members would also be pleased to arrange a conference call if that would be helpful to you.

Sincerely yours on behalf of the Association,

A handwritten signature in black ink that reads "Mary C. Bennett". The signature is written in a cursive style with a long, sweeping horizontal line extending to the right.

Mary C. Bennett
Baker & McKenzie LLP
Secretariat and Counsel to the Association

Attachment: Association Letter of September 8, 2010

Cc:
Ms. Emily McMahon
Acting Assistant Secretary for Tax Policy
U.S. Department of Treasury

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September 8, 2010

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Re: **Comments on Foreign Account Tax Compliance Act (FATCA)
Provisions of the Hiring Incentives to Restore Employment (HIRE) Act**

Dear Ms. Corwin and Messrs. Caballero, Danilack, Mundaca, Musher, Shay, and Shulman:

I am pleased to provide the attached comments prepared by a working group of the Association of Global Custodians ("AGC") on certain of the Foreign Account Tax Compliance

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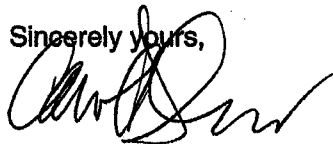
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Act (FATCA) provisions of the Hiring Incentives to Restore Employment Act (the "HIRE Act"). As you may know, the AGC is an informal group of ten global banking institutions with affiliates and branches in numerous countries that provide global custody services and related securities asset-servicing functions to cross-border institutional investors around the globe. AGC members are listed on the letterhead above.

We appreciate the openness of the IRS and Treasury to feedback from industry participants on the FATCA provisions and your active solicitation of input on these important issues. As discussed in further detail in the attached comments, the AGC respectfully requests that the IRS and Treasury clarify that financial intermediaries which are not a counterparty to a derivatives transaction should not be considered the withholding agent for purposes of new Internal Revenue Code Section 871(I). Published guidance is urgently needed on this issue as the effective date of the withholding provisions on "specified notional principal contracts" ("SNPCs") is September 14, 2010. If you have questions concerning the following comments or would like additional information, please contact the undersigned or Lisa Chavez, Northern Trust. Members would also be pleased to arrange a conference call if that would be helpful to you.

Sincerely yours,



Carol A. Dunahoo
Baker & McKenzie LLP
Counsel to the AGC

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COMMENTS:

Request for clarification of applicability of derivatives provisions to intermediaries

Notice 2010-60, which was just released on August 27, 2010, provides preliminary guidance on a number of priority issues involving the implementation of the new FATCA withholding provisions, and solicits comments on a number of issues. The AGC intends to submit comments in response to Notice 2010-60 prior to the November 1, 2010 deadline. However, at this time, AGC members believe it important to draw your attention to an issue that relates to provisions effective September 14, 2010 that was not addressed to Notice 2010-60. Members believe this issue uniquely affects global custodian banks; requires urgent priority guidance; and has not been previously addressed in other comment letters that have been submitted.

The HIRE Act provisions which provide that a payment made pursuant to a "specified notional principal contract" that is directly or indirectly contingent upon or determined by reference to the payment of a dividend from U.S. sources will be treated as a U.S. source dividend, are effective beginning September 14, 2010, and will create a withholding tax obligation on payments previously excluded from withholding as non-U.S. source. As such, the AGC believes that there is a particularly urgent need for guidance regarding who is responsible for tax withholding under these new provisions, which are set forth in new Section 871(l) of the Code.

The term "specified notional principal contract" ("SPNC") is defined in Section 871(l)(3)(A) as any notional principal contract ("NPC") where (1) the party to the contract entitled to receive a payment contingent upon or determined by reference to the payment of a dividend from U.S. sources (the long party) transfers the underlying security to another party (the short party), which in turn will transfer the underlying security back to a long party entitled to the dividend equivalent payment; (2) the underlying security is not publicly traded; (3) the underlying security is posted as collateral by a short party with the long party in connection with a contract; or (4) the contract is identified as a specified notional principal contract in regulations to be issued.

Section 871(l)(7) specifically provides that each person that is a party to a contract that provides for a dividend equivalent payment shall be treated as having control of such payment for purposes of Chapter 3 and Chapter 4. Existing regulations under Chapter 3 provide that a "withholding agent" is responsible for withholding, and that a "withholding agent" generally means any person that has the control, receipt, custody, disposal, or payment of an item of income subject to withholding.¹ Guidance is urgently needed to address the interaction of new Section 871(l)(7) with the existing definition of "withholding agent".

A custodian may be considered a "withholding agent" with respect to a dividend equivalent payment under Chapter 3 as a person that has receipt and/or custody of such payment. However, a custodian will not be a party to the contract for a SNPC, and as stated

¹ Treas. Reg. Section 1.1441-7(a)(1).

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below, will not have sufficient information to determine whether a payment is made pursuant to a SPNC or to determine the amount of withholding. Language in the Joint Committee on Taxation's Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3310, the "Hiring Incentives to Restore Employment Act," Under Consideration by the Senate (JCX-4-10) (February 23, 2010), (the "Joint Committee Technical Explanation"), indicates an intent to place the withholding responsibility on only the parties to the transaction, rather than on the custodians or other intermediaries, because only the counterparties have "control of the payment" for this purpose.² Accordingly, guidance is urgently needed to confirm that a custodian or other intermediary or agent that has receipt and/or custody of a payment made pursuant to a SNPC will not be a "withholding agent" under Chapter 3 or Chapter 4 where such custodian is not a party to the contract.

Placing the withholding obligation for dividend equivalent payments made pursuant to a SNPC with the parties to the contract as set forth in Section 871(l)(7) is also consistent with the practicalities of these transactions. Custodians and other financial intermediaries or agents are not likely to have sufficient information about the terms of the underlying contract to know whether a notional principal contract meets any of the first three criteria of Section 871(l)(3)(A) noted above. Rather, this information would be specifically within the knowledge of the counterparties to the swap transaction. In addition, intermediaries typically see only the net payment made on a notional principal contract transaction, not the gross amount (on which withholding would be required pursuant to Section 871(l)(5)). As such, AGC recommends that the Treasury and the IRS issue guidance clarifying that custodians and other intermediaries that are not parties to the contract are not considered "withholding agents" for purposes of Chapter 3 or Chapter 4 with respect to dividend equivalent payments made pursuant to SNPCs.

Conclusion

The AGC greatly appreciates the opportunity to provide the comments set forth above on the FATCA provisions, and members hope they are of assistance as you formulate guidance and regulations to implement the new rules.

² The Joint Committee Technical Explanation states: "For purposes of chapter 3 . . . and chapter 4 . . . , each person that is a party to a contract or other arrangement that provides for the payment of a dividend equivalent is treated as having control of the payment. Accordingly, Treasury may provide guidance requiring either party to withhold tax on dividend equivalents."