**Summary of Comments to 2012 NPRM-- 77 FR 3202**

C. Withholding Agents’ Reliance on Counterparty Representations and Certification

Comments indicated that withholding agents may not have the facts necessary to determine whether a transaction is a specified NPC; therefore, withholding agent should not be required to withhold when it does not have actual knowledge of facts that created the liability. ISDA at p. 14; SVSP at p. 2; NYSBA at p. 75. Withholding agent need to be permitted to rely on representation from counterparties to determine whether a transaction is a Specified NPC. NYSBA at p. 75. Withholding agents should not be liable for withholding unless they know or have “reason to know” that the representations are inaccurate or that covenants have been breached. ISDA, at p. 13; SVSP at p. 4; NYSBA at p. 75; OCC, at p. 4; ABA, at p. 29. Withholding agent should not be treated as having reason to know the existence of other transactions unless the information about other potential relevant transactions between entities is readily available in the ordinary course of business at the withholding agent entity. ISDA at p. 13. The OCC also notes that due to the large volume of transactions that it clears on a daily basis, it is not impractical for the OCC to act as a withholding agent. OCC, at p. 4. Senator Levin questioned whether these concerns are legitimate because withholding agents have already resolved similar issues in the case of direct U.S. dividend payments. Sen. Levin, at p. 1.

A reason to know standard would require withholding agents to aggregate information across a number of different systems, not at a trade unit level. Morgan Stanley, at p. 6. This level of due diligence will be complicated and impractical when many different traders enter into numerous transaction with the long party. Morgan Stanley, at p. 6. In addition, most dealers have internal policies and procedures in place to avoid regulatory issues from sharing information. Morgan Stanley, at p. 6. As a result, the SEC adopted Regulation SHO, which allows U.S. registered broker-dealers to use “aggregation units” to report short sales. Morgan Stanley, at p. 7.

*Proposal 1*: The final regulations should permit withholding agents to rely on counterparty representations and covenants made in contracts. ABA, at p. 30. Withholding agents should not be liable for withholding unless they know or have “reason to know” that the representations are inaccurate or that covenants have been breached. ISDA, at p. 13; SIFMA, at p. 14; ABA, at p. 29. The long party should be able to provide representations with respect to the following tests: (1) in the market, (2) offsetting positions, (3) aggregate notional principal amounts, and (4) whether the long party expects to terminate within 90 days. NYSBA at p. 76. The form W-8 could be revised to include a section on whether an NPC is a specified NPC, which would require the long party to update if the contract becomes a specified NPC. NYSBA at p. 78. The representations could also be provided in a Revenue Procedure. ABA, at p. 30.

*Proposal 2:* Withholding agents should only be liable for withholding with respect to dividend equivalent payments made after the withholding agent had knowledge that such payment was made with respect to a specified NPC. With respect to prior payments, the withholding agent should be required to report to the IRS the name of the payee and the amount of prior payments. ISDA at p. 13.

*Proposal 3*: Only the custodian bank, and not the issuer or other financial intermediary, should be responsible for withholding. SVSP at p. 2.

*Proposal 4*: Withholding agent’s liability for withholding should begin when the withholding agent has knowledge that a contract is a specified NPC. Morgan Stanley at p. 6.

*Proposal 5*: The reason to know standard for withholding should be based on business units or a concept similar to “aggregation units” used for securities laws. Morgan Stanley at p. 7; ABA, at p. 30.

D. Undue Burden on Withholding Agents

The proposed regulations would require broker-dealers with non-U.S. customers to develop elaborate systems to track data to determine whether an option is a specified equity-linked instrument and the amount of any dividend equivalent. U.S. Securities Market Coalition, at p. 29. This burden is unreasonable, particularly when the policy concerns underlying section 871(m) are “highly attenuated” when applied to options. U.S. Securities Market Coalition, at p. 29. In addition, a withholding agent may not know that a contract was a specified NPC until after the contract has terminated. NYSBA, at p. 53.

In addition to broker-dealers, the proposed regulations impose significant burdens on the futures markets. Withholding agents bear the burden of knowing whether (1) a transaction is subject to withholding, (2) a customer is a foreign person, (3) the long party is “in the market”, and (4) the amount that should be withheld. OneChicago at p. 13-15. Withholding agents will need to incur significant costs to establish supporting system. OneChicago at p. 13, 15. Market participants will likely refuse to transact with foreign customers to avoid the high costs of complying with the regulations. OneChicago at p. 15. The proposed regulations may push the SSF business to foreign exchanges. OneChicago at p. 16. If the current system is retained in the final regulations, the industry cannot implement it by January 2013. OneChicago at p. 16.

*Proposal 1*: Final regulations should reduce withholding burden to market markers. U.S. Securities Market Coalition, at p. 29.

**Summary of Comments to 2013 NPRM-- 78 FR 73128**

**US Chamber of Commerce**

On February 27, 2014, the U.S. Chamber of Commerce (“USCC”) submitted a comment letter relating to proposed regulations, Dividend Equivalents from Sources within the United States, REG-120282-10, which were published in the Federal Register at 78 FR 73128 (Dec. 5, 2013) (the “2013 proposed regulations”). USCC stated that the Paperwork Reduction Act requires assessment of the paperwork burden on small entities and ways to reduce or eliminate the burden.

**Reporting delta information**

NYSBA expressed concern that the delta information necessary for an investor to determine whether a transaction is subject to section 871(m) may not be available on a timely basis.[[1]](#footnote-1) They recommend requiring the information to be provided on an issuer’s website at or prior to the time of issuance and updated regularly. Investors should then be able to rely on such information between update intervals.[[2]](#footnote-2)

AII stated that it would be burdensome to calculate delta when a contract was acquired and to calculate it again to determine the amount of withholding. AII at III.a. “Conceptually, these steps do not pose a major burden, but when carried out on a large scale, it will require a substantial amount of time and investment of resources to repeatedly calculate delta.” Id. AII recommended (1) a reasonable market close calculation rather than a time of trade calculation and (2) a one-time delta calculation used for an instrument in order to relieve the burden. AII at III.b.

**Reporting of combinations**

SIFMA asked that the reporting standard for combined transactions be conformed to the narrower withholding standard that requires only “actual knowledge.”[[3]](#footnote-3) The proposed regulations provide that a broker-dealer must use “reasonable diligence” to determine whether a transaction is an 871(m) transaction. Practitioners are concerned that this could be interpreted to require broker-dealers to determine whether transactions were entered into in connection with each other in order to determine whether they must be combined. SIFMA argued that because broker-dealers are not in a position to discover a counterparty’s intent, even through “reasonable diligence,” this should not be the standard for their reporting obligation.[[4]](#footnote-4)

**Reporting of written estimates of a dividend**

OCC notes that the rule for providing upfront written estimates of dividends by a short party does not work in the listed options context, where the short party does not stand in a bilateral relationship with a long party. This comment requests that the broker be required to provide the written estimates.[[5]](#footnote-5)

**Burden on withholding agents**

Several commentators emphasized the operational and administrative burdens that the proposed regulations would impose on the parties who would be responsible for reporting and withholding on dividend equivalents.[[6]](#footnote-6) ISDA, for example, notes that “[e]ven simplified rules will require multinational financial groups to substantially enhance existing transaction systems along with such systems’ interface with various client and market data systems for multiple legal entities.”[[7]](#footnote-7) Another comment observed that the cost of building of such systems will be passed on to customers, making the market more expensive, and the customer will be forced to accept the broker’s delta calculation, which may be based on different volatility assumptions that those being made by the foreign customer.[[8]](#footnote-8)

**Withholding only on actual payments**

SIFMA emphasized the burden of withholding on dividend equivalents absent actual payments.[[9]](#footnote-9) In the absence of actual payment, continuous monitoring and withholding on each specified ELI over time is impractical. The comment observed that in a similar context Congress did not require withholding on accrual of OID but rather made the withholding due on the final maturity payment or out of sale proceeds. This comments suggests that a foreign broker only be required to withhold on dividend equivalents from ELIs when there is a final payment or from proceeds of a sale. However, these comments also note that OID is normally exempt from withholding under the portfolio interest exception.

Another letter referred to withholding on estimated or implicit dividends in the absence of actual payments as withholding on “phantom dividends.”[[10]](#footnote-10)

**Withholding on issuance proceeds/up-front premiums**

SIFMA argued that upfront payments should not be viewed as payments subject to withholding.[[11]](#footnote-11) NYSBA also argued that the regulations should not impose withholding on prepayments with respect to ELIs.[[12]](#footnote-12) Such proceeds are received in exchange for issuing the instrument and are used by the issuer to purchase related hedging positions.[[13]](#footnote-13) They are not intended to be reserves for satisfying withholding obligations. If issuers are required to withhold on upfront payments, it will be too costly for them to access foreign markets.[[14]](#footnote-14)

An up-front payment is received when the terms of the transaction are “off market” and the broker-dealer is thus not willing to enter into the transaction unless it received such proceeds in exchange. This money is not held as collateral or set aside in segregated accounts. An options clearinghouse often receives a premium for issuing longer term options but then must pay this premium to the corresponding short party. Thus, the clearinghouse cannot withhold by making payments out of such option premium.[[15]](#footnote-15)

**Withholding from funds in custody**

One comment also observed certain practical difficulties in withholding from funds that the broker-dealer has custody of.[[16]](#footnote-16) First, the broker-dealer may not be legally entitled in any given case use cash or property in one account to satisfy a withholding obligation in another. Second, foreign counterparties may hold different accounts through different affiliates of a broker-dealer, and it would be impractical to determine the existence of these accounts and apply set-off rules on that basis. Systems that deducted withholding tax liabilities out of unrelated accounts would be costly.

**Withholding and reporting obligations of options clearing organizations**

Transactions with foreign clearing members

The OCC notes that it is requiring its foreign clearing members to be qualified intermediaries. As a result, when the OCC has a transaction in a foreign clearing member’s customer account, the OCC will not be required to withhold because the QI will assume primary withholding responsibility. The clearing organization will still need to report the amount of any dividend equivalent. However, the clearing organization requests that the foreign clearing member be required to provide the clearing organization with whatever information it may need to comply with its reporting requirement in this case.[[17]](#footnote-17)

For transactions in which the foreign clearing member takes a proprietary position, however, the clearing organization requests that the QSL exception of Notice 2010-46 be extended to reach this situation so that the clearing organization will not be required to withhold.[[18]](#footnote-18)

Transactions with US clearing members

The OCC also provided comments on situations where the clearing organization faces a US clearing member that is acting for a foreign customer.[[19]](#footnote-19) The clearing organization noted that under current section 1441 regulations, the clearing organization is relieved from both withholding and reporting obligations when the “payee” is a US clearing member, regardless of whether the US clearing member is the beneficial owner of the payment. Treas. Reg. § 1.1441-1(b)(2). Even when the clearing organization has actual knowledge that the US clearing member is receiving the payment on behalf of a foreign customer, the clearing organization is relieved of its obligations when the US clearing member is a “financial institution.” However, recent amendments to the Chapter 3 regulations (intended to adopt definitions in the FATCA regulations) have changed the definition of “financial institution” to apply to entities that meet 20% gross income test for income “attributable to holding financial assets and related financial services.” The clearing organization argues that this definition is inadmininstrable in this context, as it cannot know whether a US clearing member meets this test. The comment requests that the term “financial institution” be clarified to include registered broker/dealers in this context.[[20]](#footnote-20)

Blocking Foreign customers

CBOE suggested that the systems changes required to implement the rules may result in broker-dealers prohibiting foreign customers from trading options or a subset of options. CBOE at 6. CBOE also noted that there would be operational burden on broker-dealer to track the trading activities of a foreign person. CBOE at 7.

Legend:

AI – Association of Institutional Investors 3/5/14

SF – SIFMA 5/7/14

MS – MS 5/19/14

IS – ISDA 5/16/14

NY – NYSBA 5/20/14

Cov – Covington on behalf of U.S. Securities Markets Coalition 3/5/14

MF – Managed Funds Association 3/5/14

Cit – Capital Tax Partners on behalf of Citadel 5/14/14

HI – Hillside Advisors LLC 5/29/14 (Bill Feingold)

CL – Carl Levin 3/5/14

Can - Investment Industry Association of Canada 3/12/14

AF – Allen Friedman (JPM) 5/15/14

SFa – SIFMA 2/21/14

CAI – Davis and Harman on behalf of Committee of Annuity Insurers 7/31/14

Managed Funds Association 2/10/14

ISDA 2/28/14

US Chamber of Commerce 2/27/14

Investment Industry Association of Canada 2/20/14

Options Clearing Corporation 7/15/14

TD—TD Securities 8/18/14

AII—Association of Institutional Investors 8/26/14

CBOE--Chicago Board Options Exchange 1/20/15

**Preamble to the Final Regulations**:

Access to Delta Information

Comments noted practical issues with obtaining delta information, particularly for exchange-traded positions where the dealer is not involved in determining pricing and the short party may not have the expertise to calculate delta. Comments suggested adopting an alternative test for identifying high-delta options based on their relative intrinsic value (amount by which the option is in-the-money) and relative extrinsic value (time value). This test would require the simpler calculation of determining the applicable strike price as a percentage of the current fair market value of the ELI and deeming ELIs at a certain percentage as passing or failing the delta threshold. Alternatively, comments suggested permitting the long party to rely on commonly available online tools to calculate delta for exchange-traded ELIs, provided that the taxpayer uses inputs that are within the range of commercially acceptable variation, uses a consistent methodology, and records its calculations contemporaneously. Comments also recommended relying on an anti-abuse rule for particularly complex derivatives for which delta information would be unavailable to any party other than the issuer, speculating that the increased cost and risk of complex transactions generally would outweigh any tax savings.

The Treasury Department and the IRS are concerned that these alternative tests or shorthand methods for determining delta may result in uncertainty for withholding agents and the IRS that could make it difficult to determine the status of potential section 871(m) transactions. Moreover, the changes to the final regulations to require that delta be tested only when a contract is first issued, accompanied by enhanced reporting rules (described in more detail later in this preamble), make these alternative tests unnecessary. Accordingly, the final regulations do not adopt these recommendations.

However, in order to simplify the delta calculation for contracts that reference multiple underlying securities, the final regulations provide that a short party may calculate delta using a single exchange-traded security in certain circumstances. More specifically, if a short party issues a contract that references a basket of 10 or more underlying securities and uses an exchange-traded security, such as an exchange-traded fund, that references substantially the same underlying securities to hedge the contract at the time it is issued, the short party may use the hedge security to determine the delta of the security it is issuing rather than determining the delta of each security referenced in the basket.

Reporting Obligations

The 2013 proposed regulations provide rules for reporting and withholding. The preamble to the 2013 proposed regulations explains that most equity-linked transactions involve a financial institution acting as a broker, dealer, or intermediary and that the financial institution would be in the best position to report the tax consequences of a potential section 871(m) transaction. Accordingly, §1.871-15(o) of the 2013 proposed regulations provides that when a broker or dealer is a party to a potential section 871(m) transaction the broker or dealer is required to determine whether the transaction is a section 871(m) transaction, and if so, the amounts of the dividend equivalents. If no broker or dealer is a party to a transaction or both parties are brokers or dealers, the short party is required to determine whether the transaction is a section 871(m) transaction and the amounts of the dividend equivalents. Determinations made by the broker, dealer, or short party are binding on the parties to the section 871(m) transaction unless a party to the transaction knows or has reason to know that the information is incorrect. Those determinations, however, are not binding on the IRS.

Comments expressed concern that the delta information necessary for an investor to determine whether a transaction is subject to section 871(m) may not be available on a timely basis, and requested that the regulations expand the categories of persons permitted to request information about the status and calculations associated with potential section 871(m) transactions. Comments recommended requiring the information to be provided on an issuer’s website at or prior to the time that the transaction is issued and updated regularly. Investors could then rely on such information between update intervals.

In response to these comments, the final regulations make several changes to the reporting obligations in the 2013 proposed regulations. The final regulations revise the period for providing requested information from 14 calendar days to 10 business days from the date of the request. In addition, the final regulations replace the list of persons entitled to request information in the 2013 proposed regulations with a simpler provision that entitles “any party to the transaction” to request information. The final regulations define “a party to the transaction” to include any agent acting on behalf of a long party or short party to a potential section 871(m) transaction, or any person acting as an intermediary with respect to a potential section 871(m) transaction. This simplification responds to the requests to expand the scope of persons entitled to request information. Several other changes that were requested, however, such as posting information electronically, were already permitted by the 2013 proposed regulations. Like the 2013 proposed regulations, the final regulations permit parties to a transaction to obtain information on potential section 871(m) transactions in a variety of ways, including through electronic publication (such as a website).

Comments also noted that a short party to a listed option will not be able to provide the long party with a written estimate of dividends at inception because the short party does not have a contractual relationship with the long party. These comments requested that the broker be required to provide the written estimates. As in the 2013 proposed regulations, the final regulations do not require any party to a transaction to provide written estimates of dividends. The final regulations have taken these comments into account, however, by increasing a taxpayer’s ability to obtain information from other parties to the transaction. The final regulations accomplish this by expanding the definition of a “party to the transaction” to include a broker and by clarifying that either a dealer or a middleman is a “broker.” Therefore, if written estimates of dividends are prepared when a transaction is issued, the long party should be able to obtain the information from another party to the transaction, whether the short party or a broker.

Recordkeeping Rules

The 2013 proposed regulations generally cross-reference the recordkeeping rules in §1.6001-1 for how a taxpayer establishes whether a transaction is a section 871(m) transaction and whether a payment is a dividend equivalent. For clarity and to ensure that the IRS will have access to sufficient information to audit taxpayers and withholding agents that are parties to section 871(m) transactions, the final regulations provide more detailed recordkeeping rules. The final regulations provide that any person required to retain records must keep sufficient information to establish whether a transaction is a section 871(m) transaction and the amount of a dividend equivalent. To satisfy this requirement, a taxpayer must retain documentation and work papers supporting a delta calculation or substantial equivalence calculation (including the number of shares of the initial hedge) and written estimated dividends (if any). The records and documentation must be created substantially contemporaneously with the time the potential section 871(m) transaction is issued.

Withholding Requirements and QDDs

1. Background

Section 871(m)(1) generally treats a dividend equivalent as a dividend from sources within the United States without regard to the residence of the person paying the dividend equivalent. As a result, section 871(m) may apply to payments made by a foreign payor to a foreign payee. See Staff of J. Comm. on Taxation, Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3310, the “Hiring Incentives to Restore Employment Act,” JCX-4-10, at 79 (Feb. 23, 2010) (explaining that section 871(m) may apply to a chain of dividend equivalents, including payments made by a foreign person pursuant to transactions described in Notice 97-66); see also Notice 97-66, 1997-2 C.B. 328, at §5, Examples 3 and 4 (illustrating that a foreign person making a substitute dividend payment to another foreign person must withhold U.S. tax). Because Congress was concerned that this rule may result in over-withholding in some instances, Congress granted the Secretary authority in section 871(m)(6) to reduce tax on a chain of dividend equivalents, but only to the extent that the taxpayer can establish that tax has been paid with respect to another dividend equivalent in the chain, or is not otherwise due, or as the Secretary determines is appropriate to address the role of financial intermediaries in such chain. For purposes of section 871(m)(6), a dividend is treated as a dividend equivalent.

2. Comments on the 2013 Proposed Regulations

The 2013 proposed regulations address the role of financial intermediaries in a chain of dividend equivalents with a rule that provides that payments made to a “qualified dealer” are not treated as dividend equivalents if made pursuant to a transaction that is entered into by the qualified dealer in its capacity as a dealer in securities and the dealer is the long party. For purposes of this rule, a qualified dealer is any dealer that is subject to regulatory supervision by a governmental authority in the jurisdiction in which it was created or organized and that certifies to the short party that it is receiving the payment in its capacity as a dealer. The 2013 proposed regulations require the qualified dealer to certify as to its dealer status to a short party on a transaction-by-transaction basis, and do not apply to dividends paid to a qualified dealer.

Comments requested that the qualified dealer exception in the 2013 proposed regulations be expanded, noting that it would be impractical for dealers to certify that each transaction was entered into in a dealer capacity (and not as a proprietary trade) and that the rule did not accommodate transactions entered into as a hedge of another transaction. Some comments suggested that the regulations exclude transactions entered into in the ordinary course of the dealer’s business for hedging purposes. Other comments recommended expanding the exception to include affiliates of qualified dealers that issue certain potential section 871(m) transactions. Comments further recommended that an affiliate in these circumstances should not be required to certify that it is acting in its capacity as a dealer. Several comments requested that, in addition to expanding the definition of qualified dealer, the final regulations provide rules similar to the proposed regulatory framework described in Notice 2010-46 (discussed in more detail in section III.B.4 of this preamble).

3. Qualified Intermediaries Acting as Qualified Derivatives Dealers

The comments received on both the 2012 proposed regulations and the 2013 proposed regulations consistently expressed the desire for a comprehensive withholding and documentation regime tailored to derivatives dealers. Rather than create a new regime for section 871(m) transactions, the Treasury Department and the IRS determined that the most comprehensive and efficient way to respond to the requests in the comments is to expand the existing qualified intermediary (QI) regime to accommodate taxpayers acting as financial intermediaries on section 871(m) transactions. Generally, a QI is an eligible person that enters into a QI agreement with the IRS and that acts as a QI under such agreement. See Rev. Proc. 2014-39, 2014-29 I.R.B. 150. A QI agreement typically requires the QI to assume certain documentation and withholding responsibilities in exchange for simplified information reporting for its foreign account holders and the ability to not disclose proprietary account holder information to a withholding agent that may be a competitor. A QI may either assume primary withholding responsibilities or may provide withholding information to a withholding agent from which it receives a payment.

QIs that hold stocks and bonds for customers often receive payments subject to withholding on behalf of their foreign account holders as custodians rather than as beneficial owners. In contrast, a broker that enters into derivative contracts as a principal typically receives dividends and dividend equivalents as part of a chain of transactions in which the broker is a counterparty to both long and short positions.

The Treasury Department and the IRS intend to implement the particular requirements of withholding and reporting on dividend equivalents received and paid by brokers by amending the QI agreement to include new provisions that will permit an eligible QI to act as a qualified derivatives dealer (QDD). A QI that acts as a QDD will not be subject to withholding on dividends or payments that may be dividend equivalents made with respect to potential section 871(m) transactions that the QDD receives while acting in its capacity as a dealer.

In order to act as a QDD, a QI must meet four requirements. First, the QDD must furnish to withholding agents a QI withholding certificate affirming that the recipient is acting as a QDD for dividends and dividend equivalent payments associated with the withholding certificate. Second, the QDD must agree to assume primary withholding and reporting responsibilities on all payments associated with the withholding certificate that the QDD receives and makes as a dealer, and to determine whether payments it makes are dividend equivalents. Third, a QDD must agree to remain liable for tax on any dividends and dividend equivalents it receives unless the QDD is obligated to make an offsetting dividend equivalent payment as the short party on the same underlying securities. Finally, a QDD must comply with any compliance review procedures that are applicable to a QI acting as a QDD, as specified in the QI agreement.

The class of persons eligible to act as a QDD is narrower than the class of persons that are eligible to enter into a QI agreement. A QI will be allowed to act as a QDD if it is either (1) a securities dealer that is regulated as a dealer in the jurisdiction in which it was organized or operates, or (2) a bank that is regulated as a bank in the jurisdiction in which it was organized or operates (or a wholly-owned foreign affiliate of such a bank). To act as a QDD, a QI that is not a securities dealer also must issue potential section 871(m) transactions to customers and receive dividends or dividend equivalent payments incident to hedges of potential section 871(m) transactions that it issues. The latter category of QDDs is intended to allow banks and bank affiliates that issue equity-linked instruments on an occasional basis to still act as QDDs.

4. Notice 2010-46

Shortly after section 871(m) was enacted, the Treasury Department and the IRS published Notice 2010-46, 2010-24 I.R.B. 757. Notice 2010-46 addresses potential overwithholding in the context of securities lending and sale repurchase agreements. Notice 2010-46 provides a two-part solution to the problem of overwithholding on a chain of dividends and dividend equivalents. First, it provides an exception from withholding for payments to a qualified securities lender (QSL). Second, it provides a proposed framework to credit forward prior withholding on a chain of substitute dividends paid pursuant to a chain of securities loans or stock repurchase agreements. The QSL regime requires a person that agrees to act as a QSL to comply with certain withholding and documentation requirements. Notice 2010-46 and any QI agreement imposing QSL requirements will remain effective until final regulations implementing the QDD rules are published.

As stated above, Notice 2010-46 provided a proposed framework to credit forward prior withholding on a chain of substitute dividends paid pursuant to a chain of securities loans or stock repurchase agreements. The Treasury Department and the IRS will continue to consider whether a credit forward system for prior withholding would be appropriate in the context of a chain of dividend equivalents on NPCs or ELIs. While administrating the credit forward system described in Notice 2010-46, however, the IRS has had difficulty verifying that prior withholding in a chain of securities loans had in fact occurred in order to justify the crediting of prior withholding to a subsequent payment. The temporary regulations, therefore, reserve on the issue of a general credit forward system, and the Treasury Department and the IRS request comments on the need for such a system and how it could be implemented.

5. Implementation of the QDD Regime and Phase-out of the QSL Regime

All existing QI agreements expire on December 31, 2016. Prior to January 1, 2017, the Treasury Department and the IRS intend to publish an updated QI agreement and rules addressing the requirements for QDD status. Procedures for entering into a QI agreement that permits a QI to act as a QDD are expected to be set out in this agreement. QDD status will be effective no sooner than January 1, 2017. Until these temporary regulations are finalized and appropriate provisions are incorporated into a new QI agreement, the provisions for QSLs and the credit-forward rules under Notice 2010-46 will continue to apply for dividend equivalents that are substitute dividend payments made pursuant to a securities lending or a sale-repurchase transaction.

Once fully implemented, the new QDD status under the QI regime will replace and expand the QSL regime described in Notice 2010-46. To continue to be eligible for the exception from withholding, entities that have been treated as QSLs will be required to enter into a QI agreement to satisfy and comply with the requirements for QDD treatment provided in the temporary regulations and in the updated QI Agreement. When these temporary regulations are finalized, the Treasury Department and the IRS expect the final regulations to supplant the proposed regulatory framework described in Notice 2010-46.

1. NY 56-57. [↑](#footnote-ref-1)
2. NY 57. [↑](#footnote-ref-2)
3. SF 13. [↑](#footnote-ref-3)
4. SF 13-14. [↑](#footnote-ref-4)
5. Cov 29-30. [↑](#footnote-ref-5)
6. IS 2, Cov 34, OCC 3, Can 3, AI 4. [↑](#footnote-ref-6)
7. IS 2. [↑](#footnote-ref-7)
8. Cov 35. [↑](#footnote-ref-8)
9. SF 19-23. [↑](#footnote-ref-9)
10. MF 9. [↑](#footnote-ref-10)
11. SF 20-21. [↑](#footnote-ref-11)
12. NY 43-44. [↑](#footnote-ref-12)
13. NY 44. [↑](#footnote-ref-13)
14. SF 20-21. [↑](#footnote-ref-14)
15. SF 21. [↑](#footnote-ref-15)
16. SF 22. [↑](#footnote-ref-16)
17. Options Clearing Corporation 10. [↑](#footnote-ref-17)
18. Options Clearing Corporation 11. [↑](#footnote-ref-18)
19. Options Clearing Corporation 13-14. [↑](#footnote-ref-19)
20. Options Clearing Corporation 13-14. [↑](#footnote-ref-20)