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### DEPARTMENT OF THE TREASURY

#### Internal Revenue Service

26 CFR Part 1

[TD 9887]

RIN 1545-BN76

### Dividend Equivalents From Sources Within the United States

**AGENCY:**

Internal Revenue Service (IRS), Treasury.

**ACTION:**

Final regulations and removal of temporary regulations.

**SUMMARY:**

This document contains final regulations relating to certain financial products providing for payments that are contingent upon or determined by reference to U.S. source dividend payments.

**DATES:**

*Effective date:* These regulations are effective on December 17, 2019.

*Applicability dates:* For dates of applicability, see § 1.871-15(r).

**FOR FURTHER INFORMATION CONTACT:**

D. Peter Merkel or Karen Walny at (202) 317-6938 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:**

**Background**

This document contains final regulations under § 1.871-15 defining the term broker for purposes of section 871(m) of the Internal Revenue Code (the Code). In addition, the final regulations provide guidance relating to

when the delta of an option that is listed on a foreign regulated exchange may be calculated based on the delta of that option at the close of business on the business day before the date of issuance. The final regulations also provide guidance identifying which party to a potential section 871(m) transaction is responsible for determining whether a transaction is a section 871(m) transaction when multiple brokers or dealers are involved in the transaction. Finally, this document withdraws temporary regulations under § 1.871-15T regarding these matters.

## I. Background on Section 871(m) Regulations

On January 23, 2012, the **Federal Register** published temporary regulations (TD 9572) at 77 FR 3108 (2012 temporary regulations), and a notice of proposed rulemaking by cross-reference to the temporary regulations and notice of public hearing at 77 FR 3202 (2012 proposed regulations, and together with the 2012 temporary regulations, 2012 section 871(m) regulations) under section 871(m). The 2012 section 871(m) regulations related to dividend equivalents from sources within the United States paid to nonresident alien individuals and foreign corporations. Corrections to the 2012 temporary regulations were published on February 6, 2012, March 8, 2012, and August 31, 2012, in the **Federal Register** at 77 FR 5700, 77 FR 13968, and 77 FR 53141, respectively. The Department of the Treasury (Treasury Department) and the IRS received written comments on the 2012 proposed regulations, and a public hearing was held on April 27, 2012.

On December 5, 2013, the **Federal Register** published final regulations and removal of temporary regulations (TD 9648) at 78 FR 73079 (2013 final regulations), which finalized a portion of the 2012 section 871(m) regulations. On the same date, the **Federal Register** published a withdrawal of notice of proposed rulemaking, a notice of proposed rulemaking, and a notice of public hearing at 78 FR 73128 (2013 proposed regulations). In light of comments on the 2012 proposed regulations, the 2013 proposed regulations described a new approach for determining whether a payment made pursuant to a notional principal contract (NPC) or an equity-linked instrument (ELI) is a dividend equivalent based on the delta of the contract. In response to written comments on the 2013 proposed regulations, the Treasury Department and the IRS released Notice 2014-14, 2014-13 IRB 881, on March 24, 2014 (see § 601.601(d)(2)(ii)(b)), stating that the Treasury Department and the IRS anticipated limiting the application of the rules with respect to specified ELIs described in the 2013 proposed regulations to ELIs issued on or after 90 days after the date of publication of final regulations.

On September 18, 2015, the **Federal Register** published final regulations and temporary regulations (TD 9734), at 80 FR 56866, which finalized a portion of the 2013 proposed regulations and introduced new temporary regulations based on comments received with respect to the 2013 proposed regulations (2015 final regulations and 2015 temporary regulations, respectively, and together, the 2015 regulations). On the same date, the **Federal Register** published a notice of proposed rulemaking by cross-reference to temporary regulations and a notice of public hearing at 80 FR 56415 (2015 proposed regulations, and together with the 2015 final regulations, 2015 section 871(m) regulations). A correcting amendment to the 2015 final regulations and the 2015 proposed regulations was published on December 7, 2015, in the **Federal Register** at 80 FR 75946 and 80 FR 75956, respectively.

The Treasury Department and the IRS received written comments on the 2015 proposed regulations. The public hearing scheduled for January 15, 2016, was cancelled because no request to speak was received.

On July 1, 2016, the Treasury Department and the IRS released Notice 2016-42, 2016-29 IRB 67 (QI

Notice), containing a proposed amended qualified intermediary agreement. The QI Notice included the requirements [**\*68791**] and obligations applicable to a QI that acts as a qualified derivatives dealer (QDD). The Treasury Department and the IRS received written comments on Notice 2016-42, which included comments on certain aspects of section 871(m) and QDDs. On December 30, 2016, the Treasury Department and the IRS released Revenue Procedure 2017-15, 2017-3 IRB 437 (2017 QI Agreement), which contains the final QI withholding agreement and the requirements and obligations applicable to QDDs.

On December 2, 2016, the Treasury Department and the IRS released Notice 2016-76, 2016-51 IRB 834, providing guidance for complying with the final and temporary regulations under sections 871(m), 1441, 1461, and 1473 in 2017 and 2018 and explaining how the IRS intends to administer those regulations in 2017 and 2018.

On January 24, 2017, the **Federal Register** published final and temporary regulations (TD 9815) at 82 FR 8144 (2017 final regulations and 2017 temporary regulations, respectively, and together, the 2017 regulations), which generally adopted the 2015 proposed regulations with certain changes. The 2017 regulations also included several technical amendments to the 2015 final regulations in response to comments on those regulations. Finally, the 2017 temporary regulations were based on comments received with respect to the 2015 proposed regulations. A notice of proposed rulemaking cross-referencing the 2017 temporary regulations was published in the **Federal Register** on January 24, 2017 (82 FR 8172), with correcting amendments published in the **Federal Register** on October 26, 2017 (82 FR 49508) (together, the 2017 proposed regulations). No public hearing was requested or held. On August 21, 2017, the Treasury Department and the IRS published Notice 2017-42, 2017-34 IRB 212, which extended certain transition relief with respect to certain portions of the 2017 final regulations.

On February 5, 2018, the Treasury Department and the IRS published Notice 2018-5, 2018-6 IRB 341, which permits withholding agents to apply the transition rules for securities loans to which section 871(m) applies from Notice 2010-46, 2010-24 IRB 757, in 2018 and 2019.

On September 20, 2018, the Treasury Department and the IRS published Notice 2018-72, 2018-40 IRB 522, which further extended certain transition relief and permitted withholding agents to apply the transition rules from Notice 2010-46 in 2020.

All written comments received in response to the 2012 proposed regulations, 2013 proposed regulations, 2015 proposed regulations, and 2017 proposed regulations are available at [www.regulations.gov](http://www.regulations.gov) or upon request.

This Treasury decision finalizes the 2017 proposed regulations without any substantive change.

## II. Executive Order 13789

Executive Order 13789 (82 FR 19317), issued on April 21, 2017, instructs the Secretary of the Treasury (the Secretary) to review all significant tax regulations issued on or after January 1, 2016, and to take concrete action to alleviate the burdens of regulations that (i) impose an undue financial burden on U.S. taxpayers; (ii) add undue complexity to the Federal tax laws; or (iii) exceed the statutory authority of the IRS. Executive Order 13789 further instructs the Secretary to submit to the President within 60 days an interim report that identifies regulations that meet these criteria. Notice 2017-38, 2017-30 I.R.B. 147, which was published on July 24,

2017, did not include regulations under section 871(m) in a list of eight regulations identified by the Secretary in the interim report as meeting at least one of the first two criteria specified in E.O. 13789 (no regulations were identified as meeting the third criterion).

E.O. 13789 further instructs the Secretary to submit to the President by September 18, 2017, a final report that recommends specific actions to mitigate the burden imposed by regulations identified in the interim report. On October 16, 2017, the Secretary published in the **Federal Register** that final report (82 FR 48013), which indicated, among other things, that the Treasury Department continues to analyze all recently issued significant regulations and is considering possible reforms of several recent regulations not identified in the earlier report, including the regulations under section 871(m).

### **Summary of Comments and Explanation of Provisions**

The Treasury Department and the IRS received one comment regarding the 2017 proposed regulations. After consideration of the comment, the 2017 proposed regulations are adopted as final regulations without any substantive change. In addition, the regulations under § 1.871-15T are withdrawn. Comments on the section 871(m) regulations that were not specific to § 1.871-15T are beyond the scope of this rulemaking and are not addressed in this preamble.

The Treasury Department and the IRS are continuing to study and consider possible reforms to the other provisions of the section 871(m) regulations pursuant to E.O. 13789 that are not specifically addressed by this Treasury decision, including comments received that relate to those rules. The Treasury Department and the IRS will consider these comments in connection with any future guidance projects addressing the issues discussed in the comments.

#### **I. Delta Calculation for Listed Options**

Generally, section 1.871-15(g)(2) provides the delta of a potential section 871(m) transaction is calculated on the earlier of when the contract is priced and when the contract is issued. See § 1.871-15(a)(6) (providing that a contract is issued at the inception, original issuance, or issuance as a result of a deemed exchange pursuant to section 1001). With respect to options listed on a regulated exchange, § 1.871-15(g)(4)(i) provided that the delta for those options is determined based on the delta of the option at the close of business on the business day before the date of issuance. Section 1.871-15(g)(4)(ii)(A) defines a regulated exchange as any exchange defined in § 1.871-15(l)(3)(vii). The 2017 temporary regulations and the 2017 proposed regulations provide that the term regulated exchange also includes a foreign exchange that (A) is regulated by a government agency in the jurisdiction in which the market is located, (B) maintains certain requirements designed to protect investors and to prevent fraud and manipulation, (C) maintains rules to promote active trading of listed options, and (D) had trades for which the average trading volume exceeded \$10 billion per day during the prior calendar year (the “\$10 billion threshold”). See § 1.871-15T(g)(4)(ii)(B). When a foreign securities exchange has more than one tier or market level on which listed options may be separately listed, the 2017 temporary regulations and the 2017 proposed regulations treat each tier or market level of the exchange as a separate exchange. See § 1.871-15T(g)(4)(ii)(B)(4).

A comment expressed concern that the \$10 billion threshold would exclude from the definition of a regulated exchange many European exchanges that are treated as regulated markets by the European Securities and Markets Authorities (“ESMA”) for purposes of the Markets in Financial Instruments Directive

2004/39/EC. The comment requested that the final regulations eliminate the \$10 billion threshold. Instead, the comment recommended [**\*68792**] that a foreign regulated exchange be defined to include an exchange treated as a regulated market by ESMA or a similar national authority and included in the respective ESMA register or similar national register (the “ESMA requirement”).

The \$10 billion threshold is intended to ensure that the exchange has a sufficient level of trading activity so that the pricing cannot be manipulated. The Treasury Department and the IRS have determined that the \$10 billion threshold continues to serve this purpose. In addition, the ESMA requirement requested by the comment appears duplicative of § 1.871-15T(g)(4)(ii)(B)(1), which requires a foreign securities exchange to be regulated or supervised by a governmental authority of the country in which the market is located, because the ESMA register is compiled on the basis of notifications made to ESMA by the national competent authorities of member states. Further, a foreign exchange that does not qualify under § 1.871-15T(g)(4)(ii)(B) can qualify under § 1.871-15(g)(4)(ii)(A) if the option exchange is a qualified board or exchange as determined by the Secretary pursuant to section 1256(g)(7)(C) or has a staff no action letter from the CFTC permitting direct access from the United States. Therefore, the Treasury Department and the IRS have determined that it is not appropriate to remove the requirement. However, consistent with the preamble to the 2017 regulations, the Treasury Department and the IRS have clarified that the \$10 billion threshold is determined based on the notional amount of the options, which is the number of shares referenced by the option multiplied by the stock price of those shares at the time of the computation. See § 1.871-15(g)(4)(ii)(B)(1)(iv).

The Treasury Department and the IRS, however, will continue to study this comment regarding the \$10 billion threshold in connection with future guidance projects related to E.O. 13789. The Treasury Department and the IRS request comments regarding whether an alternative trading threshold for U.S. equity options would ensure that there is sufficient trading on the exchange to prevent price manipulation. For example, instead of establishing a threshold based on the average daily trading volume for an exchange as a whole, an alternative threshold may be based on only the average daily trading volume of equity options on the exchange or only the average daily trading volume of equity options for a specific stock or stock index on the exchange. Comments recommending an alternative threshold should include information supporting the suggestion, including information regarding the average daily trading volumes for the exchange with respect to equity options separated out by exchange (and stock or stock index, if applicable).

## **Special Analyses**

### **I. Regulatory Planning and Review—Economic Analysis**

Executive Orders 13563 and 12866 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits, including potential economic, environmental, public health and safety effects, distributive impacts, and equity. Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility.

This regulation is not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Department of the Treasury and the Office of Management and Budget regarding review of tax regulations. Therefore, a regulatory impact assessment is not required.

## II. Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control numbers 1545-0096 and 1545-1597. The collection of information in these regulations is in § 1.871-15(p). There is no change to the total annual burden in the current regulations under §§ 1.1441-1 through 1.1441-9 as a result of these final regulations. Without these final regulations, however, the total annual burden in the current regulations under § 1.1441-1 through 1.1441-9 would increase because more than one taxpayer could be treated as a responsible party and be required to collect information regarding potential section 871(m) transactions.

The information is required to establish whether a payment is treated as a U.S. source dividend for purposes of section 871(m). This information will be used for audit and examination purposes. The IRS intends that these information collection requirements will be satisfied by persons complying with chapter 3 reporting requirements and the requirements of the applicable qualified intermediary (QI) revenue procedure, or alternative certification and documentation requirements set out in these regulations. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number.

The estimates for the number of impacted filers with respect to the collections of information described in this part II of the Special Analysis section are based on the distinct U.S. withholding agents who filed a form 1042-S reporting income code 34 (substitute payments—dividends) or income code 40 (Other dividend equivalents under IRS section 871(m) (formerly 871(l)) for calendar year 2017. The estimates for the number of impacted filers are also based on the number of U.S. withholding agents who filed a form 1042 and checked the box in section 3, indicating that the withholding agent made payments related to a potential section 871(m) transaction, for calendar year 2018. The IRS estimates the number of affected filers to be the following:

Tax Forms Impacted

Collection of information	Number of respondents (estimated)	Number of filings (estimated)	Forms to which the information may be attached
§ 1.871-15(p)(ii) Transactions with multiple brokers	1,500	51,000	Form 1042, Form 1042-S, and Form 1042-T.
§ 1.871-15(p)(iii) Responsible party for transactions traded on an exchange and cleared by a clearing organization	1,500	51,000	Form 1042, Form 1042-S, and Form 1042-T.
§ 1.871-15(p)(iv) Responsible party for certain structured notes, warrants, and convertible instruments	1,500	51,000	Form 1042, Form 1042-s, and Form 1042-T.

[\*68793]



The IRS does not have a reliable way of estimating the number of filings that will not need to be made as a result of these final regulations.

### **III. Regulatory Flexibility Act**

It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act(5 U.S.C. chapter 6). This certification is based on the fact that these regulations primarily will affect multinational financial institutions, which tend to be larger businesses, and foreign persons. Accordingly, a regulatory flexibility analysis under the Regulatory Flexibility Act is not required.

Pursuant to section 7805(f), the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses. No comments were received.

### **IV. Unfunded Mandates Reform Act**

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of \$100 million in 1995 dollars, updated annually for inflation. In 2019, that threshold is approximately \$154 million. This rule does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

### **V. Executive Order 13132: Federalism**

Executive Order 13132 (entitled “Federalism”) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This final rule does not have federalism implications and does not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

### **Statement of Availability of IRS Documents**

IRS Notices and other guidance cited in this preamble are published in the Internal Revenue Bulletin and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at <http://www.irs.gov>.

### **Drafting Information**

The principal authors of these final regulations are D. Peter Merkel and Karen Walny of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in their development.

## List of Subjects in 26 CFR Part 1

Income taxes

Reporting and recordkeeping requirements

Adoption of Amendments to the Regulations Accordingly, 26 CFR part 1 is amended as follows:

### PART 1—INCOME TAXES

**•Paragraph 1. The authority citation for part 1 continues to read in part as follows:**

Authority: 26 U.S.C. 7805 \* \* \*

§ 1.871-15T [Removed]

**•Par. 2. Section 1.871-15T is removed.**

**•Par. 3. Section 1.871-15 is amended by:**

**•1. Revising paragraphs (a)(1), (g)(4)(ii)(B), (p)(1)(ii) through (iv), and (p)(5);**

**•2. Removing the language “(r)(2), (3), and (4)” from paragraph (r)(1) and adding “(r)(2) and (3)” in its place; and**

**•3. Removing paragraph (r)(4).**

The revisions read as follows:

§ 1.871-15 Treatment of dividend equivalents.

(a) \* \* \*

(1) *Broker.* A *broker* is a broker within the meaning provided in section 6045(c), except that the term does not include any corporation that is a broker solely because it regularly redeems its own shares.

\* \* \* \* \*

(g) \* \* \*

(4) \* \* \*

(ii) \* \* \*

(B) *Foreign securities exchange—(1) In general.* A foreign securities exchange that:

(i) Is regulated or supervised by a governmental authority of the country in which the market is located;

(ii) Has trading volume, listing, financial disclosure, surveillance, and other requirements designed to prevent fraudulent and manipulative acts and practices, to remove impediments to and perfect the mechanism of a free and open, fair and orderly market, and to protect investors, and the laws of the country in which the exchange is located and the rules of the exchange ensure that those requirements are actually enforced;

(iii) Has rules that effectively promote active trading of listed options on the exchange; and

(iv) Has an average daily trading volume on the exchange exceeding \$10 billion notional amount during the



immediately preceding calendar year.

(2) *Application to an exchange with more than one tier or market.* If an exchange in a foreign country has more than one tier or market level on which listed options may be separately listed or traded, each tier or market level is treated as a separate exchange.

\* \* \* \* \*

(p) \* \* \*

(1) \* \* \*

(ii) *Transactions with multiple brokers.* For a potential section 871(m) transaction in which both the short party and an agent or intermediary acting on behalf of the short party are a broker or dealer, the short party must determine whether the potential section 871(m) transaction is a section 871(m) transaction. For a potential section 871(m) transaction in which the short party is not a broker or dealer and more than one agent or intermediary acting on behalf of the short party is a broker or dealer, the broker or dealer that is a party to the transaction and closest to the short party in the payment chain must determine whether the potential section 871(m) transaction is a section 871(m) transaction. For a potential section 871(m) transaction in which neither the short party nor any agent or intermediary acting on behalf of the short party is a broker or dealer, and the long party and an agent or intermediary acting on behalf of the long party are a broker or dealer, or more than one agent or intermediary acting on behalf of the long party is a broker or dealer, the broker or dealer that is a party to the transaction and closest to the long party in the payment chain must determine whether the potential section 871(m) transaction is a section 871(m) transaction.

(iii) *Responsible party for transactions traded on an exchange and cleared by a clearing organization.* Except as provided in paragraph (p)(1)(iv) of this section, for a potential section 871(m) transaction that is traded on an exchange and cleared by a clearing organization, and for which more than one broker-dealer acts as an agent or intermediary between the short party [~~\*68794~~] and a foreign payee, the broker or dealer that has an ongoing customer relationship with the foreign payee with respect to that transaction (generally the clearing firm) must determine whether the potential section 871(m) transaction is a section 871(m) transaction.

(iv) *Responsible party for certain structured notes, warrants, and convertible instruments.* When a potential section 871(m) transaction is a structured note, warrant, convertible stock, or convertible debt, the issuer is the party responsible for determining whether a potential section 871(m) transaction is a section 871(m) transaction.

\* \* \* \* \*

(5) *Example.* The following example illustrates the rules of paragraph (p) of this section.

(i) *Example 1: Responsible party for a transaction with multiple broker-dealers.* (A) *Facts.* CO is a domestic clearing organization and is not a broker as defined in paragraph (a)(1) of this section. CO serves as a central counterparty clearing and settlement service provider for derivatives exchanges in the United States. EB and CB are brokers organized in the United States and members of CO. FC, a foreign corporation, instructs EB to execute the purchase of a call option that is a specified ELI (as described in paragraph (e) of this section). EB effects the trade for FC on the exchange and then, as instructed by FC, transfers the option to CB to be cleared with CO. The exchange matches FC's order with an order for a written call option with the same terms

and then sends the matched trade to CO, which clears the trade. CB and the clearing member representing the person who sold the call option settle the trade with CO. Upon receiving the matched trade, the option contracts are novated and CO becomes the counterparty to CB and the counterparty to the clearing member representing the person who sold the call option.

(B) *Analysis.* Both EB and CB are broker-dealers acting on behalf of FC for a potential section 871(m) transaction. Under paragraph (p)(1)(iii) of this section, however, only CB is required to make the determinations described in paragraph (p) of this section because CB has the ongoing customer relationship with FC with respect to the call option.

(ii) [Reserved]

\* \* \* \* \*

Sunita Lough,

Deputy Commissioner for Services and Enforcement.

Approved: November 14, 2019.

David J. Kautter,

Assistant Secretary of the Treasury (Tax Policy).

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