



U.S. Tax Reporting and Withholding: Cost Basis Reporting and HIRE Act/FATCA

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WARNING!

- **The following presentation contains graphic descriptions of U.S. tax reporting and withholding requirements and may not be suitable for all viewers.**
- **This presentation may cause the following side effects: shock, shortness of breath, elevated heart rate and dizziness.**

Viewer discretion is advised.



Discussion Topics

- Cost Basis Reporting
- Substitute Dividends
- Foreign Account Tax Compliance Act (FATCA)



Cost Basis Reporting Legislation

- Rules passed into law October 3, 2008 requiring brokers that issue Forms 1099-B for dispositions to report
 - Cost basis of securities sold, and
 - Whether gains are long term or short term
- Phased-in effective dates
 - Jan 1, 2011 for stock in a corporation
 - Jan 1, 2012 for stock in open-end mutual funds and dividend reinvestment plans
 - Jan 1, 2013 for other securities
- Applies to securities
 - Acquired in the account on or after the effective date, and
 - Transferred to the account if basis information was received from transferor



Cost Basis Reporting Regulations

- Proposed regulations (REG. 101896-09) released December 17, 2009
- Comments requested regarding “the usefulness of information received from non-U.S. payors and non-U.S. middlemen, and the costs to non-U.S. payors and non-U.S. middlemen of complying with the requirements”



Cost Basis Reporting Regulations

- IIAC and other industry groups (e.g. SIFMA) made submissions seeking exclusion of QIs from application of basis reporting requirements
 - Beyond scope of QI Agreement
 - Excessive costs associated with compliance relative to potential additional tax revenue
 - If rules are to be applied to QIs, a deferral of applicable date for QIs
 - Most importantly, FATCA will already require an FFI to identify U.S. accountholders or substantial U.S. owners of foreign entities including providing a significant amount of information to the IRS



Cost Basis Reporting Regulations

- Obligation of a non-U.S. payor to report proceeds generally limited to the sale of securities by U.S. non-exempt recipients residing in the U.S.
- Given proximity of Canada to the U.S., Canadian QIs are likely to have a greater number of accountholders subject to 1099-B reporting than QIs in other jurisdictions
- Even Canadian QIs do not have a significant number of such accountholders (probably less than 1% of total number of accounts subject to QI Agreement)
- Given small number of accountholders subject to basis reporting, difficult to justify complex and costly systems changes required to automate and maintain cost-basis information
- Look at alternative solutions that require greater reliance on manual procedures and external vendors



Cost Basis Reporting Implementation - Next Steps

- Final regulations have not been released (expected soon!)
- If foreign QIs are not excluded from basis reporting requirements...
 - Assess which operations will be most affected
 - Consider necessary changes and updates to existing systems
 - Decide how to solicit customer methodology selections
 - In-house or third-party applications
 - Education (employees and clients)



Cost Basis Reporting IIAC Response (QI Committee)

- 2008 – 2009: Congressional policymakers (House and Senate) regarding legislative amendments to Section 6045 of the Internal Revenue Code
- 2009-2010: Department of the Treasury and IRS regarding draft regulations and guidance on exclusions and implementation
 - Pre-regulatory process
 - Notice 2009-17
 - Regulation 101896-09
- Member support: awareness and education



HIRE Act

- March 18, 2010: Hiring Incentives to Restore Employment Act (the “HIRE” Act) enacted
- Adds new Section 871(I) to the Internal Revenue Code
 - Substitute Dividend and Dividend Equivalent Payments
- Adds new Chapter 4 to the Internal Revenue Code
 - New reporting and withholding regime (Foreign Account Tax Compliance Act – FATCA)



Substitute Dividend Payments Legislation

- New section 871(l) added to the Internal Revenue Code
 - In response to concerns that non-U.S. persons were avoiding U.S. withholding tax on dividends through the use of securities lending/repo transactions, swaps and other derivatives
 - Provides that certain “dividend equivalent payments” are to be treated as U.S.-source dividends and subject to U.S. withholding tax when paid to a non-U.S. person
 - For certain “specified” notional principal contracts and securities lending and repo agreements, effective for payments made on or after September 14, 2010
 - For all other swap contracts, effective for payments made on or after March 18, 2012



Substitute Dividend Payments Legislation

- “Dividend Equivalent Payment”:
 - Any substitute dividend made pursuant to a securities lending or sale-repurchase transaction that (directly or indirectly) is contingent upon, or determined by reference to, the payment of a dividend from sources within the United States
 - Any payment made pursuant to a specified notional principle contract that (directly or indirectly) is contingent upon, or determined by reference to, the payment of a dividend from sources within the United States (i.e. certain equity swaps), and
 - Any other payment determined by the Secretary to be substantially similar to a payment described above.



Substitute Dividend Payments Guidance

- IRS Notice 2010-46, issued May 20, 2010:
- Contains guidance for new section 871(l)(6)
- Section 871(l)(6) authorizes administrative guidance to prevent cascading of withholding tax when dividends are paid on U.S. securities that have been lent in a series by a succession of foreign persons



Substitute Dividend Payments Guidance

- IRS Notice 2010-46, issued May 20, 2010:
- Withdraws Notice 97-66 (“Safe Harbour” notice that limited withholding on substitute payments on foreign to foreign lending)
- Notice 97-66 could be relied upon until September 14, 2010 only if the withholding agent knew or had reason to know that the principal purpose was not the reduction or elimination of withholding tax
- Describes new regulatory framework applicable as of January 2012
- Provides transitional rules that apply from September 14, 2010 until the issuance of new regulations under Section 871(1)



Substitute Dividend Payments Guidance

- As of January 1, 2012, two sets of rules will apply:
 - Qualified Securities Lender (QSL)
 - Credit Forward Rules



Substitute Dividend Payments Guidance

- What is a QSL?:
 - A financial institution that is a bank, custodian, broker-dealer or clearing organization subject to regulatory supervision in its country of organization and is regularly engaged in a trade or business that includes borrowing and lending U.S. securities to unrelated customers
 - Is subject to IRS audit or is a QI that amends its QI Agreement and
 - Files an annual statement with the IRS
- Substitute dividends paid to a QSL will not be subject to withholding provided that the borrower received a written certification that payee is a QSL and that the QSL will withhold and remit tax as required



Substitute Dividend Payments Guidance

- Credit Forward Rules:
 - Where payment is not to a QSL
 - Withholding agent may reduce withholding by an amount previously withheld if there is “sufficient evidence of prior withholding”, including:
 - Receiving a substitute dividend net of NRA withholding
 - Receiving a written statement from the immediately prior withholding agent showing the amount of tax withheld
 - Identifying prior withholding agent and recipient of the payment, and
 - No reason to know that the statement is unreliable



Substitute Dividend Payments Guidance

- Transitional rules from September 14 until regulations are issued:
 - Adopt a system that reasonably implements QSL rules
 - Financial institution may represent that it is a QSL
 - QI that acts as a QSL will be deemed to have agreed to amend its QI agreement as necessary to report and withhold U.S. tax
 - FI may be required to identify itself to the IRS before the end of 2010
- Receipt of net payments
 - Withholding agent making a substitute payment may presume that tax has been previously paid where certain criteria are satisfied.



Substitute Dividend Payments Implementation – Next Steps

- Withholding agents should determine if they've been relying on Notice 97-66 for any securities lending transactions
- If acting as a QSL, need to provide statement to counterparties
- Obtain statements from counterparties acting as QSLs



Substitute Dividend Payments Implementation – Next Steps

- QSL Statements During Transition Period
 - To be provided annually
 - FI must reasonably determine that it meets the requirements to qualify as a QSL as per the Notice (without regard to the requirement to file an annual statement with the IRS)
 - Certification must include a statement that the recipient of a substitute dividend is a Qualified Securities Lender and that, with respect to any substitute dividend it receives from the withholding agent, it will withhold and remit or pay the proper amount of U.S. gross-basis tax with respect to substitute dividend payments that it receives or makes.



Substitute Dividend Payments IIAC Response

- Industry roundtable convened to discuss common problems and approaches
- Working group developed to provide comments to Treasury/IRS on future guidance and regulations
- Developing an “industry standard” for certification forms



Foreign Account Tax Compliance Legislation

- **Purpose:** To actively seek U.S. persons that evade taxes through the use of foreign accounts and entities
- **Method:** To require all foreign financial institutions (FFI) to identify and report U.S. persons to U.S. authorities
- **Legislation:** All withholdable payments made to an FFI, including gross proceeds, will be withheld at 30% of the amount of such a payment



Foreign Account Tax Compliance Legislation

Broad definition of Foreign Financial Institution (FFI)

- **“Financial Institution”**: Except as otherwise provided by the Secretary, the term “financial institution” means any entity that:
 - Accepts deposits in the ordinary course of a banking or similar business,
 - Is engaged in the business of holding financial assets for the account of others, or
 - Is engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interest (including a futures or forward contract or option) in such securities, partnership interests, or commodities.



Foreign Account Tax Compliance Legislation

- The FFI may avoid the 30% withholding by entering into an agreement with the IRS, whereby the FFI agrees to:
 - Obtain information regarding each holder of each account maintained by the FFI to determine which, if any, are U.S. person accounts
 - Comply with such verifications and due diligence to be determined by the Secretary
 - Report information annually on any U.S. account maintained
 - Deduct and withhold 30% on payments made to “recalcitrant” account holders or other FFIs who do not enter into such agreements with the IRS
 - Comply with requests for any additional information regarding any U.S. account maintained
 - Obtain a valid and effective waiver of any jurisdictional law preventing the reporting of any required information described in the legislation, or, in the absence of such a waiver, close the account
- NOTE: Requirements under an agreement entered into under FATCA legislation are in addition to requirements prescribed under any current QI Agreement



Foreign Account Tax Compliance Legislation

- Information required to be reported on U.S. person accounts
 - Name, address and Tax ID Number (TIN) (including the name, address and TIN of any substantial U.S. owner of a legal entity account)
 - Account number
 - Account balance or value at such time and in such manner as the Secretary may provide
 - The gross receipts and gross withdrawal or payments from the account determined at such period and in such manner as the Secretary made provide



Foreign Account Tax Compliance Legislation

- **Exception: In regards to certain accounts held by individuals:**
 - The term “United States Account” shall not apply if the holder of such account is a natural person and the aggregate value of all deposit accounts held, in whole or in part, by such person and maintained by the same FFI does not exceed \$50,000.
 - Note: To the extent provided by the Secretary, FFIs which are members of the same expanded affiliated group shall be treated for the purposes of the above mentioned clause as a single FFI.



Foreign Account Tax Compliance Guidance

IRS Notice 2010-60

- Released August 28, 2010
- Provides preliminary guidance regarding “priority issues” involving implementation
 - Scope of obligations exempt under “grandfathering” provisions
 - Definition of “FFI”
 - Scope of information collection and identification of persons by financial persons
 - Information that FFIs must report to the IRS under FFI Agreement with respect to U.S. accounts
- Future regulations to be issued to incorporate this guidance; will publish draft FFI Agreement and forms



Foreign Account Tax Compliance Guidance

- **Scope of obligations exempt under “grandfathering” provisions**
 - Any payment made pursuant to any obligation outstanding on March 18, 2012 (or any gross proceeds from the disposition of such an obligation) will not be subject to withholding under Chapter 4
 - But, “Obligation” will not include savings deposits, demand deposits, brokerage or custodial agreements



Foreign Account Tax Compliance Guidance

- DOCUMENTATION: Scope of information collection and identification of persons by FFIs
- Participating FFIs must determine whether accounts are to be treated as:
 - U.S. accounts
 - Accounts of participating FFIs
 - Accounts of deemed-compliant FFIs
 - Accounts of non-participating FFIs
 - Accounts of entities that pose a low risk of tax evasion
 - Accounts of recalcitrant account holders
 - Accounts of excepted NFFEs
 - Accounts of other NFFEs
 - Other accounts



Foreign Account Tax Compliance Guidance

- Procedures for making determinations with regard to four categories of accounts:
 - Pre-existing individual accounts
 - New individual accounts
 - Pre-existing entity accounts
 - New entity accounts
- FFIs will be allowed to rely on forms W-9 and W8-BEN for the purposes of FATCA
- IRS will issue employer ID numbers (EINs) to participating FFIs to facilitate identification
- Until EINs distributed, withholding agents and participating FFIs will be permitted to rely on certifications



Foreign Account Tax Compliance Guidance

- **Pre-existing individual accounts** (1 year from FFI Agreement)
 - Determine if U.S. account, recalcitrant account or other account
 - All depository accounts less than \$50,000?
 - Already documented as U.S. person?
 - Electronically searchable information – indicia of U.S. status
 - If indicia, obtain documentation
- Within 2 years, reconfirm and collect all documentation for accounts >\$1 million average monthly balance
- Within 5 years, reconfirm and collect all documentation for accounts >\$50,000 monthly balance
- **New individual accounts**
 - Has the account holder already been documented?
 - FFI will obtain and examine documentary evidence establishing U.S. or non-U.S. status
 - FFI will be required to repeat steps if the FFI knows or has reason to know that circumstances of status have changed



Foreign Account Tax Compliance Guidance

- **Pre-existing entity accounts** (1 year from FFI Agreement)
 - Already identified as U.S. person?
 - Entities may provide documentation establishing non-U.S. status
 - Electronically searchable files – indicia of U.S. status – (rebuttable) presumption where U.S. indicia exists
 - Is the entity an FFI? If so, EIN/certification to be requested
 - If no EIN, documentation to be provided as to status (non-participating FFI? NFFE?)
 - If no documentation, entity presumed to be non-participating FFI
- Within 2 years, NFFE must provide documentation on each individual with interest in entity (as to U.S. status), then entity is presumed recalcitrant account holder



Foreign Account Tax Compliance Guidance

- Indicia of U.S. status:
 - Electronic fields for collection of information
 - U.S. resident or U.S. citizen
 - U.S. address (residence or correspondence)
 - U.S. place of birth
 - “hold mail” or “in care of”
 - Power of attorney or signatory authority granted to person with U.S. address
 - Standing instructions/wire instructions to transfer funds to U.S. or received from U.S.
 - Place of incorporation in U.S.
- U.S. ownership → 10% vs. 25% requirements (AML/IIROC Reg 1300)



Foreign Account Tax Compliance Guidance

- **Retirement Plans**

- Exemption for retirement plan payments where beneficial owner belongs to class of persons identified by Secretary as “posing a low risk of tax evasion” only where:
 - Plan qualifies as a retirement plan under law of country in which it is established
 - Plan sponsored by a foreign employer AND
 - Plan does not allow U.S. participants or beneficiaries other than employees that worked for the foreign employer in the country in which the plan was established.



Foreign Account Tax Compliance Implementation – Next Steps

It is not too early to begin!

- Identify your stakeholders – educate senior management
- Allocate sufficient resources – assemble a multi-disciplinary team
- Identify groups and business lines impacted
- Consider the client impact and what education is needed
- Understand the data and systems requirements



Foreign Account Tax Compliance IIAC Response

IIAC Response (QI Committee)

- Response to 2010 Revenue Proposals (Obama Administration)
- Response to House Committee (Ways and Means) on draft Foreign Account Tax Compliance Act
- Participation in international coalition of associations and financial institutions
- Industry awareness: media, newsletters, President's Letters to industry CEOs
- Response to Notice 2010-60 – by November 1, 2010



Questions?

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