



FStaxworld
Your October snapshot

In this month's *FStaxworld*, we analyze the new final and temporary Section 871(m) regulations

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The View from Deloitte

Dear Reader,

On 17 September 2015, the U.S. Treasury Department and the Internal Revenue Service (IRS) released a combined set of final and temporary §871(m) regulations (hereafter, the “New §871(m) Regulations”).

Structurally, the highly anticipated New §871(m) Regulations resemble the proposed §871(m) regulations issued in December 2013. However,

following lively debate with different affected parties, this updated version adopted several key relief provisions, while rejecting other submitted proposals.

The law aims to regulate derivative contracts referencing a U.S. equity as an underlying asset, regardless of the location of the issuer. The U.S. government is concerned that some of these contracts enable non-U.S. Persons to enjoy the economic benefits of holding the underlying U.S. equities, while avoiding any withholding on U.S. dividend payments.

Therefore, the IRS will treat dividend equivalent payments from qualifying derivative contracts as U.S.-source income, subject to withholding and reporting. The statute and New §871(m) Regulations segregate the population of derivative contracts into three general categories – securities lending and sales-repurchase agreements (repos), notional principal contracts (NPCs), generally referred to as swaps, and equity-linked instruments (ELIs), which broadly consists of futures, forwards and option contracts. The statute and New §871(m) Regulations apply different but overlapping analyses to each contract type in order to determine whether it qualifies as in-scope for purposes of §871(m) withholding and reporting. Due in part to the financial sophistication of many of the contracts governed, the New §871(m) Regulations present an especially demanding set of compliance rules.



Implementation timeline

Fortunately, the New §871(m) Regulations postpone the implementation of the full set of rules to 1 January 2017. Thus, only derivative contracts issued on or after that date will be subject to its full range of terms. Nonetheless, a limited application of the rules prior to 2017 may implicate derivative contracts issued in 2015 or 2016. NPCs contracted in 2015 and 2016 continue to be assessed under the so-called four-factor test. Moreover, NPCs contracted in 2016 that do not qualify under the four-factor test, as well as any ELI issued in 2016, are potentially in-scope of §871(m) where the contract contemplates a payment in 2018 or afterwards.

As a result of the staggered implementation of the regulations, for any contracts issued in 2016 with a payment contemplated in 2018 or beyond, designated financial institutions (brokers, dealers or any short party to such a transaction with a non-broker or non-dealer long party) will be required to provide the §871(m)-related information within 10 business days upon request from a counterparty. Furthermore, there is a requirement under the New §871(m) Regulations to keep §871(m)-related records of any derivative contract within 10 business days of issuance. Few designated financial institutions will be prepared with the processes and systems necessary to determine a contract’s status by 1 January 2016. Many had

presumed a longer implementation period in light of the delays in the release of the regulations. Many, thus, will need to assess the risks attendant to issuing any products that could potentially be captured by the notification rule and record-keeping obligation.

Key points of the New §871(m) Regulations

While retaining key structural and thematic elements of the prior version of the §871(m) regulations, the New §871(m) Regulations provide some relief, as shown in the key points set forth below:

Modifications to the eligibility criteria for in-scope derivative contracts: In order to determine whether a derivative contract is in-scope of §871(m) dividend equivalent withholding, the responsible party must apply, at issuance, one of the designated tests. Two different tests co-exist, depending on whether the contract must be treated as a Simple Contract or a Complex Contract. A Simple Contract references a fixed number of shares and has a single maturity or exercise date. A Complex Contract is any relevant contract that is not a Simple Contract.

The Delta Test for Simple Contracts: For a Simple Contract, the applicable assessment is the Delta Test.

- The Delta Test measures the movement of price of the derivative contract in relation to a movement of price in the underlying security, thereby yielding a coefficient of correlation between the two.
- Simple Contracts with a delta of 0.8 or higher (elevated from 0.7 or higher in previous §871(m) regulations) are in-scope for §871(m) dividend equivalent withholding and reporting.
- Absent substantial modification, the delta for such contracts will be calculated a single time, at issuance, and not each time the derivative is exchanged or when a payment is made, as required by the 2013 proposed regulations.
- The constant delta rule, whereby a contract with a delta that is not expected to vary over the course of the contract's lifetime will be treated as having a delta equal to 1.0 under the prior version of the §871(m) regulations, is no longer applicable under the New §871(m) Regulations.

The Substantial Equivalence test for Complex Contracts: For a Complex Contract, the assessment technique is named the Substantial Equivalence test. This is only a temporary provision, currently due to expire on 17 September 2018. The Substantial Equivalence test endeavors to compare upwards and downwards price movements between the contract and the prices of the underlying securities used to hedge the contract, in part by benchmarking the Complex Contract against a similar in-scope Simple Contract.

Exposition of presumption rules for Combined Transactions: Two contracts referencing the same underlying security continue to be treated as a Combined Transaction for purposes

of applying the relevant in-scope test, where they are entered into “in connection with” one another.

- However, the New §871(m) Regulations introduce two presumption rules such that brokers, where the short party to the transaction, may presume that two transactions are not entered “in connection with” one another if they are a) booked on two different accounts or b) separated by at least two business days, absent actual knowledge to the contrary.
- Conversely, the IRS will presume the contracts were entered into “in connection with” one another where both conditions are met. Such a presumption is, however, rebuttable.

Introduction of the Qualified Derivatives Dealer (QDD) status: Eligible and willing Qualified Intermediaries (QIs) may serve as QDDs, allotting to them a similar role as Qualified Securities Lenders (QSLs), whereby a QDD assumes overall responsibility (and liability) for ensuring the correct withholding on any payments in-scope for §871(m) and, in exchange, may exercise control over chains of payments to prevent cascading withholding (i.e. multiple levies on the same dividend equivalent).

- The IRS will promulgate a new set of provisions in the QI Agreement to define and govern this status.
- The QSL status will be phased out as the QDD status is introduced.

Definition of a Qualified Index: Derivative contracts that reference a Qualified Index do not need to consider any U.S. securities referenced in such index as an underlying security, which otherwise would be subject to the in-scope test and potentially to §871(m) dividend equivalent withholding.

- The New §871(m) Regulations ease slightly the eligibility criteria for an index to be treated as a Qualified Index, notably in respect of the previous limitations on over-weighted component securities and on the re-balancing of the index’s composition.

The scope of implied payments: Derivative contracts in-scope for §871(m) that do not pay an actual dividend equivalent, but which are deemed to embed dividend equivalents in their pricing, are subject to §871(m) withholding.

- The New §871(m) Regulations lighten the operational burden imposed by such a requirement to withhold on non-payments by limiting the incidents of §871(m) withholding on implied payments of dividend equivalent amounts, though not deleting the concept entirely.

Elimination of the lapsed short-term option exemption: The New §871(m) Regulations eliminate the relief granted in the prior regulations to exempt option contracts lasting less than one year that are not exercised prior to their termination date.

The select relief provisions and partial implementation postponement notwithstanding, daunting obstacles litter the route to full compliance with the New §871(m) Regulations. In addition to the various testing methods needed to assess whether a contract is in-scope for §871(m), payments must be identified, payees documented and withholding potentially

applied by withholding agents intermediating qualifying payments. In order to overcome such obstacles, careful planning and informed decision-making are critical. Through our experiences supporting a global Swiss bank with its preliminary implementation program, Deloitte amassed expertise in §871(m) implementation unrivalled in the Swiss marketplace. Accordingly, we will combine our tax technical acumen with our knowledge of operational best practices to prepare an expanded set of §871(m) informational materials for release shortly. Further, we will host an on-site event next month to explore in greater detail the impact of the New §871(m) Regulations on Swiss producers and consumers (i.e. issuers and investors) of derivative contracts with underlying U.S. securities.

For further information on this event, please contact [Patricia Almeri](#).

Regards,

[Paul Millen](#)
[Martin Widmer](#)
[Kevin Radon](#)

OECD launches Automatic Exchange of Information Portal

On October 13, the OECD launched the [AEOI Portal](#), a webpage intended to provide a comprehensive overview of the OECD's progress in implementing the Common Reporting Standard (CRS).

The portal content includes a historical timeline and background on information exchange, guidance and materials, details on the international framework for CRS exchange relationships, information on and assistance with implementation, and an explanation on the commitment and monitoring process. The AEOI Portal is expected to be a central repository for CRS-related information and guidance, such as Taxpayer Identification Number (TIN) formats and local tax residency idiosyncrasies.

However, the Portal is explicitly dependent on each jurisdiction for its own information and guidance, which may result in time lags, missing guidance and challenging accessibility due to unusual presentation. As such, Deloitte Switzerland's Taxparency solution, [launched this July](#), remains the most reliable source of the information needed to support global financial institutions in accessing and analyzing FATCA, CRS, and Qualified Intermediary (QI) regulatory content.

For more information, please contact [Markus Weber](#), [Michael Grebe](#) or [Robin King](#).

Report from the FATCA Frontline: IRS Notice 2015-66 Postpones Certain FATCA Deadlines

On 18 September, the IRS published a notice postponing several important FATCA deadlines. Notice 2015-66 announced that the Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) intend to amend the Treasury Regulations to extend the time that certain FATCA transitional rules will apply or to expand the coverage of the relief provided. Specifically, the amendments will extend:

- The deadline for a sponsoring entity to register certain sponsored entities and re-document such entities to withholding agents, as warranted;
- The use of limited branches and limited foreign financial institutions (limited FFIs); and
- The date for when withholding on gross proceeds and foreign passthru payments will begin.

In addition, in order to reduce compliance burdens on withholding agents that hold collateral as a secured party, the notice reported that Treasury and the IRS intend to amend the regulations under chapter 4 to modify the rules for grandfathered obligations in relation to collateral. Further, it outlined the conditions under which certain specified types of IGA jurisdictions (i.e. those with unsigned IGAs) will conduct their reporting for tax year 2014.

For more information, please contact [Paul Millen](#).

Webcast on BEPS and Corporate Tax Reform III: A Swiss Perspective

On 5 October 2015, ahead of the G20 Finance Ministers' meeting in Lima, Peru on 8 October, the OECD Secretariat published 13 final reports and an explanatory statement outlining consensus actions under the Base Erosion and Profit Shifting (BEPS) project. We are pleased to inform you that we will host a [live webcast](#) on Tuesday, 27 October from 05.00 pm to 06.00 pm (CET). Our webcast will focus on the effects of the final changes to tax and transfer pricing rules for Swiss based companies. We will also discuss the latest insights into Corporate Tax Reform III (CTR III) in the light of BEPS.

As part of our webcast, our Deloitte experts will share their insights on the following topics:

- Overview of BEPS Action Plan, a Swiss perspective

- CTR III in the light of BEPS; and
- Finding your way to cope with BEPS / CTR III

This will be a unique opportunity for you to stay up to date with these fundamental changes to international taxation that may affect you and your business. To register for the webcast, please visit our [website](#).

For more information, please contact [Laure Golly](#).

Pan-European Fund Tax Roadshow

We are pleased to inform you that our tax and regulatory experts from across Europe will update you on the latest challenges and trends of the Pan-European Tax regimes in the following countries: Austria, Belgium, Denmark, France, Germany, Switzerland and United Kingdom.



Our qualified specialists will take this opportunity to present the more recent pan-European tax developments including OECD CRS and hot topics relating to the forthcoming challenges with a special focus on cross border fund distribution.

We will host two events in Switzerland: on the 24th of November in Zurich and on the 25th of November in Geneva.

To register for the event in Zurich, please click [here](#).

To register for the event in Geneva, please click [here](#).

For more information, please contact [André Kuhn](#).

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