BNY MELLON

BROWN
BROTHERS
HARRIMAN

NORTHERN
TRUST

STATE STREET

April 26, 2016

Internal Revenue Service
CCPA:LPD:PR (REG-127895-14)
Room 5203
PO Box 7604
Ben Franklin Station, Washington, DC20044

Re: Code section 871(m) Regulations

Ladies and Gentlemen:

The Bank of New York Mellon, Brown Brothers Harriman, The Northern Trust Company and State Street Bank and Trust Company wish to comment on some of the many issues arising out of the Code section 871(m) regulations package released in September 2015. Our organizations act as major global custodians of client assets among our service offerings, and we have a keen interest in sensible and workable implementation of the section 871(m) regulations. Several points in these regulations affect custodians as well as brokers that are not issuers of instruments, and we wish to provide our comments on those issues:

A custodian Is not a party to an 871(m) transaction, and is not positioned to identify section 871(m) transactions or calculate delta

The final 871(m) regulations appear to treat a custodian (other than the issuer} as a "party to the transaction" in cases where the custodian is either (1) an "agent acting on behalf of the long party or short party" or {2) "acting as an intermediary with respect to the potential 871(m) transaction". Regulation section 1.871-15(a)(9)(iii). Regulation section 1.871-lS(p)(l) places the obligation of determining whether a potential section 871(m) transaction is a section 871{m) transaction on a broker

or dealer that is a party to a transaction, if a counterparty or customer is not a broker or dealer. If both parties are brokers or dealers, or neither party is a broker or dealer, the regulations place the responsibility to determine 871(m) applicability on the short party. Custodians meet the definition of the term "broker" in the 871{m) regulations because that term includes a broker within the very broad meaning provided in section 6045(c). Accordingly, the final87l(m) regulations would appear to provide that a custodian may be a party required to determine whether a potential section 87l(m) transaction is a section 87l(m) transaction.

We expect that the IRS created the "party to the transaction" label to facilitate the information exchange identified in Regulation section 1.871·1S(p){l)pursuant to Regulation section 1.871·15{p)(3). However, for an asset not held in custody, such as an over-the-counter instrument, the custodian does not safekeep the instrument and would not be a party to it in any sense. Rather, the client or its investment manager will execute a trade with a registered broker/dealer who is responsible for calculating payments on an option or swap and for informing clients of these amounts. For a cleared 871(m) instrument, the clearing broker or Futures Commission Merchant {FCM) acts as the conduit between the exchange and the client;the custodian's role is small (and knowledge limited) compared to the clearing organization and the brokers and FCMs involved in the transactions.

As to cleared instruments such as listed options, we understand from comments made by Treasury and Chief Counsel representatives at recent industry conferences that the dearing organization may not be viewed as the party responsible for identifying section 871{m) transactions or determining delta. Those comments present concerns as to the party best positioned to be responsible for those determinations.

For both over the counter and listed instruments, a custodian is not positioned to identify section 871(m) transactions or determine delta. Custody functions have limited information about clients' 87l{m) transactions, and lack the infrastructure to determine delta. Delta requires a financial analysis far beyond the scope of a custodian's safekeeping and recordkeeping responsibilities, and far beyond the accounting services offered to clients. Custodians rely on data vendors to pass information to them, as they are downstream from the issuers of serurities and other instruments. The focus of responsibility for 871(m) determination should be on the short party or, for cleared instruments, the clearing brokers, FCMs or clearing organizations.

Accordingly, we request a clarification that custodians acting in their capacity as such are not required to create information pursuant to Regulation section 1.871-IS{p){l). This clarification will not affect the existing withholding regimes under chapters 3, 4 and 61, and could be made by adding the following examples to Regulation section 1.871-15(a)(9)(iv)(B):

> Example (iii): CO is a domestic clearing organization. CO serves as a central counterparty clearing and settlement service provider for derivatives exchanges in the United States. CB is a broker organized in Country X, a foreign country, and a clearing member of CO. FC is a foreign corporation that has an investment account with CB. FC instructs CB to purchase a call option that is a specified Ell (as described in §1.871·15{e)}. CB effects the trade for FC on an exchange of which CO is the clearing organization. The exchange matches FC's order with an order for a written call option with the same terms. The exchange then sends the matched trade to CO, which clears the trade. CB and the clearing member representing the call option seller 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 call option seller. GC, a U.S. financial institution and custodian, receives proceeds from the

option contracts on behalf of FC and records the transaction in Fe's books and records. To the extent that there is a dividend equivalent with respect to the call option, both CO and CB are parties to the transaction. GC is not a party to the transaction.

Example (iv): C, a u.s. financial institution, acts as custodian for B. C does not custody the NPC, and only acts to receive or disburse funds as instructed by B or B's investment manager. C receives proceeds from the NPC for crediting to B's account. Cis not *a* party to the transaction.

Further, to ensure that custodians which have a withholding obligation on an 871{m) transaction are provided the information to be reported under Regulation section 1.871-lS(p)(l), we request that the text of Regulation section 1.871-15(p)(3){ii) be amended as follows:

"Any party to the transaction described in paragraph {a)(9) of this section or any withholding agent that is not a party to the transaction may request the information specified in paragraph (p) of this section with respect to a poter1tial section 871(m) transaction from the party required by paragraph (p)(3)(i) of this section to provide the information.

Combined Transactions

The final regulations include rules requiring that two or more transactions be treated as a single transaction for purposes of the application of section 871(m), in certain cases. In general, if a party enters into two or more transactions that would have been subject to withholding under section 871(m) if they were a single position, that reference the same underlying security, and that are entered into "in connection with" each other, then the positions are combined for purposes of applying section 871(m). The final regulations add certain presumption rules for short parties such that transactions should not be considered entered into "in connection with" each other if they are made two or more business days apart or are held or reflected in separate accounts. The rules under Regulation section 1.871-lS{n) also include presumption rules that the Commissioner may apply in cases where the long party reflected transactions on separate trading books or entered into the transactions two or more business days apart.

As noted above, it is our view that a financial institution acting in a custodial capacity is not a party to section 871(m) transactions. Custodians generally would have no way of knowing whether separate transactions were entered into in connection with each other, and thus are not properly positioned to know when separate transactions should be considered "combined transactions."

Regulation section 1.871-15(p)(3)(i) provides that "upon request", the party required to report information such as delta and the dividend equivalent amount under Regulation section 1.871-15(p)(1) must also "provide the requester with ... the identity of any transactions combined pursuant to paragraph (n)...." However, we request that the regulations be amended to clarify and make explicit that the party responsible for making the determinations as to the applicability *of* 871(m) under Regulation section 1.871-lS(p)(l) has an affirmative obligation to determine and communicate to withholding agents the existence of "combined transactions", if they are aware of transactions that are

required to be combined, and that a withholding agent may rely on such determination. If the party required to report the information under Regulation section 1.871-15(p) does not have the ability to determine whether a transaction should be combined with any other transactions under Regulation section 1.871-lS(n), the obligation to notify the withholding agent should fall on a party to the transaction that does have actual knowledge that two or more transactions should be combined. In all other circumstances, the withholding agent should have no obligation to know or assume that two or more transactions should be combined.

In order to implement the clarifications suggested above, we respectfully request the following:

a. Amending Regulation section 1.871-15{p)(1) as follows: "....The party to the transaction that is required to determine whether a transaction is a section 871(m) transaction must also determine and report to the counterpartyz eF customer and withholding agent the timing and amount of any dividend equivalent (as described in paragraphs (i) and M of this section). the delta of the potential section 871(m) transaction, and whether the transaction should be combined with any other transaction under paragraph fn) of this section. If the party required to report transactions under this paragraph does not know whether a transaction should be combined with any other transaction under paragraph In) of this section, the party to the transaction that has this information must report this information to the counterparty, customer or withholding agent...."

b. Amending Regulation section 1.871-1S(p)(3)(ii) as recommended in the preceding section to this letter.

c. Adding a new Regulation section 1.871-1S(p)(3)(iv) as follows; "{iv). Reason to know. For purposes of paragraph (p)(l) of this section, a withholding agent that is not a party to the transaction knows or has reason to know that a transaction should be combined with another transaction under paragraph (n) of this section only If such information was reported to the withholding agent In accordance with paragraph {p)(3)(i} or (p)(3)(11J of this section."

d. Amending Regulation section 1.1441-3(h)(2) as follows: "....When a withholding agent fails to withhold the required amount because the party described in §1.871-lS[p) fails to reasonably determine or timely provide information regarding whether a transaction is a section 871(m) transaction, the timing and amount of any dividend equivalent, whether the transaction should be combined with any other transaction, or any other information required to be provided pursuant to §1.871-15(p), and the withholding agent relied, absent actual knowledge to the contrary, on that party's determination or did not timely receive required information, then the failure to withhold is imputed to the party required to make the determinations described in §1.871-lS(p). For this purpose, a withholding agent that is not a party to the transaction will be deemed to have actual knowledge that a transaction should be combined with another transaction under§1.871-lS(n) only if such information was reported to the withholding agent in accordance with §1.871-lS(pl...."

Finally,there are significant operational complexities involved with implementing the requirement to combine transactions under these rules. For example, industry participants will need to develop a standard methodology for appropriately "tagging" a transaction as being linked to a related transaction as part of the combination rules, and therefore subject to 871(m). and implement systems and process changes accordingly. Given the additional issues and considerable resource needs associated with these requirements,we understand that many financial institutions are currently viewing implementation of the combination rules as a "phase two" part of their overall section 871(m) programs. As such, we request that the Service delay by one year the effective date of the requirement to combine transactions under Regulation section 1.871-lS(n), untilJanuary 1, 2018.

Timing of withholding: Need for flexibility

Regulation section 1.1441-2(e)(8)(i) provides that withholding on a dividend equivalent amount must be performed on one of the following two days, whichever is tater: (a) the day that the amount of a dividend equivalent is determined, or (b) the day a payment occurs with respect to the 871(m) transaction.

It is our understanding that the above provision takes into consideration an industry request that withholding not be required until an actual payment event. While we appreciate the deferral of tax withholding until an actual payment event, we request that the regulations be changed to accommodate a date range within which withholding is required to be performed. A date range takes into consideration the wide variety of derivatives (options, futures, structured notes, swaps, etc.),both cleared and over-the-counter, that may give rise to dividend equivalent amounts, and the corresponding wide variety of transaction flaws and systems functionalities.

For example,for certain derivatives for which an actual dividend equivalent payment is not made, based on discussions with our information technology colleagues, it is our understanding that it would be significantly less burdensome to implement functionality to withhold for 871(m) purposes on the payment date of the actual dividend on the underlying security. This date generally falls in between the two days in current Regulation section 1.1441-2(e}{8Hi), but can be shortly after the later of these two days.

We request that withholding agents be permitted to withhold on any day within a specified date range provided that the withholding agent takes a consistent approach with respect to a dearly identified group of derivatives. This proposal will accommodate the two days in current Regulation section 1.1441-2(e)(8Hi),the date of the actual dividend on the underlying security (our above proposal),and perhaps another day falling within the three foregoing days, to be determined once we complete our impact assessment on all derivatives. This proposal also would accommodate the variety of systems and processes at different withholding agents. Permitting withholding agents to withhold on any day within a defined date range as opposed to mandating withholding on the later of two or more specified days also would enable withholding agents to withhold earlier than demanded by the current regulation. Some of our agreements with customers prohibit withholding earlier than the date mandated under

regulations. Therefore, withholding agents would need explicit regulatory authority to withhold within a date range.

Accordingly, we request that Regulation section 1.1441-2(e)(8)(i) be replaced in its entirety with the following:

§ 1.1441-2(e)(8) Payments of dividend equivalents.

(i) In General. A withholding agent may treat a payment of a dividend equivalent as made on any day falling within the following time period--

(A) The day when the amount of a dividend equivalent is determined as provided in §1.871-1SUJI2), and

(B) The later of

(1) the first day after the day described in paragraph (e)(S)(i)(A) of this section that a payment occurs with respect to the section 871(m) transaction, or

(2) the dividend payment date of the referenced security,

in each case, provided that the withholding agent takes a consistent approach with respect to a clearly identified group of derivatives (such as by derivative type or system in which derivative transactions are recorded).

Use of the end of the day delta for listed instruments:

We recommend that delta for listed options be determined based on the prior day's closing price. This recommendation was also made on behalf of the U.S. Securities Market Coalition in the letter prepared by Covington & Burling LLP on section 871(m) dated February 24, 2016, which describes this proposal in detaiL This topic is of interest to those of us which act as a clearing broker for listed options, but not in our role as a custodian because, in this role, we do not believe that we will be a withholding agent for listed options {in part, because we do not "custody" option contracts or broker options transactions).

[Remainder of this page is blank]

We appreciate your attention to these matters, and we are happy to discuss them if needed. Please let us know if you have any questions about these subjects.

Sincerely,

Jacob Braun
Bank of New York Mellon

Stephen *Vescio*
Brown Brothers Harriman

Laura E. Durham
The Northern Trust Company

Robert J. Foley
State Street Bank and Trust Company

We appreciate your attention to these matters, and we are happy to distuss them if needed. Please let us know if you have any questions about these subjects.

Sincerely,

Jacob Braun
Bank of New Yor Mellon

StePhen o
Brown Brothers Harriman

E /flu,f.pvv
Uura E. Durham
The Northern Tru5-t Company

Robert J. Foley
State Street Ba1lk and Trust Company