

reveal the identity of a source who provided information under an express promise of confidentiality.

(3) From 5 U.S.C. 552a(d)(2), because to require the Commission to amend information thought to be incorrect, irrelevant, or untimely, because of the nature of the information collected and the length of time it is maintained, would create an impossible administrative and investigative burden by continually forcing the Commission to resolve questions of accuracy, relevance, timeliness, and completeness.

(4) From 5 U.S.C. 552a(e)(1) because:

(i) It is not always possible to determine relevance or necessity of specific information in the early stages of an investigation.

(ii) Relevance and necessity are matters of judgment and timing in that what appears relevant and necessary when collected may be deemed unnecessary later. Only after information is assessed can its relevance and necessity be established.

(iii) In any investigation the Commission may receive information concerning violations of law under the jurisdiction of another agency. In the interest of effective law enforcement and under 25 U.S.C. 2716(b), the information could be relevant to an investigation by the Commission.

(iv) In the interviewing of individuals or obtaining evidence in other ways during an investigation, the Commission could obtain information that may or may not appear relevant at any given time; however, the information could be relevant to another investigation by the Commission.

Dated: December 30, 2016.

**Jonodev Chaudhuri,**  
*Chairman.*

**Kathryn Isom-Clause,**  
*Vice-Chair.*

**Sequoyah Simermeyer,**  
*Commissioner.*

[FR Doc. 2017-00585 Filed 1-23-17; 8:45 am]

**BILLING CODE 7565-01-P**

## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Part 1

[TD 9815]

RIN 1545-BM33

#### Dividend Equivalents From Sources Within the United States

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Final regulations and temporary regulations.

**SUMMARY:** This document provides guidance to nonresident alien individuals and foreign corporations that hold certain financial products providing for payments that are contingent upon or determined by reference to U.S. source dividend payments. This document also provides guidance to withholding agents that are responsible for withholding U.S. tax with respect to a dividend equivalent, as well as certain other parties to section 871(m) transactions and their agents.

**DATES:** *Effective Date:* These regulations are effective on January 19, 2017.

*Applicability Dates:* For dates of applicability, see §§ 1.871-15(r); 1.871-15T(r)(4); 1.1441-1(f)(5); 1.1441-2(f); 1.1441-7(a)(4); 1.1461-1(i).

**FOR FURTHER INFORMATION CONTACT:** D. Peter Merkel or Karen Walny at (202) 317-6938 (not a toll-free number).

#### **SUPPLEMENTARY INFORMATION:**

##### **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 collections of information in these regulations are in § 1.871-15T(p) and are an increase in the total annual burden in the current regulations under §§ 1.1441-1 through 1.1441-9. This information is required to establish whether a payment is treated as a U.S. source dividend for purposes of section 871(m) of the Internal Revenue Code (Code). 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.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and return information are confidential, as required by 26 U.S.C. 6103.

#### **Background**

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) of the Code. The 2012 section 871(m) regulations relate 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, and March 8, 2012, in the **Federal Register** at 77 FR 5700 and 77 FR 13969, respectively. A correcting amendment to the 2012 temporary regulations was also published on August 31, 2012, in the **Federal Register** at 77 FR 53141. 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, which are available at [www.regulations.gov](http://www.regulations.gov). 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 (see § 601.601(d)(2)(ii)(b)) (QI Notice), containing a proposed amended qualified intermediary agreement. The QI Notice included the requirements 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 to the extent related to section 871(m) and QDDs are discussed in the “Qualified Derivatives Dealer” section of this preamble. 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) and 1441, 1461, and 1473 in 2017 and 2018 and explaining how the IRS intends to administer those regulations in 2017 and 2018.

On March 6, 2014, temporary regulations (TD 9658) revising certain provisions of the final chapters 3 and 61 regulations were published in the **Federal Register** (79 FR 12726), and corrections to those temporary regulations were published in the **Federal Register** (79 FR 37181) on July 1, 2014. Those regulations were issued to coordinate with certain provisions of the 2013 final chapter 4 regulations, as well as temporary regulations (TD 9657)

under chapter 4 published in the **Federal Register** (79 FR 12812). A notice of proposed rulemaking cross-referencing the 2014 temporary coordination regulations was published in the **Federal Register** on March 6, 2014 (79 FR 12880). On January 6, 2017, the Treasury Department and IRS published in the **Federal Register** (82 FR 2046) final chapters 3 and 61 regulations, as well as temporary regulations (TD 9808).

This Treasury decision generally adopts the 2015 proposed regulations with the changes discussed in this preamble. This Treasury decision also includes several technical amendments to the 2015 final regulations in response to comments on those regulations, which are discussed in this preamble. Finally, this Treasury decision provides new temporary regulations based on comments received with respect to the 2015 proposed regulations.

## Summary of Comments and Explanation of Provisions

### I. Technical Corrections to Certain Definitions

#### A. Broker

Section 1.871-15(p) generally provides that a broker or dealer is responsible for determining whether a potential section 871(m) transaction is a section 871(m) transaction and for reporting to the customer the timing and amount of any dividend equivalent. Section 1.871-15(a)(1) defines the term broker as “a broker within the meaning provided in section 6045(c).” Comments explained that many regulated investment companies satisfy the definition of a broker under section 6045(c) and the regulations thereunder because the term broker includes a corporation that regularly redeems its own shares. The comments noted that these regulated investment companies may enter into transactions as a short party with a foreign financial institution who is the long party. In these transactions, the comments asserted, the foreign financial institution (not the regulated investment company) is more capable of determining delta and making other calculations.

The Treasury Department and the IRS agree that an entity should not be treated as a broker for purposes of section 871(m) solely because it redeems its own shares. The rules are intended to assign responsibility for making the determinations related to potential section 871(m) transactions to the party that regularly enters into equity derivatives with customers or holds equity derivatives on behalf of customers. When a regulated investment

company is the short party in a transaction with a financial institution, the Treasury Department and the IRS agree that the financial institution is in the better position to determine delta and make other determinations required by section 871(m). Accordingly, the definition of the term broker has been revised in the temporary regulations so that it will not apply to a corporation that would be treated as a broker pursuant to section 6045(c) solely because it regularly redeems its own shares.

#### B. Dividend Equivalents

Section 1.871-15(c) provides that, subject to certain exceptions, a dividend equivalent includes any payment that references the payment of a dividend from an underlying security pursuant to a securities lending or sale-repurchase transaction, specified NPC, or specified ELI. A dividend is defined in § 1.871-15(a)(3) as “a dividend as described in section 316.” Section 1.871-15(c)(2)(ii) reduces a dividend equivalent by any amount treated in accordance with sections 305(b) and (c) as a dividend (a “section 305(c) dividend”) with respect to the underlying security referenced by the section 871(m) transaction.

A comment suggested that the regulations clarify how this rule applies when a derivative references an underlying security that has a section 305(c) dividend. Another comment noted that § 1.871-15(c)(2)(ii) reduces the dividend equivalent amount by section 305(c) dividends, and that this reduction arguably applies both to the person who holds the underlying security giving rise to the section 305(c) dividend and to a holder of a section 871(m) transaction that references the underlying security that gives rise to the section 305(c) dividend.

To address these comments, these final regulations revise the definition of a dividend to explicitly provide that it applies without regard to whether there is an actual distribution of cash or property. A conforming change is also made to § 1.871-15(c)(2)(ii), which is revised to clarify that only a long party that is treated as receiving a section 305(c) dividend is entitled to reduce its dividend equivalent amount and that a section 305(c) dividend gives rise to a dividend equivalent.

Thus, for example, a long party that owns a convertible note that is a section 871(m) transaction and has a section 305(c) dividend can reduce its dividend equivalent by the section 305(c) dividend. In contrast, a long party that owns a specified NPC that references the same convertible note would receive a dividend equivalent that includes the

section 305(c) dividend and would not be entitled to reduce its dividend equivalent by the section 305(c) dividend on the convertible note because the long party does not own the note, and therefore, is not treated as receiving a section 305(c) dividend for federal income tax purposes.

### C. Simple Contract

To be a simple contract as defined in § 1.871–15(a)(14)(i), the number of shares required to calculate the amounts paid or received on any payment determination date must be ascertainable at the time the delta for the transaction is calculated. Several comments noted that transactions may provide for anti-dilution adjustments to the number of shares as a result of certain corporate actions, and that these adjustments could cause contracts that otherwise would be simple contracts subject to the delta test to become complex contracts subject to the more complicated substantial equivalence test. Adjustments that are intended to maintain the status quo of shareholders generally should not preclude a transaction from being treated as a simple contract. Accordingly, a sentence is added to § 1.871–15(a)(14)(i) to provide that an adjustment to the number of shares of the underlying security for a merger, stock split, cash dividend, or similar corporate action that impacts all the holders of the underlying security will not prevent the transaction from being a simple contract.

## II. Certain Insurance Contracts

The exceptions for payments made pursuant to annuity, endowment, and life insurance contracts were issued as a temporary rule in § 1.871–15T(c)(2)(iv) of the 2015 temporary regulations. Comments generally agreed with the result in § 1.871–15T(c)(2)(iv)(A) with respect to insurance contracts issued by domestic insurance companies. Several comments requested that § 1.871–15T(c)(2)(iv)(A) be issued as a final regulation without any change. These comments noted that any U.S. source dividend that a foreign insurer receives on U.S. stock it owns with respect to an annuity, endowment, or life insurance contract is already subject to withholding tax.

Another comment recommended changes to make the exception for insurance issued by a foreign company more administrable. That comment suggested that the regulations be extended to any foreign insurance company, without regard to whether the company is predominantly engaged in the business of insurance and would be

subject to tax under subchapter L. This comment also recommended that the regulations define the terms “annuity contract,” “insurance contract,” “life insurance contract,” “endowment contract,” and “foreign insurance company” based on regulations under section 1471. Finally, the comment noted that the requirement that a company be “predominantly engaged in an insurance business” is unnecessary in light of the requirement that a corporation “would be subject to tax under subchapter L if it were a domestic corporation” because a corporation that would be “subject to tax under subchapter L if it were a domestic corporation” necessarily would be “predominantly engaged in an insurance business.”

Comments also recommended that the temporary rule relating to reinsurance should be finalized. Another comment noted that reinsurance subject to the U.S. federal excise tax under section 4371 is not subject to withholding and expressed concern about the interaction of the excise tax and the application of section 871(m) if the reinsurance exception in the temporary regulations was allowed to expire.

These regulations finalize § 1.871–15T(c)(2)(iv) with one change. The Treasury Department and the IRS agree that a company that is taxable under subchapter L as an insurance company is necessarily predominantly engaged in an insurance business. Accordingly, in finalizing § 1.871–15T(c)(2)(iv)(B), the redundant phrase “predominantly engaged in an insurance business” is removed. Although comments suggested other modifications to certain terms and the addition of certain defined terms, these final regulations do not make these additional changes. The Treasury Department and the IRS have determined that the scope of entities and contracts described in the temporary regulations as eligible for the exception is appropriate for section 871(m), and that it is beyond the scope of these regulations to define terms relating to insurance.

## III. Determining Delta and the Initial Hedge

Section 1.871–15(g)(2) provides that the delta of a potential section 871(m) transaction is determined only when the contract is issued. For this purpose, an NPC or ELI is issued at the time of the contract’s inception, original issuance, or issuance as a result of a deemed exchange pursuant to section 1001. See § 1.871–15(a)(6). The same standard is used to determine when a contract is issued for purposes of the substantial equivalence test for complex contracts.

For simple contracts, comments generally suggested changing the time for calculating delta to the earlier of the trade date or the date on which the parties agreed to the material terms or final pricing for the contract. One comment recommended that the date and time when the material terms are finalized is the appropriate date for determining delta because that is the time when the economic terms of the potential section 871(m) transactions are established. Finally, the parties to the contract are generally bound by the terms on the pricing date, not the settlement date. A comment suggested using the trade date if the pricing date is more than 14 days before the issue date because providing too long a period between the pricing and issue date may present an opportunity for abuse.

For listed options, comments suggested a different method for determining the delta of the contract. These comments recommend that the delta for listed options should be based on the closing price from the prior trading day. The comments acknowledged that this approach would be less accurate than the requirement in the final regulations; however, these comments asserted that using the delta calculation from the prior day for listed options would substantially reduce the burden on taxpayers and make the rules more administrable. Comments also noted that the Options Clearing Corporation currently calculates the end-of-day delta for options listed on U.S. options exchanges.

For complex contracts, comments recommended that the substantial equivalence test should be conducted on the date when the short party’s hedge is established. According to the comments, the issuer of a complex contract enters into a hedge on the pricing date, not the settlement date. The pricing date therefore reflects the economics of a complex contract more accurately than the settlement date, as long as the two dates are not separated by too much time.

The Treasury Department and the IRS agree with the comments that the date for determining delta and for performing the substantial equivalence test should be revised to be more administrable and to reflect more accurately the economics of the transactions. Accordingly, these regulations provide that the delta of a simple contract is determined on the earlier of the date that the potential section 871(m) transaction is priced and the date when the potential section 871(m) transaction is issued; however, the issue date must be used to determine the delta if the potential section 871(m) transaction is priced

more than 14 calendar days before it is issued. A similar rule also applies to the substantial equivalence test.

In addition, the regulations provide a new rule for determining the delta of an option listed on a regulated exchange. For these options, the delta is determined based on the delta of the option at the close of business on the business day before the date of issuance. For this purpose, the regulations define a regulated exchange. A regulated exchange is any exchange defined in § 1.871-15(l)(3)(vii) or a foreign exchange that (A) is regulated by a government agency in the jurisdiction in which the exchange 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 notional value exceeded \$10 billion per day during the prior calendar year.

The 2015 final regulations provided a simplified delta calculation for certain simple contracts that reference 10 or more underlying securities, provided that the short party uses an exchange-traded security that references substantially all the underlying securities to hedge the NPC or ELI at the time it is issued (the "hedge security"). The simplified delta calculation allows the short party to calculate the delta of the NPC or ELI by reference to changes in the value of the hedge security. Comments suggested that this rule be extended to cases in which the short party could fully hedge its position by acquiring the exchange-traded security even if it does not in fact hedge in this manner. Because the exchange-traded security must provide a full hedge of the NPC or ELI for this rule to apply, the Treasury Department and the IRS agree that the exchange-traded security will provide an acceptable delta calculation whether or not the short party actually uses that security as its hedge. Accordingly, the regulations are amended to permit the delta with respect to those NPCs and ELIs to be calculated by determining the ratio of the change in the fair market value of the simple contract to a small change in the fair market value of an exchanged-traded security when the exchange-traded security would fully hedge the NPC or ELI.

Some comments noted that third-party data, including delta calculations, may be available for certain potential section 871(m) transactions. These comments requested that the final regulations be amended to explicitly permit withholding agents to rely on this data. Although the final regulations

are not amended, the Treasury Department and the IRS note that nothing in the regulations prohibits a taxpayer from obtaining information from a third party. While taxpayers and withholding agents can use third party data to determine whether a potential section 871(m) transaction is a section 871(m) transaction, taxpayers and withholding agents that rely on third-party data remain responsible for the accuracy of that information.

One comment noted that the issuer of a structured note (or an affiliate of the issuer) may act as a market maker for the structured note, and thus may purchase the note in its dealer capacity and then sell the note to the market. According to the comment, if the purchase is treated as a redemption by the issuer of the instrument for tax purposes, the subsequent sale to the market would be treated as a new issue for section 871(m) purposes, in which case the delta for the instrument (or substantial equivalence test) would need to be recomputed at such time. The comment suggested that rules similar to those in section 108 with respect to the purchase of debt instruments by an issuer acting in a dealer capacity could apply to equity derivative structured notes. The Treasury Department and the IRS acknowledge the concern raised by the comment. However, the Treasury Department and the IRS are concerned that an overly broad exception for dealer activity may facilitate transactions that are inconsistent with section 871(m) by allowing dealers to offer instruments that would be subject to section 871(m) so long as the instruments were originally issued with a delta below 0.80. While a dealer that issued such an instrument holds the instrument in inventory, the dealer does not need to hedge the position with an unrelated party. For this reason, market making activity by the issuer of an instrument (or an affiliate of the issuer) presents different policy concerns from market making by an unrelated dealer. The Treasury Department and the IRS invite further comments on the appropriate treatment of structured notes and similar instruments that are acquired by the issuer or an affiliate in its dealer capacity.

#### IV. Substantial Equivalence Test

Comments to the 2013 proposed regulations generally agreed that the delta test was fair and practical for the majority of equity-linked derivatives. However, comments explained that the delta test would be impractical or impossible to apply to more exotic equity derivatives, such as structured

notes in which the long party's return was determined based on an initially indeterminate number of shares of the underlying security. The 2015 section 871(m) regulations address this concern by providing an alternative test—the "substantial equivalence test"—for contracts with indeterminate deltas. For purposes of applying this test, the regulations distinguish between simple and complex contracts. Generally, a simple contract is a contract that references a single, fixed number of shares and has a single maturity or exercise date. A complex contract is any contract that is not a simple contract. Contracts with indeterminate deltas are classified as complex contracts and are subject to the substantial equivalence test.

Generally, the substantial equivalence test measures the change in value of a complex contract when the price of the underlying security referenced by that contract is hypothetically increased by one standard deviation or decreased by one standard deviation (each, a "testing price") and compares that change to the change in value of the shares of the underlying security that would be held to hedge the complex contract when the contract is issued (the "initial hedge") at each testing price. The smaller the proportionate difference between the change in value of the complex contract and the change in value of its initial hedge at multiple testing prices, the more equivalence there is between the contract and the referenced underlying security. When this difference is equal to or less than the difference for a simple contract benchmark with a delta of 0.80 and its initial hedge, the complex contract is treated as substantially equivalent to the underlying security. When the steps of the substantial equivalence test cannot be applied to a particular complex contract, a taxpayer must use the principles of the substantial equivalence test to reasonably determine whether the complex contract is a section 871(m) transaction with respect to each underlying security.

The Treasury Department and the IRS requested comments regarding the substantial equivalence test. In particular, comments were requested on whether two testing points were adequate to ensure that the test would capture appropriate transactions and on the administrability of the test. Comments also were requested on the application of the test to complex contracts that reference multiple securities, including path-dependent instruments (that is, an instrument for which the final value depends, in whole or in part, on the price sequence (or

path) of the underlying security before the maturity of the instrument). Comments generally did not recommend material changes to the test. As a result, these final regulations adopt the substantial equivalence test as proposed in the 2015 proposed regulations with minor changes as described in this section.

One comment noted that the substantial equivalence test might be unduly burdensome in certain cases, such as when it is obvious that a particular instrument would satisfy the test and application of the test would have no effect on the amount of withholding. This comment suggested that an issuer of a complex contract be allowed to use an alternative test to determine the withholding tax imposed with respect to a dividend equivalent as long as the alternative test resulted in the same amount of withholding tax as would have been the case if the issuer had used the substantial equivalence test. These final regulations do not adopt this comment. Even in those cases where the result for a potential section 871(m) transaction is intuitive, administration of such an alternative approach would generally require applying the substantial equivalence test to demonstrate that the alternative test results in the same amount of withholding tax as the substantial equivalence test. As issuers of complex contracts become proficient with the substantial equivalence test it is expected that it will be relatively straightforward to determine whether a particular instrument is subject to withholding under section 871(m).

Another comment suggested that the Treasury Department and the IRS consider whether the substantial equivalence test could be manipulated to allow taxpayers to understate the similarity of a complex contract to the underlying security. This comment suggested that more guidance should be offered about the criteria for determining whether a simple contract is “closely comparable” to a complex contract for purposes of choosing a simple contract benchmark. The same comment recommended that the regulations specify that the benchmark contract could be a hypothetical instrument, and that the material terms, including the treatment of dividends, should be consistent with the terms of the complex contract (aside from the terms that make the contract complex and that make the delta of the closely comparable benchmark 0.8).

In response to this comment, the final regulations provide that the simple contract benchmark may be an actual or hypothetical simple contract that, at the

time the substantial equivalence test is applied to the complex contract, has a delta of 0.8, references the applicable underlying security referenced by the complex contract, and has terms that are consistent with all the material terms of the complex contract, including the maturity date. In addition, to further ensure comparability between the simple contract benchmark and the complex contract, the final regulations provide that the simple contract benchmark must consistently apply reasonable inputs, including a reasonable time period for the contract. For example, the reasonable time period for the contract must be consistently applied in determining the standard deviation and probability, as well as the maturity date and any other terms dependent on that time period.

#### **V. Amount and Timing of a Taxpayer's Liability**

Section 1.871–15(j) contains rules for determining the amount of the dividend equivalent. In addition, § 1.871–15(j) requires that the amount of a dividend equivalent be determined on the earlier of the record date of the dividend and the day before the ex-dividend date with respect to the dividend. In many cases, the amount of a dividend equivalent will be determined before a withholding agent will be required to withhold any tax pursuant to newly redesignated § 1.1441–2(e)(7) (formerly § 1.1441–2(e)(8)). Comments requested that a foreign holder's tax liability be deferred until withholding is required, in order to avoid the need for the foreign holder to file a return and pay tax. The comments noted that this approach would be consistent with the general withholding regime under chapter 3 of the Code. With respect to a section 871(m) transaction acquired by a foreign investor after its initial issuance, a comment requested clarification that the foreign investor is only liable for dividends determined on the underlying security during the period that the foreign investor is the beneficial owner of the section 871(m) transaction.

These regulations include several new provisions in response to these comments. First, § 1.871–15(j)(4) is added to provide that a long party generally is liable for tax on a dividend equivalent in the year the dividend equivalent payment is subject to withholding pursuant to § 1.1441–2(e)(7), or in the case of a QDD, when the payment of the applicable dividend on the underlying security is subject to withholding.

Second, the regulations are amended to clarify that the amount of a dividend equivalent subject to tax will not change

because the tax is withheld at a later date. Section 1.871–15(j)(2) establishes the time for determining the amount of a dividend equivalent; the amount of the long party's tax liability should not change because the withholding agent does not withhold at the time the tax liability arises. Therefore, changes in facts (such as the tax rate or whether the recipient is a qualified resident of a country with which the U.S. has an income tax treaty) between the time that the amount of a dividend equivalent is determined and the time that withholding occurs, do not affect tax liability. For example, if at the time for determining the dividend equivalent amount, the long party qualifies for a treaty, but in the year the amount is withheld the long party does not, the dividend equivalent would qualify for treaty benefits.

Finally, § 1.871–15(j)(1) expressly provides that the long party is only liable for tax on dividend equivalents that arise while the long party is a party to the transaction. For example, if long party A, a foreign person, enters into a section 871(m) transaction on an underlying stock that pays quarterly dividends, and sells the transaction to B, a foreign person, after four dividends on the underlying stock have been paid, A will be subject to tax on those four dividend equivalents and B will be subject to tax on subsequent dividend equivalents as long as B holds the section 871(m) transaction. Alternatively, if A is a U.S. person, B would still only be subject to tax on the dividend equivalents after it acquires the transaction.

#### **VI. Qualified Index**

Section 1.871–15(l) provides a safe harbor for derivatives based on certain qualified indices. Section 1.871–15(l)(1) provides that the purpose of the exception for qualified indices is to provide a safe harbor for potential section 871(m) transactions that reference certain passive indices, and that an index is not a qualified index if treating the index as a qualified index would be contrary to this purpose. Section 1.871–15(l)(4) provides a specific safe harbor for derivatives based on an index in which the U.S. stock components comprise, in the aggregate, 10 percent or less of the weighting of all the component securities in the index. A comment regarding the 10 percent safe harbor indicated that some taxpayers, notwithstanding the purpose test for indices in § 1.871–15(l)(1), may seek to use a customized index to make tax-advantaged investments in specific U.S. stocks. Although the index described by the comment may not be

a qualified index as a result of the purpose rule in § 1.871–15(l)(1), the final regulations are revised to clarify that, in order to meet this 10 percent safe harbor, an index must be widely traded and must not be formed or availed of with a principal purpose of tax avoidance.

Comments to the qualified indices rules in the 2015 final regulations also requested that the Treasury Department and the IRS address how the rules apply to an index in the first year it is created. Accordingly, these final regulations add § 1.871–15(l)(2)(ii) to provide that, for the first year, an index is tested on the first business day it is listed, and the dividend yield calculation is determined using the dividend yield that the index would have had in the immediately preceding year if it had the same components throughout that year that it has on the day it is created.

### VII. Combined Transactions

For purposes of determining whether transactions are section 871(m) transactions, the 2015 final regulations treat two or more transactions as a single transaction when a long party (or a related person) enters into multiple transactions that reference the same underlying security, the combined potential section 871(m) transactions replicate the economics of a transaction that would be a section 871(m) transaction, and the transactions were entered into in connection with each other. The 2015 final regulations also provide brokers acting as short parties with two presumptions that may be applied to determine whether to combine potential section 871(m) transactions. First, a broker may presume that transactions are not entered into in connection with each other if the long party holds the transactions in separate accounts. Second, a broker may presume that transactions entered into two or more business days apart are not entered into in connection with each other. A broker, however, cannot rely on the first presumption if it has actual knowledge that the long party created or used separate accounts to avoid section 871(m). In addition, neither presumption applies if the broker has actual knowledge that transactions were entered into in connection with each other. Section 1.1441–1(b)(4)(xxiii) also permits withholding agents to rely on these presumptions.

Comments suggested several changes to the combined transaction rules. Comments noted that it will be burdensome to identify every contract that a customer entered into with respect to the same underlying security

within two days of each other. To replace the presumptions, comments recommended that a withholding agent only be required to combine contracts if the withholding agent had actual knowledge that two contracts were priced, marketed, or sold in connection with each other.

The Treasury Department and the IRS disagree that the priced, marketed, or sold standard should replace the combination presumptions. Comments noted a “not uncommon” example of an active foreign investor who acquires or sells within a two-day period hundreds of listed options referencing the same underlying security. The Treasury Department and the IRS, however, intended to treat those transactions as combined to the extent that the potential section 871(m) transactions are entered into in connection with each other and satisfy the other requirements of § 1.871–15(m)(1). The priced, marketed, or sold standard provides an inadequate substitute for the combined transaction test and the presumptions because investors can replicate a section 871(m) transaction by entering into multiple potential section 871(m) transactions. For example, an investor could replicate a delta one transaction by entering into a put option and a call option on the same underlying security at the same time, with the same strike price, whether or not the options are priced, marketed, or sold together. For this reason, the priced, marketed, or sold standard provides an inadequate substitute for the presumptions. The comments submitted with respect to the combination rule acknowledge short parties and withholding agents are aware that foreign investors use multiple transactions in a manner that are combined under the final regulations. The “priced, marketed, or sold” standard would undermine the enforcement of the combination rules.

Notwithstanding the prior paragraph, Notice 2016–76 provides a simplified standard for withholding agents to determine whether transactions entered into in 2017 are combined transactions. A withholding agent will only be required to combine transactions entered into in 2017 for purposes of determining whether the transactions are section 871(m) transactions when the transactions are over-the-counter transactions that are priced, marketed, or sold in connection with each other. Withholding agents will not be required to combine any transactions that are listed securities that are entered into in 2017.

Another comment noted that the final regulations indicated that transactions would only be combined into simple

contracts. This comment recommended that the final regulation be amended if the Treasury Department and the IRS disagreed with this reading of the combination rule. The Treasury Department and the IRS agree that transactions will only be combined into simple transactions pursuant to § 1.871–15(n); therefore, the final regulations are not amended.

Other comments suggested some clarifications to the combination rules to resolve ambiguities. For example, comments requested, among other things, that (1) ordering rules provide that a contract cannot be combined more than once and (2) no combination transaction should have a delta of more than one. The final regulations are not amended to address these issues because the final regulations are intended to provide a general framework for determining when two or more transactions should be combined. The comments received to date show that industry understanding of how the combination rules may be administered continues to develop as financial institutions work to establish systems. As this understanding evolves, the Treasury Department and the IRS may publish subsequent guidance to address the issues raised by these comments. Until such further guidance is issued, taxpayers may adopt any reasonable methodology to combine transactions within the general framework of the final regulations.

### VIII. Party Responsible for Determining Delta and Other Information

The 2015 final regulations provide that when one of the parties to a potential section 871(m) transaction is a broker or dealer, that broker or dealer is responsible for determining whether the transaction is a section 871(m) transaction. When both parties to a potential section 871(m) transaction are a broker or dealer or neither party to a potential section 871(m) is a broker or dealer, the short party to the transaction must determine whether the transaction is a section 871(m) transaction.

Comments noted that multiple parties could be responsible for determining whether a transaction is a section 871(m) transaction because the definition of a “party to the transaction” includes a long party, a short party, any agent acting on behalf of a long party or short party, and any person acting as an intermediary with respect to a potential section 871(m) transaction. Comments noted that both a short party and one or more agents of the short party may be a broker or dealer; in this case, the 2015 final regulations do not identify which of the responsible parties has the

primary obligation to determine whether the transaction is a section 871(m) transaction.

Comments requested that the regulations clarify which broker has the obligation to determine whether a listed option is a section 871(m) transaction when multiple brokers or dealers are involved. One comment recommended that the long party's broker that has custody of the transaction at the end of the day would be best suited to act as the responsible party. Comments also noted that the short party or the agent of a short party may not have the relevant information necessary to determine when withholding should take place. For example, when a long party has sold an instrument in the secondary market, the short party and its agent may not have any knowledge of that sale. As a result, the long party's broker should be the responsible party.

Other comments indicated that the issuer should be the responsible party when the issuer itself is a broker or a dealer, or when the issuer has an affiliate that is a broker or dealer. In these cases, the issuer or its affiliate is likely to have the information necessary to determine whether the transaction is a section 871(m) transaction. As noted in other comments, an intermediary to a transaction issued by a broker or dealer, such as a clearinghouse, will not have the information necessary to determine whether a potential section 871(m) transaction is a section 871(m) transaction, and is unlikely to know either the time or the amount to withhold.

The Treasury Department and the IRS agree that the final regulations may result in multiple parties to a transaction qualifying as the party responsible for determining whether a potential section 871(m) transaction is a section 871(m) transaction. New temporary regulations resolve this duplication of responsible parties under § 1.871-15(p)(1) in the following circumstances: (1) Both the short party and an agent or intermediary of the short party are a broker or a dealer; (2) the short party is not a broker or dealer and more than one of the agents or intermediaries of the short party is a broker or dealer; (3) the short party and its agents or intermediaries are not brokers or dealers, and more than one agent or intermediary acting on behalf of the long party is a broker or dealer; and (4) potential section 871(m) transactions are traded on an exchange and cleared by a clearing organization.

Specifically, § 1.871-15T(p)(1)(ii) provides that the short party is the responsible party when both the short party and an agent or intermediary

acting on behalf of the short party are a broker or dealer. In these circumstances, the Treasury Department and the IRS have determined that the short party should be the responsible party because it will have access to the relevant data regarding that transaction, whereas an agent or intermediary may not have the necessary information. As the responsible party, the short party may contract with a third party to make the determinations on its behalf; however, the short party remains responsible for the accuracy of any calculations by the third party.

In addition, if the short party is not a broker or dealer, but more than one agent or intermediary acting on behalf of the short party is a broker or dealer, § 1.871-15T(p)(1)(ii) provides that the broker or dealer closest to the short party in the payment chain is the responsible party. The Treasury Department and the IRS have determined that the agent or intermediary closest in the chain to the short party will have the best access to any information the short party has that is necessary to determine whether a potential section 871(m) transaction is a section 871(m) transaction and to make other relevant determinations.

Section 1.871-15T(p)(1)(ii) also generally provides that when one or more agents or intermediaries acting on behalf of the long party are brokers or dealers, the agent or intermediary that is closest to the long party in the payment chain is the responsible party when neither the short party nor any agent or intermediary acting on behalf of the short party is a broker or dealer. In this situation, the temporary regulations place the responsibility with the agent or intermediary closest to the long party because this agent or intermediary will know whether or not the long party is subject to tax under section 871 or 881 and when the long party has terminated or otherwise disposed of the transaction.

Similarly, these temporary regulations also provide a rule for determining the responsible party when potential section 871(m) transactions are traded on an exchange and cleared by a clearing organization. When more than one broker or dealer acts as an agent or intermediary between the short party and a foreign investor on an exchange-traded contract, the broker or dealer that has an ongoing customer relationship with the foreign investor is the responsible party. Generally, this intermediary will be the clearing firm.

Finally, these temporary regulations provide that the issuer of a potential section 871(m) transaction will be the responsible party for certain ELIs. Specifically, the issuer is the

responsible party for structured notes (including contingent payment debt instruments), warrants, convertible stocks, and convertible debt instruments. Because the issuer of these ELIs ordinarily will have structured the ELI, determined the pricing of the ELI, and hedged the ELI, the issuer ordinarily will be in the best position to act as the responsible party. While the issuer of an ELI may not be a broker or dealer, an issuer of an ELI typically is advised by a broker or dealer.

## IX. Qualified Derivatives Dealer

Section 1.871-15T(q) permits a QDD to reduce its liability under section 871 or 881 for a dividend or dividend equivalent to the extent it makes an offsetting dividend equivalent payment in its dealer capacity. Only an eligible entity that has entered into a QI agreement can be a QDD. An eligible entity is defined as: (1) A dealer in securities subject to regulatory supervision as a dealer, (2) a bank subject to regulatory supervision as a bank, or (3) a wholly-owned entity of a bank subject to regulatory supervision as a bank when the wholly-owned entity (a) issues potential section 871(m) transactions to customers and (b) receives dividends or dividend equivalent payments from stock or potential section 871(m) transactions that hedge the potential section 871(m) transactions issued to customers. § 1.1441-1T(e)(6). An entity is only a QDD when acting in its QDD capacity.

### A. Income Tax Treaties

In general, section 871(m) and the regulations thereunder apply to a dividend equivalent payment without regard to whether the payor of the dividend equivalent payment is domestic or foreign. Section 1.894-1(c)(2) provides that "[t]he provisions of an income tax convention relating to dividends paid to or derived by a foreign person apply to the payment of a dividend equivalent described in section 871(m) and the regulations thereunder." Consistent with the foregoing, the 2017 QI Agreement provides that a QDD must treat any dividend equivalent as a dividend from sources within the United States for purposes of section 881 and chapters 3 and 4 consistent section 871(m) and the regulations thereunder. The 2017 QI Agreement provides that a QDD may reduce the rate of withholding under chapter 3 based only on a beneficial owner's claim that it is entitled to a reduced rate of withholding for portfolio dividends under the dividends article of an applicable income tax treaty.



### B. Eligible Entities

Comments requested that the Treasury Department and the IRS expand the scope of entities that qualify as an eligible entity under § 1.1441-1(e), and therefore can act as a QDD under a QI agreement. One comment requested that the eligibility criteria be expanded to permit a controlled foreign corporation (CFC) of a U.S. financial institution to act as a QDD even if the CFC is not a QI. Other comments recommended that the definition of an eligible entity be expanded to include a bank holding company if the entity regularly issues potential section 871(m) transactions to customers and receives dividends or dividend equivalent payments pursuant to potential section 871(m) transactions to hedge the transactions issued to customers. Comments noted that a bank holding company is subject to a wide range of regulatory regimes.

Comments also recommended that the scope of eligible entities be expanded to include subsidiaries of securities dealers and bank holding companies that regularly issue potential section 871(m) transactions to customers and receive dividends or dividend equivalent amounts with respect to hedges of those customer transactions. Comments noted that these entities are part of a regulated financial group.

In response to comments, the 2017 QI Agreement announced the expansion of the definition of eligible entities to include a bank holding company and subsidiaries of a bank holding company. The Treasury Department and the IRS agree that a bank holding company and subsidiaries of a bank holding company should be included in the definition of an eligible entity because these entities are regulated financial institutions.

The 2017 QI Agreement clarified that the eligible entity test is applied at the home office or branch level, and that each home office or branch is a separate QDD. The 2017 QI Agreement also expanded what constitutes an eligible entity to include a foreign branch of a U.S. financial institution that would meet the requirements of an eligible entity if the branch were a separate entity, though such a branch will not be subject to tax on its QDD tax liability because it is otherwise subject to tax on a net income basis under chapter 1. Both of these changes are incorporated in these final regulations. These final regulations also clarify that a subsidiary of a bank or bank holding company could be indirectly wholly-owned by the qualifying bank or bank holding company provided that the subsidiary, acting in its equity derivatives dealer

capacity, (1) issues potential section 871(m) transactions to customers, and (2) receives dividends with respect to stock or dividend equivalent payments pursuant to potential section 871(m) transactions that hedge potential section 871(m) transactions that it issues.

These final regulations do not expand the eligible entity definition to specifically include CFCs. The comments generally did not adequately explain why CFCs cannot avail themselves of the QI regime (with the QDD provisions). Permitting CFCs that are not QIs to be QDDs would eliminate the compliance benefits provided in the 2017 QI Agreement and would make it more difficult for the IRS to verify compliance with the QDD rules. However, to provide the IRS with flexibility to administer the QDD regime, an eligible entity is defined to include any other person acceptable to the IRS, which is similar to the allowance provided to the IRS in defining persons eligible to enter into a QI agreement as provided in § 1.1441-1(e)(5)(ii)(D).

A comment also raised a technical issue with who can qualify as a QI, expressing concern that some eligible entities that are not foreign financial institutions may not be able to enter into QI agreements because they are not eligible to become a QI. The 2017 QI Agreement and these final regulations now clarify that an eligible entity (notwithstanding that the entity otherwise would not be eligible to be a QI) can enter into a QI agreement in order to implement the QDD provisions.

### C. Section 871(m) Amount and QDD's Tax Liability

Section 1.871-15T(q)(1) of the 2015 temporary regulations provided that a QDD generally would not be liable for tax under section 871 or 881 on a dividend or dividend equivalent payment that the QDD receives in its capacity as a QDD, provided that the QDD complies with its obligations under the qualified intermediary agreement. Section 1.1441-1T(e)(6) of the 2015 temporary regulations provided that a QDD would not be subject to withholding on such dividends or dividend equivalents. Section D of this Part IX describes certain changes to the foregoing rules that the Treasury Department and the IRS determined are appropriate in light of the adoption of the net delta approach described in this Part IX.C.

Section 1.871-15T(q)(1) of the 2015 temporary regulations further provides that, if a QDD receives a dividend or dividend equivalent payment and the offsetting dividend equivalent payment

the QDD is contractually obligated to make on the same underlying security is less than the dividend and dividend equivalent amount the QDD received, the QDD would be liable for tax under section 871(a) or 881 for the difference.

The QI Notice described proposed changes to the QI agreement that would implement the QDD tax liability described in § 1.871-15T(q). Under the QI Notice, a QDD's section 871(m) amount for a dividend was the excess of the dividends on underlying securities associated with potential section 871(m) transactions and dividend equivalent payments that it received that reference the same dividend over dividend equivalent payments and any qualifying dividend equivalent offsetting payment that the QDD made or was contractually obligated to make with respect to the same dividend. The QI Notice described a qualifying dividend equivalent offsetting payment as (a) any payment made or contractually obligated to be made to a United States person that would be a dividend equivalent payment if made to a person who was not a United States person and (b) any payment made to a foreign person that would be a dividend equivalent payment if the payment were not treated as income effectively connected with the conduct of a U.S. trade or business.

In addition, the QI Notice proposed rules regarding how a QDD would calculate its QDD tax liability. Specifically, under the QI Notice, the QDD tax liability was the sum of a QDD's liability under sections 871(a) and 881 for (a) its section 871(m) amount; (b) its dividends that are not on underlying securities associated with potential section 871(m) transactions and its dividend equivalent payments received as a QDD in its non-dealer capacity; and (c) any other payments, such as interest, received as a QDD with respect to potential section 871(m) transactions or underlying securities that are not dividend or dividend equivalent payments.

Comments requested that a QDD be permitted to elect to calculate its section 871(m) amount either by using (1) the method described in the QI Notice or (2) its net delta exposure to an underlying security. According to comments, the net delta exposure is a calculation, measured in shares of stock, that aggregates all the shares of an underlying security and all equity derivative transactions referring to the same underlying security that the QDD has entered into in a dealer capacity (whether customer transactions or hedging transactions). Comments explained that net delta accurately measures a QDD's residual exposure to



an underlying security. Comments noted that financial institutions use net delta exposure for business and non-tax regulatory purposes.

Comments also requested that the Treasury Department and the IRS expand the offsetting dividend equivalent payment to include all customer transactions, such as potential section 871(m) transactions with a delta below 0.8, grandfathered transactions, and transactions that reference a qualified index.

In response to comments relating to the QI Notice, Notice 2016-76 announced that the regulations would be revised to require a QDD to calculate its section 871(m) amount based on the net delta approach. The Treasury Department and the IRS agree that the net delta approach provides an administrable and accurate method for a QDD to determine its residual exposure to underlying securities. The Treasury Department and the IRS, however, do not agree with comments indicating that QDDs should be permitted to elect to use the net delta exposure method or the rule described in the QI Notice. It would be burdensome to the IRS to administer a system that permits a QDD to use multiple methods to calculate its section 871(m) amount. The Treasury Department and the IRS, however, will consider comments that explain in more detail why a choice of methods for determining the section 871(m) amount is in the best interests of both taxpayers and the government.

These final regulations further explain how a QDD's section 871(m) amount is computed. The amount is determined separately for each dividend on an underlying security. For example, if a QDD enters into section 871(m) transactions that reference stock A (which pays a \$5 dividend per share), hedges the transactions by acquiring actual shares of stock, and has a net delta exposure to one share of stock, the QDD will have a tax liability pursuant to sections 871(a) and 881 with respect to a \$5 dividend based on its net delta exposure to one share of stock A. Amounts with respect to other dividends on the same stock or another stock are not taken into account.

Because these final regulations adopt the net delta exposure method for calculating the section 871(m) amount, the concepts of offsetting dividend equivalent payments and qualifying dividend equivalent offsetting payments have been eliminated from these final regulations.

These final regulations revise the calculation of a QDD's tax liability on the section 871(m) amount to correspond with the changes regarding

the determination of the section 871(m) amount discussed in this section and the changes to withholding on payments to a QDD that are discussed in the following section of this preamble. Specifically, a QDD's tax liability on its section 871(m) amount is, for each dividend on each underlying security, the amount by which its tax liability under section 881 for its section 871(m) amount exceeds the amount of tax paid by the QDD under section 881 (including amounts withheld on payments to the QDD) on dividend payments received by the QDD in its capacity as an equity derivatives dealer. The QDD also is liable for tax under section 881 for dividend equivalent payments received by a QDD in its non-equity derivatives dealer capacity and for any other payments (including dividends) it receives as a QDD to the extent the full liability was not satisfied by withholding.

#### *D. Withholding on Dividends Paid to a QDD*

In general, under the law in effect prior to 2017, an eligible entity that would qualify as a QDD under these final regulations generally was subject to tax under section 881 and to withholding tax under chapters 3 and 4 on actual dividends in the same manner as any other foreign recipient. As described in the preceding section, the 2015 temporary regulations provided that a QDD would no longer be subject to tax or to withholding on actual dividends received in its capacity as a QDD. The Treasury Department and the IRS are concerned that this exemption in the 2015 temporary regulations, when combined with the net delta exposure method, could result in U.S. source dividends escaping U.S. tax completely in certain circumstances. For example, if a QDD holds physical shares of an underlying security that it uses to hedge a delta 0.5 option, both the dividend and the option would not be subject to tax under section 871 or section 881. In response to this concern, Notice 2016-76 announced that the Treasury Department and the IRS intended to revise §§ 1.871-15T(q)(1) and 1.1441-1(b)(4)(xxii) to provide that a QDD will remain liable for tax under section 881(a)(1) and subject to withholding under chapters 3 and 4 on dividends on physical shares and deemed dividends received. These final regulations revise §§ 1.871-15T(q)(1) and 1.1441-1(b)(4)(xxii) accordingly. However, as announced in the 2017 QI Agreement, in order to allow taxpayers time to implement the net delta approach, these regulations continue to provide that dividends on physical shares and

deemed dividends received by a QDD in its QDD capacity in 2017 will not be subject to tax under section 881(a)(1) or subject to withholding under chapters 3 and 4. A QDD will be subject to withholding on dividends (including deemed dividends) received on or after January 1, 2018.

The Treasury Department and the IRS will consider comments recommending approaches for alleviating any overwithholding (and preventing any underwithholding) that might occur on dealer transactions with customers and on positions that hedge customer transactions when withholding on dividends (including deemed dividends) paid to QDDs resumes in 2018.

The QI Notice provided that a withholding agent (other than a withholding agent that itself was acting as a QDD) would not be required to withhold or report on payments made to a QDD with respect to potential section 871(m) transactions and underlying securities, other than reporting for dividends and substitute dividends. A comment requested that a withholding agent should only be exempt from withholding and reporting on dividends and dividend equivalents paid to a QDD. In response to this comment, the 2017 QI Agreement provides that all payments (other than dividend equivalent payments) made to a QDD with respect to underlying securities will be subject to withholding and reporting if the payments would be subject to withholding and reporting to a non-QDD. Consistent with the 2017 QI Agreement, the final regulations provide that all payments (other than dividend equivalent payments) made to a QDD with respect to underlying securities will be subject to withholding and reporting if those payments would be subject to withholding and reporting when received by a foreign person.

#### *E. Dealer Versus Proprietary Capacity*

The 2015 temporary regulations only permitted a taxpayer to act as a QDD with respect to certain payments received in its dealer capacity. Comments requested that a taxpayer be permitted to act as a QDD for payments received in its proprietary capacity for administrative reasons. The QI Notice and the 2017 QI Agreement reflect this change to the scope of QDD payments. The change in QDD scope does not impact the limitation on amounts entitled to be offset, which remain limited to dealer activity.

Consistent with the 2015 regulations, the QI Notice and the 2017 QI Agreement provide that, for purposes of determining the QDD tax liability,

payments received by a QDD acting as a proprietary trader are treated as payments received in its non-dealer capacity, while transactions properly reflected in a QDD's dealer book are presumed to be held by a dealer in its dealer capacity. For purposes of determining the QDD tax liability, dealer activity is limited to its activity as an equity derivatives dealer. One comment requested that the regulations clarify and qualify the distinction between receiving a payment in a dealer versus in a proprietary trader capacity and the impact of the distinction on the ability of an entity to act as a QDD. The Treasury Department and the IRS have determined that the regulations adequately delineate between dealer and proprietary transactions in § 1.871-15(q)(2).

#### F. Timing of Withholding

Generally, newly redesignated § 1.1441-2(e)(7) (formerly § 1.1441-2(e)(8)) provides that a withholding agent must withhold on a dividend equivalent on the later of the date on which the amount of the dividend equivalent is determined and the date that a payment occurs. A payment generally occurs when money or other property is paid to or by the long party, or the long party sells, exchanges, transfers, or otherwise disposes of a section 871(m) transaction. Notwithstanding this general rule applicable to withholding agents, the QI Notice announced that a QDD must withhold with respect to a dividend equivalent payment on the dividend payment date for the applicable dividend on the underlying security as determined in § 1.1441-2(e)(4).

Comments noted that this change would require a QDD to pay tax prior to the date that other withholding agents would have been required to withhold. In addition, comments expressed concern that this rule would result in cashless withholding for many transactions. Comments also noted that withholding agents have been building withholding systems according to the general rule provided in the final section 871(m) regulations. Comments recommended that the final section 871(m) regulations be amended to permit a QDD to elect to withhold on the payment of the dividend equivalent as provided in newly redesignated § 1.1441-2(e)(7) or on the dividend payment date as determined in § 1.1441-2(e)(4).

The Treasury Department and the IRS have determined that a QDD should continue to be required to withhold on the dividend payment date as determined in § 1.1441-2(e)(4), because

the time that a QDD withholds on customer transactions should match the time period for which it determines its own tax liability with respect to the section 871(m) amount. This is because the withholding tax that may apply to customer transactions is the justification for relieving the QDD from tax on its section 871(m) amount. In addition, this rule simplifies the reconciliation statement, makes it easier for reviewers and the IRS to verify that a QDD has complied with the requirements of the 2017 QI Agreement, and avoids a number of other issues that would arise under the requested approach, including statute of limitation issues. With respect to the concerns expressed regarding the need to build systems, the Treasury Department and the IRS note that this timing rule is consistent with the rule that was proposed in the QI Notice, released July 1, 2016. Moreover, as described in Notice 2016-76, during 2017, the IRS will take into account the extent to which a QDD has made a good faith effort to comply with the QDD provisions in the QI agreement when enforcing those provisions.

#### G. Qualified Securities Lenders (QSL) and Credit Forward

Notice 2010-46, 2010-24 I.R.B. 757 (see § 601.601(d)(2)(ii)(b)), (QSL Notice) outlined a proposed credit forward system that allowed a withholding agent to limit the aggregate U.S. gross-basis tax in a series of securities lending transactions to the amount of U.S. gross-basis tax applicable to the foreign taxpayer receiving a substitute or actual dividend in the series of transactions who bears the highest rate of U.S. gross-basis tax. The preamble to the 2015 regulations indicated that the credit forward system remained under consideration, but noted that, during the transition period provided in Notice 2010-46, the IRS has experienced difficulty verifying that prior withholding has occurred. Comments were requested on the need for the regime and how it could be implemented.

Comments requested that the credit forward system be retained. One comment requested that the credit forward system be retained when QDD status was not available. In contrast, another comment suggested that the stringency resulting from tightening the eligibility requirements for QDDs to QIs that are subject to reporting and compliance requirements would improve the ability to verify that prior withholding occurred.

As discussed in Part IX.B of this preamble the Treasury Department and the IRS have concluded that it is not

appropriate to permit credits or offsets for any entity that does not qualify as an eligible entity. In reaching this conclusion, the Treasury Department and the IRS agree with the comment that indicated that the QDD rules provide a more administrable method of determining that withholding properly occurred. If the entity is acting as an intermediary instead of acting as a principal, it may choose to be a QI that is not a QDD. The second comment did not explain why the existing QDD regime is insufficient.

In addition to comments regarding the credit forward system, a comment requested that QSL status be preserved as a standalone rule for securities lending transactions that are part of a separate line of business from other potential section 871(m) transactions. Another comment recommended reverting to the eligibility requirements for a QSL in the QSL Notice by extending QDD status to custodian QIs that are subject to regulatory supervision by a governmental authority in the jurisdiction in which the entity was created, as long as the entity agrees to assume primary withholding and reporting responsibility with respect to dividend equivalent payments and complies with all QDD certification requirements.

While the Treasury Department and the IRS understand that the QSL regime was administratively more convenient for taxpayers than the QI regime, it created administrability problems, particularly with respect to verification, for the IRS. That regime is being replaced by incorporating the QDD rules into the existing QI framework, including the specific rules for pooled reporting on Form 1042-S, and the QI requirements for compliance review and certification. With respect to banks, custodians, and clearing organizations that do not issue potential section 871(m) transactions to customers, the Treasury Department and the IRS are concerned that reverting to the eligibility requirements for a QSL in the QSL Notice would permit an entity to act as a QDD that does not act as a financial intermediary in a chain of section 871(m) transactions.

As part of the transition relief announced in Notice 2016-76, the Treasury Department and the IRS announced that taxpayers may continue to rely on the QSL Notice during 2017. The QSL Notice will be obsoleted as of January 1, 2018.

#### X. Rules for Withholding on Dividend Equivalents

Newly designated § 1.1441-2(e)(7) provides that a withholding agent is not

obligated to withhold on a dividend equivalent until the later of when a payment is made with respect to a section 871(m) transaction and when the amount of a dividend equivalent is determined. For purposes of § 1.1441–2(e)(7), a payment with respect to a section 871(m) transaction occurs when the long party receives or makes a payment, when there is a final settlement of the section 871(m) transaction, or when the long party sells or otherwise disposes of the section 871(m) transaction. The 2015 final regulations adopted this approach in response to taxpayer comments.

#### *A. Transactions Transferred to a Different Account*

The 2015 final regulations provide that a payment occurs when the long party sells or disposes of a section 871(m) transaction; however, when a long party transfers a section 871(m) transaction from one broker or custodian to another broker or custodian, the 2015 final regulations do not treat that transfer as a payment. A comment noted that it is common for investors to change relationships with brokers and custodians who hold their securities, which may result in section 871(m) transactions being transferred from one broker or custodian to another. The comment asserted that it is inappropriate and burdensome for a withholding agent to be responsible for dividend equivalent amount calculations relating to dividends that occurred before the date that the new broker or custodian holds the section 871(m) transaction on behalf of a long party. The comment recommended that the Treasury Department and the IRS amend the 2015 final regulations to provide that a transfer of a section 871(m) transaction from one broker or custodian to another, without a change in beneficial ownership, constitutes a payment for purposes of § 1.1441–2(e)(7).

The Treasury Department and the IRS agree that requiring a broker or custodian to withhold on dividend equivalent payments that occurred before holding a section 871(m) transaction on behalf of a customer would be burdensome to the withholding agent. As a result, § 1.1441–2(e)(7) is revised to provide that a payment of a dividend equivalent occurs when a section 871(m) transaction is transferred to an account not maintained by the withholding agent or upon a termination of the account relationship.

#### *B. Option To Withhold on Dividend Payment Date*

While § 1.1441–2(e)(7) generally defers withholding on a section 871(m) transaction until there is a payment made pursuant to the transaction, comments noted that § 1.1441–2(e)(7) will require cashless withholding in certain circumstances. To implement the 2015 final regulations, comments noted that market participants would be required to develop or amend collateral and indemnity arrangements with customers. Some comments recommended amending the 2015 final regulations to allow withholding agents to treat a dividend equivalent as paid and subject to withholding on the dividend payment date for the underlying security referenced by the section 871(m) transaction. Comments indicated that some withholding agents believe that it will be easier to implement withholding on the dividend payment date for the underlying security because their systems are already designed to track the time and amount of actual dividends. Many withholding agents, however, have contractual agreements with customers that prohibit withholding earlier than a date permitted by regulations.

The Treasury Department and the IRS appreciate that some withholding agents would rather not develop new systems to track dividend equivalents over multiple years, while other financial institutions prefer the time for withholding provided by § 1.1441–2(e)(7). To accommodate both approaches, the Treasury Department and the IRS are amending the regulations to allow withholding agents the flexibility to withhold either based on the “later of” rule, as determined under § 1.1441–2(e)(7), or on the dividend payment date for the underlying security. This change will allow withholding agents that prefer to withhold on the dividend payment date to do so, without eliminating the “later of” rule in § 1.1441–2(e)(7) that generally ties withholding to a cash payment. As discussed in Part IX.F of this preamble, if a withholding agent acts as a QDD, it will be required to use the dividend payment date.

A withholding agent that chooses to withhold on the dividend payment date for the underlying security referenced by the section 871(m) transaction must apply the election consistently to all section 871(m) transactions of the same type. In other words, a withholding agent that chooses to withhold on the dividend payment date for securities lending transactions must do so for all securities lending transactions, but may

choose to withhold on NPCs under the rule in § 1.1441–2(e)(7). When a withholding agent withholds on the dividend payment date under this alternate method, the withholding agent must notify each payee in writing before the time for determining the long party’s first dividend equivalent payment. A withholding agent that withholds on the dividend payment date for the underlying security also must attach a statement to its Form 1042 for the year of the change notifying the IRS of the change and when it applies.

#### **XI. Applicability Date**

The current regulations provide that § 1.871–15(d)(2) and (e) apply to any payment made on or after January 1, 2017, with respect to any transaction issued on or after January 1, 2017. Several comments requested that implementation of these provisions be delayed until at least January 1, 2018. One comment requested that implementation be delayed until at least one year after the date guidance resolving all issues raised by the comment is issued. The primary reasons comments provided for the requests to delay implementation were the need for additional guidance, the need for additional time to make systems operational, and the recent release of additional QDD guidance in the QI Notice and in Notice 2016–76. Comments also requested a delay in the combination rule generally. Another comment agreed with the request for a delayed effective date for the combination rule, unless the rule was revised to require withholding agents only to combine transactions that the withholding agent has actual knowledge are priced, marketed, or sold in connection with each other. A comment also requested a transition period until December 31, 2018, for enforcement and administration of QDD obligations.

The 2013 proposed regulations provided that the proposed sections would apply to payments made on or after the date the regulations were finalized. However, when the regulations were finalized in 2015, the Treasury Department and the IRS provided that the regulations generally would only apply to transactions issued on or after January 1, 2017, to ensure adequate time to develop systems needed to implement the regulations.

Both the 2015 regulations and the amendments to those regulations that are included in these regulations, many of which were previously announced in the QI Notice, Notice 2016–76, and the 2017 QI Agreement, make the withholding required under section 871(m) easier to implement and more

administrable. In light of these revisions, the Treasury Department and the IRS have determined that it is not necessary or appropriate to uniformly extend the applicability date for all section 871(m) transactions. In particular, taxpayers have had ample time to develop systems to implement withholding on section 871(m) transactions that are delta one transactions. The Treasury Department and the IRS have determined, however, that taxpayers and withholding agents need additional time to implement the section 871(m) regulations for section 871(m) transactions other than delta one transactions. Accordingly, these regulations postpone the implementation of the section 871(m) regulations with respect to non-delta one transactions until January 1, 2018.

In addition, in response to comments, Notice 2016–76 announced transition relief for combined transactions by providing a simplified rule for withholding agents to determine whether transactions entered into in 2017 are combined transactions. Also in response to comments, Notice 2016–76 delayed the application of section 871(m) for certain exchange-traded notes. Notice 2016–76 also announced that calendar years 2017 and 2018 would be phase-in years. In enforcing and administering section 871(m) (1) with respect to delta-one transactions in 2017, and (2) with respect to non-delta-one transactions in 2018, the IRS will take into account the extent to which the taxpayer or withholding agent made a good faith effort to comply with the section 871(m) regulations. Similarly, Notice 2016–76 and the 2017 QI Agreement provide that calendar year 2017 will be a phase-in year for QDDs. As discussed in Part XI.D, the 2017 QI Agreement and these regulations provide that a QDD will not be subject to withholding on actual or deemed dividends in 2017. Finally, the 2017 QI Agreement and these final regulations do not impose tax on a QDD's section 871(m) amount for tax years beginning before January 1, 2018.

#### Effect on Other Documents

Notice 2010–46 (2010–24 I.R.B. 757) is obsolete as of January 1, 2018.

#### Special Analyses

Certain IRS regulations, including these, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial

number of small entities. This certification is based on the fact that few, if any, small entities will be affected by these regulations. The regulations primarily will affect multinational financial institutions, which tend to be larger businesses, and foreign persons. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

#### Drafting Information

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

#### 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 is amended by removing the sectional authority for § 1.871–15 and adding in its place a sectional authority for §§ 1.871–15 and 1.871–15T to read in part as follows:

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

§§ 1.871–15 and 1.871–15T also issued under 26 U.S.C. 871(m). \* \* \*

■ **Par. 2.** Section 1.871–15 is amended by:

- 1. Revising paragraph (a)(1).
- 2. Revising paragraph (a)(14)(i).
- 3. Adding a new second sentence to paragraph (a)(14)(ii)(B).
- 4. Revising paragraph (c)(2)(ii).
- 5. Revising paragraph (c)(2)(iv).
- 6. Revising paragraphs (g)(2) through (g)(3), redesignating paragraph (g)(4) as (g)(5), and adding new paragraph (g)(4).
- 7. Revising paragraph (h).
- 8. Revising paragraphs (i)(3)(ii) and (i)(3)(iii).
- 9. Adding introductory text to paragraph (j)(1).
- 10. Adding paragraph (j)(4).
- 11. Revising paragraph (l)(2).
- 12. Revising paragraph (l)(4).
- 13. Redesignating paragraphs (n)(3)(i) and (n)(3)(ii) as (n)(3)(ii) and (n)(3)(iii), respectively.

- 14. Adding new paragraph (n)(3)(i).
- 15. Revising paragraph (p)(1).
- 16. Adding paragraphs (p)(4)(iii) and (p)(5).
- 17. Revising paragraph (q).
- 18. Revising paragraphs (r)(3) and (r)(4).
- 19. Adding paragraph (r)(5).

The additions and revisions read as follows:

#### § 1.871–15 Treatment of dividend equivalents.

(a) \* \* \* (1) *Broker*. [Reserved]. For further guidance, see § 1.871–15T(a)(1).  
\* \* \* \* \*

(14) \* \* \* (i) *Simple contract*. A *simple contract* is an NPC or ELI for which, with respect to each underlying security, all amounts to be paid or received on maturity, exercise, or any other payment determination date are calculated by reference to a single, fixed number of shares (as determined in paragraph (j)(3) of this section) of the underlying security, provided that the number of shares can be ascertained at the calculation time for the contract, and there is a single maturity or exercise date with respect to which all amounts (other than any upfront payment or any periodic payments) are required to be calculated with respect to the underlying security. For purposes of this section, a contract that provides an adjustment to the number of shares of the underlying security for a merger, stock split, cash dividend, or similar corporate action that affects all holders of the underlying securities proportionately will not cease to be treated as referencing a single, fixed number of shares solely as a result of that provision. A contract has a single exercise date even though it may be exercised by the holder at any time on or before the stated expiration of the contract. An NPC or ELI that includes a term that discontinuously increases or decreases the amount paid or received (such as a digital option), or that accelerates or extends the maturity is not a simple contract. A simple contract that is an NPC is a *simple NPC*. A simple contract that is an ELI is a *simple ELI*.  
\* \* \* \* \*

(ii) \* \* \* (B)

*Example.* \* \* \* Pursuant to paragraph (j)(3) of the section, the ELI references 200 shares when Stock X appreciates, but only 100 shares when Stock X depreciates. \* \* \*

(c) \* \* \*

(2) \* \* \* (ii) *Section 305*

*coordination.* A dividend equivalent received by a long party, who is a shareholder as defined in § 1.305–1(d) of an instrument that gives rise to a dividend pursuant to sections 305(b)

and (c) (including a debt instrument that is convertible into shares of stock and stock that is convertible into shares of another class of stock) that is also a section 871(m) transaction, is reduced by any amount treated as a dividend by sections 305(b) and (c) to the long party. For other section 871(m) transactions that reference an underlying security that is an instrument treated as paying a dividend pursuant to sections 305(b) and (c) and for which the long party is not a shareholder as defined in § 1.305-1(d), the dividend equivalent received by the long party with respect to the section 871(m) transaction includes (and is not reduced by) any amount treated as a dividend pursuant to sections 305(b) and (c).

\* \* \* \* \*

(iv) *Payments made pursuant to annuity, endowment, and life insurance contracts*—(A) *Insurance contracts issued by domestic insurance companies.* A payment made pursuant to a contract that is an annuity, endowment, or life insurance contract issued by a domestic corporation (including its foreign or U.S. possession branch) that is a life insurance company described in section 816(a) does not include a dividend equivalent if the payment is subject to tax under section 871(a) or section 881.

(B) *Insurance contracts issued by foreign insurance companies.* A payment does not include a dividend equivalent if it is made pursuant to a contract that is an annuity, endowment, or life insurance contract issued by a foreign corporation that would be subject to tax under subchapter L if it were a domestic corporation.

(C) *Insurance contracts held by foreign insurance companies.* A payment made pursuant to a policy of insurance (including a policy of reinsurance) does not include a dividend equivalent if it is made to a foreign corporation that would be subject to tax under subchapter L if it were a domestic corporation.

\* \* \* \* \*

(g) \* \* \*

(2) *Time for determining delta*—(i) *In general.* Except as provided in paragraph (g)(4) of this section, the delta of a potential section 871(m) transaction is determined at the calculation time for the potential section 871(m) transaction.

(ii) *Calculation time.* The calculation time for a potential section 871(m) transaction is the earlier of when the potential section 871(m) transaction is priced and when the potential section 871(m) transaction is issued. Notwithstanding the preceding sentence, if the pricing time is more

than 14 calendar days before the potential section 871(m) transaction is issued, the calculation time is when the potential section 871(m) transaction is issued.

(iii) *Pricing time.* A potential section 871(m) transaction is priced when all material economic terms for the transaction have been agreed upon, including the price at which the transaction is sold.

(3) *Simplified delta calculation for certain simple contracts that reference multiple underlying securities.* If an NPC or ELI references 10 or more underlying securities and an exchange-traded security (for example, an exchange-traded fund) is available that would fully hedge the NPC or ELI at the calculation time, the delta of the NPC or ELI may be calculated by determining the ratio of the change in the fair market value of the simple contract to a small change in the fair market value of the exchange-traded security. A delta determined under this paragraph (g)(3) must be used as the delta for each underlying security for purposes of calculating the amount of a dividend equivalent as provided in paragraph (j)(1)(ii) of this section.

(4) *Delta calculation for listed options*—(i) *In general.* The delta of an option contract that is listed on a regulated exchange described in paragraph (g)(4)(ii) of this section is the delta of that option at the close of business on the business day before the date of issuance. On the date an option contract is listed for the first time, the delta is the delta of that option at the close of business on the date of issuance. Notwithstanding the preceding two sentences, the delta of a listed option that is also a customized option is determined under the rules of paragraphs (g)(2) and (g)(3) of this section.

(ii) *Regulated exchange.* For purposes of paragraph (g)(4)(i) of this section, a regulated exchange is any exchange that is either:

(A) Described in paragraph (l)(3)(vii) of this section; or

(B) [Reserved]. For further guidance, see § 1.871-15T(g)(4)(ii)(B).

\* \* \* \* \*

(h) *Substantial equivalence test*—(1) *In general.* The substantial equivalence test described in this paragraph (h) applies to determine whether a complex contract is a section 871(m) transaction. The substantial equivalence test assesses whether a complex contract substantially replicates the economic performance of the underlying security by comparing, at various testing prices for the underlying security, the

differences between the expected changes in value of that complex contract and its initial hedge with the differences between the expected changes in value of a simple contract benchmark (as described in paragraph (h)(2) of this section) and its initial hedge. If the complex contract contains more than one reference to a single underlying security, all references to that underlying security are taken into account for purposes of applying the substantial equivalence test with respect to that underlying security. With respect to an equity derivative that is embedded in a debt instrument or other derivative, the substantial equivalence test is applied to the complex contract without taking into account changes in the market value of the debt instrument or other derivative that are not directly related to the equity element of the instrument. The complex contract is a section 871(m) transaction with respect to an underlying security if, for that underlying security, the expected change in value of the complex contract and its initial hedge is equal to or less than the expected change in value of the simple contract benchmark and its initial hedge when the substantial equivalence test described in this paragraph (h) is calculated at the calculation time for the complex contract. To the extent that the steps of the substantial equivalence test set out in this paragraph (h) cannot be applied to a particular complex contract, a taxpayer must use the principles of the substantial equivalence test to reasonably determine whether the complex contract is a section 871(m) transaction with respect to each underlying security. For purposes of this section, the test must be applied and the inputs must be determined in a commercially reasonable manner. The term of the simple contract benchmark must be, and the inputs must use, a reasonable time period, consistently applied (for example, in determining the standard deviation and probability). If a taxpayer calculates any relevant input for non-tax business purposes, that input ordinarily is the input used for purposes of this section.

(2) *Simple contract benchmark.* The simple contract benchmark is an actual or hypothetical simple contract that, at the calculation time for the complex contract, has a delta of 0.8, references the applicable underlying security referenced by the complex contract, and has terms that are consistent with all the material terms of the complex contract, including the maturity date. If an actual simple contract does not exist, the taxpayer must create a hypothetical

simple contract. Depending on the complex contract, the simple contract benchmark might be, for example, a call option, a put option, or a collar.

(3) *Substantial equivalence.* A complex contract is a section 871(m) transaction with respect to an underlying security if the complex contract calculation described in paragraph (h)(4) of this section results in an amount that is equal to or less than the amount of the benchmark calculation described in paragraph (h)(5) of this section.

(4) *Complex contract calculation*—(i) *In general.* The complex contract calculation for each underlying security referenced by a potential section 871(m) transaction that is a complex contract is computed by:

(A) Determining the change in value (as described in paragraph (h)(4)(ii) of this section) of the complex contract with respect to the underlying security at each testing price (as described in paragraph (h)(4)(iii) of this section);

(B) Determining the change in value of the initial hedge for the complex contract at each testing price;

(C) Determining the absolute value of the difference between the change in value of the complex contract determined in paragraph (h)(4)(i)(A) of this section and the change in value of the initial hedge determined in paragraph (h)(4)(i)(B) of this section at each testing price;

(D) Determining the probability (as described in paragraph (h)(4)(iv) of this section) associated with each testing price;

(E) Multiplying the absolute value for each testing price determined in paragraph (h)(4)(i)(C) of this section by the corresponding probability for that testing price determined in paragraph (h)(4)(i)(D) of this section;

(F) Adding the product of each calculation determined in paragraph (h)(4)(i)(E) of this section; and

(G) Dividing the sum determined in paragraph (h)(4)(i)(F) of this section by the initial hedge for the complex contract.

(ii) *Determining the change in value.* The change in value of a complex contract is the difference between the value of the complex contract with respect to the underlying security at the calculation time for the complex contract and the value of the complex contract with respect to the underlying security if the price of the underlying security were equal to the testing price at the calculation time for the complex contract. The change in value of the initial hedge of a complex contract with respect to the underlying security is the difference between the value of the

initial hedge at the calculation time for the complex contract and the value of the initial hedge if the price of the underlying security were equal to the testing price at the calculation time for the complex contract.

(iii) *Testing price.* The testing prices must include the prices of the underlying security if the price of the underlying security at the calculation time for the complex contract were alternatively increased by one standard deviation and decreased by one standard deviation, each of which is a separate testing price. In circumstances where using only two testing prices is reasonably likely to provide an inaccurate measure of substantial equivalence, a taxpayer must use additional testing prices as necessary to determine whether a complex contract satisfies the substantial equivalence test. If additional testing prices are used for the substantial equivalence test, the probabilities as described in paragraph (h)(4)(iv) of this section must be adjusted accordingly.

(iv) *Probability.* For purposes of paragraphs (h)(4)(i)(D) and (E) of this section, the probability of an increase by one standard deviation is the measure of the likelihood that the price of the underlying security will increase by any amount from its price at the calculation time for the complex contract. For purposes of paragraphs (h)(4)(i)(D) and (E) of this section, the probability of a decrease by one standard deviation is the measure of the likelihood that the price of the underlying security will decrease by any amount from its price at the calculation time for the complex contract.

(5) *Benchmark calculation.* The benchmark calculation with respect to each underlying security referenced by the potential section 871(m) transaction is determined by using the computation methodology described in paragraph (h)(4) of this section with respect to a simple contract benchmark for the underlying security.

(6) *Substantial equivalence calculation for certain complex contracts that reference multiple underlying securities.* If a complex contract references 10 or more underlying securities and an exchange-traded security (for example, an exchange-traded fund) is available that would fully hedge the complex contract at its calculation time, the substantial equivalence calculations for the complex contract may be calculated by treating the exchange-traded security as the underlying security. When the exchange-traded security is used for the substantial equivalence calculation pursuant to this paragraph (h)(6), the

initial hedge is the number of shares of the exchange-traded security for purposes of calculating the amount of a dividend equivalent as provided in paragraph (j)(1)(iii) of this section.

(7) *Example.* The following example illustrates the rules of paragraph (h) of this section. For purposes of this example, Stock X is common stock of domestic corporation X. FI is the financial institution that structures the transaction described in the example, and is the short party to the transaction. Investor is a nonresident alien individual.

*Example. Complex contract that is not substantially equivalent.* (i) FI issues an investment contract (the Contract) that has a stated maturity of one year, and Investor purchases the Contract from FI at issuance for \$10,000. At maturity, the Contract entitles Investor to a return of \$10,000 (i) plus 200 percent of any appreciation in Stock X above \$100 per share, capped at \$110, on 100 shares or (ii) minus 100 percent of any depreciation in Stock X below \$90 on 100 shares. At the calculation time for the Contract, the price of Stock X is \$100 per share. Thus, for example, Investor will receive \$11,000 if the price of Stock X is \$105 per share at maturity of the Contract, but Investor will receive \$9,000 if the price of Stock X is \$80 per share when the Contract matures. At issuance, FI acquires 64 shares of Stock X to fully hedge the Contract issued to Investor. The calculation time for this example is the issuance.

(ii) The Contract references an underlying security and is not an NPC, so it is classified as an ELI under paragraph (a)(4) of this section. At the calculation time for the Contract, the Contract does not provide for an amount paid at maturity that is calculated by reference to a single, fixed number of shares of Stock X. When the Contract matures, the amount paid is effectively calculated based on either 200 shares of Stock X (if the price of Stock X has appreciated up to \$110) or 100 shares of Stock X (if the price of Stock X has declined below \$90). Consequently, the Contract is a complex contract described in paragraph (a)(14) of this section.

(iii) Because it is a complex ELI, FI applies the substantial equivalence test described in paragraph (h) of this section to determine whether the Contract is a specified ELI. FI determines that the price of Stock X would be \$120 if the price of Stock X were increased by one standard deviation, and \$79 if the price of Stock X were decreased by one standard deviation. Based on these results, FI next determines the change in value of the Contract to be \$2000 at the testing price that represents an increase by one standard deviation (\$12,000 testing price minus \$10,000 issue price) and a negative \$1,100 at the testing price that represents a decrease by one standard deviation (\$10,000 issue price minus \$8,900 testing price). FI performs the same calculations for the 64 shares of Stock X that constitute the initial hedge, determining that the change in value of the initial hedge is \$1,280 at the testing price that represents an increase by one standard

deviation (\$6,400 at issuance compared to \$7,680 at the testing price) and negative \$1,344 at the testing price that represents a decrease by one standard deviation (\$6,400 at issuance compared to \$5,056 at the testing price).

(iv) FI then determines the absolute value of the difference between the change in value of the initial hedge and the Contract at the testing price that represents an increase by one standard deviation and a decrease by one standard deviation. Increased by one standard deviation, the absolute value of the difference is \$720 (\$2,000-\$1,280); decreased by one standard deviation, the absolute value of the difference is \$244 (negative \$1,100 minus negative \$1,344). FI determines that there is a 52% chance that the price of Stock X will have increased in value when the Contract matures and a 48% chance that the price of Stock X will have decreased in value at that time. FI multiplies the absolute value of the difference between the change in value of the initial hedge and the Contract at the testing price that represents an increase by one standard deviation by 52%, which equals \$374.40. FI multiplies the absolute value of the difference between the change in value of the initial hedge and the Contract at the testing price that represents a decrease by one standard deviation by 48%, which equals \$117.12. FI adds these two numbers and divides by the number of shares that constitute the initial hedge to determine that the transaction calculation is 7.68 ((374.40 plus 117.12) divided by 64).

(v) FI then performs the same calculation with respect to the simple contract benchmark, which is a one-year call option that references one share of Stock X, settles on the same date as the Contract, and has a delta of 0.8. The one-year call option has a strike price of \$79 and has a cost (the purchase premium) of \$22. The initial hedge for the one-year call option is 0.8 shares of Stock X.

(vi) FI first determines that the change in value of the simple contract benchmark is \$19.05 if the testing price is increased by one standard deviation (\$22.00 at issuance to \$41.05 at the testing price) and negative \$20.95 if the testing price is decreased by one standard deviation (\$22.00 at issuance to \$1.05 at the testing price). Second, FI determines that the change in value of the initial hedge is \$16.00 at the testing price that represents an increase by one standard deviation (\$80 at issuance to \$96 at the testing price) and negative \$16.80 at the testing price that represents a decrease by one standard deviation (\$80.00 at issuance to \$63.20 at the testing price).

(vii) FI determines the absolute value of the difference between the change in value of the initial hedge and the one-year call option at the testing price that represents an increase by one standard deviation is \$3.05 (\$16.00 minus \$19.05). FI next determines the absolute value of the difference between the change in value of the initial hedge and the option at the testing price that represents a decrease by one standard deviation is \$4.15 (negative \$16.80 minus negative \$20.95). FI multiplies the absolute value of the difference between the change in value of the initial hedge and the option at the testing

price that represents an increase by one standard deviation by 52%, which equals \$1.586. FI multiplies the absolute value of the difference between the change in value of the initial hedge and the option at the testing price that represents a decrease by one standard deviation by 48%, which equals \$1.992. FI adds these two numbers and divides by the number of shares that constitute the initial hedge to determine that the benchmark calculation is 4.473 ((1.586 plus 1.992) divided by .8).

(viii) FI concludes that the Contract is not a section 871(m) transaction because the transaction calculation of 7.68 exceeds the benchmark calculation of 4.473.

(i) \* \* \*

(3) \* \* \* (ii) *Publicly available dividend amount.* For purposes of paragraph (i)(3)(i) of this section, if a section 871(m) transaction references the same underlying securities as a security (for example, stock in an exchange-traded fund) or index for which there is a publicly available quarterly dividend amount, the publicly available dividend amount may be used to determine the per-share dividend amount for the section 871(m) transaction with any adjustment for special dividends.

(iii) *Dividend amount for a section 871(m) transaction using the simplified delta calculation.* When the delta of a section 871(m) transaction is determined under paragraph (g)(3) of this section, the per-share dividend amount for that section 871(m) transaction must be determined using the dividend amount for the exchange-traded security that would fully hedge the section 871(m) transaction (whether or not the exchange-traded security is actually acquired).

\* \* \* \* \*

(j) \* \* \* (1) *Calculation of the amount of a dividend equivalent.* The long party is liable for tax on any dividend equivalents required to be determined pursuant to paragraph (j)(2) of this section only with respect to dividend equivalents that arise while the long party is a party to the transaction. The amount of any dividend equivalent is determined as follows:

\* \* \* \* \*

(4) *Taxable year of a dividend equivalent.* A long party is liable for tax on a dividend equivalent in the year the dividend equivalent is subject to withholding pursuant to § 1.1441-2(e)(7). Notwithstanding the preceding sentence, a long party that is a qualified derivatives dealer is liable for tax on a dividend equivalent when the applicable dividend on the underlying security would be subject to withholding pursuant to § 1.1441-

2(e)(4). The amount of the long party's tax liability, however, is determined by reference to the amount that would have been due at the time the dividend equivalent amount is determined pursuant to paragraph (j)(2) of this section based on the beneficial owners at that time (for example, based on the tax rate at that time, whether the long party qualified for a treaty benefit at that time, and in the case of a partnership, based on the partners at that time).

\* \* \* \* \*

(1) \* \* \*

(2) *Qualified index not treated as an underlying security—(i) In general.* For purposes of this section, a qualified index is treated as a single security that is not an underlying security. The determination of whether an index referenced in a potential section 871(m) transaction is a qualified index is made at the calculation time for the transaction based on whether the index is a qualified index on the first business day of the calendar year containing the calculation time.

(ii) *Rule for the first year of an index.* In the case of an index that was not in existence on the first business day of the calendar year containing the calculation time for the transaction, paragraph (l)(2) of this section is applied by testing the index on the first business day it is created, and the dividend yield calculation required by paragraph (l)(3)(vi) of this section is determined by using the dividend yield that the index would have had in the immediately preceding year if it had the same components throughout that year that it has on the day it is created.

\* \* \* \* \*

(4) *Safe harbor for certain indices that reference assets other than underlying securities.* Notwithstanding paragraph (l)(3) of this section, an index is a qualified index if the index is widely traded, the referenced component underlying securities in the aggregate comprise 10 percent or less of the weighting of the component securities in the index, and the index was not formed or availed of with a principal purpose of avoiding U.S. withholding tax.

\* \* \* \* \*

(n) \* \* \*

(3) *Short party presumptions regarding combined transactions—(i) In general.* If a short party relies on the presumption provided in paragraph (n)(3)(ii) of this section or in paragraph (n)(3)(iii) of this section, the short party is not required to treat those potential section 871(m) transactions as part of a



single transaction pursuant to paragraph (n)(1) of this section.

\* \* \* \* \*

(p) \* \* \* (1) *Responsible party*—(i) *In general*. If a broker or dealer is a party to a potential section 871(m) transaction with a counterparty or customer that is not a broker or dealer, the broker or dealer is required to determine whether the potential section 871(m) transaction is a section 871(m) transaction. If both parties to a potential section 871(m) transaction are brokers or dealers, or neither party to a potential section 871(m) transaction is a broker or dealer, the short party must determine whether the potential section 871(m) transaction is a section 871(m) transaction.

(ii) [Reserved]. For further guidance, see § 1.871–15T(p)(1)(ii).

(iii) [Reserved]. For further guidance, see § 1.871–15T(p)(1)(iii).

(iv) [Reserved]. For further guidance, see § 1.871–15T(p)(1)(iv).

(v) *Obligations of the responsible party*. 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 counterparty or customer the timing and amount of any dividend equivalent (as described in paragraphs (i) and (j) of this section). Except as otherwise provided in paragraph (n)(3) of this section, the party required to make the determinations described in this paragraph is required to exercise reasonable diligence to determine whether a transaction is a section 871(m) transaction, the amount of any dividend equivalents, and any other information necessary to apply the rules of this section. The information must be provided in the manner prescribed in paragraphs (p)(2) and (p)(3) of this section. The determinations required by paragraph (p) of this section are binding on the parties to the potential section 871(m) transaction and on any person who is a withholding agent with respect to the potential section 871(m) transaction unless the person knows or has reason to know that the information received is incorrect. The determinations are not binding on the Commissioner.

\* \* \* \* \*

(4) \* \* \*

(iii) *Recordkeeping required for certain options*. With respect to any option to which paragraph (g)(4) of this section applies, contemporaneous documentation is not required to be retained provided that there is a pre-existing documented methodology that is sufficient to permit the delta for the transaction to be verified at a later time.

(5) [Reserved]. For further guidance, see § 1.871–15T(p)(5).

(q) *Dividend and dividend equivalent payments to a qualified derivatives dealer*—(1) *In general*. Except as otherwise provided in this paragraph (q), a qualified derivatives dealer described in § 1.1441–1(e)(6) that receives a payment (within the meaning of paragraph (i) of this section) of a dividend equivalent in its equity derivatives dealer capacity will not be liable for tax under section 881 on that dividend equivalent, provided that the qualified derivatives dealer complies with its obligations under the qualified intermediary agreement described in §§ 1.1441–1(e)(5) and 1.1441–1(e)(6). A qualified derivatives dealer is liable for tax under section 881(a)(1) on its section 871(m) amount for each dividend on each underlying security. This tax liability is reduced (but not below zero) by the amount of tax paid by the qualified derivatives dealer under section 881(a)(1) on dividends it receives with respect to that underlying security on that same dividend in its capacity as an equity derivatives dealer. In addition, a qualified derivatives dealer is liable for tax under section 881(a)(1) for all dividend equivalents it receives that are not received in its equity derivatives dealer capacity. A qualified derivatives dealer also is liable for tax under section 881(a)(1) for all dividends it receives, other than dividends received in 2017 in its equity derivatives dealer capacity. This paragraph does not apply for a qualified derivatives dealer that is a foreign branch of a United States financial institution (within the meaning of § 1.1471–5(e)).

(2) *Transactions on the books of an equity derivatives dealer*. Transactions properly reflected in a qualified derivatives dealer's equity derivatives dealer book are presumed to be held by the dealer in its equity derivatives dealer capacity for purposes of determining the qualified derivatives dealer's tax liability. For purposes of determining whether a dealer is acting in its equity derivatives dealer capacity, only the dealer's activities as an equity derivatives dealer are taken into account. Accordingly, for purposes of this paragraph (q), a dividend or dividend equivalent is treated as received by a qualified derivatives dealer acting in its non-equity derivatives dealer capacity if the dividend or dividend equivalent is received by a qualified derivatives dealer acting as a proprietary trader.

(3) *Section 871(m) amount*. For each dividend on each underlying security, the section 871(m) amount is the product of:

(i) The qualified derivatives dealer's net delta exposure to the underlying security for the applicable dividend, multiplied by;

(ii) The applicable dividend amount per share.

(4) *Net delta exposure*. The net delta exposure to an underlying security is the amount (measured in number of shares) by which (A) the aggregate number of shares of an underlying security that the qualified derivatives dealer has exposure to as a result of positions in the underlying security (including as a result of owning the underlying security) with values that move in the same direction as the underlying security (the long positions) exceeds (B) the aggregate number of shares of an underlying security that the qualified derivatives dealer has exposure to as a result of positions in the underlying security with values that move in the opposite direction from the underlying security (the short positions). The net delta exposure calculation only includes long positions and short positions that the qualified derivatives dealer holds in its equity derivatives dealer capacity (as described in paragraph (q)(2) of this section). Any long positions or short positions that are treated as effectively connected with the qualified derivatives dealer's conduct of a trade or business in the United States for U.S. federal income tax purposes are excluded from the net delta exposure computation. The net delta exposure to an underlying security is determined at the end of the day on the date provided in § 1.871–15(j)(2) for the applicable dividend. For purposes of this calculation, net delta must be determined in a commercially reasonable manner. If a qualified derivatives dealer calculates net delta for non-tax business purposes, the net delta ordinary will be the delta used for that purpose, subject to the modifications required by this definition. Each qualified derivatives dealer must determine its net delta exposure separately only taking into account transactions that are recognized and are attributable to that qualified derivatives dealer for U.S. federal income tax purposes.

(5) *Examples*. The following examples illustrate the rules of this paragraph (q):

*Example 1. Forward contract entered into by a foreign equity derivatives dealer.* (i) *Facts*. FB is a foreign bank that is a qualified intermediary that acts as a qualified derivatives dealer. On April 1, Year 1, FB enters into a cash settled forward contract initiated by a foreign customer (Customer) that entitles Customer to receive from FB all of the appreciation and dividends on 100 shares of Stock X, and obligates Customer to

pay FB any depreciation on 100 shares of Stock X, at the end of three years. FB hedges the forward contract by entering into a total return swap contract with a domestic broker (U.S. Broker) and maintains the swap contract as a hedge for the duration of the forward contract. The swap contract entitles FB to receive an amount equal to all of the dividends on 100 shares of Stock X and obligates FB to pay an amount referenced to a floating interest rate each quarter, and also entitles FB to receive from or pay to U.S. Broker, as the case may be, the difference between the value of 100 shares of Stock X at the inception of the swap and the value of 100 shares of Stock X at the end of 3 years. Stock X pays a quarterly dividend of \$0.25 per share. At the end of the day on the date provided in paragraph (j)(2) of this section for the dividend, FB owns the forward contract and total return swap; FB does not own any shares of Stock X or any other transactions that reference Stock X. FB provides valid documentation to U.S. Broker that FB will receive payments under the swap contract in its capacity as a qualified derivatives dealer, and FB contemporaneously enters both the swap contract with U.S. Broker and the forward contract with Customer on its equity derivatives dealer books.

(ii) *Application of rules.* At the end of the day on the date provided in paragraph (j)(2) of this section for the dividend, FB is a long party on a delta one contract (the total return swap) and a short party on a delta one contract (the forward contract with Customer). Pursuant to § 1.1441-1(b)(4)(xxii), U.S. Broker is not obligated to withhold on the dividend equivalent payments to FB on the swap contract that are referenced to Stock X dividends because U.S. Broker has received valid documentation that it may rely upon to treat the payment as made to FB acting as a qualified derivatives dealer. Pursuant to paragraph (q)(1) of this section, FB is not liable for tax under sections 871(m) and 881 on the payments it receives from U.S. Broker referenced to Stock X dividends because FB's net delta exposure with respect to 100 shares of Stock X is zero at the end of the day on the date provided in paragraph (j)(2) of this section for the dividend. The net delta exposure is zero because the taxpayer has 100 shares of Stock X long position exposure as a result of the total return swap that is reduced by 100 shares of Stock X short position exposure as a result of the forward contract. FB is required to withhold on dividend equivalent payments to Customer on the forward contract in accordance with § 1.1441-2(e)(7).

*Example 2. At-the-money option contract entered into by a foreign equity derivatives dealer.* (i) *Facts.* The facts are the same as Example 1, but Customer purchases from FB an at-the-money call option on 100 shares of Stock X with a term of one year. The call

option has a delta of 0.5, and FB hedges the call option by entering into a total return swap that references 50 shares of Stock X with U.S. Broker. At the end of the day on the date provided in paragraph (j)(2) of this section for the dividend, the call option has a delta of 0.6, FB hedges the call option with a total return swap that references 60 shares of Stock X with U.S. Broker, and FB has no shares of Stock X or other transactions that reference Stock X.

(ii) *Application of rules.* At the end of the day on the date provided in paragraph (j)(2) of this section for the dividend, FB is a long party on 60 shares of Stock X through the total return swap and a short party on an option. Because the option has a delta of less than 0.8 at the calculation time, it is not a section 871(m) transaction. Therefore, there will be no dividend equivalent payments made by FB to Customer that are subject to withholding. Pursuant to § 1.1441-1(b)(4)(xxii), U.S. Broker is not obligated to withhold on the dividend equivalents with respect to Stock X paid to FB because U.S. Broker has received valid documentation that it may rely upon to treat the dividend equivalents as paid to FB acting as a qualified derivatives dealer. The net delta exposure is zero at the end of the day on the date provided in paragraph (j)(2) of this section for the dividend because FB has a long position of 60 shares as a result of the total return swap, which is reduced by FB's short position of 60 shares as a result of the option.

*Example 3. In-the-money option contract entered into by a foreign equity derivatives dealer.* (i) *Facts.* The facts are the same as Example 2, but Customer purchases from FB an in-the-money call option on 100 shares of Stock X with a term of one year. The call option has a delta of 0.8 and FB hedges the call option by purchasing 80 shares of Stock X, which are held in an account with U.S. Broker, who also acts as paying agent. The price of Stock X declines substantially and the option lapses unexercised. At the end of the day on the date provided in paragraph (j)(2) of this section for the dividend, the call option has a delta of 0.48 and FB has reduced its hedge to 50 shares of Stock X with U.S. Broker. In addition, on that date, FB owns no other shares of Stock X or any other transactions that reference Stock X in its equity derivatives dealer capacity.

(ii) *Application of rules.* At the end of the day on the date provided in paragraph (j)(2) of this section for the dividend, FB is a long party on 50 shares of Stock X and a short party on an option. Because the option has a delta of 0.8 at the calculation time, it is a section 871(m) transaction. Therefore, FB is required to withhold on dividend equivalent payments to Customer on the option contract in accordance with § 1.1441-2(e)(7). U.S. Broker is required to withhold on the Stock X dividends paid to FB. Assuming that FB is

a qualified resident of a country that provides withholding on dividends at a 15 percent rate, U.S. Broker is required to withhold on the dividends with respect to the 50 shares of stock held by FB. FB's net delta exposure is two shares of Stock X at the end of the day on the date provided in paragraph (j)(2) of this section because FB has a long position of 50 shares, reduced by FB's short position of 48 shares as a result of the option. FB's section 881 tax on the \$0.50 (two shares multiplied by a dividend of \$0.25 per share) is reduced (but not below zero) by the section 881 tax amount paid by qualified derivatives dealer on the 50 shares. Therefore, FB's section 871(m) amount is zero.

(r) \* \* \*

(3) *Effective/applicability date for paragraphs (d)(2) and (e).* Paragraphs (d)(2) and (e) of this section apply to any payment made on or after January 1, 2017, with respect to any transaction with a delta of one issued on or after January 1, 2017. Paragraphs (d)(2) and (e) of this section apply to any payment made on or after January 1, 2018, with respect to any other transaction issued on or after January 1, 2018.

Notwithstanding the prior sentence, paragraphs (d)(2) and (e) of this section will apply to any payments made on or after January 1, 2020, with respect to the exchange-traded notes issued on or after January 1, 2017, that are identified in a separate notice, and not payments made before January 1, 2020, with respect to those notes. Notwithstanding the first sentence of this paragraph (r)(3), paragraphs (d)(2) and (e) of this section do not apply to payments made in 2017 to a qualified derivatives dealer in its equity derivatives dealer capacity to hedge transactions that have a delta of less than one.

(4) *Effective/applicability date for paragraphs (c)(2)(iv), (h), and (q) of this section.* Paragraphs (c)(2)(iv), (h), and (q) of this section apply to payments made on or after January 1, 2017.

(5) *Effective/applicability date for paragraphs (g)(4)(ii)(B), (p)(1)(ii) through (iv), and (p)(5) of this section.* [Reserved]. For further guidance, see § 1.871-15T(r)(5).

**§ 1.871-15 [Amended]**

■ **Par. 3.** For each section listed in the table, remove the language in the "Remove" column and add in its place the language in the "Add" column as set forth below:

Section	Remove	Add
§ 1.871-15(a)(3) .....	section 316 .....	section 316 (even if there is no actual distribution of cash or property).
§ 1.871-15(a)(5) .....	the time the NPC or ELI is issued, .....	the calculation time for the NPC or ELI.
§ 1.871-15(a)(14)(ii)(B), newly designated third sentence.	issuance .....	the calculation time.

Section	Remove	Add
§ 1.871–15(a)(15), first sentence	a payment with respect to	
§ 1.871–15(c)(1) introductory text	paragraph (2)	paragraph (c)(2) of this section.
§ 1.871–15(c)(1)(i)	references the payment of a dividend	references a dividend.
§ 1.871–15(c)(1)(ii)	references the payment of a dividend	references a dividend.
§ 1.871–15(c)(1)(iii)	references the payment of a dividend	references a dividend.
§ 1.871–15(c)(2)(i), first sentence and second sentence.	section 871	section 871(a).
§ 1.871–15(d)(2)(i)	when the NPC is issued	at the calculation time for the NPC.
§ 1.871–15(d)(2)(ii)	when the NPC is issued	at the calculation time for the NPC.
§ 1.871–15(e)(1)	when the ELI is issued	at the calculation time for the ELI.
§ 1.871–15(e)(2)	when the ELI is issued	at the calculation time for the ELI.
§ 1.871–15(i)(1)	references the payment of a dividend	references a dividend.
§ 1.871–15(i)(2)(i)	estimated payment of dividends	estimated dividend.
§ 1.871–15(i)(2)(ii)	estimated dividend payment	estimated dividend.
§ 1.871–15(i)(2)(iii), first sentence and second sentence.	the time the transaction is issued	the calculation time.
§ 1.871–15(i)(2)(iii), last sentence	to pay a dividend	to have a dividend.
§ 1.871–15(j)(1)(i)	each underlying security	each dividend on an underlying security.
§ 1.871–15(j)(1)(ii) introductory text	each underlying security	each dividend on an underlying security.
§ 1.871–15(j)(1)(iii) introductory text	each underlying security	each dividend on an underlying security.
§ 1.871–15(l)(1), first sentence	The purpose of this section	The purpose of this paragraph (l).
§ 1.871–15(l)(1), second sentence	described in this paragraph	described in this paragraph (l).
§ 1.871–15(l)(7)	references a security (for example, stock in an exchange-traded fund).	references an exchange-traded fund.
§ 1.871–15(m)(2)(ii), first sentence	at the time the potential 871(m) transaction referencing that partnership interest is issued.	at the calculation time for the potential section 871(m) transaction referencing that partnership interest.
§ 1.871–15(m)(2)(ii), first sentence	paragraph (m)(2)(i)	paragraph (m)(2)(i) of this section.
§ 1.871–15(n)(4)(iii), heading and first sentence	less than	fewer than.
§ 1.871–15(p)(4)(ii)	10 business days of the date the potential section 871(m) transaction is issued.	10 business days of the date containing the calculation time for the potential section 871(m) transaction.
§ 1.871–15(r)(4), heading	paragraphs (c)(2)(iv), (h), and (q)	paragraphs (g)(4)(ii)(B), (p)(1)(ii) through (iv), and (p)(5).

■ **Par. 4.** Revise § 1.871–15T to read as follows:

**§ 1.871–15T Treatment of dividend equivalents (temporary).**

(a) [Reserved]. For further guidance, see § 1.871–15(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.

(a)(2) through (g)(4)(ii)(A) [Reserved]. For further guidance, see § 1.871–15(a)(2) through (g)(4)(ii)(A).

(B) A foreign securities exchange that:  
(1) Is regulated or supervised by a governmental authority of the country in which the market is located;

(2) 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;

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

(4) Has an average daily trading volume on the exchange exceeding \$10 billion during the immediately preceding calendar year. 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.

(g)(5) through (p)(1)(i) [Reserved]. For further guidance, see § 1.871–15(g)(5) through (p)(1)(i).

(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 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.

(p)(1)(v) through (p)(4) [Reserved]. For further guidance, see § 1.871-15(p)(1)(v) through (p)(4).

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

*Example 1.* CO is a domestic clearing organization and is not a broker as defined in § 1.871-15(a)(1). 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 § 1.871-15(e)). 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. 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 § 1.871-15(p).

(q) through (r)(4) [Reserved]. For further guidance, see § 1.871-15(r)(1) through (4).

(5) *Effective/applicability date.* This section applies to payments made on or after on January 19, 2017.

(s) *Expiration date.* This section expires January 17, 2020.

■ **Par. 5.** Section 1.1441-1 is amended by:

- 1. Revising paragraphs (b)(4)(xxii), (e)(3)(ii)(E), (e)(5), and (e)(6).
- 2. Adding a new sentence to the end of paragraph (e)(2)(i).
- 3. Adding new paragraph (f)(5).

The additions and revisions read as follows:

**§ 1.1441-1 Requirement for the deduction and withholding of tax on payments to foreign persons.**

\* \* \* \* \*

- (b) \* \* \*
- (4) \* \* \*

(xxii) Certain payments to qualified derivatives dealers (as described in

paragraph (e)(6) of this section). For purposes of this withholding exemption, the qualified derivatives dealer must furnish to the withholding agent the documentation described in paragraph (e)(3)(ii) of this section. A withholding agent that makes a payment to a qualified intermediary that is acting as a qualified derivatives dealer is not required to withhold on the following payments if the withholding agent can reliably associate the payment with a valid qualified intermediary withholding certificate as described in paragraph (e)(3)(ii) of this section, including the certification described in paragraph (e)(3)(ii)(E):

(A) A payment with respect to a potential section 871(m) transaction that is not an underlying security;

(B) A payment of a dividend equivalent; or

(C) A payment of a dividend in 2017.

\* \* \* \* \*

(e) \* \* \*

(2) \* \* \*

(i) \* \* \* For purposes of a qualified intermediary acting as a qualified derivatives dealer, a qualified intermediary withholding certificate, as described in paragraph (e)(3)(ii) of this section is a beneficial owner withholding certificate for purposes of treaty claims for dividends.

\* \* \* \* \*

(3) \* \* \*

(ii) \* \* \*

(E) In the case of any payment with respect to a potential section 871(m) transaction (including any dividend equivalent payment within the meaning of § 1.871-15(i) or underlying security (as defined in § 1.871-15(a)(15)) received by a qualified intermediary acting as a qualified derivatives dealer, a certification that the home office or branch receiving the payment, as applicable, meets the requirements to act as a qualified derivatives dealer as further described in paragraph (e)(6) of this section and that the qualified derivatives dealer assumes primary withholding and reporting responsibilities under chapters 3, 4, and 61, and section 3406 with respect to any payments it makes with respect to potential section 871(m) transactions;

\* \* \* \* \*

(5) *Qualified intermediaries—(i) In general.* A qualified intermediary, as defined in paragraph (e)(5)(ii) of this section, may furnish a qualified intermediary withholding certificate to a withholding agent. The withholding certificate provides certifications on behalf of other persons for the purpose of claiming and verifying reduced rates of withholding under section 1441 or

1442 and for the purpose of reporting and withholding under other provisions of the Code, such as the provisions under chapter 61 and section 3406 (and the regulations under those provisions), or for the qualified derivative dealer (if applicable). Furnishing such a certificate is in lieu of transmitting to a withholding agent withholding certificates or other appropriate documentation for the persons for whom the qualified intermediary receives the payment, including interest holders in a qualified intermediary that is fiscally transparent under the regulations under section 894. Although the qualified intermediary is required to obtain withholding certificates or other appropriate documentation from beneficial owners, payees, or interest holders pursuant to its agreement with the IRS, it is generally not required to attach such documentation to the intermediary withholding certificate. Notwithstanding the preceding sentence, a qualified intermediary must provide a withholding agent with the Forms W-9, or disclose the names, addresses, and taxpayer identifying numbers, if known, of those U.S. non-exempt recipients for whom the qualified intermediary receives reportable amounts (within the meaning of paragraph (e)(3)(vi) of this section) to the extent required in the qualified intermediary's agreement with the IRS. When a qualified intermediary is acting as a qualified derivatives dealer, the withholding certificate entitles a withholding agent to make payments with respect to potential section 871(m) transactions that are not underlying securities and dividend equivalent payments on underlying securities to the qualified derivatives dealer free of withholding. A withholding agent is required to withhold on all other U.S. source FDAP payments made to a qualified derivatives dealer as required by applicable law. Paragraph (e)(6) of this section contains detailed rules prescribing the circumstances in which a qualified intermediary can act as a qualified derivatives dealer. A person may claim qualified intermediary status before an agreement is executed with the IRS if it has applied for such status and the IRS authorizes such status on an interim basis under such procedures as the IRS may prescribe.

(ii) [Reserved]. For additional guidance, see § 1.1441-1T(e)(5)(ii).

(A) Through (C) [Reserved]. For additional guidance, see § 1.1441-1T(e)(5)(ii)(A)-(C).

(D) A foreign person that is a home office or has a branch that is an eligible entity as described in paragraph (e)(6)(ii) of this section, without regard

to the requirement that the person be a qualified intermediary; or

(E) [Reserved]. For additional guidance, see § 1.1441-1T(e)(5)(ii)(E).

(iii) [Reserved]. For additional guidance, see § 1.1441-1T(e)(5)(iii).

(iv) [Reserved]. For additional guidance, see § 1.1441-1T(e)(5)(iv).

(v) [Reserved]. For additional guidance, see § 1.1441-1T(e)(5)(v).

(A) [Reserved]. For additional guidance, see § 1.1441-1T(e)(5)(v)(A).

(B) [Reserved]. For additional guidance, see § 1.1441-1T(e)(5)(v)(B).

(1)-(3) [Reserved]. For additional guidance, see § 1.1441-1T(e)(5)(v)(B)(1)-(3).

(4) If a qualified intermediary is acting as a qualified derivatives dealer, designate the accounts:

(i) For which the qualified derivatives dealer is receiving payments with respect to potential section 871(m) transactions or underlying securities as a qualified derivatives dealer;

(ii) For which the qualified derivatives dealer is receiving payments with respect to potential section 871(m) transactions (and that are not underlying securities) for which withholding is not required;

(iii) For which qualified derivatives dealer is receiving payments with respect to underlying securities for which withholding is required; and

(iv) If applicable, identifying the home office or branch that is treated as the owner for U.S. income tax purposes; and

(6) *Qualified derivatives dealers*—(i)

*In general.* To act as a qualified derivatives dealer under a qualified intermediary withholding agreement, the home office or branch that is a qualified intermediary must be an eligible entity as described in paragraph (e)(6)(ii) of this section and, in accordance with the qualified intermediary agreement, must—

(A) Furnish to a withholding agent a qualified intermediary withholding certificate (described in paragraph (e)(3)(ii) of this section) that indicates that the home office or branch receiving the payment is a qualified derivatives dealer with respect to the payments associated with the withholding certificate;

(B) Agree to assume the primary withholding and reporting responsibilities, including the documentation provisions under chapters 3, 4, and 61, and section 3406, the regulations under those provisions, and other withholding provisions of the Internal Revenue Code, for payments made as a qualified derivatives dealer with respect to potential section 871(m) transactions. For this purpose, a

qualified derivatives dealer is required to obtain a withholding certificate or other appropriate documentation from each counterparty to whom the qualified derivatives dealer makes a reportable payment (including a dividend equivalent payment within the meaning of § 1.871-15(i)). The qualified derivatives dealer is also required to determine whether any payment it makes with respect to a potential section 871(m) transaction is, in whole or in part, a dividend equivalent;

(C) Agree to remain liable for tax under section 881, if any, on any payment with respect to a potential section 871(m) transaction (including a dividend equivalent payment within the meaning of § 1.871-15(i) and underlying securities (including dividends) it receives as a qualified derivatives dealer, or in the case of dividend equivalents received in the equity derivatives dealer capacity, the taxes required pursuant to § 1.871-15(q);

(D) Comply with the compliance review procedures applicable to a qualified intermediary that acts as a qualified derivatives dealer under the qualified intermediary withholding agreement, which will specify the time and manner in which a qualified derivatives dealer must:

(1) Certify to the IRS that it has complied with the obligations to act as a qualified derivatives dealer (including its performance of a periodic review applicable to a qualified derivatives dealer);

(2) Report to the IRS any amounts subject to reporting on Forms 1042-S (including dividend equivalent payments that it made);

(3) Report to the IRS on the appropriate U.S. tax return, its tax liabilities, including its tax liability pursuant to § 1.871-15(q)(1) and any other taxes on payments with respect to potential section 871(m) transactions or underlying securities as defined in § 1.871-15(a)(15) it receives; and

(4) Respond to inquiries from the IRS about obligations it has assumed as a qualified derivatives dealer in a timely manner;

(E) Agree to act as a qualified derivatives dealer for all payments made as a principal with respect to potential section 871(m) transactions and all payments received as a principal with respect to potential section 871(m) transactions and underlying securities as defined in § 1.871-15(a)(15) (including dividend equivalent payments within the meaning of § 1.871-15(i)), excluding any payments made or received by the qualified derivatives dealer to the extent the

payment is treated as effectively connected with the conduct of a trade or business within the United States within the meaning of section 864, and not act as a qualified derivatives dealer for any other payments. For purposes of this paragraph (E), any securities lending or sale-repurchase transaction that the qualified intermediary enters into that is a section 871(m) transaction is treated as entered into as a principal unless the qualified intermediary determines that it is acting as an intermediary with respect to that transaction; and

(F) Each home office or branch must qualify and be approved for qualified derivatives dealer status and must represent itself as a QDD on its Form W-8IMY and separately identify the home office or branch as the recipient on a withholding statement (if necessary). The home office means a foreign person, excluding any branches of the foreign person, that applies for qualified derivatives dealer status. Each home office or branch that obtains qualified derivatives dealer status must be treated as a separate qualified derivatives dealer.

(ii) *Definition of eligible entity.* An eligible entity is a home office or branch that is a qualified intermediary and that, treating the home office or branch as a separate entity, is—

(A) An equity derivatives dealer subject to regulatory supervision as a dealer by a governmental authority in the jurisdiction in which it was organized or operates;

(B) A bank or bank holding company subject to regulatory supervision as a bank or bank holding company (as applicable) by a governmental authority in the jurisdiction in which it was organized, or operates or an entity that is wholly-owned (directly or indirectly) by a bank or bank holding company subject to regulatory supervision as a bank or bank holding company (as applicable) by a governmental authority in the jurisdiction in which the bank or bank holding company (as applicable) was organized or operates and that in its equity derivatives dealer capacity—

(1) Issues potential section 871(m) transactions to customers; and

(2) Receives dividends with respect to stock or dividend equivalent payments pursuant to potential section 871(m) transactions that hedge potential section 871(m) transactions that it issued;

(C) A foreign branch of a U.S. financial institution, if the foreign branch would meet the requirements of paragraph (A) or (B) of this section if it were a separate entity; or

(D) Any person otherwise acceptable to the IRS.

\* \* \* \* \*

(f) \* \* \*

(5) *Effective/applicability date.*

Paragraphs (e)(5)(ii)(D) and (e)(5)(v)(B)(4) of this section apply to payments made on or after on January 19, 2017.

■ **Par. 6.** Section 1.1441-1T is amended by:

■ 1. Redesignating paragraph (e)(5)(ii)(D) as paragraph (e)(5)(ii)(E), redesignating paragraph (e)(5)(v)(B)(4) as paragraph (e)(5)(v)(B)(5) and adding new paragraphs (e)(5)(ii)(D) and (e)(5)(v)(B)(4).

■ 2. Revising paragraphs (e)(3)(ii)(E), (e)(5)(i), (e)(5)(v)(B)(4), and (e)(6).

■ 3. Removing the language “Except for paragraphs (e)(3)(ii)(E) and (e)(6), this section” from the first sentence of paragraph (f)(3) and adding in its place “This section”, and removing the third sentence in paragraph (f)(3), and

■ 4. Removing the language “Except for paragraphs (e)(3)(ii)(E) and (e)(6), the applicability” from the first sentence of paragraph (g) and adding in its place “The Applicability” and removing the second sentence in paragraph (g).

**§ 1.1441-1T Requirement for the deduction and withholding of tax on payments to foreign persons (temporary).**

\* \* \* \* \*

(e) \* \* \*

(3) \* \* \*

(ii) \* \* \*

(E) [Reserved]. For additional guidance, see § 1.1441-1(e)(3)(ii)(E).

\* \* \* \* \*

(5) *Qualified Intermediaries—(i)* [Reserved]. For additional guidance, see § 1.1441-1(e)(5)(i).

(ii) \* \* \*

(D) [Reserved]. For additional guidance, see § 1.1441-1(e)(5)(ii)(D).

\* \* \* \* \*

(v) \* \* \*

(B) \* \* \*

(4) [Reserved]. For additional guidance, see § 1.1441-1(e)(5)(v)(B)(4).

\* \* \* \* \*

(6) [Reserved]. For additional guidance, see § 1.1441-1(e)(6).

\* \* \* \* \*

■ **Par. 7.** Section 1.1441-2 is amended by:

■ 1. Revising paragraphs (e)(7)(i) and (e)(7)(ii).

■ 2. Removing “paragraph (e)(8)(ii)(A)” from paragraph (e)(7)(iii) and adding in “paragraph (e)(7)(ii)(A)” in its place.

■ 3. Adding paragraphs (e)(7)(iv) through (ix).

■ 4. Revising the last sentence of paragraph (f)(1) and adding a new last sentence.

The revisions and additions read as follows:

**§ 1.1441-2 Amounts subject to withholding.**

\* \* \* \* \*

(e) \* \* \*

(7) *Payments of dividend equivalents—(i) In general.* Subject to paragraphs (e)(7)(iv), (vi), and (vii) of this section, a payment of a dividend equivalent is not considered to be made until the later of when—

(A) The amount of a dividend equivalent is determined as provided in § 1.871-15(j)(2), and

(B) A payment occurs with respect to the section 871(m) transaction after the amount of a dividend equivalent is determined as provided in § 1.871-15(j)(2).

(ii) *Payment.* For purposes of paragraph (e)(7) of this section, a payment occurs with respect to a section 871(m) transaction when—

(A) Money or other property is paid to or by the long party, unless the section 871(m) transaction is described in § 1.871-15(i)(3), in which case a payment is treated as being made at the end of the applicable calendar quarter;

(B) The long party sells, exchanges, transfers, or otherwise disposes of the section 871(m) transaction (including by settlement, offset, termination, expiration, lapse, or maturity); or

(C) The section 871(m) transaction is transferred to an account that is not maintained by the withholding agent or the long party terminates the account relationship with the withholding agent.

\* \* \* \* \*

(iv) *Option to withhold on dividend payment date.* A withholding agent may withhold on the payment date described in paragraph (e)(4) of this section for the applicable dividend on the underlying security (the dividend payment date) if it withholds on that date for all section 871(m) transactions of the same type (securities lending or sale-repurchase transaction, NPC, or ELI) and satisfies the requirements to paragraph (e)(7)(v) of this section.

(v) *Changes to time of withholding.* This paragraph describes how a withholding agent changes the time that it withholds on a dividend equivalent payment to a time described in paragraph (e)(7)(i) or (iv) of this section and these requirements must be satisfied for a withholding agent to change the time it withholds. A withholding agent must apply the change consistently to all transactions of the same type entered into on or after the change. For transactions of the same type entered into before the change, a withholding agent must withhold under

the original approach throughout the term of the transaction. When a withholding agent changes the time that it will withhold, the withholding agent must notify each payee in writing that it will withhold using the approach described in paragraph (e)(7)(i) or (iv) of this section, as applicable, before the time for determining the payee’s first dividend equivalent payment (as determined under § 1.871-15(j)(2)). With respect to transactions held by an intermediary or foreign flow-through entity, a withholding agent is treated as providing notice to each payee holding that transaction through the entity when it notifies the intermediary or foreign flow-through entity of the time it will withhold, as described in the preceding sentence, provided that the intermediary or foreign flow-through entity agrees to provide the same notice to each payee. The withholding agent must attach a statement to its relevant income tax return (filed by the due date, including extensions) for the year of the change notifying the IRS of the change and when it applies, identifying the types of section 871(m) transaction to which the change applies, and certifying that has notified its payees. For purposes of this paragraph, a withholding agent will be considered to have entered into a transaction on the first date the withholding agent becomes responsible for withholding on the transaction (based on the rule in paragraph (e)(7)(ix) of this section).

(vi) *Withholding by qualified derivatives dealers.* A withholding agent that is acting as a qualified derivatives dealer must withhold with respect to a dividend equivalent payment on the payment date described in paragraph (e)(4) of this section for the applicable dividend on the underlying security and must notify each payee in writing that it will withhold on the dividend payment date before the time for determining the payee’s first dividend equivalent payment (as determined under § 1.871-15(j)(2)).

(vii) *Withholding with respect to derivatives that reference partnerships.* To the extent that a withholding agent is required to withhold with respect to a partnership interest described in § 1.871-15(m), the liability for withholding arises on March 15 of the year following the year in which the payment of a dividend equivalent (determined under § 1.871-15(i)) occurs.

(viii) *Notification to holders of withholding timing.* If a withholding agent is required to notify a payee of when it will withhold under paragraph (e)(7)(v) of this section, it may use the reporting methods prescribed in § 1.871-15(p)(3)(i).

(ix) *Withholding agent responsibility.* A withholding agent is only responsible for dividend equivalent amounts determined (as provided in § 1.871–15(j)(2)) during the period the withholding agent is a withholding agent for the section 871(m) transaction.

\* \* \* \* \*

(f) \* \* \* (1) Except as otherwise provided in this paragraph, paragraph (e)(7) of this section applies to payments made on or after September 18, 2015. Paragraphs (e)(7)(ii)(D) and (e)(7)(iv) through (viii) of this section apply to payments made on or after January 19, 2017.

■ **Par. 8.** Section 1.1441–7 is amended by:

■ 1. Revising *Example 7* in paragraph (a)(3).

■ 2. Adding *Example 8* and *9* to paragraph (a)(3).

■ 3. Adding a sentence to the end of paragraph (a)(4).

The additions read as follows:

**§ 1.1441–7 General provisions relating to withholding agents.**

(a) \* \* \*  
(3) \* \* \*

*Example 7.* 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. CB is a nonqualified

intermediary, as defined in § 1.1441–1(c)(14). FC is a foreign corporation that has an account with CB. FC instructs CB to purchase a call option that is a specified ELI (as described in § 1.871–15(e)). CB effects the trade for FC on the exchange. 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 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. To the extent that there is a dividend equivalent with respect to the call option, both CO and CB are withholding agents as described in paragraph (a)(1) of this section. As a withholding agent, CO and CB must each determine whether it is obligated to withhold under chapter 3 of the Internal Revenue Code and the regulations thereunder.

*Example 8.* FCO is a foreign clearing organization. FCO serves as a central counterparty clearing and settlement service provider for derivatives exchanges in Country A, a foreign country. CB is a broker organized in Country A, and a clearing member of FCO. CB is a nonqualified intermediary, as defined in § 1.1441–1(c)(14). FC is a foreign corporation that has an account with CB. FC instructs CB to purchase a call option that is a section 871(m) transaction. CB effects the trade for FC on the exchange. 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 FCO, which clears the

trade. CB and the clearing member representing the call option seller settle the trade with FCO. Upon receiving the matched trade, the option contracts are novated and FCO becomes the counterparty to CB and the counterparty to the clearing member representing the call option seller. To the extent that there is a dividend equivalent with respect to the call option, both FCO and CB are withholding agents as described in paragraph (a)(1) of this section.

*Example 9.* The facts are the same as Example 8, except that CB is a qualified intermediary, as defined in § 1.1441–1(c)(15), that has assumed the primary obligation to withhold, deposit, and report amounts under chapters 3 and 4 of Internal Revenue Code. CB provides a written statement to FCO representing that it has assumed primary withholding responsibility for any dividend equivalent payment with respect to the call option. FCO, therefore, is not required to withhold on a dividend equivalent payment to CB.

(4) \* \* \* *Example 8* and *Example 9* of paragraph (a)(3) of this section apply to payments made on or after January 19, 2017.

\* \* \* \* \*

**§ 1.1461–1 [Amended]**

■ **Par. 9.** For each section listed in the table, remove the language in the “Remove” column and add in its place the language in the “Add” column as set forth below:

Section	Remove	Add
§ 1.1461–1(c)(2)(i) introductory text, fourth sentence.	a withholding agent withheld an amount .....	a withholding agent withheld (including under § 1.1441–2(e)(7)) an amount.
§ 1.1461–1(c)(2)(i)(M) .....	references the payment of a dividend .....	references a dividend.
§ 1.1461–1(c)(2)(ii)(J) .....	or (xxiii); .....	or (xxiii). This exception does not apply to withholding agents that are qualified derivatives dealers;

**John Dalrymple,**  
*Deputy Commissioner for Services and Enforcement.*

Approved: January 11, 2017.

**Mark J. Mazur,**  
*Assistant Secretary of the Treasury (Tax Policy).*

[FR Doc. 2017–01163 Filed 1–19–17; 4:15 pm]

BILLING CODE 4830–01–P

**DEPARTMENT OF THE TREASURY**

**Internal Revenue Service**

**26 CFR Part 1**

[TD 9790]

RIN 1545–BN40

**Treatment of Certain Interests in Corporations as Stock or Indebtedness; Correction**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Correcting amendments.

**SUMMARY:** This document contains corrections to the final and temporary regulations (T.D. 9790) that were published in the **Federal Register** on Friday, October 21, 2016 (81 FR 72858).

The regulations relate to the determination of whether an interest in a corporation is treated as stock or indebtedness for all purposes of the Internal Revenue Code.

**DATES:** These corrections are effective on January 23, 2017, and applicable October 21, 2016.

**FOR FURTHER INFORMATION CONTACT:** Austin M. Diamond-Jones, (202) 317–5363, or Joshua G. Rabon, (202) 317–6938 (not toll-free numbers).

**SUPPLEMENTARY INFORMATION:**

**Background**

The final and temporary regulations that are the subject of this correction are under sections 385 and 752 of the Internal Revenue Code.