

# Upcoming Regulatory Changes – 871(m) and the Common Reporting Standard

A Closer Look at 871(m) and CRS

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Following recently released regulatory changes associated with the United States Internal Revenue Code Section 871(m) and the upcoming implementation of the Organisation for Economic Co-operation and Development (OECD) Common Reporting Standard (CRS) by the Canadian Department of Finance, there are several considerations and key deadlines that may be relevant to your organization. Please note that the following does not constitute tax, legal, or compliance advice, and clients are encouraged to consult with their legal, compliance and tax advisors for specific guidance.

## Background Details on U.S. Regulations on Section 871(m) Dividend Equivalent Withholding

### 871(M) INTRODUCTION

In past, the U.S. government expressed concerns over investors' use of derivatives to avoid payment of U.S. tax on dividends from U.S. corporations. In 2010, Section 871(m) of the U.S. Internal Revenue Code was enacted as part of the Hiring Incentives to Restore Employment (HIRE) Act, the same piece of U.S. legislation that also contains the Foreign Account Tax Compliance Act (FATCA) legislation. It imposes U.S. non-resident withholding tax on "dividend equivalent payments."

The 871(m) regulation focuses on withholding taxes on any financial contract that references an underlying security that could give rise to U.S. source dividend payments and meet certain conditions. While U.S. source dividends

paid to non-U.S. persons is generally subject to a 30 per cent U.S. withholding tax rate, the U.S. government wants to impose the same withholding on dividend equivalent amounts (DEAs) made from derivatives referencing U.S. equities to prevent investors from using it as a loophole to avoid tax. Impacted financial instruments include: swaps (notional principal contracts), futures, options (listed and OTC), forwards, derivatives over equity-linked indices, structured notes, other equity-linked contracts, securities lending, repurchase agreements, certain compensation agreements, and convertible debt. Note that certain distributions are exempt from section 871(m) withholding, such as an exemption for instruments issued before December 31, 2015. Trade capture identification of derivatives will require more details from clients in the future as part of the "identifying in-scope transactions" process.

In the latest communication from the IRS, a correction was issued revising the effective date of the final regulations on the U.S. non-resident withholding tax requirements for DEAs under Section 871(m) – the 2016 implementation provision was eliminated. Now, for specified notional principal contracts (NPCs) and specified equity-linked instruments (ELIs), the final regulations apply to any payment made on or after January 1, 2017, with respect to any transaction issued on or after January 1, 2017. We encourage clients to review the impacts of Section 871(m) with their advisors.

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### SUMMARY OF 871(M) REQUIREMENTS

Financial Institutions (FIs) must have the ability to:

- Establish the status of an entity as non-U.S.
- Determine taxability and related treaty status
- Identify “in-scope” transactions
- Calculate “Equivalent Dividends”
- Provide coding and withholding to satisfy appropriate tax reporting
- Calculate tax withholding based on account tax settings
- Account for tax withholding as a debit to the account

CIBC Mellon is actively participating in the U.S. Tax Committee and Section 871(m) Working Group of the Investment Industry Association of Canada (IIAC). CIBC Mellon acts as custodian for its clients and is not a party to any Section 871(m) transaction. Therefore, we will look to clients to provide us with detailed information on such transactions to which they are a party. CIBC Mellon will continue to keep you apprised of information that may be relevant to you as you determine your organization's specific obligations and requirements under these rule changes. For more information, [view the proposed Section 871\(m\) regulations](#).

Related to the 871(m) regulatory change, the U.S. Treasury Department and IRS recently issued new proposed regulations on the U.S. non-resident withholding tax requirements for deemed distributions payments under Internal Revenue Code (IRC) Section 305(c). The proposed regulation for 305(c) relates to convertible debt, whereas in comparison, 871(m) deals with derivatives referencing a U.S. security. Conversion price or ratio changes in convertible debt may be treated as dividends subject to withholding. They may also be treated as dividend equivalents under section 871(m).

CIBC Mellon and BNY Mellon continue to assess how the 305(c) guidance will be implemented operationally. As procedures are developed, additional information will be communicated. CIBC Mellon expects to begin withholding, when appropriate, on deemed dividends at some point in 2016, and will include deemed dividends and any related withholding in its 1042-S and 1099 reporting for 2016. To prevent excessive withholding, any amount treated as a dividend under section 305 can reduce a dividend equivalent under section 871(m). For more information, view the [proposed 305\(c\) regulations](#).

### Common Reporting Standard (CRS) Background Information

#### CRS INTRODUCTION

The CRS is intended to be a global standard for the exchange of financial account information, including disclosure of income earned by non-resident individuals and organizations. The purpose of the CRS is to address tax evasion, improve international tax compliance, encourage international tax cooperation, and help governments protect the integrity of their tax systems.

The Government of Canada intends to implement the CRS beginning on July 1, 2017 with the first inter-jurisdictional exchange of information with other tax jurisdictions taking place in 2018. The CRS draft legislative proposals and related explanatory notes were recently released on April 15, 2016. The Department of Finance notes that as of July 1, 2017, Canadian financial institutions will be required to have procedures in place to identify accounts held by non-residents and will be required to report certain information to the Canada Revenue Agency (CRA).

CIBC Mellon and many of its clients will be required to take action to implement the provisions of the CRS. CIBC Mellon will be complying with CRS standards and relevant regulatory, tax and disclosure requirements. It is currently assessing changes that may be relevant to clients, as well as the associated roles and responsibilities that may impact both CIBC Mellon and its clients.

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Financial institutions that are located in the jurisdictions that have committed to the [early adoption](#) of the CRS may request certain CRS-related documentation as part of the documentation to open markets at the time of account opening.

#### HIGHLIGHTS OF THE CRS:

- OECD modelled the CRS on FATCA. Unlike the FATCA regime, the reporting requirements for CRS are significantly greater as CRS focuses on tax residency – not citizenship – in any participating jurisdiction, which is likely to impact more people.
- Account holders subject to reporting include foreign resident individuals, foreign resident entities, and foreign resident controlling persons of certain entities.
- Information will need to be reported such as personal data (name, address, jurisdiction of residence, tax identification number – TIN, and the date and place of birth) and financial data (account balance, investment income and sales proceeds from financial assets). There will be different procedures for each of the particular financial account types.
- In 2015, 90 jurisdictions, including Canada, signed a multilateral competent authority agreement to automatically exchange information. Canada is not an early adopter and accordingly, the Government of Canada has committed to a 2017 start.
- Generally, it is expected that FIs, including CIBC Mellon, will review financial accounts to identify reportable accounts by applying due diligence rules and then report relevant information to CRA.
- FIs could be exposed to certain risks if considered non-compliant

#### CRS VS. FATCA

Both CRS and FATCA are designed around the exchange of financial account information, including disclosure of income earned by non-resident individuals and organizations, for the purposes of collecting applicable taxes. The two instruments have certain aspects in common, but there remain key differences between them.

<p><b>SIMILARITIES OF CRS TO FATCA:</b></p>	<ul style="list-style-type: none"> <li>• Both CRS and FATCA require FIs, including banks, credit unions, custodians, brokers, investment entities and select insurance companies, to identify and report taxpayers to the CRA holding accounts outside their domestic jurisdiction of taxation.</li> <li>• Both regulatory instruments require similar documentation and due diligence procedures.</li> <li>• Under both instruments, account holder information is to be reported.</li> </ul>
<p><b>DIFFERENCES BETWEEN CRS AND FATCA:</b></p>	<ul style="list-style-type: none"> <li>• Client identification/onboarding for CRS:               <ul style="list-style-type: none"> <li>- Entity classifications under CRS are not the same as they are under FATCA.</li> <li>- Self-certifications must include the tax residency of the entity and the CRS classification</li> <li>- Undocumented entities are generally considered passive non-foreign financial entities (NFFEs) and controlling persons and their tax residency must be determined.</li> </ul> </li> <li>• Withholding differences for CRS:               <ul style="list-style-type: none"> <li>- No withholding</li> <li>- Participating jurisdictions are expected to employ effective local enforcement provisions to address non-compliance</li> </ul> </li> <li>• Compliance changes for CRS:               <ul style="list-style-type: none"> <li>- No “non-participating foreign financial institution (FFI)” category</li> <li>- Limited impact on FIs located in non-participating jurisdictions</li> </ul> </li> <li>• Reporting for CRS:               <ul style="list-style-type: none"> <li>- Significant increase in reporting data</li> <li>- Greater reliance on systems to capture classifications, tax residencies, and reportable information</li> </ul> </li> </ul>

## RECAP OF CIBC MELLON'S ACTIONS

CIBC Mellon is contributing to the joint financial institution associations' meetings with the Department of Finance and the CRA, as well as participating on the OECD CRS Working Group of the IIAC. For more information, read the [Department of Finance's draft legislative proposals](#) on the implementation of the CRS and its accompanying explanatory notes. The comment period on the draft proposals is to end on July 15, 2016.

## AUTHORIZED SIGNERS LIST

As your asset servicing provider, CIBC Mellon's aim is client-focused service excellence; we strive to provide our clients with information on industry requirements and good practices that may be of interest to them. This article is also a reminder that you may wish to refresh your Authorized Signers Lists (ASLs) on a yearly basis. ASLs are used by CIBC Mellon to authenticate your business and transactional instructions, therefore it is good practice to ensure that these lists are kept up-to-date. ASLs are provided on a good-until-revised basis and it is the responsibility of our clients (or their designated investment managers) to refresh their ASLs as needed. No action is required if you do not wish to refresh your ASLs at this time. CIBC Mellon will assume no action is required if a response is not received within 30 days of receiving this article. If you have any questions or would like to update your ASL, please do not hesitate to contact your Service Director or Account Manager. Please note that this reminder is for your information only and CIBC Mellon is assuming no liability in connection with providing it to you or as a result of our clients (or their designated investment managers) taking or omitting to take any action related to it.

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## More Information

CIBC Mellon will be providing further information on both 871(m) and the CRS in due course and a more detailed communication will be issued shortly. If you have questions or would like to update your ASL, please do not hesitate to contact your Service Director or Account Manager.

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## About CIBC Mellon

CIBC Mellon is a Canadian company exclusively focused on the investment servicing needs of Canadian institutional investors and international institutional investors into Canada. Founded in 1996, CIBC Mellon is 50-50 jointly owned by The Bank of New York Mellon (BNY Mellon) and Canadian Imperial Bank of Commerce (CIBC). CIBC Mellon's investment servicing solutions for institutions and corporations are provided in close collaboration with our parent companies, and include custody, multicurrency accounting, fund administration, recordkeeping, pension services, exchange-traded fund services, securities lending services, foreign exchange processing and settlement, and treasury services. As at March 31, 2016, CIBC Mellon had more than C\$1.6 trillion of assets under administration on behalf of banks, pension funds, investment funds, corporations, governments, insurance companies, foreign insurance trusts, foundations and global financial institutions whose clients invest in Canada. CIBC Mellon is part of the BNY Mellon network, which as at March 31, 2016 had US\$29.1 trillion in assets under custody and/or administration. CIBC Mellon is a licensed user of the CIBC trade-mark and certain BNY Mellon trade-marks, is the corporate brand of CIBC Mellon Global Securities Services Company and CIBC Mellon Trust Company, and may be used as a generic term to refer to either or both companies.

For more information visit [www.cibcmellon.com](http://www.cibcmellon.com).

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