



# NEW YORK STATE BAR ASSOCIATION

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## TAX SECTION

2011-2012

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March 5, 2011

The Honorable Michael Mundaca  
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The Honorable Douglas H. Shulman  
Commissioner,  
Internal Revenue Service  
1111 Constitution Avenue, NW  
Washington, DC 20224

The Honorable William J. Wilkins  
Chief Counsel  
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1111 Constitution Avenue, NW  
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### **Re: Report on Section 871(m)**

Dear Sirs,

I am pleased to submit the New York State Bar Association Tax Section's Report No. 1234, offering recommendations for future administrative guidance under Section 871(m) of the Internal Revenue Code of 1986, as amended. Section 871(m) was enacted as part of P.L. 111-147, which was signed into law on March 18, 2010. Under Section 871(m), a withholding tax is imposed on "dividend equivalents" as defined therein. Specifically, Section 871(m) defines a "dividend equivalent" as (A) a "substitute dividend" pursuant to a stock lending or sale-repurchase transaction or (B) a payment pursuant to a "specified notional principal contract," that in either case (A) or (B) is (directly or indirectly) contingent on or determined by reference to the payment of a U.S.-source dividend, or (C) any other payment determined by the Secretary of the Treasury to be substantially similar to a payment described in Section 871(m)(2)(A) or (B).

The attached report identifies areas where the statutory language and/or intended scope of Section 871(m) are unclear. For example, important concepts such as what types of notional

principal contracts “do not have the potential for tax avoidance” or what it means for a payment to be “substantially similar” to a dividend equivalent under the statute should be addressed. The report offers recommendations for administrative guidance to address these and other uncertainties. Our recommendations include the following:

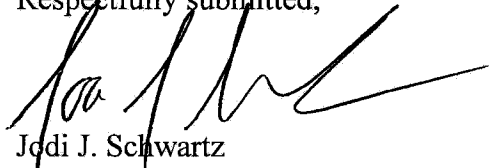
1. We recommend that administrative guidance articulate a view as to the policy basis and intended scope of Section 871(m), which will inform a range of aspects of the regime, including when a payment should be viewed as substantially similar to a dividend equivalent and when a notional principal contract is of a type that does not have the potential for tax avoidance.
2. We recommend that administrative guidance provide definitions for several of Section 871(m)’s undefined terms or phrases, including “notional principal contract,” “readily tradable on an established securities market,” “underlying security,” what it means to “transfer” an underlying security, when is something “contingent upon, or determined by reference to” the payment of a U.S.-source dividend, what constitutes a “payment” under a specified notional principal contract, and when a payment is “directly or indirectly” contingent upon or determined by reference to a U.S.-source dividend.
3. We recommend that administrative guidance consider whether “projected” or “assumed” dividend amounts should be considered “payments” under Section 871(m).
4. We recommend that administrative guidance provide clarity as to whether a “dividend equivalent” is considered a dividend for U.S. tax treaty purposes.
5. We recommend that administrative guidance discuss the applicability of FATCA to instruments that are or may be subject to Section 871(m).
6. We recommend that administrative guidance clarify that Section 871(m) dividend equivalents are exempt from U.S. withholding tax under Section 892.
7. We recommend that administrative guidance address multiplicative withholdings in situations other than chains of stock loans, which are addressed in Notice 2010-46, as we believe that these rules should apply equally to chains of stock loans, notional principal contracts or any combination thereof. Additionally, we recommend that guidance exempt from withholding actual dividends paid to qualified securities lenders acting as such.

The Honorable Douglas H. Shulman  
The Honorable Michael Mundaca  
The Honorable William J. Wilkins

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We would be pleased to discuss with appropriate personnel the issues addressed in this report if that would be helpful.

Respectfully submitted,



Jodi J. Schwartz  
Chair

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