Extension of the Phase-in Period for the Enforcement and Administration of Section 871(m)

Notice 2022-37

I. PURPOSE

This Notice provides taxpayers with additional guidance for complying with the final regulations with respect to dividend equivalents under sections 871(m), 1441, 1461, and 1473 of the Internal Revenue Code (the Code) (collectively referred to as the section 871(m) regulations) in 2023,[1] 2024, and 2025. Specifically, this Notice extends the transition relief provided in Notice 2020-2, 2020-3 I.R.B. 327, for two years, as described in more detail below. The Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) intend to amend the section 871(m) regulations to delay the effective/applicability date of certain rules in those final regulations.

The anti-abuse rule provided in §1.871-15(o) will continue to apply during the phase-in years described in this Notice. As a result, a transaction that would not otherwise be treated as a section 871(m) transaction (including as a result of this Notice) may be a section 871(m) transaction under §1.871-15(o).[2]

II. BACKGROUND

On June 14, 2010, the Treasury Department and the IRS published Notice 2010-

[1] Unless otherwise provided, all references to years refer to calendar years.
[2] The terms used in this Notice have the meanings provided in the section 871(m) regulations.

46, which addresses potential overwithholding in the context of securities lending and sale-repurchase agreements. Notice 2010-46 provides a two-part solution to the problem of overwithholding on a chain of dividends and dividend equivalents. First, it provides an exception from withholding for payments to a qualified securities lender (QSL). Second, it provides a proposed framework to credit forward prior withholding on a chain of substitute dividends paid pursuant to a chain of securities loans or stock repurchase agreements. The QSL regime requires a person that agrees to act as a QSL to comply with certain withholding and documentation requirements. The Treasury Department and the IRS permitted withholding agents to rely on transition rules described in Notice 2010-46, Part III, until guidance was developed that would include documentation and substantiation of withholding.

On September 18, 2015, the **Federal Register** published final regulations and temporary regulations (TD 9734, 80 FR 56866) (2015 final regulations and 2015 temporary regulations, respectively). The 2015 final regulations finalized a portion of a 2013 notice of proposed rulemaking (78 FR 73128). The 2015 temporary regulations were based on comments received with respect to the 2013 notice of proposed rulemaking and were accompanied by a notice of proposed rulemaking cross-referencing the 2015 temporary regulations (80 FR 56415). The Treasury Department and the IRS stated in the preamble to the 2015 temporary regulations that the final qualified derivatives dealer ("QDD") regulations would supplant the proposed regulatory framework described in Notice 2010-46. 80 FR at 56878.

On July 18, 2016, the Treasury Department and the IRS published Notice 2016-42, 2016-29 I.R.B. 67, which contained the proposed qualified intermediary agreement (QI Agreement) that included provisions relating to the QDD regime and reiterated the intent to replace the proposed regulatory framework described in Notice 2010-46 with the QDD regime.

On December 19, 2016, the Treasury Department and the IRS published Notice 2016-76, which provided for the phased-in application of certain provisions of the section 871(m) regulations to allow for the orderly implementation of those final regulations and announced that taxpayers may continue to rely on Notice 2010-46 until January 1, 2018.

On January 17, 2017, the Treasury Department and the IRS published Revenue Procedure 2017-15, 2017-3 I.R.B. 437, which sets forth the final QI Agreement (2017 QI Agreement), including the requirements and obligations applicable to QDDs, and provided that taxpayers may continue to rely on Notice 2010-46 during 2017.

On January 24, 2017, the **Federal Register** published final regulations and temporary regulations (TD 9815, 82 FR 8144) (2017 final regulations and 2017 temporary regulations, respectively, and together, the 2017 regulations). The 2017 final regulations finalized the 2015 notice of proposed rulemaking (80 FR 56415) that was issued in conjunction with the 2015 temporary regulations. On the same day, the **Federal Register** also published a notice of proposed rulemaking cross-referencing the 2017 temporary regulations (82 FR 8172), with correcting amendments published in the

Federal Register on October 26, 2017 (82 FR 49508) (together, the 2017 proposed regulations).

The effective/applicability dates in the 2017 regulations reflect the phased-in application described in Notice 2016-76. See Treas. Reg. §1.871-15(r). Also, consistent with Notice 2016-76 and other announcements, the "Effect on Other Documents" section of the preamble to the 2017 regulations obsoleted Notice 2010-46 as of January 1, 2018. In response to a comment requesting that the QSL regime remain, the preamble to the 2017 regulations noted that "[w]hile 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." 82 FR at 8153.

On August 21, 2017, the Treasury Department and the IRS published Notice 2017-42, 2017-34 I.R.B. 212, which extended certain transition relief.

On February 5, 2018, the Treasury Department and the IRS published Notice 2018-5, 2018-6 I.R.B. 341, which permits withholding agents to apply the transition rules from Notice 2010-46 in 2018 and 2019.

On October 1, 2018, the Treasury Department and the IRS published Notice 2018-72, 2018-40 I.R.B. 522, which further extended certain transition relief and permitted withholding agents to apply the transition rules from Notice 2010-46 in 2020.

On December 17, 2019, the **Federal Register** published final regulations (TD 9887, 84 FR 68790), which finalized the 2017 proposed regulations.

On January 13, 2020, the Treasury Department and the IRS published Notice 2020-2, 2020-3 I.R.B. 327, which extended the phase-in period described in Notice 2018-72 through 2022. This Notice further extends the phase-in period described in Notice 2020-2 through 2024.

The Treasury Department and the IRS continue to evaluate the section 871(m) regulations and will take into account comments already received, and welcome any additional comments regarding tax policy considerations, legal authority for, and the IRS administrative feasibility of any suggested modifications to the section 871(m) regulations. The Treasury Department and the IRS intend to provide sufficient time for taxpayers and withholding agents to implement any changes to the section 871(m) regulations.

III. EXTENSION OF THE PHASE-IN YEAR FOR DELTA-ONE AND NON-DELTA-ONE TRANSACTIONS

This section describes the extension to the phased-in application of the section 871(m) regulations to delta-one and non-delta-one transactions. This Notice does not apply to any transaction that is a section 871(m) transaction pursuant to §1.871-15(d)(1) (providing that before January 1, 2017, a notional principal contract (NPC) is a specified NPC if certain factors are present).

The Treasury Department and the IRS have determined that it is appropriate for taxpayers and withholding agents to delay certain provisions in the section 871(m) regulations for non-delta-one transactions, including transactions that are combined transactions under §1.871-15(n). Therefore, the Treasury Department and the IRS intend to revise the effective/applicability date for §1.871-15(d)(2) and (e) to provide that these rules will not apply to any payment made with respect to any non-delta-one transaction issued before January 1, 2025. As noted in Part I of this Notice, the anti-abuse rule continues to apply to the phased-in application of the section 871(m) regulations, including for the purpose of determining whether a transaction is a delta-one transaction.

Notice 2016-76 provided that 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 with respect to delta-one transactions in 2017 and non-delta-one transactions in 2018 when it enforces the section 871(m) regulations. As a result of extensions in Notice 2017-42, Notice 2018-72, and Notice 2020-2, the good faith effort standard applies to (1) any delta-one transaction in 2017 through 2022, and (2) any non-delta-one transaction that is a section 871(m) transaction pursuant to §1.871-15(d)(2) or (e) in 2023. This Notice further extends the periods during which the enforcement standards provided by Notice 2020-2 will apply. Consistent with this extension, 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 in enforcing the section 871(m) regulations for (1) any delta-one transaction in 2017 through 2024, and (2) any non-delta-one transaction that is a section 871(m) transaction pursuant to §1.871-15(d)(2) or (e) in 2025.

Similarly, for purposes of the IRS's enforcement and administration of the QDD rules in the section 871(m) regulations and the relevant provisions of the 2017 QI Agreement and of a revised QI Agreement that is anticipated to apply beginning January 1, 2023 (2023 QI Agreement), this Notice extends through 2024 the period during which the IRS will take into account the extent to which the QDD made a good faith effort to comply with the section 871(m) regulations and the relevant provisions of the 2017 QI Agreement and the 2023 QI Agreement. See Rev. Proc. 2017-15, sec. 11.01 (providing that the 2017 QI Agreement expires after December 31, 2022). In addition, the IRS is considering providing guidance that a QDD will be considered to satisfy the obligations that apply specifically to a QDD under its QI Agreement(s) for years before 2025 provided that the QDD makes a good faith effort to comply with the relevant provisions of the 2017 QI Agreement and the 2023 QI Agreement, each to the extent applicable to the QDD.

IV. EXTENSION OF THE SIMPLIFIED STANDARD FOR DETERMINING WHETHER TRANSACTIONS ARE COMBINED TRANSACTIONS

Notice 2016-76 provided a simplified standard for withholding agents to determine whether transactions entered into in 2017 are combined transactions. Specifically, a withholding agent is required to combine transactions entered into in 2017 for purposes of determining whether the transactions are section 871(m) transactions only when the transactions are over-the-counter transactions that are priced, marketed, or sold in connection with each other. Withholding agents are not required to combine any transactions that are listed securities entered into in 2017. Notice 2017-42, Notice 2018-72, and Notice 2020-2 extended the period during which this simplified standard for combined transactions applies to include 2018 through 2022. This Notice further extends the period during which this simplified standard for combined transactions applies to include 2023 and 2024. Transactions that are entered into in 2017 through 2024 that are combined under this simplified standard will continue to be treated as combined transactions for future years and will not cease to be combined transactions as a result of applying §1.871-15(n) or disposing of less than all of the potential section 871(m) transactions that are combined under this rule. Transactions that are entered into in 2017 through 2024 that are not combined under this simplified standard will not become combined transactions as a result of applying §1.871-15(n) to these transactions in future years, unless a reissuance or other event causes the transactions to be retested to determine whether they are section 871(m) transactions. See §1.871-15(g)(2) (providing that the delta of a potential section 871(m) transaction generally is determined on the earlier of when the transaction is (1) priced or (2) issued); see also §1.871-15(a)(6) (defining the term “issue” to include “an issuance as a result of a deemed exchange pursuant to section 1001”). This simplified standard applies only to withholding agents and does not apply to taxpayers that are long parties to potential section 871(m) transactions. As noted in Part I of this Notice, the anti-abuse rule continues to apply to the phased-in application of the section 871(m) regulations, including for the purpose of determining whether multiple transactions should be combined.

V. EXTENSION OF PHASE-IN RELIEF FOR QUALIFIED DERIVATIVES DEALERS

Section 1.871-15T(q)(1) of the 2015 temporary regulations provided that when a QDD received a dividend or dividend equivalent payment and the QDD was contractually obligated to make an offsetting dividend equivalent payment on the same underlying security in an amount that was less than the dividend and dividend equivalent amount received, the QDD would be liable for tax under section 871(a) or section 881 for the difference. The 2015 final regulations provided that a withholding agent who made a payment of a dividend to a qualified intermediary acting as a QDD was not required to withhold on that payment if the withholding agent reliably associated the payment with a valid qualified intermediary withholding form containing a certification described in §1.1441-1(e)(3)(ii)(E). See §1.1441-1(b)(4)(xxii) of the 2015 final regulations.

Comments requested that the Treasury Department and the IRS adopt a different method of determining a QDD’s tax liability. Those comments generally requested that this method be based on the QDD’s net delta exposure for each underlying security. The Treasury Department and the IRS agreed that the net delta exposure method was an administrable and accurate method for a QDD to determine its residual exposure to underlying securities, and the 2017 final regulations adopted the net delta exposure method.

In adopting the net delta exposure method, the Treasury Department and the IRS were concerned that the exemption from withholding on dividends paid to a QDD, when combined with the net delta exposure method, could result in U.S. source dividends escaping U.S. tax completely in certain circumstances. Therefore, the 2017 final regulations revised §§1.871-15(q)(1) and 1.1441-1(b)(4)(xxii) to provide that a QDD remains liable for tax under section 881(a)(1) and subject to withholding under chapters 3 and 4 on dividends. However, to allow taxpayers time to implement the net delta exposure method, the 2017 QI Agreement and the 2017 final regulations provided that dividends and dividend equivalents received by a QDD in its equity derivatives dealer capacity in 2017 will not be subject to tax under section 881(a)(1) or subject to withholding under chapters 3 and 4.

Notice 2017-42, Notice 2018-72, and Notice 2020-2 announced that the Treasury Department and the IRS intend to amend §§1.871-15(q)(1) and (r)(3), and 1.1441-1(b)(4)(xxii)(C) to provide that a QDD will not be subject to tax on dividends and dividend equivalents received in 2017 through 2022 in its equity derivatives dealer capacity or withholding on those dividends (including deemed dividends). This Notice announces that the Treasury Department and the IRS intend to amend those provisions to provide that a QDD will not be subject to tax on dividends and dividend equivalents received in 2023 and 2024 in its equity derivatives dealer capacity or withholding on those dividends (including deemed dividends) as well.

Section 4.01(1) of Rev. Proc. 2017-15 provides that a QDD will be required to compute its section 871(m) amount using the net delta exposure method beginning in 2018. Notice 2017-42, Notice 2018-72, and Notice 2020-2 provided that a QDD would be required to compute its section 871(m) amount using the net delta exposure method beginning in 2023. This Notice provides that a QDD will be required to compute its section 871(m) amount using the net delta exposure method beginning in 2025.

A QDD will remain liable for tax under section 881(a)(1) on dividends and dividend equivalents that it receives in any capacity other than as an equity derivatives dealer, and on any other U.S. source FDAP payments that it receives (whether or not in its equity derivatives dealer capacity). In addition, a QDD is responsible for withholding on dividend equivalents it pays to a foreign person on a section 871(m) transaction, whether acting in its capacity as an equity derivatives dealer or otherwise.

Finally, section 10.01(C) of the 2017 QI Agreement provides that: "For calendar year 2017, a QDD is not required to perform a periodic review with respect to its QDD activities (as otherwise required by section 10.04 of this Agreement) or provide the factual information specified in Appendix I." Notice 2017-42, Notice 2018-72, and Notice 2020-2 provided that a QDD is not required to perform a periodic review with respect to its QDD activities for 2017 through 2022. This Notice provides that a QDD is not required to perform a periodic review with respect to its QDD activities for 2023 or 2024. Treasury and the IRS anticipate incorporating into the 2023 QI Agreement the waiver of a QDD's periodic review and the other transitional provisions for QDDs for 2023 and 2024.

VI. EXTENSION OF TRANSITION RULES FROM NOTICE 2010-46

Notice 2018-5, Notice 2018-72, and Notice 2020-2 provided that notwithstanding the preamble to the 2017 regulations, withholding agents may apply the QSL transition rules described in Notice 2010-46, Part III, for payments made in 2018 through 2022. This Notice provides that withholding agents may also apply the QSL transition rules described in Notice 2010-46, Part III, for payments made in 2023 and 2024.

VII. TAXPAYER RELIANCE

Before the promulgation of the amendments to the section 871(m) regulations or the issuance of other guidance, taxpayers may rely on the provisions of this Notice regarding the proposed amendments described in sections III and V. Withholding agents may rely on the simplified standard for determining whether transactions are combined transactions as described in section IV and may apply the QSL transition rules described in section VI.

VIII. DRAFTING INFORMATION

The principal authors of this Notice are Karen Walny and Peter Merkel of the Office of Associate Chief Counsel (International). For further information regarding this Notice, contact Karen Walny or Peter Merkel at (202) 317-6938 (not a toll-free call).