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Effective Dates of Dividend Equivalent Rules Delayed Again: IRS (1)

BNA Snapshot

- Market participants asked for more time to refine new withholding systems
- Delay is welcome but long-term certainty needed, practitioner says

By Allyson Versprille and Siri Bulusu

The IRS is extending prior relief it offered to taxpayers dealing with regulations aimed at stopping foreign investors from skirting the U.S. withholding tax on dividends.

In Notice 2018-72, the Internal Revenue Service said that it will delay the effective date of certain provisions of regulations under tax code Section 871(m) and extend the phase-in period for other deadlines for the withholding tax.

“Market participants have indicated that they will require additional time to refine their systems based on any amendments to the section 871(m) regulations,” the agency said in the notice.

Dealers, issuers, and other withholding agents have been requesting more time from the agency to design, build, and test new withholding and reporting systems.

This tax relief “is very helpful and comes not a moment too soon,” Mark H. Leeds, a tax partner at Mayer Brown LLP in New York, told Bloomberg Tax in an email.

Section 871(m) aims to prevent foreign investors from using derivative instruments to avoid paying a withholding tax on U.S. equities like warrants, convertible bonds, and structured notes.

The IRS's rules were directed at non-U.S. persons who were perceived as playing “fast and loose” with U.S. withholding rules on dividends, Leeds said. But the regulations have the potential to roil the market for structured notes, which are non-abusive instruments that could get trapped by the rules, Leeds said.

Two More Years

The IRS further delayed the new withholding requirement for payments related to transactions involving financial products in which the movement in the price of the derivative doesn't result in an identical shift in the price of the underlying asset. These are called “non-delta-one” transactions.

For such transactions, the new withholding regime was originally slated to go into effect Jan. 1, 2018. In 2017, the IRS delayed that date to Jan. 1, 2019. The new notice delays it an additional two years to Jan. 1, 2021.

Leeds said a lot of taxpayers and practitioners were beginning to get anxious because the Jan. 1, 2019, effective date was fast approaching.

“Industry was anticipating this notice and was delaying costly builds for this reason,” said Tara Ferris, a principal with Ernst & Young LLP in New York. “Unfortunately, we still don't have certainty on what's to come,” she said in an email. Before the 2017 tax overhaul (Pub. L. No. 115-97), practitioners were looking for additional guidance under Section 871(m) but that still hasn't materialized, she said.

The postponement of withholding on non-delta-one exposures is an especially welcome development for the structured note world, Leeds said.

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