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Article

Holiday Party: The IRS Releases Final Regulations on Cross-Border Dividend Equivalents Paid on Swaps and in Security Lending Transactions

By Mark Leeds[1]

The waiting for the final regulations addressing when US federal income tax withholding would be imposed on dividend equivalent payments made to non-US persons under notional principal contracts ("NPCs" or "swaps") and in security lending transactions bore a strong similarity to the plight of nine-year-old Ralphie in Jean Shepherd's "A Christmas Story." Ralphie suspects that his parents have gotten him a Red Ryder BB gun as a Christmas present, but until Christmas morning arrives, he doesn't know for sure. The anticipation, brilliantly portrayed in both the book[2] and the movie, is palpable. It's fair to say that participants in the swap and securities lending markets exhibited at least the same degree of eagerness for final regulations under Section 871(m) of the Internal Revenue Code of 1986, as amended (the "Code") as Ralphie did for his BB gun. Well, unlike Ralphie, we got our present early this year. On December 4, 2013, final regulations were issued for dividend equivalents paid prior to 2016 and regulations have been proposed for dividend equivalents paid after such date.

I. The Briefest of Backgrounds

In 1991, the IRS promulgated a regulation providing that income from a swap is sourced to the residence of the payee.[3] This rule created the potential for a discontinuity with respect to equity swaps and total return swaps, on one hand, and actual stock ownership, on the other. Specifically, if a non-US person[4] held a stock directly, unless an income tax treaty provided for a total exemption from US federal income tax, any dividends paid on a US stock would be treated as US-source income and subject to either 15% (most tax treaties) or 30% US federal income tax withholding.[5] In contrast, a dividend equivalent payment[6] made to a non-US person under a swap in respect of a dividend paid on a US stock included in the specified index[7] would be treated as non-US-source income and not be subject to US federal income tax withholding. Congress became dissatisfied with these results.[8] The IRS perceived that banks and non-US taxpayers abused this disparity through a variety of transactions and initiated an audit campaign to curtail these perceived abuses.[9]

In March 2010, Congress addressed the perceived abuse through the passage of the HIRE Act.[10] Specifically, Section 541 of the HIRE Act enacted Code § 871(m). Code § 871(m)(1) provides that a dividend equivalent "shall be treated as a dividend from sources within the United States." For the period from the effective date of the HIRE Act, dividend equivalents paid or credited on certain swaps and in securities lending transactions could be subject to withholding.[11] Accordingly, Code § 871(m) reverses the rule contained in the 1989 Treasury Regulation for dividend equivalents on certain swaps. As a result, certain dividend equivalents are subject to the same US federal income tax withholding that an actual dividend would be subject to. Indeed, Temporary Regulations amended the 1991 regulation to specifically state that it no longer applied to dividend equivalents and these regulations have now been finalized.[12]

In January 2012, the IRS released three sets of rules. First, a set of rules was provided for payments on swaps made or credited on or after January 23, 2012 and before January 1, 2013.[13] These rules generally followed the rules that had been in effect since 2010. Second, a set of new rules for dividend equivalents were proposed to be effective after final regulations are published.[14] Third, rules were proposed to expand the categories of swaps affected by the dividend equivalent withholding rules (referred to as "specified notional principal contracts" or "specified NPCs") beginning in 2013.[15] The proposed regulations were pulled by the IRS in August 2012[16] and practitioners have been waiting for revised guidance since that time.

II. The 2013 Final Regulations

The 2013 Regulations provide final regulations for dividend equivalents paid before 2016 and address certain technical comments raised by practitioners. First, they provide that the four categories of statute-specified swaps that can give rise to dividend equivalents remain the sole types of equity derivative transactions (apart from securities loans) that can give rise to US-source dividend equivalents. Second, they make payers of dividend equivalents absolutely liable for the correct amount of withholding even if the portion of a distribution that constitutes a dividend cannot be determined at the time that the dividend equivalent is paid.

A. THE EXISTING CATEGORIES OF TRANSACTIONS THAT CAN GIVE RISE TO US-SOURCE DIVIDEND EQUIVALENTS REMAIN UNCHANGED FOR PAYMENTS BEFORE JANUARY 1, 2016

In Code § 871(m)(3)(B), Congress provided the IRS with the right to revise the statutory rules for the withholding of US federal income tax on derivatives referencing US stocks for payments made after March 18, 2012. The applicable tax rules also provide the IRS with the right to extend the withholding rules for dividend equivalents from swaps to financial contracts other than swaps.[17] The legislative history accompanying the enactment of the statute provided, "under this rule, for example, the [IRS] may conclude that payments made under certain forward contracts . . . that reference stock of US corporation are dividend equivalents."[18] In the new regulation package, the IRS chose not to exercise grants of authority for payments made prior to January 1, 2016.

Specifically, in new final Treasury Regulation § 1.871-15(d), the IRS spells out that only four types of swap transactions can give rise to dividend equivalents that when paid or credited to the account of a non-US person prior to January 1, 2016:

1. The non-US person, in connection with entering into the swap, transfers the underlying security to the short party;
2. The short party, in connection with closing or terminating the swap, transfers the underlying security to the non-US person;
3. The underlying security is not readily tradable on an established securities exchange; or
4. In connection with the opening of the swap, the short party posted the underlying security to the non-US person.

These four transactions, known as "specified notional principal contracts," dovetail with the four Congressional-specified transactions that give rise to dividend equivalents subject to withholding when paid or credited to a non-US person for periods prior to March 18, 2012.[19]

B. OTHER TECHNICAL ASPECTS OF THE FINAL DIVIDEND EQUIVALENT REGULATIONS

The final 2013 dividend equivalent regulations make a number of technical changes and clarifications. First, the regulations regarding the impact of tax treaties on the amount to be withheld have been amended to specifically provide that dividend equivalents are eligible for a reduced rate of withholding in those cases in which a tax treaty provides for a lower withholding rate on actual dividends.[20] Second, foreign sovereign entities who can receive dividends exempt from US withholding tax may receive dividend equivalents free from US withholding tax.[21]

Code § 871(m)(5) provides that the word "payment" as used in Code § 871(m) includes any gross amount used to compute any net amount payable to or by a taxpayer. This rule ensures that a dividend equivalent subsumed in another payment retains its character as a US-source income item, potentially subject to withholding. For example, assume that in a single-stock equity swap over a US Stock, the bank counterparty ("ShortCo") has an obligation to make dividend equivalents payments to a non-US person ("LongCo"). LongCo has an obligation to make so-called funding payments to ShortCo. The funding payments equal the product of the value of the stock included in the specified index and an objective interest rate index. On a payment date, ShortCo's obligation to make a dividend equivalent payment to LongCo is $500 and LongCo's obligation to make a funding payment to ShortCo is also $500. As a result, no money passes hands between the counterparties. On these facts, ShortCo is considered to have made a $500 dividend equivalent payment to LongCo. The final withholding regulations specifically impose a withholding requirement on ShortCo in this situation.[22]

The preamble to the final regulations makes clear that any person who is treated as a withholding agent (including custodians and financial intermediaries) can be treated as a withholding agent on dividend equivalents. Interestingly, the same issue arose under the Foreign Account Tax Compliance Act ("FATCA") and the IRS ultimately limited withholding responsibility to only those persons who had knowledge that the payment was a withholdable payment. The initial IRS-proposed FATCA regulations provided that, "when multiple withholding agents that are brokers are involved in effecting a sale, each broker must determine whether it is required to withhold on its payment of gross proceeds by reference to the chapter 4 [FATCA] status of its payee."[23] This language was interpreted by the banking community as imposing FATCA withholding responsibility both on executing brokers and Clearing Organizations.[24]

In January 2013, the IRS released final FATCA regulations that superseded and replaced the proposed regulations.[25] The final regulations deleted what had been Proposed Treasury Regulation § 1.1471-2(a)(2)(v). Instead, a regulation with the same title ("Payments of gross proceeds") was left as a placeholder and was reserved.[26] While the rule that provided for cascading broker responsibility was deleted, the final regulation addressing when a person acting as an agent is a FATCA withholding agent was expanded. Under the expanded FATCA agency rule, a person treated as a withholding agent has an obligation to withhold only to the extent that "it has control over or custody of money or property owned by the payee or beneficial owner from to which to withhold an amount and has knowledge of the facts that give rise to the payments."[27] Unfortunately, the final dividend equivalent payment rules do not contain a similar standard.

It is often unclear as to whether an extraordinary distribution made with respect to stock will be fully taxable as a dividend or whether some portion of the distribution will exceed earnings and profits and be taxable as a return of capital.[28] Commentators had requested that payers be able to use an issuer's estimate of the taxable portion of the distribution in determining their withholding responsibility. The IRS refused this request. As a result, it is likely that payers of dividend equivalents will withhold against the full amount of a dividend equivalent even if issuer has indicated that the full amount may not be taxable.

C. ANTI-ABUSE ENFORCEMENT

The preamble to the final regulations specifically states that the IRS will continue to pursue ("scrutinize") transactions that skirt the literal dividend equivalent withholding rules but present abusive circumstances. While not specifically mentioned, the directive is likely a reference to the IRS Large Scale and Midsize Business ("LMSB") "Industry Directive on Total Return Swaps ('TRSs') Used to Avoid Dividend Withholding Tax" (the "Swap Audit Guidelines").[29] The Swap Audit Guidelines assists IRS agents in "uncovering and developing cases related to [total return swap] TRS transactions that may have been executed in order to avoid tax with respect to US source dividend income" paid to non-US persons. The Swap Audit Guidelines then posit four different transaction structures involving equity swaps. If an IRS agent uncovers one of these fact patterns, he is encouraged to "develop facts supporting a legal conclusion that the Foreign Person retained ownership of the reference securities." Auditors are also advised to look for elements of the facts described in each of the fact patterns. In this way, the IRS can attack transactions that don't neatly fit into the transactions that it has identified.

III. The Proposed Regulations for Dividend Equivalents Paid on or After January 1, 2016

A. SUMMARY OF EFFECTIVE DATES

The proposed regulations generally will apply to payments made on or after the regulations are adopted as final. A couple of exceptions, however, are provided. The definition of specified NPC will apply to payments made pursuant to a specified NPC on or after January 1, 2016, i.e., the proposed rules do not grandfather swap transactions entered into before January 1, 2016. Accordingly, if a swap is executed prior to January 1, 2016, but is outstanding on such date, payments made under the swap after January 1, 2016 are proposed to be subject to withholding if encompassed by the proposed rules and the swap itself will not be grandfathered. In contrast to the 2012 proposed regulations, however, payments made prior to the effective date of the new rules cannot be recharacterized as dividend equivalents subject to withholding.

The proposed regulations do provide a grandfather rule, albeit limited, for equity-linked instruments. For equity-linked instruments (referred to as a "Specified ELI") the proposed rules will apply to payments made on or after January 1, 2016 but only with respect to instruments that were acquired by the long party on or after March 5, 2014.

B. THE IMPORTANCE OF DELTA

The proposed regulations discard the seven filters that had been proposed under the 2012 proposed regulations and replace those filters with a delta standard. Specifically, a payment made on a swap or a Specified ELI that has a "delta of 0.70 or greater" with respect to a US stock at the time that the long party acquires the swap or ELI[30] is treated as a dividend equivalent subject to withholding when the payment is made to a non-US person not in connection with the conduct of a US trade or business.[31] "Delta" is defined as the relationship of the change in fair market value of the swap or ELI to the change in the fair market value of referenced security.[32] For example, if a $.01 change in value of the referenced stock results in a $.01 change in value of the swap or ELI, the swap or ELI has a delta of 1.0. If the swap or ELI references more than one stock, the transaction is disaggregated and delta is determined with reference to each underlying security.[33] If delta is determined for non-tax purposes, that delta ordinarily is the delta used to determine whether the 0.70 delta standard is met.

A swap or an ELI that has a constant delta with respect to an underlying security is treated as having a delta of 1.0. If a transaction has a delta of less than 1.0, the number of underlying shares is adjusted so that the transaction has an underlying delta of 1.0 with respect to a specified number of shares. This retesting (and overlap standard) is substantially similar to the retesting (and overlap standard) required by the substantial overlap rule for determining if a position in a basket of stocks reduces the dividend-received deduction with respect to a specific long stock holding.[34] This rule is illustrated by a swap that provides for 50% of the appreciation and dividends to be paid on 100 shares of US stock (which would be a delta of 0.50). The example concludes that the swap has a delta of 1.0 with respect to 50 shares of the stock.[35]

C. THE AMOUNT OF THE DIVIDEND EQUIVALENT

The proposed regulations treat the full amount of the dividend paid on the underlying shares as a dividend equivalent in sale-repurchase transactions and securities lending transactions.[36] In specified NPCs and ELIs, however, the amount of the dividend equivalent is adjusted for the delta of the transaction.[37] For example, if an ELI transaction has a delta of 0.80 (greater than the 0.70 threshold), the amount of the dividend equivalent would be the full dividend paid on underlying stock, multiplied by 80%. If the delta remains constant over the life of the transaction, then the initial delta would be used. If the delta changes over the life of the transaction, however, the delta applicable to the time that the dividend equivalent entitlement is determined is used.[38] If the transaction has a term of one year or less, however, the delta at the termination of the transaction is applied.[39]

D. CERTAIN AFFECTED TRANSACTIONS

The proposed regulations would impose withholding on dividend equivalents on a wide range of instruments, included equity-linked debt, futures contracts and potentially on option transactions as well. Option and other transactions are proposed to be subject to withholding even if such positions are exchange-traded.

1. Price Return Swaps

A price return swap is a swap in which one party (the short party) pays any price appreciation in referenced equities to the other party (the long party) and that long party pays any price depreciation to the short party. The short party is not required to make any payments that are determined with reference to dividends paid on the reference stocks. Facially, a price return swap does not appear to provide for any dividend equivalent payments that could be subject to US federal income tax under Code § 871(m). Nonetheless, the proposed regulations would treat price return swaps as generating dividend equivalents "because the anticipated dividend payments are presumed to be taken into account in determining the other terms of the NPC."[40] In an example included in the proposed regulations, the long party is presumed to enjoy an obligation to make lower funding payments because the short party is not making dividend equivalent payments to the long party. The example concludes that the lower funding payments include an "implicit dividend."[41]

2. Equity-Linked Indebtedness

If a debt instrument bears interest that is linked to the dividends paid on one or more US stocks, such debt instrument could be used as a host instrument to avoid the application of the withholding rules on dividend equivalents. Accordingly, the proposed regulations deny portfolio interest treatment to any interest that is a dividend equivalent. While the preamble to the proposed regulations suggests that a debt instrument would not be treated as paying dividend equivalent interest if it had a delta of less than 0.70, the applicable proposed regulations do not appear to impose this requirement. Instead, the proposed regulations state that portfolio interest treatment is denied to any interest to the extent determined with reference to dividends paid on US stocks. If the IRS intended for equity-linked yield on debt to lose portfolio interest status, it would be helpful if the IRS clarified whether the delta is applied and, if so, whether it applies to the debt or the derivative embedded in the debt.

3. Option Transactions

At-the-money option transactions, on a stand-alone basis, should not have a delta of 0.70 or greater because an at-the-money option does not provide downside risk (purchased call option) or upside potential (purchased put option) in excess of the option premium. When put and call options are acquired as a package, however, they replicate a forward contract over the referenced stock and can have a delta as high as 1.0. The proposed regulations aggregate two or more transactions even if not entered into together or with the same counterparty, when the multiple transactions (i) are entered into by the same or related persons, (ii) reference the same stock, and (iii) are entered into "in connection with each other."[42] If the aggregated transactions have a delta in excess of 0.70, the combined transactions and dividend equivalents paid or credited in connection with the transaction will be subject to US federal income tax.[43]

In general, exchange-traded options do not provide for dividend equivalent payments. Such options do, however, often provide for adjustments to the strike prices for extraordinary dividends. (Frequently, any dividend in excess of zero is within the definition of an extraordinary dividend.) Thus, the adjustments to the strike prices of the options to reflect the dividend would be subject to withholding. A withholding agent is relieved of the obligation to withhold on combined transactions, provided that it "did not know that the long party (or a related person) entered into the potential section 871(m) transaction in connection with any other potential section 871(m) transactions."[44]

It is worth noting that in-the-money option transactions can have deltas in excess of 0.70. If a non-US person buys an outstanding exchange-traded option, such a LEAPS option, that is in-the-money, it is possible that the broker holding such option for a non-US person can be treated as a withholding agent if the option has a delta in excess of 0.70 and the underlying equity is dividend paying.[45] Of course, in order for there to be an event that would have to give rise to withholding, there would have to be an adjustment to the strike price of the option as a result of a dividend because whether the option would be treated as a specified ELI must be tested "at the time that the long party acquires the ELI," not at the time that the option is issued. Accordingly, brokers will be required to undertake delta testing when non-US persons buy outstanding options.

4. Single Stock Futures

Certain single stock futures contracts provide for an adjustment to the futures price that is based upon an anticipated dividend but is not trued up for any difference between such assumed dividend and the actual dividend. Under the prior proposed regulations, provided that the futures contract was not entered into after such dividend had been announced, the price adjustment for the anticipated dividend would not have been treated as a dividend equivalent potentially subject to withholding. The new proposed regulations reverse this rule.

Under the proposed regulations, a payment based upon an estimated dividend or any contractual term that is based upon an actual or estimated dividend is treated as the payment of a dividend equivalent.[46] Accordingly, given the facts that (i) exchange-traded instruments are not carved out of the rules for the payments of dividend equivalents (indeed, such instruments are explicitly included) and (ii) there is no exception for anticipated dividends, it appears that single stock futures contracts over US equities that span a dividend record date after 2015 and have dividend adjustments could have withholding tax implications for non-US persons who do not hold such contracts in connection with the conduct of a US trade or business. The fact that no dividend passes under the contract (the futures prices is adjusted for the dividend) does not provide a basis for avoiding the finding of a dividend equivalent. Neither does the fact that there is no counterparty, and the contract is exchange-traded, provide a basis for not finding the payment of a dividend equivalent.

It is less clear as to whether single stock futures without a dividend adjustment provision, or any reference to dividends for that matter, specifically, the "1C Contract,"[47] should be considered to have an "implicit dividend" within the meaning of Proposed Treasury Regulation § 1.871-15(h)(2)(ii). If a 1C futures contract will span a dividend record date, it is likely that the parties will have taken that fact into account in determining the futures price at which they are willing to enter into the contract. But the parties could very well have different expectations as to what future dividends (if any) will be paid on the referenced equity during the duration of the futures contract. When there is no meeting of the minds as to the affect of dividends that could be paid during the life of the contract, can it be said that the dividend was "implicitly taken into account in computing one or more terms of a potential section 871 transaction?"[48]

E. RULES ADDRESSING THE LACK OF AN PAYMENT ON WHICH TO WITHHOLD

As can readily be discerned from the discussion above, many dividend equivalents will arise from implicit dividends, contract adjustments and net payments, instead of actual payments. If withholding agents were required to withhold on such items, the withholding agents would have to either pay the tax from their own funds or demand that the counterparties pay over their tax liability to the withholding agent. The withholding agent would then remit the appropriate amount of tax to the IRS. The proposed regulations, however, provide a saving rule. Under this saving rule, withholding is not required until the latest of (i) the time that the dividend equivalent is considered to have been made or (ii) the time that the withholding agent has cash or property (A) that it has to pay to the non-US person, (B) constituting collateral belonging to the non-US person or (C) that was received as an up-front payment on the transaction from the counterparty.[49]

F. INDICES

One of the tougher questions involving dividend equivalents is whether an equity index is treated as an underlying security. In other words, when do the dividend equivalent rules look through an index? The proposed regulations provide that a "qualified index" is not disaggregated, with the result that financial products that reference qualified indices will not be looked through to find dividend equivalents. A qualified index means an index that:

i. References 25 or more component underlying securities;
ii. References only long positions in component underlying securities;
iii. Contains no component underlying security that represents more than 10% of the

weighting of the underlying securities in the index;

iv. Is modified or rebalanced only according to predefined objective rules at set dates or intervals;

v. Does not provide a dividend yield from component underlying securities that is greater than 1.5 times the current dividend yield of the S&P 500 Index as reported for the month immediately preceding the date the long party acquires the potential section 871(m) transaction; and

vi. Futures contracts or option contracts on the index (whether the contracts provide price only or total return exposure to the index) trade on a national securities exchange that is registered with the Securities and Exchange Commission or a domestic board of trade designated as a contract market by the Commodity Futures Trading Commission.[50]

Under an anti-abuse rule, if exposure to the qualified index is coupled with a short position in less than all of the index components, then the index ceases to be a qualified index.[51] In addition, long-only indices that have less than 10% of their assets in securities are not looked through to find dividend equivalents.[52]

G. THE QUALIFIED DEALER EXCEPTION

The proposed regulations will not require withholding on dividend equivalents paid or accrued to non-US persons who are "qualified dealers."[53] A non-US person is a qualified dealer if it is subject to supervision by a governmental authority in the jurisdiction of its organization and it furnishes a written statement to the payer of the dividend equivalent (or other withholding agent) that it is acting in its capacity as a dealer in securities and will withhold on dividend equivalents paid or credited to the account of other non-US persons.[54] Importantly, the certification is not limited to the transaction in which the dividend equivalent is paid or credited to the account of the non-US dealer. It appears that in order for the non-US dealer to be treated as a qualified dealer, it must make such representation with respect to all US dividend equivalents that it will pay or credit to other non-US persons.

H. BROKER-DEALER REPORTING RESPONSIBILITIES

Clearly, the determination as to the delta of a transaction (especially one with multiple reference securities) can be a complex determination that only a financial institution could accurately calculate. As a result, the proposed regulations would subject brokers and dealers (within the meaning of the mark-to-market rules) to substantial reporting and withholding responsibilities when they enter into a "potential section 871(m) transaction" with a person who is not a broker or a dealer.[55] First, the broker or dealer must determine whether the potential section 871(m) transaction should be treated as giving rise to dividend equivalents. Second, if the broker determines that a transaction should be treated as giving rise to dividend equivalents, it must report to the counterparty or customer the timing and amount of any dividend equivalent, as well as the delta number. The dealer's determination of whether the transaction gives rise to dividend equivalents and the amount thereof is binding on withholding agents. Third, the broker must provide this information to other brokers and persons required to file Form 1042 with respect to the transaction.[56]

It appears that brokers will be required to calculate and provide this information even when facing US persons. For example, a broker could enter into a transaction that gives rise to dividend-equivalent payments with a US hedge fund that has one or more non-US partners, such as a master fund. The master fund would be entitled to rely on the broker in determining its withholding tax responsibilities with respect to its non-US partners on dividend equivalents.

Thus, the regulation does not limit the broker's obligation to provide this information only to situations in which it is facing a non-US person.

I. THE USE OF PASS-THRU ENTITIES

Under an anti-abuse rule, if a swap or ELI references an interest in an entity that is not a C corporation, and the entity holds US stocks, the dividend equivalent rules look through the reference entity to find dividend equivalents paid with respect to the underlying equities.[57] There is no look-through, however, if two conditions are satisfied. First, the value of referenced equities at the time of the acquisition of the interest in the swap or ELI constitutes 10% or less of the value of the reference entity. Second, there must not a plan or intention to exchange the 90% or greater portion of non-US equity holdings for US equities.[58]

IV. Chains of Transactions

Under the proposed regulations, overwithholding can occur when back-to-back swap transactions are executed. For example, assume that an offshore hedge fund enters into an equity swap over US stocks with a non-US dealer in securities in which the non-US dealer is the short party and the offshore hedge fund is the long party. Assume further that the non-US dealer acquires the physical stocks that are subject to equity swap. For periods after January 1, 2016, dividend equivalents paid or accrued on the equity swap will be subject to US federal income tax withholding by the non-US dealer. Likewise, the non-US dealer will be subject to US federal income tax withholding on actual dividends that it receives on the physical stocks held as hedges. The non-US dealer cannot claim a credit for amounts that it is required to withhold on the swap for amounts that are withheld against it on the physical stocks. The IRS acknowledged that so-called "cascading withholding" is a problem in the preamble to the proposed regulations. Interestingly, the IRS has alleviated this issue under Code § 871(m) for chains of securities lending transactions, but has apparently chosen to ignore the issue when swaps are involved.[59] ◆

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Endnotes

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2 The book from which "A Christmas Story" is taken is entitled, *In God We Trust, All Others Pay Cash* (Doubleday 1966). And yes, your author dutifully lined up at the time of publication to have his copy autographed by Mr. Shepherd and the signed first edition remains one of his most prized possessions.

3 Treas. Reg. § 1.863-7(b)(1).

[4] All references to non-US persons who are subject to the withholding rules of Section 871(m) of the Internal Revenue Code of 1986, as amended (the "Code") are to non-US persons who did not enter into the swap or other transaction in connection with the conduct of a trade or business.

[5] *See* Code § 871(a)(1)(A).

[6] The phrase "dividend equivalent" as used in this article has the meaning assigned to such term in Code § 871(m)(2).

[7] *See* Treas. Reg. § 1.446-3(c)(2).

[8] *See* Staff Report, Permanent Subcommittee on Investigations, *Dividend Tax Abuse: How Offshore Entities Dodge Taxes on US Stock Dividends*

[9] LMSB Control No. LMSB-4-1209-044 Impacted IRM 4.51.5 (January 14, 2010). Your trusty author reported on the IRS audit guidelines in Leeds, *New IRS Guidelines Target Equity Swaps with Non-US Counterparties* (January 2010).

[10] The Hiring Incentives to Restore Employment Act, P.L. 111-147.

[11] *See* Code § 871(m)(2).

[12] Temp. Treas. Reg. § 1.871-7T(a)(1); now see Treas. Reg. § 1.873-7(a)(1), effective as of January 23, 2012.

[13] T.D. 9572 (January 19, 2012)

[14] See Prop. Treas. Reg. § 1.871-15(f).

[15] REG-120282-10 (January 19, 2012)

[16] T.D. 9572 (Rev.) (August 30, 2012).

[17] Code § 871(m)(3)(A)(v).

[18] Staff of the Joint Committee on Taxation, Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3310, *The Hiring Incentives to Restore Employment Act, Under Consideration by the Senate*, JCX-4-10 (February 23, 2010).

[19] *See* Code § 871(m)(3)(A)(i)-(iv).

[20] Treas. Reg. § 1.894-1(c)(2).

[21] Treas. Reg. § 1.982-3(a)(6).

[22] Treas. Reg. § 1.1441-2(b)(6); Treas. Reg. § 1.1441-3(h)(1).

[23] Prop. Treas. Reg. § 1.1471-2(a)(2)(v).

[24] *See* Letter from Herb Green of Pershing to Mr. John Sweeney, Internal Revenue Service, *re: Comments on Internal Revenue Service Notice 2011-34 regarding the Foreign Account Tax Compliance Act* (May 16, 2011); Letter from Securities Industry and Financial Markets Association ("SIFMA") to the Internal Revenue Service, *re: SIFMA Comments on the Proposed FATCA Regulations* (April 30, 2012).

[25] T.D. 9610 (Jan. 2013).

[26] *See* Treas. Reg. § 1.1471-2(a)(2)(vi).

[27] Treas. Reg. § 1.1471-2(a)(4)(i).

[28] Earnings and profits is "computed as of the close of such year," regardless of the timing of the distribution itself and without reduction for distributions made during the year. Treas. Reg. § 1.316-2(b); Rev. Rul. 74-164, 1974-1 C.B. 74, Situation 1.

[29] LMSB Control No. LMSB-4-1209-044 Impacted IRM 4.51.5 (January 14, 2010). The Audit Swap Guidelines refers to itself as the industry director directive or "IDD."

[30] Note that retesting is required every time the swap or ELI changes hands.

[31] Prop. Treas. Reg. § 1.871-15(d)(2); Prop. Treas. Reg. § 1.871-15(e).

[32] Prop. Treas. Reg. § 1.871-15(g)(1).

[33] *Id.*

[34] See Treas. Reg. § 1.246-5(c)(1)(iii)(A).

[35] Treas. Reg. § 1.871-15(g)(3)(Ex. 3).

[36] Prop. Treas. Reg. § 1.871-15(i)(1)(i).

[37] Prop. Treas. Reg. § 1.871-15(i)(1)(ii).

[38] Prop. Treas. Reg. § 1.871-15(i)(2)(i).

[39] Prop. Treas. Reg. § 1.871-15(i)(2)(ii).

[40] REG-120282-10, p. 24.

[41] Prop. Treas. Reg. § 1.871-15(h)(2)(ii).

[42] Prop. Treas. Reg. § 1.871-15(l)(1).

[43] Prop. Treas. Reg. § 1.871-15(l)(6)(Ex. 1).

[44] Prop. Treas. Reg. § 1.1441-1(b)(4)(xxiii).

[45] Prop. Treas. Reg. § 1.871-15(e) (testing occurs "at the time that the long party acquires the ELI").

[46] Prop. Treas. Reg. § 1.871-15(h)(2)(i).

[47] For a description of this product, *see* Downey, *Dividend Withholding: Clarifying a Few Points, Tax Notes*, 2013 TNT 18-29 (January 28, 2013).

[48] Prop. Treas. Reg. § 1.1441-15(h)(2)(ii).

[49] Prop. Treas. Reg. § 1.1441-2(d)(5).

[50] Prop. Treas. Reg. § 1.871-15(k)(2).

[51] Prop. Treas. Reg. § 1.871-15(k)(6).

[52] Prop. Treas. Reg. § 1.871-15(k)(3).

[53] Prop. Treas. Reg. § 1.871-15(j)(1)(i).

[54] Prop. Treas. Reg. § 1.871-15(j)(1)(ii).

[55] Prop. Treas. Reg. § 1.871-15(o)(1).

[56] Prop. Treas. Reg. § 1.871-15(o)(3)(ii).

[57] Prop. Treas. Reg. § 1.871-15(m)(1).

[58] Prop. Treas. Reg. § 1.871-15(m)(2).

[59] Notice 2010-46.

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