



Securities Industry Association

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April 29, 2005

Courier's Desk
Internal Revenue Service
Attn:CC:PA:LPD:PR
(Notice 2005-25)
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Tax Withholding on Dividends Paid to Puerto Rico Corporations

Dear Sir/Madam:

The Securities Industry Association ("SIA")¹ requests guidance concerning implementation of the new beneficial reduction in the U.S. withholding tax on certain dividends paid to Puerto Rico corporations as provided in new Section 1442(c)(2)(A) of the Internal Revenue Code ("the Code").

Background

The American Jobs Creation Act of 2004 ("2004 Jobs Act") added Section 1442(c)(2)(A) to the Code to provide a reduction in the U.S. withholding tax rate from 30 percent to 10 percent on U.S. source dividends paid to a Puerto Rico corporation. This provision applies to dividend payments made after October 22, 2004 (the date the 2004 Jobs Act was enacted).

¹ The Securities Industry Association brings together the shared interests of nearly 600 securities firms to accomplish common goals. SIA's primary mission is to build and maintain public trust and confidence in the securities markets. At its core: Commitment to Clarity, a commitment to openness and understanding as the guiding principles for all interactions between investors and the firms that serve them. SIA members (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs nearly 800,000 individuals, and its personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2004, the industry generated an estimated \$227.5 billion in domestic revenue and \$305 billion in global revenues. (More information about SIA is available at: www.sia.com.)

The lower withholding tax rate is applicable with respect to dividends received by corporations that are created or organized in, or under the law of, the Commonwealth of Puerto Rico, and that meet the following three requirements:

1. At all times during such taxable year less than 25 percent in value of the stock of such corporation is beneficially owned (directly or indirectly) by foreign persons,
2. At least 65 percent of the gross income of such corporation is shown to the satisfaction of the Secretary to be effectively connected with the conduct of a trade or business in Puerto Rico or the United States for the 3-year period ending with the close of the taxable year of such corporation (or for such part of such period as the corporation or any predecessor has been in existence), and
3. No substantial part of the income of such corporation is used (directly or indirectly) to satisfy obligations to persons who are not bona fide residents of Puerto Rico or the United States.

Need for Guidance

U.S. withholding agents require immediate guidance to determine when it is appropriate to apply new Section 1442(c)(2)(A) and lower the withholding tax rate on dividends paid to Puerto Rico corporations. To reduce the rate of withholding on U.S. source dividends paid to foreign persons, a U.S. withholding agent must associate the dividends with documentation upon which it can rely to treat the dividends as paid to a foreign beneficial owner that is entitled to a reduced rate of withholding pursuant to an income tax treaty. Withholding agents meet this documentation standard by obtaining Form W-8BEN from foreign persons that are the beneficial owners of the U.S. source dividends.

Since Form W-8BEN does not presently contain the additional certifications needed to apply the lower withholding tax rate in Section 1442(c)(2)(A), there is uncertainty in the payor community as to the type of documentation that must be obtained in order to reduce the tax withheld from dividends paid to Puerto Rico corporations.

Guidance is needed to ensure that the correct amount of tax is withheld from U.S. source dividends paid to Puerto Rico corporations. This guidance will ensure that withholding taxes will not place Puerto Rico corporations at an economic disadvantage relative to corporations organized in foreign countries with which the United States has a tax treaty. This goal is consistent with the legislative intent behind adding Section 1442(c)(2)(A) to the Code. According to the Senate Finance Committee, Section 1442(c)(2)(A) was added for the following reason:

The 30-percent withholding tax rate on U.S.-source dividends to Puerto Rico corporations places such companies at an economic disadvantage relative to corporations organized in foreign countries with which the United States has a tax treaty, and relative to corporations organized in other possessions. The Committee believes that creating and maintaining parity between U.S. and Puerto Rico dividend withholding tax rates would place Puerto Rico corporations on a more level playing field with corporations organized in treaty countries and other possessions.

Suggested Guidance

Amend Instructions to Form W-8BEN - SIA believes that the instructions to Form W-8BEN should be modified to allow Puerto Rico corporations to make the necessary certifications on a separate statement and attach them to a Form W-8BEN. Under this approach, the instructions to Form W-8BEN would be modified to explain that a Puerto Rico corporation could certify that it satisfies the requirements of Section 1442(c)(2)(A) by completing Form W-8BEN in the usual manner and attaching a statement containing the additional representations that entitle the beneficial owner to the reduced tax rate of 10 percent. Foreign corporations are able to certify their entitlement to a reduced rate of withholding pursuant to an income tax treaty by making the required treaty representation in Part II of Form W-8BEN. Although the benefits of Section 1442(c)(2)(A) are not provided pursuant to an income tax treaty, a similar certification approach is consistent with the congressional intent of placing Puerto Rico corporations on a level playing field with corporations organized in treaty countries. A sample certification letter is attached. The validity period of the additional certifications would be the same as the associated Form W-8BEN.

This approach is also the most efficient means of implementing the change. Most U.S. withholding agents have already built the facilities to grant reduced withholding tax rates pursuant to income tax treaties. By coupling the additional certifications with Form W-8BEN, U.S. withholding agents could grant immediate withholding tax relief without having to make significant changes to their computer systems and operating procedures.

Interim procedure – Until such time as the instructions to Form W-8BEN are modified, the SIA suggests allowing U.S. withholding agents to rely on additional certifications from Puerto Rico corporations substantially in the form of the sample. Consistent with the October 22, 2004 effective date of the new statute, this would enable withholding agents to grant Puerto Rico corporations immediate relief from the 30 percent tax.

* * * * *

Thank you for your consideration of our comments. Please do not hesitate

to contact me (at 202-216-2031 or pmcclanahan@sia.com) if we can be of assistance in any way as you consider these issues.

Sincerely,

Patti McClanahan
Vice President and Director for Tax Policy

Attachment

**Certification of Puerto Rico Corporation Entitled to 10% Withholding Tax
Supplement to U.S. Internal Revenue Service Form W-8BEN (Certificate of
Foreign Status of Beneficial Owner for United States Tax Withholding)**

Sections 881(b)(2) and 1442(c)(2) of the United States Internal Revenue Code of 1986, as amended by the American Jobs Creation Act of 2004, require that dividends distributed by United States corporations to entities organized under the laws of Puerto Rico and treated as "corporations" by the Internal Revenue Code be subject to 10% withholding tax, provided that they satisfy the requirements of section 881(b)(2). If a Puerto Rico corporation cannot, or does not, certify to the conditions set forth below, it is subject to 30% U.S. tax withholding.

THE UNDERSIGNED HEREBY CERTIFIES UNDER PENALTIES OF PERJURY TO [NAME OF US WITHHOLDING AGENT], FOR THE VALIDITY PERIOD OF THE ATTACHED FORM W-8BEN, OR UNTIL [NAME OF US WITHHOLDING AGENT] IS OTHERWISE NOTIFIED IN WRITING BY THE CORPORATION, THAT:

(1) _____ is a corporation created or organized in, or under the law of, the Commonwealth of Puerto Rico (the "Corporation").

(2) Pursuant to Section 881(b)(2) of the U.S. Internal Revenue Code of 1986:

(i) at all times during each taxable year, less than 25% in value of the stock of the Corporation will be beneficially owned (directly or indirectly) by persons foreign to the United States and Puerto Rico;

(ii) at least 65% of the gross income of the Corporation will be effectively connected with the conduct of a trade or business in Puerto Rico or the United States for the three-year period ending with the close of each taxable year of the Corporation (or for such part of such period as the Corporation or any predecessor has been in existence); and

(iii) no substantial part of the income of the Corporation will be used (directly or indirectly) to satisfy the obligations to persons who are not bona fide residents of Puerto Rico or the United States.

THEREFORE, THE CORPORATION HEREBY REQUESTS THAT:

Pursuant to the Code, for each taxable year, [Name of US Withholding Agent] withhold tax at a rate of 10%, rather than 30%, on dividends received by the Corporation from sources within the United States.

[NAME OF US WITHHOLDING AGENT] MAY RELY ON THE ABOVE CERTIFICATIONS AND REQUEST FOR THE VALIDITY PERIOD OF THE ATTACHED FORM W-8BEN OR UNTIL OTHERWISE NOTIFIED IN WRITING BY THE CORPORATION. THE CORPORATION SHALL PROMPTLY NOTIFY [NAME OF WITHHOLDING AGENT] OF ANY CHANGE IN CIRCUMSTANCES AFFECTING THE ABOVE CERTIFICATIONS AND REQUEST.

[INSERT NAME OF PUERTO RICO CORPORATION]

[INSERT ACCOUNT

NUMBER]

By: _____

Date:

Name:

Title: