

January 16, 2008

Eric Solomon
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Ave., N.W.
Washington, DC 20220

Donald L. Korb
Chief Counsel
Internal Revenue Service
1111 Constitution Ave., N.W.
Washington, DC 20224

CC:PA:LPD:PR (REG-140206-06)
Courier's Desk
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Comments on proposed regulations concerning withholding procedures under section 1441 for certain distributions to which section 302 applies; request to testify

Dear Mr. Solomon and Mr. Korb:

I am pleased to submit comments of the Securities Industry and Financial Markets Association ("SIFMA")¹ concerning the proposed regulations that would provide securities dealers with new escrow procedures that could be used to satisfy their withholding, reporting and deposit responsibilities with respect to distributions in redemption of stock of a corporation that is actively traded on an established financial market. SIFMA's request to testify at the public hearing follows the comments below.

The proposed regulations are intended to provide brokers with a means of achieving certainty regarding their withholding practices while avoiding the onerous

¹ The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

result of a withholding tax imposed on the full amount of redemption distributions to foreign investors by corporations that are actively traded on an established financial market. Under the proposed regulations, as an alternative to withholding the broker has the option of utilizing the 60-day period following a redemption distribution to determine from each of its foreign investors receiving the distribution - - in the manner specified in the regulations - - whether or not the distribution is properly characterized as made in exchange for the stock. The broker is to hold back and place in escrow an amount of the distribution equal to the withholding tax that would be due if the distribution is not properly treated as made in exchange for the foreign investor's stock. If, however, the foreign investor provides the broker with an appropriate certification within the 60-day period that shows the necessary reduction in share ownership following the distribution, the broker may release the escrowed funds to the investor. If not, the escrowed funds are to be treated as a tax paid on the 61st day and deposited pursuant to IRS procedures.

SIFMA appreciates the IRS and Treasury making the promulgation of new rules in this area a priority as requested by the Securities Industry Association, one of SIFMA's predecessor organizations.² There is an urgent need for clear, uniform and sound rules in this area. We believe that the proposed regulations represent an important first step in a necessary reexamination of the proper withholding tax treatment of redemption distributions by publicly traded corporations. The procedures set forth in the proposed regulations, with some changes,³ may be used to good effect in some cases to avoid a withholding outcome that is not justified. Unfortunately, however, SIFMA foresees the proposed escrow procedures being of limited value with respect to the vast majority of redemption distributions by publicly traded corporations because the procedures would not be effective in providing relief from withholding in most cases that deserve such relief. *As a result, we believe the existing regulations under section 1441 of the Internal Revenue Code need a more fundamental change to provide clearly that as a general rule there is no withholding on these redemption distributions.* Without this change, most foreign retail investors would face the limited choices of not participating in these transactions or absorbing the withholding tax due to the lack of a cost effective alternative.

There are numerous reasons why SIFMA believes that the proposed rules would leave shareholders of publicly traded corporations subject to withholding on these distributions, even though such distributions should almost always result in exchange treatment for investors. No amount of streamlining of procedures by brokers could serve to avoid the major costs and challenges arising from the need to make after-the-fact ownership determinations. Similarly, the need for action on a distribution-by-distribution and investor-by-investor basis would make it very costly and cumbersome for both withholding agents and investors. As a result, in many if not most instances it would be noneconomic to utilize the procedures. Withholding agents would face particularly strong resistance to the rules in attempting to educate investors and obtain

² See SIA's letter dated December 7, 2005 to Eric Solomon and Steve Musher.

³ To the extent that it would be helpful, SIFMA stands ready to submit additional comments at a later date addressing the specifics of the proposed escrow procedures.

accurate certifications due to established and reasonable investor expectations of no withholding tax being due upon share dispositions. The technical complexities involved in applying section 302 would also be a major hurdle. Investors attempting to complete the required mathematical calculations would be forced to grapple with the detailed constructive ownership rules of section 318 of the Internal Revenue Code, a daunting task. Because obtaining certifications often would lag significantly behind the redemption distribution, intervening sales or other transactions with respect to an investor's shareholdings would make it difficult to accomplish many aspects of the procedures in many cases. Finally, retail investors with diversified portfolios could see these procedures come into play multiple times with respect to a single brokerage account, compounding the costs and paperwork burdens.

As a policy matter, it is extremely problematic for withholding to be the default rule with respect to these distributions since they rarely are properly characterized as dividends. They typically are not pro rata, and it is reasonable to assume that almost all shareholders' interests in the issuer are insignificant in size to begin with and will be reduced by the distribution. Further, putting aside percentage ownership calculations, small shareholders of publicly traded corporations would seem to have none of the characteristics that might give rise to policy concerns with respect to exchange treatment (e.g., the ability to influence the issuer's actions). Withholding is all the more inappropriate given that the very significant costs to withholding agents and shareholders of complying with the rules would be unlikely to produce significant legitimate revenues or other benefits to the government. Worse, the withholding results under the proposed procedures would run directly counter to sound tax, cross-border investment, market efficiency, and international competitiveness policies against imposing a gross basis withholding tax on returns of capital and asset gains of foreign investors.

For all of these reasons, SIFMA urges that the existing regulations be amended to clearly provide that there is no withholding with respect to the vast majority of shareholders receiving redemption distributions with respect to the stock of a corporation that is actively traded on an established financial market. To accomplish this result, we recommend the regulations be amended to provide for a presumption that redemption distributions from publicly traded corporations are properly treated as exchanges instead of dividends for withholding and reporting purposes.⁴ If there are policy concerns with a presumption in certain circumstances, SIFMA would welcome the opportunity to work with Treasury and the IRS in the development of workable parameters for a presumption and alternative procedures for identified cases.

Thank you for your consideration of our views and your continuing efforts to provide early guidance on this important issue. Please do not hesitate to contact me (at 202-962-7326 or pmcclanahan@sifma.org) with respect to any aspect of this

⁴ Alternatively, guidance under Section 302 of the Code could be considered.

guidance project. We look forward to continuing to work together toward the development of sound rules in this area.

Sincerely,

Patti McClanahan
Managing Director
SIFMA

Cc: Clarissa Potter
Steve Musher
Mike Mundaca
Karen Gilbreath Sowell
Carl Cooper

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Request to Testify at Public Hearing

SIFMA respectfully requests to testify at the public hearing on these proposed regulations. All available time will be used to address the sole issue of the need for the regulations under section 1441 to be modified to provide as a general rule that there is no withholding on distributions in redemption of stock of a corporation that is actively traded on an established financial market.

Patti McClanahan
Managing Director
SIFMA