



August 17, 2026

[VIA E-MAIL]

Mr. Kevin Salinger
Assistant Secretary for Tax Policy (Acting)
U.S. Department of the Treasury
Chief Counsel (Acting)
Internal Revenue Service
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Ms. Rebecca Oakes Burch
Deputy Assistant Secretary (International
Tax Affairs)
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Ms. Erika Nijenhuis
Senior Counsel
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: Qualified Derivatives Dealers under Section 871(m)

The Securities Industry and Financial Markets Association (“SIFMA”)¹ respectfully submits this letter regarding the authority of the Department of the Treasury (“Treasury”) and the Internal Revenue Service (the “IRS”) to amend the regulations under Section 871(m) of the Internal Revenue Code of 1986 (the “Code”) to permanently preserve two aspects of the qualified derivatives dealer (“QDD”) transition relief currently provided in Notice 2024-44 and its predecessors (the “Transition Notices”).

Specifically, the government asked us to address two questions.

First, the government asked whether we believe there is statutory authority for the final regulations to preserve the rule currently provided in the Transition Notices under which dividends on shares received by a QDD in its dealer capacity are not subject to tax

¹ SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's one million employees, we advocate on legislation, regulation and business policy affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.

under Sections 871 or 881, even if the QDD does not make a corresponding dividend equivalent payment to a foreign investor that is subject to tax under Section 871(m). In this regard, the government identified an example in which a QDD enters into one or more derivatives with foreign investors, each having a delta of, for example, 0.5, that in the aggregate cause the QDD to have a short delta-one position with respect to the reference shares. The QDD then hedges that position by acquiring and holding the reference shares. If the current rule under the Transition Notices were continued, no withholding tax would apply to the dividends received by the QDD, and no Section 871(m) withholding tax would apply with respect to amounts paid or deemed paid to the foreign investors.

Second, the government asked us to address whether we believe there is statutory authority for the final regulations to preserve the rule currently provided in the Transition Notices under which a QDD is not subject to tax under Sections 871 or Section 881 on dividends or dividend equivalents that it receives in a dealer capacity with respect to shares of a United States corporation, even if the QDD has a positive net delta with respect to such shares. In this regard, the government identified an example in which a QDD, as part of its dealer books, is short 99 shares of a reference equity and long 100 shares of the same reference equity and therefore has a net long position of one share of the reference equity.

As discussed below, we believe that the government has statutory authority to continue both exemptions provided in the Transition Notices and to incorporate them into the final regulations.

In addition, because the existing transition rules under Notice 2024-44 are scheduled to expire on January 1, 2027, SIFMA respectfully requests that the Treasury Department and the IRS issue a notice as soon as practicable confirming that the transition relief provided in Notice 2024-44 will be extended until a date that is no earlier than 18 months after the publication in the Federal Register of permanent guidance (such as amendments to the final regulations), and in any event no earlier than January 1, 2029. Market participants need to know well before January 1, 2027, what rules will apply so that they can make documentation, trading and hedging decisions and corresponding systems changes without disruption to the cross-border equity derivatives market.

I. Executive Summary

For the reasons discussed in Parts III and IV below, SIFMA believes that the government has sufficient statutory authority to make permanent the two QDD provisions referenced above. At the request of Treasury and the IRS, this letter is limited to the statutory authority for those provisions. It does not restate the policy reasons for SIFMA's recommendation, which SIFMA has discussed separately with Treasury and the IRS, except to the extent relevant to interpreting and applying the statutory language.

The basis for both forms of relief is Section 871(m)(6), which authorizes Treasury to reduce tax as "appropriate to address the role of financial intermediaries" and expressly treats dividends as dividend equivalents for that purpose. That authority is not conditioned on a

QDD making a corresponding dividend equivalent payment and permits Treasury to address residual net long exposure arising in the QDD's equity derivatives dealer books.

Specifically, Section 871(m)(6) should not be interpreted to require "that the taxpayer can establish that such tax has been paid with respect to another dividend equivalent in such chain, or is not otherwise due" as a precondition to the Secretary having the authority to reduce the tax on a dividend or dividend equivalent received by a QDD, as doing so would effectively read the clause "or as the Secretary determines is appropriate to address the role of financial intermediaries in such chain" out of the statute altogether. We believe the broad statutory language gives the Secretary authority to consider practical and policy considerations, such as administrability and the benefits of encouraging foreign financial institutions to voluntarily become qualified intermediaries, when determining what is "appropriate" in this regard.

II. Background

Section 871(m)(1) generally treats a dividend equivalent as a dividend from U.S. sources for purposes of 871(a), 881 and 4948(a), and chapters 3 and 4. Section 871(m)(2) defines a "dividend equivalent" to include any substitute dividend made pursuant to a securities lending or sale-repurchase transaction, or any payment made pursuant to a specified notional principal contract, if such substitute dividend or payment is contingent upon, or determined by reference to, a U.S.-source dividend, as well as any other payment that the Secretary determines is substantially similar to the foregoing.²

Section 871(m)(6) provides that in the case of any chain of dividend equivalents one or more of which is subject to tax under subsection 871(a) or section 881, the Secretary may reduce such tax, but only to the extent that the taxpayer can establish that such tax has been paid with respect to another dividend equivalent in the chain, or is not otherwise due or as the Secretary determines is appropriate to address the role of financial intermediaries in such chain. For these purposes, a dividend shall be treated as a dividend equivalent.

Treasury and the IRS issued final regulations under Section 871(m) and related withholding provisions in 2017, including rules addressing QDDs. Under those regulations, a QDD that receives a dividend equivalent in its equity derivatives dealer capacity generally is not liable for tax under Section 881 on that dividend equivalent if it complies with its obligations under the qualified intermediary agreement, but the QDD remains liable for tax on its "Section 871(m) amount" for each dividend on an underlying security. The Section 871(m) amount is computed by multiplying the QDD's net delta exposure by the applicable dividend amount per share.³ The regulations also generally exempt dividend equivalent payments to a QDD from withholding, but treat physical dividends paid to a QDD as subject

² Section 871(m)(1), (2)(A)-(C), (5).

³ Treas. Reg. § 1.871-15(q)(1)-(3).

to withholding except for dividends received in 2017 in the QDD's equity derivatives dealer capacity.⁴

The 2017 preamble described the net-delta approach as an “administrable and accurate method” for determining a QDD's residual exposure and illustrated that method with an example in which a QDD had net delta exposure to one share of stock. That discussion explains the regulatory choice reflected in the 2017 regulations; it does not state that section 871(m) requires a QDD's tax liability to be calculated by reference to net delta. The statute itself does not prescribe a net-delta methodology, and section 871(m)(6) expressly authorizes Treasury, in the case of a chain of dividend equivalents, to reduce the tax as Treasury determines appropriate to address the role of financial intermediaries in the chain.⁵

In a series of notices beginning with Notice 2016-76, Treasury and the IRS have provided transition relief with respect to certain aspects of the rules described above.⁶ Notice 2024-44 extends that relief through 2026 and states that Treasury and the IRS intend to amend the regulations to provide that QDDs will not be subject to tax on dividends and dividend equivalents received in 2025 and 2026 in their equity derivatives dealer capacity.⁷

III. Authority Under Section 871(m)(6) for Exempting QDD's Physical Dividends from Tax

Section 871(m)(6) provides Treasury with statutory authority to reduce or eliminate the tax imposed under Section 871(a) or Section 881 on physical dividends received by a QDD in its equity derivatives dealer capacity. Specifically, Section 871(m)(6) is the special statutory rule that addresses financial intermediaries in chains of dividend equivalents. It permits the Secretary to reduce the tax imposed under Section 871(a) or Section 881 on one or more dividend equivalents in such a chain to the extent the taxpayer establishes that the tax has been paid with respect to another dividend equivalent in the chain, that the tax is not otherwise due, or as the Secretary determines is appropriate to address the role of financial intermediaries in such chain. The final sentence of Section 871(m)(6) provides that, for this purpose, a dividend is treated as a dividend equivalent. The provision therefore grants Treasury authority to address QDDs in their intermediary capacity and, in doing so, to reduce or eliminate the tax imposed under Section 871(a) or Section 881 on physical dividends received by QDDs in that capacity and the corresponding withholding.

a. A corresponding taxable dividend equivalent payment by the QDD is not required by the statutory text.

We understand that Treasury and the IRS may be concerned that the reference at the beginning of Section 871(m)(6) to a “chain of dividend equivalents” means that Treasury

⁴ Treas. Reg. § 1.1441-1(b)(4)(xxii), (e)(6).

⁵ T.D. 9815, 82 Fed. Reg. 8,144, 8,152 (Jan. 24, 2017).

⁶ See Notice 2016-76; Notice 2017-42; Notice 2018-72; Notice 2020-2; Notice 2022-37; Notice 2024-44.

⁷ Notice 2024-44, Part V.

may reduce or eliminate the tax on a physical dividend received by a QDD only if the QDD makes an identifiable, corresponding dividend equivalent payment to an investor that is subject to tax under Section 871(m). If that were the required interpretation, the QDD in the government's example—which enters into one or more derivatives with foreign investors, each having a delta of 0.5, that in the aggregate cause the QDD to have a short delta-one position, and then hedges that exposure by holding the reference shares—would not be eligible for relief under Section 871(m)(6), because the customer transactions are not Section 871(m) transactions and the QDD makes no corresponding taxable dividend equivalent payment. A similar result presumably could arise even where the QDD enters into contracts that are subject to Section 871(m), if the QDD could not demonstrate that a specific client-facing contract corresponds to the specific physical shares that it holds.

We do not believe the reference to a chain should be interpreted in that manner. In the government's example, the QDD receives the physical dividend solely because it acquired the reference shares to hedge its aggregate customer-facing exposure and therefore is acting in the financial-intermediary capacity that Section 871(m)(6) expressly authorizes Treasury to address. The absence of a corresponding taxable dividend equivalent payment by the QDD should not prevent Treasury from exercising that authority. A contrary interpretation would be inconsistent with the remaining technical language of Section 871(m)(6), the provision's express focus on financial intermediaries, and the commercial realities of QDD hedging.

First, the reference to a "chain of dividend equivalents" is qualified by the words "one or more of which is subject to tax under subsection (a) or section 881." Those words indicate that Congress did not intend to impose a literal tracing requirement to two taxable dividend equivalent payments. The statutory text contemplates relief in a chain even though only one dividend equivalent in the chain would, absent such relief, be subject to tax. Accordingly, the provision should not be construed as requiring the QDD to make a taxable dividend equivalent payment to a client as a condition for obtaining relief with respect to the physical dividend received by the QDD.

Second, the broad grant of authority in Section 871(m)(6) further confirms that the provision does not require tracing an actual chain in every case. The provision authorizes the Secretary to reduce tax not only where the taxpayer establishes that the tax has been paid with respect to another dividend equivalent in the chain, but also where the tax "is not otherwise due," or as the Secretary determines appropriate to address the role of financial intermediaries in such chain. The express reference to tax that is "not otherwise due" shows that Congress contemplated cases in which a dividend equivalent exists but no tax is payable because, for example, the beneficial owner is exempt under Section 892 or eligible for treaty benefits. The separate authorization to reduce tax as appropriate to address financial intermediaries therefore must do additional work. The third clause is an independent grant of authority and, unlike the first two clauses, is not conditioned on tax having been paid or otherwise not being due with respect to another payment. It is naturally read to permit Treasury to reduce the tax on a physical dividend received as part of a QDD's intermediary

hedging activity even when no corresponding taxable dividend equivalent payment by the QDD is required, or when any such payment cannot be traced to a particular physical dividend.

Third, construing Section 871(m)(6) narrowly would be inconsistent with the way that QDDs actually manage risk. A dealer may be part of a classic chain in the simple case where it issues a delta-one contract to a client and holds the underlying shares as a hedge, but dealers generally hedge their entire derivatives books on a net-delta basis across in-scope and out-of-scope positions and do not trace particular physical shares to particular derivatives.

b. The chain requirement can be satisfied without one-to-one tracing.

We next discuss how to understand the reference to a “chain of dividend equivalents” in a manner that is consistent with the understanding above and with the remainder of Section 871(m)(6). Two interpretations support the relief requested here.

First, the reference to a “chain” in Section 871(m)(6) should be understood as a general reference to entities that act as part of dividend-equivalent chains because they are intermediating entities. We recognize that this could be viewed as a somewhat strained reading of “chain” if that word is considered in isolation. It is nevertheless the most logical reading in light of the remainder of Section 871(m)(6), which, as discussed above, contemplates relief without requiring a traceable taxable dividend equivalent payment, and in light of the provision’s express authorization for Treasury to address financial intermediaries. As a practical matter, a QDD would almost certainly have some client-facing contracts that produce dividend equivalents to clients; therefore, a QDD is generally, in fact, an intermediary with respect to chains of dividend equivalent payments. Section 871(m)(6) therefore should not be read to require an identifiable chain in each individual case; rather, it permits Treasury to address the intermediary role of QDDs as a category and to adopt an administrable rule that reflects how QDDs actually conduct and hedge their dealer businesses.

Second, although the language of Section 871(m)(6) itself should be sufficient authority, Section 871(m)(2)(C) provides additional support for interpreting Section 871(m)(6) in this manner. Section 871(m)(2)(C) provides that the term “dividend equivalent” includes “any other payment determined by the Secretary to be substantially similar” to a substitute dividend or a specified notional-principal-contract dividend payment. Section 871(m)(5) further defines “payment” to include any gross amount used in computing a net amount transferred to or from the taxpayer. Read together, these provisions give Treasury flexibility to identify dividend-related economics embedded in derivative payments as dividend equivalents for purposes of determining whether a QDD is part of a “chain of dividend equivalents” within the meaning of Section 871(m)(6), without requiring every such amount to be treated as a dividend equivalent that is independently subject to tax as a dividend under Section 871(m)(1).

In other words, even if Treasury determined that the existence of a “chain of dividend equivalents” must be established in order for Treasury to have statutory authority to reduce the taxes imposed on a QDD, such a chain could be established even in fact patterns where the QDD sold a call option and hedged its short exposure either by holding the physical shares or through a swap. Notwithstanding that no actual dividend equivalent payments would be made by the QDD in respect of the written call option for withholding tax purposes, the fact that expected dividends are embedded in the gross amount transferred to the QDD provides Treasury sufficient authority to treat the QDD as receiving dividend equivalents for the limited purpose of being in a “chain of dividend equivalents” within the meaning of Section 871(m)(6).

c. A contrary rule would produce arbitrary and anomalous results.

Based on the above, there is a statutory basis for the position SIFMA is advocating. A contrary result would not only be inconsistent with the language of the statute but would produce an anomalous result that Section 871(m)(6) was designed to prevent. If a QDD issues an option and hedges the resulting exposure synthetically through a swap, the QDD would not be subject to tax under Section 871(m) merely because of that hedge. If the same QDD hedges the same option exposure by holding physical shares, a restrictive interpretation of Section 871(m)(6) would impose tax under Section 881, and corresponding withholding, on the dividends received on the physical hedge. That would be an inappropriate result because Section 871(m)(6), which is the provision that specifically addresses the role of financial intermediaries such as QDDs, expressly provides that dividends and dividend equivalents are to be treated the same for that purpose.

Furthermore, such a distinction may cause tax considerations to influence whether a dealer uses a physical hedge or derivative hedge, even if in such cases the physical hedge is the more commercially appropriate or regulatory-efficient hedge. The distinction between hedges established by acquiring the physical shares and synthetic hedges would be especially problematic for QDDs that cannot efficiently hedge with U.S. affiliates or that are subject to regulatory or other constraints on affiliate hedging. Subjecting those dividends to withholding could adversely affect the U.S. equities derivatives market by reducing dealer capacity to intermediate customer transactions, which in turn could reduce liquidity, and make it more costly for market participants to obtain exposure to, or hedge exposure to, U.S. equities.

The distinction between physical and synthetic hedges would also raise numerous complex questions regarding the proper treatment of transactions involving physical shares used to establish hedges. Many QDDs lend shares, enter into sale-repurchase transactions involving shares, or pledge shares as collateral under arrangements that permit counterparties to rehypothecate the collateral. In many cases, it may be unclear whether a QDD should be treated as owning the relevant shares and receiving an actual dividend or, instead, as having transferred or otherwise used those shares in a repo or similar arrangement for U.S. federal income tax purposes and receiving a dividend equivalent payment. This uncertainty arises both because the applicable legal rules are not entirely clear and because

the sheer volume of these transactions makes it difficult, as a practical matter, to analyze the facts and circumstances of each transaction.

Accordingly, if a QDD were subject to withholding tax on physical dividends, taxpayers and the government could face substantial practical difficulties in determining whether a particular dividend amount received by a QDD constitutes an actual dividend or a dividend equivalent, particularly given the frequency with which shares are used in financing and collateral arrangements. Drawing that distinction could require complex legal analysis, as well as detailed tracking of shares and contractual rights, to determine whether a particular use of shares gives rise to a dividend equivalent or an actual dividend. Requiring QDDs to make these distinctions would impose substantial administrative and compliance burdens while undermining a central policy objective of Section 871(m): achieving parity between the tax treatment of actual dividends and economically equivalent payments.

IV. Section 871(m) Does Not Mandate Taxation of QDD's Net Delta Exposure

Section 871(m)(6) also provides Treasury with statutory authority to reduce or eliminate the tax imposed under Section 871(a) or Section 881 on a dividend or dividend equivalent attributable to a QDD's net long position in the underlying stock when that position is held in the QDD's equity derivatives dealer capacity. The same financial-intermediary authority discussed in Section III applies to residual net long exposure arising in the QDD's dealer books. That conclusion does not depend on the QDD making a corresponding dividend equivalent payment with respect to the residual exposure.

a. A corresponding taxable dividend equivalent payment with respect to the residual net long position is not required by the statutory text.

We understand that Treasury and the IRS may be concerned that Section 871(m)(6) permits relief only to the extent of a matching outbound dividend equivalent payment. Under that interpretation, the QDD in the government's long-100/short-99 example would remain subject to tax on the dividend or dividend equivalent attributable to its one-share net long position, even though that residual position arose in the course of its dealer intermediation activity. We do not believe Section 871(m)(6) requires that result.

First, Section 871(m)(6) authorizes the Secretary to reduce tax where the taxpayer establishes that tax has been paid with respect to another dividend equivalent in the chain, where the tax is not otherwise due, "or as the Secretary determines is appropriate to address the role of financial intermediaries in such chain." As discussed above, the three grounds are stated in the disjunctive. The third ground therefore is an independent grant of authority and is not limited by the amount of a matching outbound payment. Reading it otherwise would cause the financial-intermediary clause to add little or nothing to the preceding clauses and would import a matching requirement to the financial-intermediary clause that Congress did not include.

Second, the one-share residual in the government’s example ordinarily would not be a separately identified share acquired and held as an investment. A QDD manages customer transactions and hedges on an aggregate and dynamic book basis, and a small net long position may arise from imperfect hedge ratios, timing differences, customer activity, minimum trade sizes, liquidity constraints or routine rebalancing. In those circumstances, the residual exposure remains part of the same dealer intermediation activity. Treasury may therefore determine that imposing gross-basis tax on the dividend or dividend equivalent attributable to that residual exposure is inconsistent with the QDD’s role as a financial intermediary and may reduce that tax to zero under Section 871(m)(6).

b. The chain requirement can be satisfied at the level of the QDD’s dealer books.

As explained in Part III, the statutory reference to a “chain” does not require one-to-one tracing between each incoming dividend or dividend equivalent and a particular outbound payment. The statute does not specify a tracing convention, a testing moment or a requirement that every unit of a dealer’s long position have a contemporaneous customer offset. Treasury may therefore identify the relevant chain by reference to the customer transactions, hedges and inventory that comprise the QDD’s equity derivatives dealer books over the ordinary dealer activity cycle. In the long-100/short-99 example, the customer transactions and the QDD’s associated positions remain part of the same chain even though no particular outbound payment corresponds to the one-unit residual.

c. The requested relief can be limited to dealer positions.

The existing regulations already provide the appropriate boundary. Transactions properly reflected in a QDD’s equity derivatives dealer books are presumed to be held in its equity derivatives dealer capacity, whereas a dividend or dividend equivalent received by a QDD acting as a proprietary trader is treated as received outside that capacity.⁸ Thus, a permanent rule may continue to exclude proprietary positions and retain anti-abuse requirements. If a position is in fact a proprietary directional investment, it falls outside both the government’s assumed facts and the requested relief.

The fact that the 2017 regulations selected net delta as the measure of a QDD’s residual exposure does not limit Treasury’s statutory authority. The one-share residual described in the 2017 preamble reflects the regulatory approach then chosen; it does not establish that Section 871(m)(6) requires tax on every residual long unit. Treasury and the IRS have repeatedly deferred that rule and, in Notice 2024-44, announced that QDDs will not be subject to tax on dividends and dividend equivalents received through 2026 in their equity derivatives dealer capacity. Treasury may now determine, pursuant to the express delegation in Section 871(m)(6), that the same treatment is appropriate on a permanent basis.

Accordingly, Treasury may rely principally on Section 871(m)(6) to reduce to zero the tax on the dividend or dividend equivalent attributable to the QDD’s net long position,

⁸ Treas. Reg. § 1.871-15(q)(2).

provided the position is held in the QDD's equity derivatives dealer capacity and the payment is not income effectively connected to the QDD's U.S. trade or business. That approach gives effect to the statutory financial-intermediary clause without extending relief to proprietary investment positions.

V. Conclusion

SIFMA appreciates the efforts of Treasury and the IRS to issue further guidance under Section 871(m) in a fair and administrable manner. We would be happy to discuss these comments further and to answer any questions that Treasury or the IRS may have. You can contact me at jbarker@sifma.org.

Respectfully submitted,

A handwritten signature in black ink that reads "Jessica Barker". The signature is written in a cursive, flowing style.

Jessica Barker
Managing Director, Tax & Associate General Counsel