



## Financial Services

# Capital Changes 871M Automated Compliance Tool

**In January 2017 the IRS issued final and temporary regulations under Sec. 871(m), updating 2015 regulations which implemented withholding tax requirements for brokers and dealers holding or making payments relating to derivative financial instruments linked to U.S. stocks (equity-linked instruments or “ELIs”) on behalf of non-U.S. investors.**

The rules also apply to certain securities lending and sales-repurchase transactions or “sec-lending” and certain notional principal contracts (NPCs) such as equity-linked swaps. Failure to comply with these new withholding tax requirements results in such brokers and dealers being liable for the tax that should have been withheld with the liability possibly millions of dollars in the aggregate.

These new rules apply to an extremely broad range of financial derivatives linked to U.S. stock. For every such financial derivative, complicated rules in the regulations determine 1) whether a particular derivative is subject or excluded from the rules, 2) each dividend equivalent amount on which withholding applies relating to the derivative, and 3) the date when withholding must occur for all dividend equivalent amounts determined for a particular tax lot.

*Brokers and other U.S. withholding agents generally must comply with...new rules for payments made with respect to equity-linked financial derivatives issued on or after January 1, 2017. The financial consequences of failing to comply could be severe.*

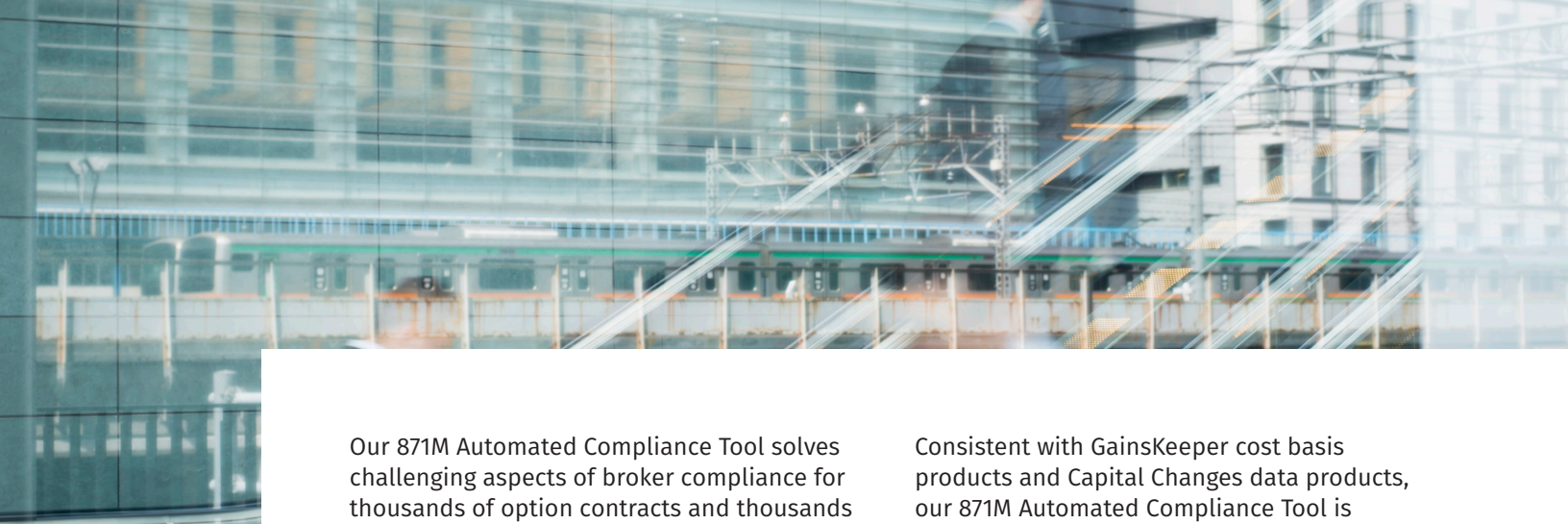


## *Sec. 871(m) compliance is complex*

In addition to the complexity of these rules, their breadth forces brokers to consider how to comply with them for widely-held financial derivatives such as listed options on stocks, where the number of contracts is in the thousands. The precise calculations for withholding based on thousands of separate tax lots are generally beyond the scope of manual processes and necessitate automated solutions. Accounting for the consequences of corporate actions on the underlying U.S. stocks that can affect thousands of outstanding options contracts or other financial derivatives is an additional complication for any compliance solution.

*“Our 871M Automated Compliance Tool is an industrial-strength solution ...designed for daily processing, batch file transfers, and high volumes.”*

Brokers and other U.S. withholding agents generally must comply with these new rules for payments made with respect to certain equity-linked financial derivatives on January 1, 2017. Pursuant to subsequent notices, the rules come into full effect on January 1, 2021. The financial consequences of failing to comply could be severe.



Our 871M Automated Compliance Tool solves challenging aspects of broker compliance for thousands of option contracts and thousands of tax lots by 1) determining whether the rules apply to a particular contract, 2) computing each dividend equivalent amount by tax lot for contracts subject to withholding, and 3) determining the date and amount on which withholding must occur for all dividend equivalent amounts determined for a particular tax lot. Our product requires only buys and sells (or transfers in or out) for most exchange listed option and futures contracts. In addition, our product is designed to complement solutions that address aspects of the regulations that do not lend themselves to automation and can be readily extended with additional data and systems to address all types of ELLs potentially subject to these new requirements.

Consistent with GainsKeeper cost basis products and Capital Changes data products, our 871M Automated Compliance Tool is an industrial-strength solution that is not spreadsheet-based but rather is designed for daily processing, batch file transfers, and high volumes. In addition, security master type reference data, including corporate action details, for each option contract and other exchange listed products are integrated into the product and do not need to be provided by the broker. Potential combination transactions within the applicable range specified by the regulations are flagged in output files to facilitate broker review.

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*Contact information:*

Wolters Kluwer  
Governance, Risk & Compliance  
111 8th Avenue, 13th Floor  
New York City,  
New York 10011  
+1-212-894-8940

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