

MEMO# 30535

January 24, 2017

IRS Issues Guidance Exempting RICs from Definition of "Broker" Under Sec. 871(m)

[30535] January 24, 2017 TO: ICI Members

ICI Global Members SUBJECTS: Tax RE: IRS Issues Guidance Exempting RICs from Definition of "Broker" Under Sec. 871(m)

The Internal Revenue Service ("IRS") and the Treasury Department have released [new final and temporary regulations](#) under section 871(m) regarding dividend equivalent payments from sources within the United States. The recently issued regulations provide technical corrections to the regulations that were finalized in 2015. Importantly, we are pleased to report that the IRS and Treasury department also provided temporary regulations that exempt regulated investment companies ("RICs") from the definition of "broker" under section 871(m), as requested by the Institute.[\[1\]](#)

The definition of the term "broker" is important for purposes of section 871(m) because it is a significant factor in identifying the party to a potential section 871(m) transaction who is responsible for, among other things, determining whether the transaction is a section 871(m) transaction and, if so, determining and reporting to the counterparty or customer the timing and amount of any dividend equivalent. Generally, if one party to a potential section 871(m) transaction is a broker, that party is required to comply with these requirements. If both parties are brokers, the short party is responsible for determining and reporting the required information.

The regulations under section 871(m) use the term "broker" as that term is defined in section 6045(c) and the regulations thereunder. RICs that are open-end mutual funds are brokers for purposes of section 6045 because they regularly redeem their own shares.

RICs sometimes enter into transactions with foreign counterparties that could be potential section 871(m) transactions. Funds typically enter into these types of transactions with financial institutions (*i.e.*, U.S. and foreign banks) that are brokers/dealers. Because open-end funds are brokers under section 6045, they also could have been considered brokers under the original section 871(m) regulations. Thus, if a RIC were the short party in a potential section 871(m) transaction, it could have been responsible for the requirements under section 871(m). In such a case, the foreign broker/dealer counterparty is better suited for making the determinations and undertaking the reporting obligations under the regulations.[\[2\]](#)

The Institute thus asked the IRS and Treasury Department to clarify that the term “broker” does not include RICs for purposes of section 871(m). The recently issued regulations state that the government agrees that, when a RIC is the short party in a transaction with a financial institution, the financial institution is in the better position to satisfy the requirements under section 871(m). The temporary regulations thus clarify that a broker for purposes of section 871(m) does not include any corporation that is a broker solely because it regularly redeems its own shares.^[3]

The new administration has ordered a freeze on all new regulations after noon on January 20, 2017, and any regulations released but not yet published in the Federal Register as of that date were to have been withdrawn, subject to certain conditions. Because these regulations were published in the Federal Register after the freeze, it appears that they are in effect. Nevertheless, taxpayers may wish to consult with their legal advisers before relying upon them.

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endnotes

^[1] See Institute Memorandum No. 29584, dated December 22, 2015, which can be found here: https://www.ici.org/my_ici/memorandum/memo29584.

^[2] Closed-end funds, in contrast, would not be responsible for the requirements under section 871(m) in the same scenario, because they are not brokers under section 6045.

^[3] Treas. Reg. § 1.871-15T(a)(1). This also should apply to a foreign fund to the extent that it is a “broker” under section 6045(c) because it is treated as a corporation that redeems its own shares.