

**MEMO# 21880**

October 23, 2007

# **Proposed Regulations Impose Escrow Procedure On Certain Distributions in Redemption of Stock; Comments Requested**

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TO: TAX COMMITTEE No. 46-07    RE: PROPOSED REGULATIONS IMPOSE ESCROW PROCEDURE ON CERTAIN DISTRIBUTIONS IN REDEMPTION OF STOCK; COMMENTS REQUESTED

Treasury has released proposed regulations (attached) that would require withholding agents to implement an escrow procedure when a distribution is made to a foreign shareholder in redemption of the stock of a publicly traded corporation (a "section 302 payment"). Specifically, a withholding agent would be required on the date it receives a section 302 payment to set aside in an escrow account thirty percent (or the applicable dividend rate provided under a treaty) of the payment. Amounts would be held in escrow for at least sixty days, during which time the withholding agent would attempt to obtain a certification from the beneficial owner regarding the character of the distribution. The balance of the payment remaining after the escrow would be credited to the beneficial owner's account.

The preamble to the proposed regulations states that the regulations generally apply to a transaction in which a publicly traded corporation offers to purchase stock from its shareholders (a self tender). The regulations also would apply to transactions described in section 304(a)(2) involving parent/subsidiary corporations. For purposes of the proposed regulations, withholding agents must be U.S. financial institutions.

The regulations provide special rules for qualified intermediaries (“QIs”), prohibiting them from assuming primary withholding responsibility and receiving a section 302 payment in gross. Instead, QIs must request a certification from their account holders using a process similar to the procedures applicable to withholding agents. Based on the certifications of its account holders, a QI would provide the withholding agent with a withholding statement that sets forth the appropriate rate of withholding and information reporting for amounts paid to the QI. If there is a chain of QIs, each QI in the chain would apply the procedures described in the regulations. The rules applicable to QIs also apply to withholding foreign partnerships and withholding foreign trusts.

The regulations provide special rules applicable to nonqualified intermediaries (“NQIs”). The rules for NQIs generally are the same as the rules applicable to QIs. The withholding agent would provide the information and instructions for obtaining a certification regarding the character of the payment to the NQI. The NQI would provide this information to its account holders. The withholding agent would treat the payment as a dividend or a payment in exchange for stock based on the documentation it receives from the NQI regarding the NQI’s account holders.

### **Certifications From Beneficial Owners**

On or before the date it receives the section 302 payment, the withholding agent would provide certain information regarding the payment and instructions in writing to a beneficial owner:

1. the total number of the distributing corporation’s shares outstanding before and after the public section 302 distribution;
2. an explanation regarding when the section 302 payment will be treated as a dividend or a payment in exchange for stock for Federal income tax purposes (including an explanation of applicable constructive ownership rules); and
3. a request that the beneficial owner provide a certification within 60 days of the section 302 payment, stating whether the payment is a dividend or a payment in exchange for stock.

The proposed regulations set forth the information that must be included in the beneficial owner’s written section 302 certification, including the number of shares actually and constructively owned by the beneficial owner before and after the distribution, the beneficial owner’s percentage ownership of the corporation before and after the distribution and a penalties of perjury statement.

If, within the sixty-day period following the withholding agent’s request for a certification, the beneficial owner certifies that the section 302 payment is a payment in exchange for stock, then the withholding agent would credit the owner’s account with the amount set aside in escrow and report the entire amount paid (including the amount initially set aside) as capital gains on Form 1042-S. A withholding agent may rely on a beneficial owner’s certification if the agent does not know or have reason to know that the information

provided in the certification is unreliable or incorrect.

The withholding agent would treat the section 302 payment as tax withheld and report the entire amount paid as dividends on Form 1042-S if:

1. the withholding agent knows or has reason to know that the information provided on the statement is unreliable or incorrect;
2. the beneficial owner certifies that the payment is a dividend; or
3. the withholding agent does not receive a timely certification.

If, after the sixty-day period has expired, the withholding agent receives a certification from a foreign beneficial owner that the payment is a payment in exchange for stock and certain conditions related to adjustments for overwithholding are satisfied, the withholding agent may apply relevant refund or offset procedures. If, after the sixty-day period has expired, the withholding agent determines that the section 302 payment was incorrectly treated as a distribution in exchange for stock, then the withholding agent would apply the relevant procedures regarding underwithholding. The withholding agent would withhold on and report amounts in excess of the section 302 payment, such as interest accrued on the escrowed funds, in accordance with the withholding rules.

A withholding agent would withhold at 30 percent on the entire amount paid (and report the payment as dividends on Form 1042-S) to an improperly documented beneficial owner that is presumed to be a foreign person. The withholding agent would treat beneficial owners that are U.S. non-exempt recipients and hold stock in the distributing corporation through other entities (e.g., QIs or withholding foreign partnerships) in accordance with the certifications received from those U.S. non-exempt recipients and instruct the foreign intermediaries for such recipients to do the same.

## **Notices to the Distributing Corporation**

The withholding agent would be required to notify the distributing corporation, in writing, by the filing date of Form 1042-S, of the aggregate amount of the section 302 payment that the withholding agent has reported on Forms 1042-S as capital gains, and the aggregate amount of the section 302 payment that it has reported on Forms 1042-S as dividends.

## **Effective Date**

The proposed regulations would apply to stock redemptions made after December 31, 2008. A withholding agent could rely on the proposed regulations for a stock redemption that occurs before January 1, 2009.

## **Request for Comments**

Treasury is requesting comments regarding the proposed regulations. Comments are

specifically requested regarding alternatives to the escrow procedure, especially for withholding agents that maintain accounts for a large number of customers. Comments also are requested regarding the impact of the proposed regulations on small businesses. Comments must be received by January 16, 2008. Please provide any comments regarding these regulations to Lisa Robinson ([lrobinson@ici.org](mailto:lrobinson@ici.org) or 202-326-5835) no later than Friday, December 14, 2007.

Lisa Robinson  
Associate Counsel

[Attachment](#)

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