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In this issue

In this month's FStaxworld, we highlight the main changes set forth in the proposed revised QI Agreement

The View from Deloitte

Dear Reader,

On 1 July 2016, the Internal Revenue Service (IRS) published the proposed revised Qualified Intermediary (QI) Agreement (contained in **Notice 2016-42**) intended to replace the current QI Agreement (contained in Rev. Proc. 2014-39), which will expire on 31 December 2016. Once finalized, the revised QI Agreement will come into effect for existing QIs on 1 January 2017, provided the renewal is executed prior to 31 March 2017, via the FATCA registration website and will be effective for a period of three years.

The main changes set forth in the proposed revised QI Agreement are discussed in detail below.

Introduction of the Qualified Derivatives Dealer (QDD) status (Sections 3, 8 and 10, generally)

One of the major aspects of the proposed revised QI Agreement is the introduction of the Qualified Derivatives Dealer (QDD) status. The QDD status originated in the final and temporary 871(m) U.S. Treasury Regulations (the "871(m) Regulations") released in September 2015. The proposed revised QI Agreement sets forth the eligibility requirements and compliance obligations for entities that elect to be treated as a QDD. This status will be applicable as of 1 January 2017, simultaneous with the activation of the 871(m) Regulations.

Purpose of the QDD status
• The incoming 871(m) Regulations impose new withholding obligations on payments of so-called Dividend Equivalent payments, treating them like U.S. source income under the existing QI regime.
• The QDD status will allow non-U.S. entities to alleviate the risk of double taxation on the 871(m)-related withholdable Dividend Equivalent payments and payments on offsetting hedge positions.

Entities eligible for the QDD status
To be a QDD, the entity must have entered into a QI Agreement and be an eligible party. An eligible party includes:
• A dealer in securities that is subject to regulatory supervision as a dealer by a governmental authority in the jurisdiction in which it is organized or operates;
• A bank subject to regulatory supervision as a bank by a governmental authority in the jurisdiction in which it is organized or operates and that issues potential section 871(m) transactions; or
• An entity that is wholly-owned by an eligible bank and that issues potential section 871(m) transactions.

Application of the QDD status
• The QDD must assume primary chapter 3 and 4 withholding responsibility and

primary Form 1099 reporting and section 3406 backup withholding responsibility (if needed) for all payments it makes as a principal with respect to potential 871(m) transactions.
• In return for assuming primary withholding responsibility, the QDD is entitled to receive the gross amount of incoming payments used to hedge in-scope derivative transactions (subject to a variety of conditions).

The QDD tax liability
• A QDD must calculate, report and assess withholding on its "QDD tax liability".
• In its simplest form, the QDD tax liability is the difference between the incoming payments received gross and the outgoing 871(m)-related payment for which the QDD is acting as primary withholding agent (though the set of potential ingredients in the QDD tax liability may vary depending on the QDD's hedge and proprietary trading activities).
• For any amount received that does not have a designated offsetting Dividend Equivalent payment per 871(m), the QDD must assess the withholding tax against itself as the beneficial owner of the payment and deposit the amount with the IRS in a timely fashion.
• In addition to the self-assessed withholding, a QDD must report its QDD tax liability annually on the Form 1042.

Registration as a QDD
• Entities that are not currently QIs must file a Form 14345, which the IRS will amend to incorporate the QDD-specific registration commitments.
• Entities that are already QIs will need to certify the QDD information from the amended Form 14345 upon renewal of their QI Agreement via the FATCA portal, but not be required to re-submit the application form.
• In order for the status to be applicable as of 1 January 2017, entities will need to have registered by 31 March 2017.

Joint Account Treatment (Section 4.05)

The relief under the joint account treatment has been an integral part of the QI Agreement since the publication of Rev. Proc. 2003-64. It provides QIs with operational simplifications when dealing with payments to nonwithholding foreign partnerships or grantor/simple trusts through the application of the same withholding rate (the rate applicable to the partner, owner or beneficiary subject to the highest rate) for all payments to the partnership or trust and the elimination of the requirement to disclose each partner, owner or beneficiary separately. The proposed revised QI Agreement includes the following updates to the joint account treatment:

• With the implementation of FATCA, the IRS restricted the joint account treatment to partnerships and trusts qualifying for specific FATCA statuses (mainly certified deemed-compliant FFIs, exempt BOs and excepted NFFEs). The proposed revised QI Agreement is modified to allow a QI to apply the joint account treatment to passive NFFEs and ODFFIs (as already announced by the IRS on 23 September 2014) as well as the holders of accounts excluded under FATCA. In addition, the proposed revised QI Agreement requires QIs to obtain a certification from affected partnerships or trusts that they have maintained an admissible FATCA status during each certification period. This will require QIs not only to update their documentation but also their processes to comply with this periodic re-certification requirement.
• While a QI has been allowed to include payments to partnerships and trusts that qualify for the joint account treatment in its Form 1042-S pool reporting of direct account holders, the proposed revised QI Agreement requires separate (but still anonymous) Forms 1042-S for each such partnership and trust (as already announced in the instructions for Form 1042-S for 2015). With many QIs preparing individual Forms 1042-S manually, this modification might burden their operations heavily.
• Further, the anonymity granted to partnerships and trusts under the joint account treatment will be softened, as QIs will be required to disclose to the IRS as part of their periodic certifications the names of the partnerships and trusts concerned. This not only implies that disclosure waivers will be required from all such partnerships and trusts, but generally diminishes the attractiveness of the joint account treatment.
• Finally, it is worth noting that the joint account treatment may not be applied where the QI acts as a QDD with respect to the account (i.e. where the account holder receives a payment that is in-scope for 871(m) withholding).

Beneficial Owner’s claim of Treaty Benefits (Section 5.03)

The latest revisions to the Form W-8BEN-E (Rev. April 2016) already advertised the IRS’s concern regarding incorrect treaty claims (see FStaxworld issue 15 **here**). Although many QIs hoped that the limitation on benefits (LOB) certification would not be applicable to treaty statements, which can be collected together with Documentary Evidence as an alternative to the Form W-8BEN-E, the proposed revised QI Agreement dashed such hopes: The LOB certifications are also applicable to treaty statements.
• All treaty statements collected after 1 January 2017 must include the appropriate LOB certification as described on Form W-8BEN-E. Existing treaty statements must be renewed accordingly prior to 1 January 2019 (unless there is a change in circumstances requiring an earlier renewal).

• Where clients have previously been documented with a Form W-8BEN-E that does not include the LOB certification (rather than with Documentary Evidence and a treaty statement), the preamble to the proposed revised QI Agreement clarifies that no renewal is required before the normal expiration period (i.e. the last day of the third calendar year following the signing year).
• Positive relief provided in the proposed revised QI Agreement regarding the LOB certification is that the client's claim is subject to only an actual knowledge (and not a reason to know) standard. Consequently and unless the instructions for the requester of Forms W-8 provide otherwise, QIs need to reject Forms W-8BEN-E and treaty statements only if they know that the LOB claim is incorrect, but not if there are only indications that it might be.
• With regards to reporting, the 2016 version of the Form 1042-S includes a new box where the applicable LOB code can be recorded. This information, however, does not need to be provided if payments are reported on a pooled basis.
In addition to the LOB certification, the proposed revised QI Agreement introduces a new check with regard to treaty benefits that should – hopefully – have already been in place in the past: A QI should not accept a claim for benefits under a treaty that does not exist or is not in force.

Compliance Procedure (Section 10)

The current QI Agreement replaced the previous external audit requirement with an internal compliance and review program. The compliance framework under the current QI Agreement consists of four main pillars:
• The designation of a Responsible Officer (RO), which according to the proposed revised QI Agreement does not need to be the same person as the FATCA RO, although it would make sense to have a single RO for both regimes given they are interdependent;
• The implementation of a compliance program (i.e. policies, procedures, training, etc.);
• Periodic reviews; and
• Periodic certifications.
As the compliance procedures introduced in the current QI Agreement pose many concerns among commentators, the proposed revised QI Agreement provides further clarifications on key parts of the compliance framework.

<u>Factual information included in the periodic compliance certification</u>
• The QI is required to report certain factual information regarding its documentation, withholding, reporting and other obligations under the QI Agreement and, in case it is acting as a QDD, certain information related to the determination of its QDD tax liability as detailed in Appendix I of the proposed

revised QI Agreement.

• Given the wide scope and level of details of the factual information to be provided, the RO should consider involving the adequate functions inside and outside the organization to ensure that the obligations under the QI Agreement and its FATCA requirements as an FFI are properly operationalized and any deviation is captured in time for the certification.

Sampling methodology to determine review population

• The proposed revised QI Agreement clarifies that if a QI has fewer than 50 accounts, it must review all accounts and cannot rely on a sample to test accounts within the periodic review. Conversely, a QI with 50 accounts or more must review at least 50 accounts and may use, but is not required to use, a sampling methodology to select the accounts reviewed.

• Appendix II of the proposed revised QI Agreement outlines a sampling methodology to determine the size of the sample, strata allocation and projection. The use of this methodology is not mandatory, but would be a pre-approved approach, if applied.

Flexibility to conduct the periodic review

• The proposed revised QI Agreement clarifies that the periodic review no longer needs to be conducted with respect to the most recent calendar year of the certification period, but may be performed with respect to any calendar year covered by the certification period. However, a QI also acting as a QDD must use 2017 for its periodic review for the initial certification period.

• The proposed revised QI Agreement also clarifies that the periodic review does not need to satisfy the standards of a financial audit or other attestation engagement (substituting the term “reviewer” for the term “auditor”).

• The RO may designate an independent internal or external reviewer or use any combination thereof to perform the periodic review and may rely in addition on any other processes or reviews that he/she believes are necessary in order to make the periodic certification. In any case, the internal or external reviewer must be sufficiently independent to conduct the periodic review, i.e. it cannot review its own work.

• Although the proposed revised QI Agreement clarifies in detail the factual objectives of the periodic review, it does not provide a systematic review plan. This allows on one hand a QI to have more flexibility in determining how to reach the objectives of the periodic review, but requires on the other the QI to create its own review plan.

Waiver from performing a periodic review

The proposed revised QI Agreement offers QIs the possibility to apply for a waiver

of the periodic review requirement, provided all the following conditions are met:
• The QI must be an FFI, but may not also act as a QDD;
• The QI must not be part of a consolidated compliance program;
• For each calendar year covered by the certification period, reportable amounts received by the QI must not exceed USD 5 million;
• The QI must have timely filed forms 1042, 1042-S, 945, 1099 and 8966 for all calendar years covered by the certification period;
• The QI must have made all periodic certifications and reviews as required under section 10.02 and 10.03 of the proposed revised QI Agreement as well as any certification required under FATCA; and
• The QI must have made the certification of effective internal controls.
A QI must apply for a waiver for each certification period for which a waiver is sought and must request the waiver at the time the RO makes the periodic certification. Even where the waiver is granted however, nothing precludes the IRS from requesting information or conducting a correspondence review.

The proposed revised QI Agreement provides welcome direction on the anticipated amendments. However, given the extended scope of the changes and the approaching effective date, existing QIs do not have much time left to implement them. Moreover, as with any update to an existing complex system, the refinements build on an existing structure and assume a familiarity with past standards. Accordingly, the institutional knowledge of the QI regime within each financial institution must be maintained. Otherwise, each revision is akin to the re-introduction of the entire regime.

Regards,

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CRS Relationship Monitor

The implementation of the OECD Common Reporting Standard (CRS) is especially complex for Financial Institutions (FIs) that are part of financial groups with operations in multiple jurisdictions. Much of the additional complexity compared to FATCA is due to the multilateral nature of CRS. It is a major operational challenge for global FI groups to monitor local developments and assess their impact on each of their subsidiaries or other entities for which they are responsible.

Pertinent examples of questions that must be clarified include:
• Does country A have a CRS exchange agreement with country B?
• Is country A considered a Participating and/or Reportable jurisdiction from country B’s perspective?
• When is the onset of CRS in country C and by when is it required to identify the pre-existing clients and report?
• Is an FI in country D required to collect a TIN from an account holder resident in country E and, if so, what format is a valid format for such a TIN?

Moreover, the answers to these questions are dynamic as the relationships may evolve over time. In order to avoid any shortfall in their CRS compliance, FIs must closely monitor CRS agreements and relevant lists published by local authorities. However, these monitoring efforts are burdensome. Accordingly, Deloitte developed a web-based solution, which tracks relevant information and provides FIs access to the answers to the above and other questions on a regularly updated basis.

If you wish to get further details, please contact **Brandi Caruso** or **Michael Grebe**.

FATCA Online Course available now and CRS on its way!

As announced back in May, Deloitte Switzerland and VisionCompliance successfully collaborated to provide a state of the art FATCA Online Course with a particular focus on relationship managers. The unique cooperation brings together the technology and training know-how of VisionCompliance with our professionals’ tax technical expertise to help banks and other FIs assess and address implications related to compliance with the FATCA regime. The purpose of our new training is to instill in such personnel a sufficient understanding of the FATCA regime in order to effectively and efficiently fulfil its role as the front line in the client on-boarding process.

The FATCA Online Course is more than a comprehensive training for client facing staff, it has been designed to serve as a valuable tool to create a coherent understanding of FATCA compliance within FIs as a whole, and is thus of added value for support functions as well. You may find further details on the training under this **link**.

Our FATCA Online Course is available for subscription now. Our CRS course is in development; it will follow the same approach, and will be available later this year.

For more information, please contact **Brandi Caruso** or **Karim Schubiger**.

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