

IRS releases updated QI agreement providing guidance for QIs under FATCA and Chapter 3

July 3, 2014

In brief

On June 27, 2014, the Internal Revenue Service (IRS) released Revenue Procedure 2014-39 which provides guidance on the reporting, withholding, account documentation and registration requirements for a non-US intermediary entering into or renewing a qualified intermediary (QI) agreement.

The issuance of a new QI agreement has been anticipated, and the majority of the changes from the existing QI agreement reflect the reporting and withholding requirements set forth under the provisions of the Foreign Account Tax Compliance Act (FATCA). The new QI agreement coordinates account documentation, withholding, and reporting requirements under QI with those under FATCA. Finally, as expected, the external audit procedures in the previous QI agreement have been replaced by a responsible officer concept which requires periodic compliance certifications and mandatory periodic reviews of an internal compliance program.

PwC Observation: *QIs should immediately assess the impact of the revisions to the QI agreement on their current QI operations, with a specific focus on outsourced functions, and implement changes where required. The new procedures should be aligned with current FATCA compliance programs. Special attention should be applied to the specific withholding requirements, particularly in the intergovernmental agreement (IGA) context.*

In detail

The QI agreement is intended to set out how a non-US intermediary should assume the withholding and reporting obligations for payments of US source income (including interest, dividends, royalties, etc.) made to its account holders or payees. The revised QI agreement describes the FATCA requirements that apply to a QI that is also an FFI.

An FFI that has entered into a QI agreement is subject to the FATCA requirements for all accounts that it maintains irrespective of whether the FFI is acting as a QI with respect to the account. When an FFI acts as a QI with respect to an account that it maintains, the FFI must comply with its FATCA obligations, unless such FATCA obligations have been explicitly modified in the QI agreement.

Legal Entities Impacted

Entities eligible to execute a QI agreement

A QI agreement may be entered into by foreign financial institutions (FFIs), foreign clearing organizations, and foreign branches of US financial institutions (USFIs) or US clearing organizations. In addition, the revised QI agreement clarifies that in certain cases, a non-financial foreign entity (NFFE)

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may enter into a QI agreement (without any need for a rider) and describes the specific requirements for such an entity to the extent they differ from the requirements applicable to a QI that is an FFI.

Furthermore, while not all FFIs must enter into a QI agreement, for those institutions that do enter into a QI agreement, compliance with FATCA has become a prerequisite to becoming a QI.

Type of Entity	Can execute a QI agreement when it:
<i>FFI</i>	is able and agrees to satisfy the requirements and obligations of: <ol style="list-style-type: none"> 1. a participating FFI (PFFI) (including a reporting Model 2 FFI), 2. a registered deemed-compliant FFI (including a reporting Model 1 FFI and a nonreporting Model 2 FFI treated as registered deemed-complaint), 3. a registered deemed-compliant Model 1 IGA FFI (which includes an FFI treated as a deemed-compliant FFI under an applicable Model 1 IGA that is subject to similar due diligence and reporting requirements with respect to U.S. accounts as those applicable to a registered deemed-compliant FFI under Treasury Regulation §1.1471-5(f)(1)), or 4. a limited FFI, for a transitional period.
<i>A certified deemed-complaint FFI (including a nonreporting IGA FFI)</i>	meets the requirements and agrees to assume the FATCA obligations of an FFI (see above) with respect to all accounts that it maintains. This includes accounts that the FFI does not intend to designate as accounts for which it will act as a QI.
<i>A central bank of issue</i>	meets the criteria and agrees to assume the respective obligations of a PFFI (including a reporting Model 2 FFI) or a registered deemed-compliant FFI (including a reporting Model 1 FFI) with respect to any account that it maintains and that is held in connection with a commercial financial activity and for which it receives a withholdable payment.
<i>A foreign branch of a USFI</i>	is a reporting Model 1 FFI or it agrees to assume the requirements and obligations of a PFFI (including a reporting Model 2 FFI).
<i>An NFFE acting on behalf of its shareholders</i>	meets the criteria for treatment as a direct reporting NFFE and agrees to assume the respective obligations of such treatment.
<i>An NFFE acting on behalf of persons other than its shareholders</i>	satisfies the FATCA withholding and reporting requirements that generally apply to withholding agents.

An entity that is a territory financial institution (territory FI) or a nonparticipating FFI may not apply for a QI agreement. While QI and FATCA remain distinct requirements, the QI status needs to be aligned to the FATCA status. Thus, a QI that assumes primary withholding obligations for Chapter 3 must also assume primary withholding obligations for FATCA (i.e., Chapter 4).

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PwC Observation: As a result of the QI eligibility rules, it appears that an existing QI wishing to maintain its QI status that qualifies for a FATCA status with reduced due diligence obligations, such as a certified deemed-compliant FFI, may be required to perform a higher level of due diligence than is generally required under FATCA, if it wishes to maintain its QI status.

Consistent with the previous QI agreement, a QI may act as a QI only in a jurisdiction with IRS approved know-your-customer-rules. [Link to List of Approved jurisdictions](#)

Treatment of certain partnerships and trusts

The revised QI agreement includes the joint account and agency options of the existing QI agreement, which allow a QI to enter into an agreement with a nonwithholding foreign partnership or nonwithholding foreign trust to apply simplified documentation, withholding, and reporting requirements for payments made to these entities. However, there are specifications on the FATCA statuses required of the partnerships and trusts as well as their partners, owners, and beneficiaries in order to apply such procedures.

Effective date of QI agreement

The revised QI agreement has an effective date of on or after June 30, 2014. The following table outlines the general effective dates based on application and renewal dates:

Type of Entity	Application or Renewal Date	QI Effective Date
An FFI, an NFFE acting as a QI on behalf of its shareholders, or an NFFE that is a sponsoring entity	Applies before June 30, 2014	June 30, 2014, provided that it is also issued a global intermediary identification number (GIIN) before June 30
	Applies on or after June 30, 2014	The date its GIIN is issued
A QI that is an NFFE that is not acting on behalf of its shareholders and is not a sponsoring entity	Renews on or before June 30, 2014	June 30, 2014
	Renews after June 30, 2014	An effective date consistent with the date of renewal provided in the IRS approval notice
An NFFE that is not acting on behalf of its shareholders and is not a sponsoring entity	Applies to obtain QI status	The date that it is issued a QI employer identification number

A QI that has submitted a QI application before July 31, 2014 and is approved during calendar year 2014 may act as a QI in accordance with the existing QI agreement from January 1, 2014 through June 30, 2014.

PwC Observation: It would appear that if an entity did not apply for QI status or apply to renew QI status prior to June 30, 2014, there will be a “gap” in QI status from July 1, 2014 through the time QI status is approved or renewed by the IRS. For example, an existing QI that applies for renewal after June 30, 2014 would have had its existing agreement expire on June 30, 2014 and thus would have a gap in coverage from July 1, 2014 through the date its GIIN is issued or the date of renewal provided in the IRS approval notice. Similarly, it would appear that an entity that applies for QI

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status prior to July 31, 2014 will have QI status from January 1, 2014 through June 30, 2014, NQI status from July 1, 2014 through the date of approval, and QI status from the date of approval forward. It is not clear if this gap – particularly in the second instance – is intentional.

Due Diligence Procedures

QI's documentation requirements for Chapters 3 and 4 purposes

The revised QI agreement updates the documentation requirements under the existing QI agreement to reference the documentation requirements applicable to a QI with respect to payees to which it makes withholdable payments. Furthermore, the QI agreement updates the due diligence requirements applicable to establish an FFI's FATCA status with respect to a QI that is:

- a PFFI (including a Model 2 FFI),
- a registered deemed-compliant FFI (including a reporting Model 1 FFI or a nonreporting Model 2 FFI treated as registered deemed-compliant), or
- a registered deemed-compliant Model 1 FFI.

QIs documenting their direct account holders for purposes of Chapters 3 and 61 are permitted under the QI agreement to use documentary evidence permitted under the QI's know-your-customer rules. The requirements relating to the use of documentary evidence do not apply to an NFFE acting as a QI, because the entity is required to obtain Forms W-8 and W-9 from its account holders. The QI agreement also incorporates changes to the documentation requirements applicable to a QI for purposes of Chapter 3 consistent with temporary regulations under Section 1441.

QI's presumption rules and reliable association of payments

The revised QI agreement modifies the presumption rules of the previous QI agreement to coordinate with the presumption rules of FATCA as well as with the revisions to the presumption rules made in the temporary coordinating regulations. The QI agreement also revises the circumstances in which a QI can avoid application of the presumption rules by modifying the rules for when the QI can reliably associate a payment with valid documentation and the rules for how intermediaries and flow-through entities may provide withholding statements to withholding agents (including QIs) for FATCA purposes.

Reporting Obligations

QI's reporting on Form 1042-S

The updated QI agreement substantially modifies a QI's Form 1042-S reporting requirements by incorporating certain FATCA reporting obligations with respect to intermediaries and flow-through entities that provide FATCA withholding rate pool information to the QI on withholding statements. The revised rules provide that a withholding agent "may" use a single Form 1042-S to report information required under both Chapters 3 and 4 with respect to a withholdable payment of US source FDAP income subject to withholding under Chapter 4 and for which a credit against the beneficial owner's Chapter 3 liability, if any, may be claimed.

PwC Observation: In practice, the "crediting" of FATCA-withholding towards Chapter 3 liability seems to be the rule and only one Form 1042-S is required.

The revised requirements also reference the Form 1042-S requirements of a QI with respect to its direct account holders when FATCA withholding applies, and allow the QI to file Forms 1042-S with respect to a Chapter 4 withholding rate pool.

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QI's 1042 reporting and reconciliation of Chapter 3 and Chapter 4

A QI must annually file Form 1042 reconciling the taxes withheld for Chapter 3 and Chapter 4. Form 1042 includes over- and underwithholding adjustments for Chapters 3 and 4, provided that all pre-conditions of the adjustment procedures are met within a rather short time frame, i.e. until the due date of Form 1042 on March 15 of the following calendar year. This timing is consistent with the prior version of the QI agreement and the Chapter 3 regulations.

QI's FATCA U.S. Account and Form 1099 Reporting

FATCA reporting is now part of the QI agreement and all QIs have to adhere to this obligation; however, the updated QI agreement provides for certain alignments between FATCA and QI reporting. Thus, to the extent that a QI has assumed Form 1099 reporting responsibilities, and the QI reports such account for purposes of FATCA as a U.S. reportable account, the QI is generally not required to file Forms 1099 for such account.

Reporting under Section 1472

Regardless of whether a foreign intermediary is an FFI or did not assume a withholding obligation under the QI agreement, the QI will be required to assume a reporting obligation with respect to passive NFFEs that have substantial US owners (or controlling persons that are specified US persons) and will not be required to provide specific payee information to other withholding agents for purposes of the reporting under Section 1472. A QI will also be required to act as a direct reporting NFFE for purposes of reporting its substantial US owners under Section 1472 when it acts as a QI on behalf of its shareholders

PwC Observation: *The updates to the QI agreement regarding the alignment between FATCA and QI reporting allow QIs to continue current procedures to satisfy certain FATCA requirements, if they wish to do so, and also relieve QIs of having to perform duplicative reporting on certain accounts.*

Withholding Obligations

Withholding responsibilities

The withholding provisions under the updated QI agreement have been enhanced to incorporate FATCA withholding obligations, and the updated QI agreement states that a QI is a withholding agent for purposes of FATCA and subject to the withholding and reporting provisions applicable to withholding agents under sections 1471 and 1472 with respect to its accounts. Consistent with the previous QI agreement and with FATCA, withholding only applies to US source FDAP (fixed and determinable annual and periodical income) income and certain equivalents thereof.

The updated QI agreement incorporates the changes previously seen in IRS notices regarding the satisfaction of withholding on recalcitrant account holders by performing backup withholding. QIs can simply impose FATCA withholding on recalcitrant account holders instead of backup withholding. In either event, withholding is only applied once to payments made to a recalcitrant account holder (i.e., FATCA or backup withholding).

PwC Observation: *The updated QI agreement now provides clarity on the FATCA withholding obligations of a QI which is an FFI, which had been unclear under the Model 1 IGA regime. Under the updated QI agreement, a QI is a withholding agent under Chapters 3 and 4 for amounts that it pays to its account holders. This, however, creates uncertainty on the scope of the withholding obligations for a QI in a Model 1 IGA jurisdiction, where the IGA limits the withholding to NPFFIs. The new QI agreement further clarifies that a QI must comply with its FATCA requirements as a Model 1 IGA FFI with respect to all financial accounts that it maintains, irrespective of whether an*

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account is designated as an account for which it will act as a QI, thus, creating more uncertainty as to the scope of withholding, which is currently limited in a Model 1 context to those accounts for which a QI currently withholds on under the QI regime.

QIs acting as qualified securities lenders (QSLs)

The revised QI agreement permits a QI to act as a QSL with respect to payments of US source substitute dividends as long as it acts as a QSL with respect to all US source substitute dividends it receives as an intermediary or dealer.

Compliance Obligations

QI's compliance procedures

The new QI agreement substantially modifies QI audit requirements. A QI is required to designate a responsible officer with authority to establish an internal compliance program including policies, procedures and processes sufficient for a QI to satisfy the documentation, reporting and withholding requirements under the QI agreement. The responsible officer is also required to make compliance certifications to the IRS every three calendar years, starting with the period ending on the third full calendar year that the QI agreement is in effect.

Furthermore, the responsible officer must designate an auditor that will perform a periodic review of the QI's compliance with the QI agreement and its FATCA requirements. Under the new QI agreement it is possible to appoint either an internal or an external auditor.

PwC Observation: *Through the QI agreement, Model 1 IGA FFIs that are QIs will now have to implement a comprehensive responsible officer compliance program to enable periodic certification. Furthermore, it remains to be seen whether financial institutions will continue to rely on external auditors to assist with the fulfillment of these compliance obligations.*

Events of default

An event of default occurs if a QI fails to perform any material duty or obligation required under the QI agreement and the responsible officer had actual knowledge or should have known the facts relevant to the failure. Specific cases are listed in the QI agreement.

Term of the revised QI agreement

The revised QI agreement will expire, unless otherwise previously terminated, on December 31, 2016, which is consistent with the term of the FFI agreement.

PwC Observation: *On January 1, 2017, withholding on payments of gross proceeds and foreign passthru payments is expected to enter into force. These new requirements coincide with the December 31, 2016 expiration of the QI and participating FFI agreements.*

QI Agreement Application Procedures

Application for QI status

The Revenue Procedure describes the application procedures for becoming a QI or renewing a QI agreement. Once a prospective QI has an approved QI application it will be instructed to register through the FATCA registration website to obtain its FATCA status and register as a QI. Except as otherwise provided in future guidance, the IRS will not enter into a QI agreement with an FFI that provides for the

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use of documentary evidence obtained under a jurisdiction's "know-your-customer" rules if the IRS has not approved the know your customer practices and procedures for opening accounts.

The IRS intends to update the online FATCA registration website to allow prospective QIs to submit a QI application electronically; however, until this update is made, an entity wishing to become a QI must submit a paper application.

Key Takeaways

With July 1 as the effective date for many FATCA obligations, the Revenue Procedure provides guidance which QIs are required to implement in a short period of time. While many of the provisions for FFIs were expected, compliance programs may still need to be expanded to include certain additional requirements arising from the QI agreement. The bigger challenges may apply to certified deemed-compliant FFIs that are QIs, because of the requirement to comply with the enhanced due diligence requirements for all of the accounts they maintain.

Let's talk

For more information on how the new QI agreement might impact your business, please contact a member of the PwC's Global Information Reporting Network. To view contacts for over 70 countries worldwide, click [here](#).

Additional information

For other information regarding FATCA and QI guidance and implementation, please click [here](#) for the Global Information Reporting thought leadership archive.

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