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# *IRS releases final qualified intermediary agreement*

*January 12, 2017*

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## ***In brief***

The Internal Revenue Service (IRS) on December 30, 2016 released [Rev. Proc. 2017-15](#), which sets forth the final 2017 qualified intermediary (QI) agreement (2017 QI Agreement). The QI regime permits certain foreign persons acting as intermediaries to simplify their federal tax withholding and information reporting responsibilities (1) under Chapter 3 and Chapter 4 of the Internal Revenue Code (Code) and (2) as a payor under Chapter 61 and Section 3406 of the Code (i.e., Form 1099 reporting and backup withholding).

The 2017 QI Agreement is based on the 2016 Proposed QI Agreement released by the IRS in July 2016, but contains certain changes and points of clarification made in response to stakeholder comments regarding certain provisions of the QI agreement. See our [Insight: IRS proposes updated qualified intermediary agreement](#) for more information on the 2016 Proposed QI Agreement. The more notable changes and points of clarification among others include information on:

- QI compliance program - periodic review and certification of compliance
  - Standards of independence and competence for reviewers
  - Timing of the responsible officer's (RO's) certification of compliance
  - Consolidated compliance programs
  - Statistical sampling and spot-checking
  - Coordination with requirements of the Foreign Account Tax Compliance Act (FATCA)
- Partnerships or trusts applying the joint account or agency options
- Entities eligible for QI agreements
- Documentation requirements relating to account holders
  - Validity period for documentary evidence and treaty statements
  - Documentation of account holders and presumption rules
- Application for QI status, term of the agreement, effective date, and
- Qualified derivatives dealers (QDDs).

The 2017 QI Agreement has an effective date of January 1, 2017. QIs with expired agreements must renew before March 31, 2017 to have a new QI agreement with a retroactive effective date of January 1, 2017.

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## In detail

### Background

The IRS in 2014 issued a new QI Agreement (2014 QI Agreement) to coordinate a QI's account documentation, withholding, and reporting requirements with similar requirements under FATCA and to introduce a new governance model that involves appointing an RO required to make periodic compliance certifications to the IRS. See our [Insight: IRS releases updated QI agreement providing guidance for QIs under FATCA and Chapter 3](#) for more information on the 2014 QI Agreement.

The IRS in July 2016 issued Rev. Proc. 2016-42 proposing a new QI agreement (2016 Proposed QI Agreement) that contained provisions setting out terms and requirements for derivatives dealers and securities lenders that are QIs and that plan to act as qualified derivatives dealers (QDDs) with respect to transactions that give rise to US source dividend equivalent payments under Code Section 871(m) and that give rise to US source substitute interest. The IRS requested and received many comments from stakeholders during an extended comment period. See our [Insight: IRS proposes updated qualified intermediary agreement](#) for more information on the 2016 Proposed QI Agreement.

The 2017 QI Agreement is the next in a series of revised and proposed agreements intended to coordinate a QI's account documentation, withholding, and reporting requirements with similar requirements under FATCA, implement a new governance model that involves appointing an RO required to make periodic compliance certifications to the IRS, and setting out terms for QDDs and securities lenders regarding transactions that

give rise to dividend equivalent payments under Code Section 871(m) and to substitute dividends and interest.

### Periodic review and certification of compliance, timing of certification, and consolidated compliance programs

Consistent with the 2014 QI Agreement and the 2016 Proposed QI Agreement, the 2017 QI Agreement replaces the external audit requirement with a requirement for a compliance program that includes the appointment of an RO to establish and maintain a compliance program for the QI. Components of the compliance program include:

- Drafting and updating written policies and procedures sufficient for the QI to satisfy its obligations under the QI agreement,
- Training relevant personnel in the policies and procedures necessary to comply with their provisions,
- Ensuring that systems and processes are in place to allow the QI to comply with obligations under the QI agreement,
- Monitoring business practices and arrangements affecting the QI's compliance with its QI agreement,
- Designating a reviewer to perform a periodic review of the QI's compliance with its QI agreement, and
- Making periodic certifications of compliance and providing to the IRS with these certifications certain factual information based, in part, on the results of a periodic review.

The 2017 QI Agreement retains the various components of the QI's compliance program as described in

the 2016 Proposed QI Agreement and as outlined above. Significant changes and clarifications to the compliance program are discussed below.

### Periodic review and certifications of compliance

ROs are required to arrange for a periodic review of the QI's documentation, withholding, reporting, and other obligations under the QI agreement. Consistent with the 2016 Proposed QI Agreement, the 2017 QI Agreement permits the RO to rely on the results of the periodic review, as well as any other processes, procedures, reviews or certifications made by other persons that the RO has determined are necessary in order to make the certification. The IRS, in the 2017 QI Agreement, did not provide additional prescriptive requirements for the processes or procedures that an RO may rely upon to support its certification. Instead, the RO is allowed discretion to structure a periodic review and rely on whatever processes or procedures deemed necessary to facilitate certification of compliance.

**Observation:** While the IRS has not imposed a specific audit or review methodology for purposes of conducting the periodic review, Appendix 1 of the 2017 QI Agreement, like the 2016 Proposed QI Agreement, contains an extensive description of the factual information that must be disclosed to the IRS and the compliance certifications that the RO is required to make.

### Independence and competence of reviewers

The 2017 QI Agreement retains the 2016 Proposed QI Agreement's requirement that a QI's internal or external reviewer be competent and satisfy an independence standard. In response to stakeholder comments,

Rev. Proc. 2017-15 clarifies that an external reviewer is required under the 2017 QI agreement to maintain an appropriate level of independence and integrity in the review process, should not be reviewing its own work, and should be in a position where it would be able to make a negative assessment of the QI's processes and procedures. Rev. Proc. 2017-15 also clarifies that although the independence of an external reviewer depends on specific facts and circumstances, its independence should be assessed on an entity- or firm-wide basis, not on the basis of a particular individual or group within a firm.

The 2017 QI Agreement also states that reviewers must be competent, meaning that reviewers (internal or external) must have enough knowledge and experience to conduct the required review to enable the RO to make its compliance certification.

**Observation:** *The IRS has provided a broad standard for QIs in selecting reviewers. However, the IRS does impose an important limitation in applying the independence standard on an entity- or firm-wide basis. For instance, an outside advisory firm that assists a QI in creating its policies and procedures regarding QI compliance likely would be prohibited from performing any periodic review, even if the work in each case were performed by separate individuals or teams within the firm.*

The 2017 QI Agreement also retains the 2016 Proposed QI Agreement's provision that a QI must request a waiver of the periodic review if it meets certain conditions.

#### **Timing of RO's compliance certification**

A QI is subject to a certification period that ends on December 31 of the third full calendar year that its QI

agreement is in effect. The RO may select any year within that three year timeframe to conduct a periodic review. Under the 2016 Proposed QI Agreement, the RO was required to submit the certification to the IRS by July 1 of the calendar year following the end of the third year.

The 2017 QI Agreement alters the timing of the RO's compliance certification so that if a QI selects the third and final year within the certification period to conduct the review, its RO now has an additional six months (to December 31) to submit the certification. Consistent with the 2016 Proposed QI Agreement, the QI may select a year for review only if, on the due date for furnishing factual information relating to the periodic review, there are at least 15 months remaining under the applicable statute of limitations on assessment or if the QI submits, upon request from the IRS, a Form 872, *Consent to Extend the Time to Assess Tax*, that satisfies the 15-month requirement. Subsequent certification periods are every three calendar years following the close of the initial certification period.

**Observation:** *The IRS did not respond favorably to comments suggesting the creation of a means to apply for an automatic extension of time to submit the RO's compliance certification. It remains to be seen how the IRS will enforce the due dates under provision of the 2017 QI Agreement, particularly in light of their flexibility regarding the completion of audit reports required under the original 2002 QI Agreement.*

#### **Consolidated compliance program**

The 2017 QI Agreement retains the 2016 Proposed QI Agreement's provision for a consolidated compliance program, under which QIs that are members of a group of entities under common ownership

may designate a single compliance QI to provide a single compliance certification on behalf of all member QIs if they (1) operate a uniform compliance program, (2) share practices, procedures, and systems subject to uniform monitoring and control, and (3) are subject to a consolidated periodic review. Such program, however, would be at the discretion of the IRS.

The 2017 QI Agreement clarifies that nonfinancial foreign entities (NFFEs) that are QIs also may participate in a consolidated compliance program. The 2017 QI Agreement also provides that the RO of the compliance QI may rely on certifications made by ROs of the member QIs, but still is responsible for making the certification for the consolidated compliance group. The IRS did not provide any further guidance on the standards it would apply in permitting consolidated compliance programs.

**Observation:** *The IRS still retains complete discretion in granting requests for consolidated compliance programs. Entities that have multiple QIs may wish to apply to the IRS to use this procedure to simplify and coordinate their overall compliance burden. However, the application process still is not defined and will require close interaction with the IRS to reach approval. Note that participation in a consolidated compliance program will have no effect on the documentation the individual QIs will be required to provide to their withholding agents or on each QI's withholding and information reporting requirements.*

#### **Statistical sampling for periodic review**

The 2017 QI Agreement allows QIs reviewing 60 or more accounts to use statistical sampling in performing their periodic review. This is an

increase from the 2016 Proposed QI Agreement's 50 account threshold. The 2017 QI Agreement provides a safe harbor statistical sampling methodology in Appendix II, but also allows other sampling techniques to be used if the parameters and methodology are documented for IRS scrutiny as part of the periodic review.

The 2017 QI Agreement requires QIs using statistical sampling to pay any underwithheld tax discovered in the course of reviewing the selected sample of accounts. However, QIs are not required to automatically project the underwithholding from the sample to the entire population. The IRS, upon review of the RO's compliance certification, may require the QI to perform a projection based on the sample to estimate the total underwithholding on its accounts.

The 2017 QI Agreement re-introduces the availability of spot-checks for certain parts of the periodic review relating to QI withholding rate pools, withholding responsibilities, and return filing and information reporting requirements. However, spot-checking is not permitted for reviewing documentation. Spot-checks were allowed under the original 2002 QI Agreement, but were not permitted under the 2014 QI Agreement or the 2016 Proposed QI Agreement.

**Observation:** *The provision of a statistical sampling safe harbor method will be helpful for QIs with large numbers of accounts that previously had to petition the IRS to use sampling techniques. The IRS also has provided some leeway in cases of underwithholding, as there will be no automatic use of projections of tax due across an entire population. Instead, the QI and the IRS will have an opportunity to discuss the matter and come to a resolution.*

### **Coordination with FATCA requirements**

QIs are required to satisfy their FATCA obligations in their capacities as participating foreign financial institutions (PFFIs), registered-deemed compliant FFIs, registered-deemed compliant FFIs under a Model 1 intergovernmental agreement (IGA) (Model 1 FFIs), or direct-reporting NFFEs. A QI's periodic review must include a review of its FATCA compliance. However, due to questions raised under the 2014 QI Agreement and the 2016 Proposed QI Agreement, the 2017 QI Agreement clarifies that QIs are required to include in any periodic review only those accounts for which they are acting as a QI (i.e., not every account for which FATCA compliance may be required). The 2017 QI Agreement also reiterates that the RO, in making the required certifications, may rely on other personnel with oversight or responsibility for the QI's FATCA compliance.

### **Entities eligible for QI agreements**

The types of entities eligible to enter into a QI Agreement has been narrowed from the 2016 Proposed QI Agreement as follows:

- NFFEs that present claims of treaty benefits on behalf of their shareholders will no longer be eligible for QI status. These entities may be able to enter into a withholding foreign partnership (WP) agreement as a reverse hybrid entity.
- Limited branches and limited FFIs are Chapter 4 statuses subject to a transitional rule that expired on December 31, 2016 and have been removed from the 2017 QI Agreement's list of eligible entities.

### **Partnerships or trusts applying the joint account or agency options**

Consistent with the 2014 QI Agreement and the 2016 Proposed QI Agreement, the 2017 QI Agreement permits a QI to apply the joint account or agency option with respect to accounts that it maintains for certain nonwithholding foreign partnerships (NWFs) and nonwithholding foreign trusts (NWTs). The joint account and agency options in the QI agreement provide an alternative method for account documentation, reporting, and withholding with respect to accounts held by NWFs and NWTs.

The 2016 Proposed QI Agreement contained inconsistencies regarding whether a QI is required to specifically report and provide names of the partnerships or trusts to which it applies the joint account option. The 2017 QI Agreement resolves these inconsistencies and provides that a QI is not required to identify the names of the partnerships or trusts for which it applied the joint account or agency option on a Form 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*. The requirement to report these names also has been removed from Appendix 1 of the 2017 QI Agreement, except in cases in which the QI reports a material failure with respect to a partnership or trust for which it applied the agency option. Appendix 1 of the QI agreement contains factual information and certifications that a QI must report to the IRS.

The 2017 QI Agreement allows a QI that is a QDD to use the joint account option when making payments in its capacity as a QDD; however, a QDD is not allowed to apply the agency option with respect to an account or transaction in its QDD capacity due to concerns about the administration of the QDD rules and the calculation of the QDD liability.

## QI documentation requirements

### Documentation of account holders and presumption rules

The 2017 QI Agreement resolves inconsistencies in prior versions of the QI agreement as to whether an FFI must document its account holders according to requirements under an applicable IGA or the QI agreement by providing that a QI that is an FFI may document account holders for FATCA purposes consistent with its requirements under Annex I of an applicable IGA.

The 2017 QI Agreement also clarifies a QI's responsibilities to apply the presumption rules. The presumption rules are a set of guidelines that a QI applies to determine the status of an account holder that has not provided sufficient documentation to enable the QI to determine its status. There was uncertainty in the 2014 QI Agreement as to whether the presumption rules under an applicable IGA or the presumption rules in the QI agreement or in the US Department of the Treasury (Treasury) regulations apply.

The 2017 QI Agreement provides that if a QI that is a reporting Model 1 FFI or reporting Model 2 FFI does not have information in its possession or that is publicly available to reasonably determine the FATCA status of an entity account holder, the FFI must obtain a self-certification to establish the status of such entity (or in some cases, a self-certification to establish the status of the controlling persons of a passive NFFE) consistent with Annex I of the applicable IGA. When the QI acts as an intermediary for a withholdable payment made to an entity account and is unable to document the account by obtaining information or a self-certification consistent with the procedures described in Annex I of the applicable IGA, the 2017 QI Agreement provides that the QI must apply the

presumption rules from the Treasury regulations (specifically Treas. Reg. [Sec.1.1471-3\(f\)](#)) to treat such entity account as a nonparticipating FFI.

**Observation:** *Although additional clarity has been provided regarding the use of the presumption rules, the IRS noted that typically there should not be undocumented accounts pursuant to an applicable IGA, and that if an FFI has many such undocumented accounts, the US Competent Authority may determine that there is significant non-compliance with respect to the FFI.*

### Validity period for documentary evidence and treaty statements

Consistent with the revised Chapter 3 regulations, the 2017 QI Agreement provides that a treaty statement will be subject to the same validity period as prescribed in the Chapter 3 regulations (i.e., three years).

The 2017 QI Agreement retains the existing rule for the validity period of documentary evidence that was included in prior versions of the QI agreement, including documentary evidence supporting a claim for treaty benefits (i.e., it could remain valid until its expiration date). It is important to note that Treasury and the IRS are considering applying the same three-year validity period to documentary evidence obtained by QIs supporting the claim for treaty benefits by an account holder, so that it aligns with the validity period of the treaty statement.

### Validation of treaty claims and standard of knowledge for limitation on benefits

The 2017 QI Agreement requires that QIs collect information from an entity account holder regarding the limitation on benefits (LOB) provision under an applicable treaty. This

requirement is consistent with the 2016 Proposed QI agreement and Form W-8BEN-E, *Certificate of Status of Beneficial Owner for United States Tax Withholding and Reporting (Entities)*, which was revised in April 2016 to include checkboxes for a beneficial owner to provide information regarding the LOB provision that it satisfies.

The 2017 QI Agreement provides that a QI generally may rely on an entity account holder's LOB claim unless it has actual knowledge or reason to know that the claim is unreliable or incorrect. The 2017 QI Agreement also provides that a QI will be considered to have reason to know that a claim for treaty benefits is unreliable or incorrect if, among other requirements, the account holder claims benefits under a treaty that does not exist or is not in force.

**Observation:** *Although the 2017 QI Agreement requires QIs to collect additional LOB information from entity account holders in order to grant treaty benefits, the actual knowledge or reason to know standards are generally perceived to be fairly workable. They require a QI to verify the existence of an income tax treaty rather than checking to see whether a particular LOB claim is reasonable or included in a treaty, etc. The [IRS website](#) provides information as to whether a treaty does not exist or is not in force.*

### Applications, term of agreement, and effective date

#### Application for QI status

Existing QIs wishing to renew their status and prospective QIs applying for QI status will submit their applications through the newly released *Qualified Intermediary (QI), Withholding Foreign Partnership (WP), and Withholding Foreign Trust (WT) Application and Account*

*Management System* (QI/WP/WT System). The [QI/WP/WT System](#) is a new IRS secure web-based platform that enables users to apply to become a QI, WP, or WT; renew or terminate an existing QI, WP, or WT agreement; and manage their QI, WP, or WT information online. The IRS recently released a user guide (IRS Publication 5262) to accompany the QI/WP/WT System.

**Prospective QIs**

Prospective QIs must submit the information specified in IRS Form 14345, *Application for Qualified Intermediary, Withholding Foreign Partnership, or Withholding Foreign Trust Status*, through the QI/WP/WT System to become a QI. An application also must include any additional information and documentation requested by the IRS. The applicant must establish to the satisfaction of the IRS that it has adequate resources and procedures to comply with the terms of the QI agreement. An entity that wishes to

become a QI to act as a QDD must apply to enter into a QI agreement and include the information on the application relating to QDDs.

Prior to entering information in the QI/WP/WT System, a prospective QI (other than an NFFE that is acting as an intermediary on behalf of persons other than its shareholders and certain foreign central banks of issue) must submit the information specified in Form 8957, *Foreign Account Tax Compliance Act (FATCA) Registration*, through the FATCA registration website available at [www.irs.gov/FATCA](http://www.irs.gov/FATCA), and obtain its Chapter 4 status along with a global intermediary identification number (GIIN).

The QI agreement, as applicable to an FFI, allows for the use of documentary evidence obtained under a jurisdiction's know-your-customer (KYC) practices. Accordingly, the IRS will not enter into a QI agreement with an FFI if it has not approved the FFI's KYC practices and procedures

for opening accounts in the jurisdiction where the FFI is located. The IRS website contains a list of jurisdictions for which the IRS has reviewed KYC procedures and for which the KYC rules have been approved. A QI that is an NFFE generally is not required to be located in an approved KYC jurisdiction because an NFFE is required to collect Forms W-8 and W-9 and may not use KYC documentation.

The IRS will notify the QI if it approves its QI application. The approval notice will include the issuance of a unique QI employer identification number (QI-EIN) used for fulfilling the requirements of a QI under the QI agreement. The effective date of the QI agreement for new QI applicants will depend on when the QI submits its application and whether the QI has received any reportable payments prior to submitting its application. The various effective dates for a prospective QI are as follows:

Date application submitted	Received reportable payment prior to date applied for QI status?	Effective date of QI agreement
Before April 1, 2017	n/a	January 1, 2017
After March 31, 2017	No	January 1, 2017
After March 31, 2017	Yes	First of the month in which its QI application is approved and the prospective QI is issued a QI-EIN

**Existing QIs**

An FFI wishing to renew its QI agreement must do so through the QI/WP/WT System. The QI will retain its existing QI-EIN. A QI wishing to renew its QI agreement and also act as a QDD must supplement the renewal request by providing all of the information required by the QDD

application. The 2017 QI Agreement is effective on or after January 1, 2017. A QI that seeks to renew its QI agreement must renew prior to March 31, 2017 for its renewed QI agreement to have an effective date of January 1, 2017.

**Observation:** Taxpayers should submit their QI applications and

renewals prior to April 1 and March 31, 2017, respectively, in order for their QI agreement to have an effective date of January 1, 2017, and to avoid facing two types of reporting in a single year: that of a QI and that of a nonqualified intermediary (NQI).

### **Term of agreement**

In response to comments received on the 2016 Proposed QI Agreement, the IRS has extended the term of the QI agreement from three full calendar years to six full calendar years following the effective date of the QI agreement.

**Observation:** *Though the term of the 2017 QI Agreement will be six full calendar years, the IRS did not*

*change the frequency of the RO's required compliance certifications.*

### **The takeaway**

Treasury and the IRS met taxpayer expectations by adopting most of the terms that were previewed in the 2016 Proposed QI Agreement. There are, however, some significant changes and clarification on several important points in the 2017 QI Agreement. Overall, the changes and clarifications provide enhanced flexibility and time

for QIs in complying with the some of the requirements of the QI regime. Taxpayers with existing QIs and those anticipating applying for QI status should review carefully the 2017 QI Agreement to assess its impact on their operations and business practices. Finally, applicants should be mindful of the March 31, 2017 deadlines for submitting information on the new QI/WP/WT System.

### **Let's talk**

For more information about how the 2017 QI Agreement may impact your business, please contact:

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