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IRS Releases Updated Qualified Intermediary (QI) Agreement

Authored by Melinda T. Schmidt

On June 27, 2014, the Internal Revenue Service (IRS) released Revenue Procedure 2014-39, containing an updated and final QI Agreement to replace the prior version set forth in Revenue Procedure 2000-12. Many of the modifications to the new Agreement relate to harmonizing a QI's requirements under chapters 3 and 61 of the Code to its chapter 4, Foreign Account Tax Compliance Act (FATCA), requirements. Notwithstanding certain fundamental modifications to the prior QI Agreement, the IRS did not issue the new agreement in draft form.

Highlights include:

- Renewal: pursuant to the new Revenue Procedure, all existing QI Agreements expired on June 30, 2014, (including those that were in full force and not in existence under the automatic extension until that date) and must be renewed immediately. The Revenue Procedure is silent as it relates to the period between July 1, 2014, and the date that the QI's Responsible Person has internal approval to enter into the new agreement with the IRS.
- Requirement that, as part of the QI Agreement, the QI must be "materially" compliant with respect to the payments it makes as a nonqualified intermediary (NQI)
- Modification of the definition of "Reportable Payment" for non-U.S. payers:
  - Elimination of the rules for Undisclosed U.S. Persons
  - Elimination of the ability for non-U.S. payers to enter into an agreement with another withholding agent to report Reportable Payments that are not Reportable Amounts (previously defined as "Designated Broker Proceeds") on the QI's behalf
- Limitation on the type of entity that can qualify as a Private Arrangement Intermediary (PAI)
- Limitation on the partnership/trust "joint account" rule
- Changes relating to due diligence failures as well as presumption rules in the absence of valid documentation
- Requirements relating to pooled reporting
- Changes in compliance requirements
- Changes for QIs that are Nonfinancial Foreign Entities (NFFEs).

Requirement to be Compliant when acting as a Nonqualified Intermediary (NQI)

The original QI Agreement covered a QI's responsibilities solely when it was acting as a QI. Specifically, the Agreement was limited to the payments made to an account that the QI had designated as a QI account with its upstream withholding agent.

The new QI Agreement provides that, as part of the Agreement, the QI "must... materially comply with the requirements of a withholding agent or payer, as applicable to a nonqualified (foreign) intermediary under chapters 3 and 61 and section 3406, for any account for which it does not (or cannot) act as a QI and for any payee that is not an account holder."

Elimination of the Undisclosed U.S. Person Concept/Modification to the Definition of "Reportable Payment" for Non-U.S. Payers

When the QI Agreement was initially drafted, the IRS and prospective QIs operating in jurisdictions with robust data privacy laws struggled to find a balance between the IRS's desire to have information relating to U.S. persons with offshore accounts and the QI's inability to provide certain information without violating local law. This resulted in the provisions relating to "undisclosed U.S. persons."

In light of FATCA's new reporting requirements for U.S. accounts, the new QI Agreement eliminates the provisions relating to undisclosed U.S. persons. In addition, it redefines a Reportable Payment for a non-U.S. payer.

Further, the new Agreement modifies the QI's ability to enter into an agreement with another withholding agent whereby that withholding agent could agree to report, on Forms 1099, the QI's Reportable Payments that are not Reportable Amounts made to U.S. non-exempt recipients (namely, this would have been foreign source income paid inside the United States or proceeds from sales effected in the United States where the QI elected Forms 1099 instead of FATCA's Form 8966 account reporting).

Private Arrangement Intermediary (PAI) Limitations

Another modification is found in the new limitation for the types of entities that are eligible to enter into PAI Agreements. PAIs are intermediaries that receive U.S. source income on behalf of their account holders but, instead of entering into a QI Agreement with the IRS to act as a QI, they enter into a PAI Agreement with the QI for whom they act as a PAI. In effect, the PAI agrees to comply with the same documentation and due diligence procedures applicable to the QI, but the PAI does not report directly to the IRS. The new QI Agreement limits the type of entity that can enter into a PAI Agreement to a certified deemed compliant FFI (other than a registered deemed compliant Model 1 IGA FI).

Limitation on the Joint Account Rules

Similar to the unexpected limitation on entities that can qualify for PAI status, the new QI Agreement has a similar unexpected limitation on the types of entities that can qualify for the so-called partnership/trust joint account solution (former Section 4A.01). The purpose of the solution was to accommodate situations where the QI could obtain adequate documentation to support the non-U.S. status for the partners or beneficiaries (or owners) of a foreign partnership or simple (or grantor) trust that was a direct account holder of the QI but where local law prohibited the QI from complying with the requisite recipient-specific Form 1042-S reporting for those underlying owners. Under the prior requirements, as long as no underlying owner was a U.S. person and the "joint account" partnership or trust provided, among others things, all underlying owner documentation and agreed to provide its partnership or trust agreement establishing that such documentation was complete, if requested, the QI was able to apply the joint account provisions. Specifically, while those provisions required the QI to withhold at the highest applicable rate for any one partner or owner, they permitted the QI to include the payments to the partnership or trust within its own pooled reporting.

Unfortunately, the new QI Agreement further restricts the use of this rule to a partnership or trust that is a "certified deemed-compliant FFI (other than a registered deemed-complaint Model 1 IGA FFI), an exempt beneficial owner, or an excepted NFFE (other than a WP or WT).

Finally, it is important to note that the new QI Agreement stipulates that the agreement between the QI and the partnership or trust provide that the partnership or trust must make records available to the QI or its auditor for purposes of the QI's compliance requirements. While this was also a requirement under the old provisions, the new language also provides that this includes records relating to IRS inquiries regarding the QI's compliance review.

Due Diligence Requirements/Presumption Rules

As anticipated, the updated due diligence requirements include the new indicia set forth in the chapter 4, as well as the updated chapters 3 and 61, regulations. One modification to note is the new apparent "fatal flaw" when an account holder provides a permanent residence address that is subject to a hold mail instruction. Specifically, the new rules will not permit a QI to treat such an account holder as a foreign person regardless of additional documentation that would support (or even definitively establish) the person's non-U.S. status.

The new QI Agreement also contains significantly more onerous presumption rules that the QI must adhere to when it does not have valid documentation for an account holder (or when the documentation it does have is not reliable).

Requirements for Pooled Reporting

The QI's pooled reporting requirements are also more complicated under the revised agreement. Under the prior agreement, the QI would pool report by income type, withholding rate, exemption code, and recipient code. Separate pools were required for payments to the QIs direct account holders and payments to the direct account holders of the QI's PAI (if any). Further, because the pool for tax-exempts had a different recipient code, payments to such entities were also required to be reported in separate pools.

While the new rules continue to require the QI to separately report the pools allocable to the direct account holders of a PAI and tax exempts, as described above, they also require the QI to separately report the pools associated with any partnership or trust that is acting as the QI's agent pursuant to section 4.06 (old section 4A.02). In addition, the new QI Agreement also requires the QI to pool report all amounts subject to chapter 4 paid to the direct account holders of the QI (also bifurcated by pools associated with the direct account holders of any PAI or partnership or trust operating under the agency rules).

Compliance Requirements

The new Agreement departs, substantially, from the external audit requirements set forth in the prior Agreement. Modeled after the compliance requirements in the FFI Agreement, the new QI Agreement requires the QI to appoint a Responsible Officer, who is required to adopt and implement a compliance plan, oversee that plan, and certify to the IRS the level of compliance every third year. The compliance program must include written policies and procedures, training, sufficient systems and processes, monitoring of business changes, as well as a periodic review and certification. The periodic review may be performed by the QI's internal audit function or by an external auditor or attorney.

Modifications for QIs that are NFFEs

In an effort to streamline QI applications for NFFEs that are acting as QIs with respect to unrelated persons, the new QI Agreement contains the restriction that this type of QI may not rely on documentary evidence and, instead, must rely on IRS forms only for documentation purposes.

Term of New QI Agreement

Finally, it is important to note that the new Agreement will be in effect through 2016, as opposed to the previous six-year term. The limited validity period was intentional, to align the validity period of the new QI agreement with the FFI and Intergovernmental Agreements.

For Your Reference

Revenue Procedure 2014-39 can be accessed by clicking here:
http://www.irs.gov/pub/irs-drop/rp-14-39.pdf

Authored by Anthony Marsicovetere, adapted from KPMG's *TaxNewsFlash*

Regulations – Duplicate filing of Form 5472 not required

The Treasury Department and IRS on June 5, 2014 released for publication in the *Federal Register* final regulations (T.D. 9667) and proposed regulations (REG-114942-14) concerning taxpayers required to file Form 5472.

Both sets of regulations concern Form 5472, *Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business.*

- The final regulations affect certain 25 percent foreign-owned domestic corporations and certain foreign corporations that are engaged in a trade or business in the United States and that are required to file Form 5472. The final regulations took effect June 6, 2014—the scheduled date of their publication in the *Federal Register*.
- The proposed regulations would remove a current provision for timely filing of Form 5472 separately from an income tax return that is untimely filed. As a result, Form 5472 would be required to be filed in all cases only with the filer's income tax return for the tax year by the due date (including extensions) of that return.

Summary

Regulations proposed in 2011 effectively eliminated the requirement for duplicate filing of Form 5472, regardless of whether the taxpayer filed a paper or an electronic income tax return. It was determined that duplicate filing was no longer necessary for corporations that file Form 5472 either by a paper or electronic return because of advances in electronic processing and data collection by the IRS.

However, the preamble to the corresponding 2011 temporary regulations stated that a reporting corporation that does not timely file an income tax return still must timely file a paper Form 5472 without the income tax return. As a result, the only remaining provision for filing a Form 5472 separately from the taxpayer's income tax return would apply when the taxpayer's income tax return was not timely filed.

No comments were received with respect to the 2011 regulations, and no public hearing was requested or held. Accordingly, the final regulations adopt the 2011 proposed regulations without substantive change, and remove the corresponding temporary regulations.

In addition, the proposed regulations would remove Reg. section 1.6038A-2(e), which provides for a taxpayer to file Form 5472 separately from an income tax return if the income tax return is untimely filed.

As a result, the proposed regulations would require that Form 5472 be filed in all instances only with the taxpayer's income tax return for the tax year by the due date (including extensions) of that return.

Treaty and IGA Update

Authored by Anthony Marsicovetere

The treaty with Poland and the protocol with Spain were reported out by Senator Menendez, Committee on Foreign Relations, with printed reports and resolutions of advice and consent to ratification. There was also some reporting out of the Committee on Foreign Relations with respect to the Chile, Switzerland, Hungary, and Luxembourg treaties and/or protocols. However, "Sen. Rand Paul (R-Ky.) is continuing his fight against Senate ratification of tax treaties, putting a hold on five accords approved by the Foreign Relations Committee.... In a May 7 letter to Senate Majority Leader Harry Reid (D-Nev.), Paul said he would object to any request for unanimous consent, motion or waiver of any rule on treaties with Luxembourg, Switzerland, Chile, Hungary and the [OECD]." See 91 DTR G-13. As another update, Treasury issued its technical explanations with respect to the Poland treaty and Spain protocol.

In the second quarter of 2014 the United States concluded fourteen Model 1 IGAs and one Model 2 IGA. The following countries concluded an IGA during the second quarter of 2014: Australia, Austria, Belgium, British Virgin Islands, Estonia, Gibraltar, Israel, Jamaica, Latvia, Liechtenstein, Mexico, New Zealand, South Africa, and Slovenia. A number of countries continue to be in the process of negotiating IGAs, and there are several more IGAs that have been agreed to and are going through the administrative process (e.g., translation) prior to the official signing.

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