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IRS Floats Updated Qualified Intermediary Agreement

In recent Notice 2016-42, the IRS has proposed a new qualified intermediary (QI) agreement. The current QI agreement, set forth in Rev. Proc. 2014-39 ("the 2014 QI agreement"), expires December 31, 2016. The IRS expects to finalize the proposed QI agreement, subject to any subsequent modifications, before the end of the year, with the agreement becoming effective on or after January 1, 2017.

Background

Generally, nonresident aliens and foreign corporations are subject to U.S. withholding tax on certain items of U.S. source income that are not effectively connected with a U.S. trade or business. To reduce or eliminate U.S. withholding tax pursuant to a statutory- or treaty-based claim, the foreign taxpayer must provide a proper Form W-8 to the withholding agent. The QI regime was implemented to simplify certain foreign persons' duties as a withholding agent under Chapters 3 and 4 and as a payor under Chapter 61 and Section 3406 (and, in most cases, to afford anonymity to foreign persons investing in the U.S.).

A person that enters a QI agreement with the IRS agrees to assume certain documentation and withholding responsibilities in exchange for streamlined information reporting and the ability to not disclose proprietary accountholder information. In general, persons eligible to be QIs include foreign financial institutions (FFIs), foreign clearing organizations, foreign branches of U.S. financial institutions and, for limited purposes, other foreign corporations. Other entities may apply to be a QI subject to IRS approval. Rev. Proc. 2000-12 laid out the IRS's initial model QI agreement and application procedures. The IRS updated the QI agreement in Rev. Proc. 2014-39 to incorporate the Foreign Account Tax Compliance Act (FATCA) and other guidance.

Proposed QI Agreement

The proposed QI agreement in Notice 2016-42 includes a number of changes in response to comments or regulatory developments since the 2014 QI agreement. One of the key changes in the proposed QI agreement is the regime for QIs eligible to act as "qualified derivatives dealers" (QDD). The IRS added these provisions to address regulations finalized in 2015 under Section 871(m) relating to "dividend equivalent" payments, which are generally subject to withholding under Chapters 3 and 4. The proposed QI agreement would allow a QDD to avoid withholding on certain payments (as defined in the Section 871(m) regulations) that the QDD receives as a principal and not as an intermediary. In exchange, the QDD would assume primary withholding and backup withholding responsibilities for such payments and be subject to additional reporting obligations.

The QDD regime is intended to replace the qualified securities lender (QSL) regime set forth in Notice 2010-46. In response to comments on the end of the QSL regime, the proposed QI agreement will allow a QI to assume primary withholding and backup withholding responsibilities for payments of interest and substitute interest that the QI receives in connection with a sale-repurchase or similar agreement, securities lending transaction or collateral held in connection with its activities as a securities dealer. This provision permits the QI to provide Form W-8IMY without distinguishing between such payments the QI receives as a principal versus as an intermediary.

Notice 2016-42 makes two significant FATCA-related changes to the QI agreement. First, the proposed QI agreement eliminates the "limited FFI" and "limited branch" categories of eligible QIs since those FATCA statuses are not available as of January 1, 2017, pursuant to Chapter 4 regulations as modified by Notice 2015-66. Second, the proposed agreement permits a QI to apply the joint account or agency option to partnerships or trusts covered as accounts but excluded from the definition of "financial accounts" under an applicable FATCA intergovernmental agreement (IGA).

The proposed QI agreement also modifies the periodic compliance review and certification procedures and documentation requirements for QIs. In general, Notice 2016-42 grants responsible officers more flexibility in conducting reviews of controls and making certifications. For entity accountholders claiming treaty benefits, the proposed QI agreement requires QIs to collect information regarding limitation on benefits (LOB)—a change that corresponds to recent revisions to Form W-8BEN-E to include LOB-related certifications. While an actual knowledge standard will apply to the QI for LOB claims, a QI will be considered to have reason to know a treaty claim is unreliable if the accountholder claims benefits under a treaty that does not exist or is not in force.

The proposed QI agreement, when finalized, would be effective on or after January 1, 2017. QIs seeking to renew their QI agreements must renew prior to March 31, 2017. The IRS also expects to update the withholding trust (WT) and withholding partnership (WP) agreements, published in Rev. Proc. 2014-47, to account for changes in the proposed QI agreement, with appropriate modifications. The WP agreement will include, starting January 1, 2017, requirements for a reverse hybrid entity that wants to enter a WP agreement. The IRS has requested comments on the proposed QI agreement by August 31.

Final CbC Reporting Regulations and OECD Transition Announced on Same Day!

On June 29, the same day the IRS and Treasury issued final regulations on country-by-country (CbC) reporting for large U.S. multinationals, the Organisation for Economic Co-operation and Development (OECD) released its own CbC guidance under Action 13 of its BEPS initiative. The OECD's guidance specifically addresses the timing and compliance issues arising from the United States' (and other jurisdictions that do not require CbC reporting for 2016) delayed implementation for CbC reporting. Under the final U.S. regulations, CbC reporting applies to reporting periods that begin on or after the first day of the ultimate parent entity's tax year that begins on or after June 30, 2016. The OECD's report on Action 13 had set a January 1, 2016, start date. The OECD's recommended solution to this time lag is a voluntary "parent surrogate filing." Subject to certain conditions, the parent surrogate filing, if available, would preempt local filing obligations for the multinational in jurisdictions that would otherwise require a local filing. The United States, Japan and Switzerland have already confirmed that they will make parent surrogate filing available for ultimate parent entities in their jurisdictions.

For more information, contact Edward Tanenbaum at 212.210.9425 or Heather Ripley at 212.210.9549.

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If you have any questions or would like additional information, please contact your Alston & Bird attorney or any of the following:

Sam K. Kaywood, Jr.
Co-Chair
404.881.7481
sam.kaywood@alston.com

Edward Tanenbaum
Co-Chair
212.210.9425
edward.tanenbaum@alston.com

George B. Abney
404.881.7980
george.abney@alston.com

John F. Baron
704.444.1434
john.baron@alston.com

Henry J. Birnkrant
202.239.3319
henry.birnkrant@alston.com

James E. Croker, Jr.
202.239.3309
jim.croker@alston.com

Jasper L. Cummings, Jr.
919.862.2302
jack.cummings@alston.com

Scott Harty
404.881.7867
scott.harty@alston.com

Brian D. Harvel
404.881.4491
brian.harvel@alston.com

L. Andrew Immerman
404.881.7532
andy.immerman@alston.com

Stefanie Kavanagh
202.239.3914
stefanie.kavanagh@alston.com

Brian E. Lebowitz
202.239.3394
brian.lebowitz@alston.com

Clay A. Littlefield
704.444.1440
clay.littlefield@alston.com

Ashley B. Menser
919.862.2209
ashley.menser@alston.com

Matthew P. Moseley
202.239.3828
matthew.moseley@alston.com

Daniel M. Reach
704.444.1272
danny.reach@alston.com

Heather Ripley
212.210.9549
heather.ripley@alston.com

ALSTON & BIRD

WWW.ALSTON.COM

ATLANTA: One Atlantic Center ▪ 1201 West Peachtree Street ▪ Atlanta, Georgia, USA, 30309-3424 ▪ 404.881.7000 ▪ Fax: 404.881.7777
BEIJING: Hanwei Plaza West Wing ▪ Suite 21B2 ▪ No. 7 Guanghua Road ▪ Chaoyang District ▪ Beijing, 100004 CN ▪ +86 10 8592 7500
BRUSSELS: Level 20 Bastion Tower ▪ Place du Champ de Mars ▪ B-1050 Brussels, BE ▪ +32 2 550 3700 ▪ Fax: +32 2 550 3719
CHARLOTTE: Bank of America Plaza ▪ 101 South Tryon Street ▪ Suite 4000 ▪ Charlotte, North Carolina, USA, 28280-4000 ▪ 704.444.1000 ▪ Fax: 704.444.1111
DALLAS: 2828 North Harwood Street ▪ 18th Floor ▪ Dallas, Texas, USA, 75201 ▪ 214.922.3400 ▪ Fax: 214.922.3899
LOS ANGELES: 333 South Hope Street ▪ 16th Floor ▪ Los Angeles, California, USA, 90071-3004 ▪ 213.576.1000 ▪ Fax: 213.576.1100
NEW YORK: 90 Park Avenue ▪ 15th Floor ▪ New York, New York, USA, 10016-1387 ▪ 212.210.9400 ▪ Fax: 212.210.9444
RESEARCH TRIANGLE: 4721 Emperor Blvd. ▪ Suite 400 ▪ Durham, North Carolina, USA, 27703-85802 ▪ 919.862.2200 ▪ Fax: 919.862.2260
SILICON VALLEY: 1950 University Avenue ▪ 5th Floor ▪ East Palo Alto, CA 94303-2282 ▪ 650-838-2000 ▪ Fax: 650.838.2001
WASHINGTON, DC: The Atlantic Building ▪ 950 F Street, NW ▪ Washington, DC, USA, 20004-1404 ▪ 202.239.3300 ▪ Fax: 202.239.3333