INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE

INTERNATIONAL REPORTING AND WITHHOLDING SUBGROUP REPORT

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The following are the principal issues that have been discussed between the International Reporting and Withholding (IRW) Subgroup of IRPAC and the IRS. Section I contains recommendations on the regulations and other non-form guidance. Section II contains recommendations on IRS forms and their instructions.

SECTION I – RECOMMENDATIONS ON THE REGULATIONS AND OTHER NON-FORM GUIDANCE

A. Section 305(c)

Recommendation

IRPAC recommends that the IRS publically announce that it will not impose withholding tax liability, penalties, or interest on withholding agents for section 305(c) events occurring in tax years prior to 2016. In an effort to direct withholding agents on how to treat such events, proposed regulations were released in April 2016 (the "2016 Proposed Regulations"). As such, it would be unfair to penalize withholding agents for events in years prior to the release of these proposed regulations by applying withholding tax liability, penalties, or interest on a retroactive basis.

Discussion

It was not until an earlier (2014) set of proposed regulations under section 871(m) were published, which regulations included a brief coordinating rule with section 305(c), that withholding agents began to struggle with understanding a potential obligation to withhold tax on section 305(c) deemed dividends notwithstanding the absence of cash payments. To date, the withholding tax regime has been based upon cash payments and an understanding of the facts and circumstances of the income giving rise to such payments. Prior to the 2016 Proposed Regulations, there was no clear guidance on how to identify section 305(c) events, how to calculate the income arising from such events, and the withholding tax obligations in light of cashless payments.

Since 2014, withholding agents have been forthcoming and cooperatively working with the IRS to address many of the open questions and complications relating to the withholding tax issues resulting from a conversion rate adjustment on convertible bonds and other securities. While the 2016 Proposed Regulations address many of the open questions and clarify many points of issue prospectively, uncertainty regarding previous years remains, which is causing, among other things, uncertainty amongst withholding agents as to whether to collect taxes for prior years in the limited cases where collection might still be possible.

While IRPAC lauds IRS efforts to clarify the applicable rules by issuing the 2016 Proposed Regulations, these proposed regulations serve as an acknowledgment by the IRS that additional guidance was needed in order to administer the section 305(c) withholding obligations. As such, withholding agents cannot reasonably be expected to have put a withholding process in place in years prior to 2016. In sum, to minimize an ever-growing burden placed on withholding agents and to allow them to focus on the development of procedures and processes for withholding tax on section 305(c) events for tax year 2016 and beyond, IRPAC requests public acknowledgement from the IRS that withholding agents will not be held liable with respect to section 305(c) events occurring prior to 2016.

B. Qualified Derivatives Dealer (QDD)

Recommendation B.1 – QDD, Implementation Timeline and Requirements

IRPAC recommends that the IRS defer the effective date for the QDD rules to January 1, 2018, in order to give QDDs sufficient time to implement the tax documentation, withholding and reporting requirements prior to the effective date.[1] Alternatively, IRPAC recommends that the IRS consider foregoing the periodic review and certifications with respect to the QDD provisions for the initial certification period and/or provide other relief (including penalty relief) that will effectively treat 2017 as a transition year.

IRPAC also recommends that the IRS consider paring back the extensive QDD reporting requirements in the proposed Qualified Intermediary (QI) agreement, such that the IRS will still obtain the necessary information that it needs, but in a manner that will be less burdensome for a QDD to comply.

Discussion

Notice 2016-42 sets forth the proposed QI agreement, which includes new provisions that allow eligible entities to act as a QDD, whereby a QDD acting as a principal is permitted to receive payments with respect to potential §871(m) transactions and payments with respect to underlying securities, free of withholding tax. The QDD provisions in the QI agreement become effective as early as January 1, 2017.

Under the proposed agreement, a QDD is required to undertake significant tax withholding and reporting obligations, and the QDD is also required to calculate and pay its QDD tax liability. In addition, the QDD's responsible officer will be required to implement a compliance and review program, to make periodic compliance certifications in regard to the QDD's internal controls, and provide certain factual information to the IRS.

[1] Presumably, a deferral in the effective date of the QDD provisions would also require a deferral of the effective date for §871(m).

In terms of timing of the periodic review, a QI that is a QDD is required to use calendar year 2017 for the periodic review for the initial certification period (which ends on December 31, 2017) because QDD status is not applicable to calendar years 2015 or 2016; and to make the certification for the initial certification period by July 1, 2018. Thus, a QDD is expected to decipher and implement the QDD tax documentation, withholding and reporting requirements between the time the final QI agreement is issued and January 1, 2017, apply those requirements to its accounts for which it acts as a QDD during calendar 2017, conduct a review of its compliance with the newly implemented requirements and certify to having effective internal controls around the process by July 1, 2018.

It would seem unlikely that there would be enough time for a QDD to implement the requirements as currently constituted in the proposed QI agreement prior to January 1, 2017. More likely, the QDD would make every effort to implement as much as it can prior to January 1, 2017 and implement the remainder of the requirements as quickly as it can during 2017. Given the high probability that a QDD will have to phase in implementation of the QDD requirements throughout 2017, it doesn't seem practical to have the QDD conduct a review of, and to certify to, its compliance in 2017 when it would appear to be a fait accompli that the QDD will have compliance gaps for 2017.

Therefore, IRPAC recommends that the effective date of the QDD rules be extended for one year to January 1, 2018 in order to provide sufficient time to implement the new QDD requirements. If the IRS is unwilling to defer the effective date of the QDD provisions, it should consider foregoing the periodic review and certifications with respect to the QDD provisions for the initial certification period and/or provide other relief (including penalty relief) that will effectively treat 2017 as a transition year.

IRPAC also recommends that the IRS consider paring back the extensive QDD reporting requirements in the proposed QI agreement, such that it will still obtain the necessary information that it needs, but in a manner that will be less burdensome for a QDD to comply. IRPAC would be happy to work with the IRS to identify specific ways to streamline these reporting requirements.

Recommendation B.2 – QDD, Agency Securities Lending

IRPAC recommends maintaining a modified version of the current QSL regime for entities engaging in securities lending and sale repurchase ("repo") transactions as agents.[2]

Discussion

[2] IRPAC acknowledges that there may be other instances not described in the report where QSL status should be preserved, including for *principal* securities lending or repo transactions.

The proposed QI agreement in Notice 2016-42 states that a QI cannot act as a QDD when acting in an intermediary capacity. This appears to indicate that entities acting as agent lenders in a securities loan or repo transaction do not qualify for QDD status as they are acting in an agent capacity rather than a principal capacity. However, there is additional language in the agreement that appears to conflict in stating:

> *"a QI must act as a QDD for any securities lending or sale-repurchase transactions (as defined in §1.871-15(a)(13)) QI enters into that are section 871(m) transactions. For purposes of this Agreement, a QDD is deemed to make and receive payments pursuant to those securities lending and sale-repurchase transactions as a principal."*

The above language appears to indicate that although agent lenders are acting in an intermediary capacity they will be treated as a principal for purposes of the QI agreement, therefore eligible for QDD status.

The complex requirements of QDD compliance places an undue burden on these agency lenders engaged in traditional stock loan and repo transactions in an intermediary capacity. Agency lenders engaging in such transactions should be allowed to simply match the stock borrows with stock loans, as they currently do under the QSL regime, without having to perform the more complex QDD tax liability calculation. As such, IRPAC recommends the continuation of the QSL regime for this type of intermediary activity where there is generally a one to one correlation between loans and borrows.

Recommendation B.3 – QDD, Controlled Foreign Corporations

IRPAC recommends that the QDD regime be expanded to allow controlled foreign corporations (CFC) to act as QDDs without having to enter into QI agreements. The foregoing should apply, at a minimum, to CFCs which are QDDs only because they enter into securities lending and/or repo transactions.

Discussion

Under TD 9734, withholding on dividends and dividend equivalents will be governed by the new QDD rules - which rules, among other things, require that QDDs become QIs under Treas. Reg. §1.1441-1T(e)(5). Previously, withholding on dividends and dividend equivalents generated as a result of certain stock lending transactions were governed by the QSL rules, which generally required that the QSL either enter into a QI agreement or be otherwise subject to IRS audit under section 7602.

QI agreements are structured to give the IRS authority over entities that are not otherwise subject to IRS jurisdiction. The books and records of CFCs, in contrast, are already subject to IRS audit under section 7602 – which gives the IRS the authority to summons the U.S. shareholders of the CFC to obtain records located abroad. QI agreements require foreign entities to perform certain tasks as a result of the privilege of entering into the QI agreement. Existing law, in contrast, already requires CFCs to comply with information reporting and withholding rules. Because CFCs are already required to comply with these rules and are already directly or indirectly subject to IRS audit, there is no reason to force CFCs to enter into the cumbersome QI agreement.

Accordingly, IRPAC recommends that an exception be made for QDDs that are CFCs, so that CFCs will not be forced to enter into QI agreements.

Recommendation B.4 – QDD, Eligible Entities

IRPAC recommends that the definition of entities eligible for QDD status extend to any entity that enters into a QI agreement or is a CFC (see recommendation B.3 above regarding CFCs).

Discussion

The updated QI agreement narrowly defines the scope of entities eligible to be QDDs to entities which are subject to regulatory oversight in their home jurisdiction. As entities operating in a QDD capacity are required to enter into a QI agreement directly with the IRS (or, if our recommendation B.3 above is adopted, be a CFC), the IRS has the necessary oversight over the QDD to ensure compliance with the QDD obligations. QDDs which are QIs will be subject to IRS reporting and reconciliation requirements as well as audit requirements, which will provide the IRS detailed information on the QDD activities. In light of this transparency and IRS control over QDDs, the definition of eligible entities should not be dependent on the entity being subject to regulatory oversight in its home jurisdiction. Similarly, as discussed in recommendation B.3 above, because the IRS has jurisdiction over CFCs, CFCs should not need to be subject to regulatory oversight in their home jurisdiction (or be QIs) to be QDDs.

Recommendation B.5 – QDD, Timing of Withholding

IPRAC recommends that the QI agreement allow for flexibility in the timing of withholding when a QI is acting as a QDD.

Discussion

Section 3.03(B) of the proposed QI agreement (IRS Notice 2016-42) states that "If QI is acting as a QDD, it must assume primary Chapters 3 and 4 withholding responsibility for any dividend equivalent payment that it makes and must withhold with respect to a dividend equivalent payment on the dividend payment date for the applicable dividend (as determined in §1.1441-2(e)(4))." This direction to withhold on dividend payment date is in contradiction to IRC §871(m) and Treas. Reg. §1.1441-2(e)(8), which provide that the time for withholding on dividend equivalent payments is the later of 1) when the amount of a dividend equivalent is determined; and 2) when a payment occurs with respect to the 871(m) transaction.

IRPAC appreciates that there will be a coordination between the QI agreement and 871(m) regulations as stated in the preamble to the proposed QI agreement [Section 2(.01)(G)]:

> "The Treasury Department (Treasury) and the IRS intend to modify, to the extent necessary, the section 871(m) regulations to coordinate with provisions of the QI agreement relevant to the requirements of QDDs and withholding agents making payments to QDDs (as those provisions are finalized)."

As part of this coordination, IRPAC recommends that the IRS allow the QI acting as a QDD flexibility in choosing the timing of the withholding so that it may either withhold on the dividend payment date or the later of when the amount of a dividend equivalent is determined and when a payment occurs with respect to the 871(m) transaction. QIs which would act as QDDs have been building their withholding systems based on the 871(m) regulations prior to the proposed QI agreement being published. Revising withholding systems in consideration of the proposed QI agreement takes time. Thus, IRPAC recommends flexibility in choosing the timing of withholding to allow for correct, consistent implementation.

C. Qualified Intermediary Agreement (ex QDD)

Recommendation C.1 – QI Agreement, Waiver of Periodic Review Requirement

IRPAC recommends that the IRS modify the proposed QI agreement to clarify what a responsible officer is intended to rely upon in making its certification of effective internal controls where the QI has obtained a waiver of the requirement to conduct a periodic review.

Discussion

Notice 2016-42 sets forth the proposed QI agreement. The proposed agreement replaces the previous external audit requirement with an internal compliance and review program. As part of the proposed compliance program, the responsible officer is required to make periodic compliance certifications in regard to the QI’s internal controls, and is required to provide certain factual information to the IRS. In making the certification of effective internal controls, the responsible officer may rely on the results of the periodic review, as well as any other processes or reviews that the responsible officer deems necessary in order to make the certification.

Under certain circumstances, the proposed QI agreement permits a QI that is a foreign financial institution (FFI) that is not acting as a QDD and that is not part of a consolidated compliance group to apply for and obtain a waiver of the requirement to conduct a periodic review and to provide some of the factual information specified in Annex I of the proposed QI agreement. However, in cases where the QI applies for the waiver, it must still make the periodic certification of effective controls, and must provide certain factual information along with the periodic certification.

Accordingly, IRPAC recommends that the IRS modify the proposed QI agreement to clarify what a responsible officer is intended to rely upon in making its certification of effective internal controls where the QI has obtained a waiver of the requirement to conduct a periodic review.

Recommendation C.2 – QI Agreement, Extrapolation

IRPAC recommends that the IRS remove the restriction on extrapolating cures in finalizing the proposed QI agreement as well as allow for sub-stratification when required to reach an equitable result. In the event the IRS declines to adopt this position, IRPAC recommends that the IRS refine the language of the finalized QI agreement to restrict curing after the implementation of field work by the auditor rather than after the drawing of the sample and further clarify that projection does not apply to sample items which have been cured view the use of publicly available information. Finally, IRPAC recommends that the IRS not extend this disallowance of remediation efforts and cure documentation broadly to U.S. withholding agent audits.

Discussion

Section 10.05 of the proposed QI agreement provides that a sample process may be used to test accounts when the QI has more than 50 accounts. The sampling methodology both as outlined in the proposed QI agreement and broadly used as part of both the legacy QI audit process and current U.S. withholding agent audits is based on the convenience of being able to review a subset of the overall population and extrapolate any exposure for underwithholding across the broader population for purposes of determining total liability versus conducting a complete review of all accounts. This process benefits both the IRS as well as withholding agents given limited resources and the ongoing drive to keep audits current.

Appendix II, Section 3(D) of the proposed QI agreement provides that "if the reviewer has determined that underwithholding has occurred with respect to the sample, based on the original assessment of the reviewer without regard to any remediation or curing after the selection of the sample units for review, then the reviewer will determine the total amount of underwithheld tax by utilizing a projection method." The projection of errors has historically been utilized by IRS auditors when the error made is a fungible item which can reasonably be extrapolated across a broader population such as the use of an invalid substitute Form W-8 or W-9 by a specific business line. However, not all withholding errors are fungible as some can be cured with the collection of additional documentation. For example, a single documentation foot fault where a formation document was not collected to cure a U.S. mailing address on a Form W-8BEN-E, Certificate of Status of Beneficial Owners for United States Tax Withholding and Reporting (Entities), is not fungible. Importantly, in the majority of cases curable errors do not result in actual loss of revenue to the IRS, but rather are technical errors where the taxpayer is not subject to tax but the withholding agent is being penalized for having missing or incomplete documentation.

Therefore, while projection does make sense for errors that are not curable, it does not make sense for those which have been cured. If a full review had taken place and the errors actually identified (assuming they even exist), they indeed could have been cured. Thus, to the extent a sample is cured the cure must also be extrapolated as otherwise the projection methodology is inherently inequitable to the QI.

Furthermore, IRPAC recommends that the audit guidance allow for different resolutions for different issues, not just extrapolation as an equitable solution in order to most accurately reflect the underwithholding that the IRS is owed. For example, in regard to errors that are not curable, there are times when it is more accurate to determine the actual amount of underwithheld tax. If, for example, the review indicates that sampled items provided for a 15% rate of withholding for dividends paid to Cayman Islands accounts, it is likely that the withholding agent’s withholding table included an incorrect withholding rate for Cayman and every Cayman Islands payee receiving dividend income was likely withheld at this incorrect rate. Thus, in these scenarios, it would make more sense to sub-stratify these accounts to determine the actual amount of underwithholding. In contrast, where the error appears to be sporadic or inadvertent (e.g., a Cayman Islands payee incorrectly shows the Canadian country code of CA versus the Cayman Islands code of CJ and is inappropriately granted treaty benefits due to an input error) then projection is appropriate.

Given this, IRPAC recommends that the IRS remove the restriction on extrapolating cures in finalizing the proposed QI agreement as well as allow for sub-stratification when required to reach an equitable result.

In addition, the proposed QI agreement fails to provide a meaningful definition for the terms “remediation” and “cure” which will result in inconsistent application of these rules across audits. As mentioned previously, Appendix II, Section 3(D) states that projection is to be made “without regard to any remediation or curing after the selection of the sample units for review.” Given that withholding agents generally are provided with a period of lead time to prepare materials following the selection of the sample, it is possible, even likely, that they will self-identify errors and be able to correct prior to the commencement of any field work by the auditor. For instance, a payee could be approached to provide a Form W-8 with an affidavit, or a certificate of formation could be requested from a country's online registry. Arguably, both of these activities would be considered curing after the selection of the sample. Therefore, to the extent the IRS does not remove the restriction on extrapolating cures, IRPAC recommends that the IRS refine the language of the finalized QI agreement with respect to timing and the use of publicly available information. For instance, in the case of the formation documents accessible via a government registry, such documents are readily available in mass and accordingly, curing is a certainty versus a Form W-8 the curing of which may vary by payee. Further, depending upon the particular type of cure, it may not be obvious when the cure documentation was obtained – e.g., was the information obtained as part of account onboarding, a previous remediation effort, or as part of preparing for the review. Therefore, IRPAC recommends the language of the finalized QI agreement at Appendix II, Section 3(D) be modified to state (changes italicized or struck-through) "if the reviewer has determined that underwithholding has occurred with respect to the sample, based on the original assessment of the reviewer without regard to any remediation or curing after the ~~selection of the sample unit for review~~ *initiation of field work by the reviewer*, then the reviewer will determine the total amount of underwithheld tax by utilizing a projection method. *Projection of underwithheld tax shall not include the sample items which have been cured via the use of publicly available information.*"

Finally, IRPAC recommends that the IRS restrict this approach to the QI review process and not extend this treatment more broadly to U.S. withholding agent audits. U.S. withholding agent audits are already inherently inequitable to the withholding agent given accounts already subjected to 30% withholding are excluded from the population subject to random sampling.

Recommendation C.3 – QI Agreement, External Reviewer

IRPAC recommends that the definition of "external reviewer" be clarified to include those who have previously advised the QI.

Discussion

In Section 10.04 of the proposed QI agreement, Subparagraph A(3), the external reviewer "...cannot be reviewing systems, policies, or procedures or the results thereof that it was involved in designing, implementing, or maintaining." However, this restriction does not clarify if an external reviewer may be used who has previously advised the QI. Many QIs have worked for years with outside consultants who are familiar with the QI agreement and who have provided helpful compliance advice. It would be beneficial for the QI to be able to use such an outside consultant as an external reviewer. Thus, IRPAC recommends the following additional language to Subparagraph A(3) in order to clarify who may act as an external reviewer:

> "An external reviewer, who has previously reviewed the QI's systems, policies or procedures or the results thereof and provided advisory services may perform the periodic review provided that the external reviewer is not involved in the ongoing maintenance of such systems, policies and procedures."

Recommendation C.4 – QI Agreement, Internal Reviewer

IPRAC recommends that the IRS clarify the term “competent” in relation to an internal reviewer being competent with regards to the QI agreement.

Discussion

As defined in Subparagraph A(1), "QI may designate an internal reviewer to perform the periodic review (or a portion of the periodic review) only when the internal reviewer is competent with respect to the requirements of this Agreement."

As the use of an internal reviewer, such as an internal auditor, is a new concept for the QI agreement, it is not clear what the term "competent" means regarding the internal reviewer. An internal reviewer, such as an internal auditor, has never performed a QI audit before because of the previous QI agreement's restriction to external auditors only. Thus, he or she does not have competency in performing the review of the QI agreement. This seems to contradict the use of an internal auditor. Thus, IRPAC recommends that competence is defined as follows:

> "An internal reviewer may be determined to be competent with respect to the requirements of this Agreement if the internal reviewer has been trained in the requirements of this Agreement by the Responsible Officer (or delegate of the Responsible Officer) of the QI or of the Compliance QI or by a reputable third party."

Recommendation C.5 – QI Agreement, Responsible Officer Certification Due Date

IRPAC recommends that the Responsible Officer certification due date is extended by an additional six months until December 31st of the calendar year following the certification period.

Discussion

Section 10.03 of the proposed QI agreement requires that "On or before July 1 of the calendar year following the certification period, QI must make the certification described in either section 10.03(A) or (B) of this Agreement." This certification relates to the QI's internal controls. The Responsible Officer, in providing this certification, "may rely on any reasonable procedure, process, or review that enables the responsible officer to make the certification described in this section 10.03." Any reasonable procedure, process or review includes the periodic review. In addition, section 10.04 requires the Responsible Officer to provide the factual information as outlined in Appendix I. The factual information to be provided in Appendix I includes information regarding the periodic review. Thus, the periodic review or any reasonable procedure, process or review that the Responsible Officer is relying upon to complete the certification must be concluded within six months from the end of the certification period so that the Responsible Officer may use it timely by July 1st. Six months is a short timeframe to complete such information.

Further, QIs acting as QDDs must use 2017 as their periodic review year (see section 10.05). The periodic review includes 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, tax reporting and reconciling withholding amounts for the Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons, tax return which are both due March 15th of the calendar year following the tax year. The March 15 due date of Forms 1042-S and 1042 is too close to the July 1 due date of the Responsible Officer certification. The personnel that is responsible for issuing Forms 1042-S and 1042 is often key personnel working with the individuals who are performing the periodic review and the Responsible Officer making the certification. The periodic review will need to commence in the few months prior to March 15, which is a busy period for personnel working on the Forms 1042-S and 1042. Accordingly, an overlap between the Form 1042-S and 1042 production, the periodic review and the certification period would occur causing a strain on the QI's resources to verify both internal controls and conduct the periodic review within a compressed timeframe to meet the July 1st certification deadline. Thus, IRPAC recommends an additional six months, until December 31st, for the QI to provide the certification described in section 10.03(A) or (B).

Recommendation C.6 – Current QI Agreement Extension

IRPAC recommends that the current QI agreement is extended by one year to allow for consistency in providing Responsible Officer certification.

Discussion

Under the current QI agreement, Revenue Procedure 2014-29, the QI Responsible Officer is required to provide certification governing the compliance period of the QI agreement (see section 10.03). The current QI agreement expires December 31, 2016. While the current QI agreement compliance period addresses 2015, 2016 and 2017 tax years, the Responsible Officer Certification would incorporate the current QI agreement for tax years 2015 and 2016 and the proposed QI agreement (Proposed Notice 2016-42) for tax year 2017. IRPAC recommends that for consistency purposes, the current QI agreement is extended through 2017. This will allow for more consistency since the Responsible Officer will certify to the new agreement (once it is finalized) starting in 2018.

Recommendation C.7 – QI Agreement, Alignment of Review and Certification

IPRAC recommends that the certification statements of Part II of the Appendix of the proposed QI agreement are restricted to QI designated accounts for QIs acting as QDDs.

Discussion

Part II of the Appendix of the proposed QI agreement (Notice 2016-42) requires all QIs, even QIs acting as QDDs, to certify to effective internal controls. The Responsible Officer of the QI must certify to several statements regarding effective internal controls in Part II. The statement of Subpart A(2) of Part II specifies that such certification of internal controls is in relation to QI designated accounts by stating, "...QI maintains effective internal controls over its documentation, withholding, and reporting obligations under the QI Agreement and according to its applicable FATCA requirements, with respect to accounts for which it acts as a qualified intermediary..." Then the following statement of Subpart A(3) requires the Responsible Officer to confirm that "...there are no material failures, as defined in section 10.03(D) of the QI Agreement..." Section 10.03(D) defines a material failure to include FATCA requirements.

Subpart B of Part II of the Appendix requires the Responsible Officer to confirm whether there have been any events of default as defined in section 11.06 of the proposed QI agreement. Section 11.06, subsection F and subsection H indicate that a failure to comply with FATCA or, for non-QI designated accounts, Chapter 3 or Chapter 61, is an event of default.

By certifying to the statements within Subpart A(3) and Subpart B of Part II of the Appendix, the Responsible Officer will be making indirect certifications as to its compliance for non-QI designated accounts. For entities that become QIs solely for the purpose of becoming QDDs, certifying compliance for non-QI designated accounts would be unreasonable as these entities have never been subject to the QI agreement before and are only entering into the agreement for a singular purpose (to be QDDs). Examining non-QI accounts, for which they are not acting as QDDs, would be an overreach of the QI agreement since such entities are not engaging in any other QI related activity other than being QDDs. Thus, IRPAC recommends that the statements within Part II of the Appendix are restricted to QI only designated accounts for QIs acting as QDDs, which would be reasonable and consistent with the periodic review the QI is required to make.

D. Withholding Statement

Recommendation

IRPAC recommends that the IRS announce as a matter of administrative convenience that information contained in valid withholding certificates attached to withholding statements not be required to be shown a second time on the face of those withholding statements.

Discussion

Treas. Reg. §§1.1441-1T(e)(3)(iv)(C)(1) and 1.1471-3T(c)(3)(iii)(B)(3) set forth requirements for what information must be contained on a withholding statement provided to withholding agents for purposes of withholding under Chapter 3 and Chapter 4, respectively. To the extent these regulations require intermediaries to take information shown on valid withholding certificates and *repeat* that same information on the face of the withholding statements to which the certificates are attached, these regulations place an unnecessary administrative burden on such intermediaries (as well as withholding agents required to collect and validate such information). A requirement that information be duplicated can result in an increased failure rate by withholding agents who must then treat an account as "undocumented" due solely to the fact that the intermediary failed to provide duplicate information on the withholding statement that is already included on the attached withholding certificate.

IRPAC, therefore, recommends that the IRS provide guidance – or even an FAQ – that clarifies that information contained on a withholding certificate does not need to be shown a second time on the face of an attached withholding statement. We have attached a model withholding statement (see Appendix A) that shows what information would still need to be provided on the withholding statement after the application of such a no-duplication rule.

IRPAC believes that the regulations provide support for a no-duplication pronouncement. Treas. Reg. §1.1471-3T(c)(3)(iii)(B)(1) states that, "[a] withholding statement forms an integral part of the withholding certificate and the penalties of perjury statement provided on the withholding certificate applies to the withholding statement as well." Treas. Reg. §1.1441-1T(e)(3)(iv)(B) has a similar provision treating the withholding statement and the underlying withholding certificates as integrally related. Given that withholding statements and withholding certificates are so related, IRPAC believes the Treasury and IRS have the authority to prevent the forced duplication on the withholding statement of information already shown on an attached withholding certificate.

In addition, to avoid any confusion on a going forward basis, IRPAC recommends that the regulations setting forth the information required to be included on the withholding statement be revised to make it clear such duplicated information is not required. Specifically, IRPAC recommends revising Treas. Reg. §1.1441-1T(e)(3)(iv)(C)(1) as follows:

> The withholding statement provided by a nonqualified intermediary <u>in combination with any associated supporting documentation</u> must contain the information required by this paragraph

(e)(3)(iv)(C).

Similarly, IRPAC recommends revising Treas. Reg. §1.1471-3T(c)(3)(iii)(B)(1) to add the following sentence to the end:

> Information required to be included in any withholding statement will be deemed provided if that information is included in the withholding certificate or any other supporting documentation required to be provided as part of the withholding certificate.

E. Use of Form W-9 as FATCA Documentation for Certain Disregarded Entities

Recommendation

IRPAC recommends that the IRS issue guidance providing that where an FFI in an intergovernmental agreement (IGA) jurisdiction maintains an account for a disregarded entity which would be a U.S. person but for its disregarded status and whose sole owner is a U.S. person, the FFI may treat the sole owner as the account holder absent local IGA guidance explicitly rejecting the foregoing IRS guidance.

Discussion

Under U.S. tax principles, an account held by a disregarded entity is treated as owned by the sole owner. If that sole owner is a U.S. person, the financial institution maintaining the account would collect a Form W-9 in the name of the sole owner and any required Form 1099 reporting would be completed in the name of the sole owner. This principle is embedded in Treas. Reg. §1.1471-5T(a)(3)(i), which states, in relevant part, "[i]n the case of an account held by an entity that is disregarded for U.S. federal tax purposes under §301.7701–2(c)(2)(i), the account shall be treated as held by the person owning such entity."

However, Article 1(1)(dd) of the Model 1 IGA and Article 1(1)(w) of the Model 2 IGA define account holder as the "person listed or identified as the holder of a Financial Account by the Financial Institution that maintains the account." This definition has created significant confusion for IGA jurisdiction financial institutions given that they are required to document the disregarded entity for FATCA purposes; however, they may also be required to collect a Form W-9 from the sole owner to meet Chapter 61 requirements if required to comply with U.S. payor regulations or Chapter 3 requirements if U.S. source income is paid. Similarly, this creates confusion for personnel of the disregarded entity and / or sole owner attempting to provide documentation given they are used to providing the Form W-9 for U.S. tax purposes and FATCA is a U.S. tax requirement. These challenges hold regardless of whether the disregarded entity is a U.S. entity or non-U.S. entity. The challenges are compounded for a disregarded entity that is a U.S. entity because there is no official IRS form on which such an entity can provide its FATCA status (in contrast, a disregarded entity which is a non-U.S. entity can provide its FATCA status on a Form W-8 for accounts that it holds at FFIs). Also, we see no policy reason for FFIs collecting, and FATCA reporting based upon, the FATCA status of a disregarded entity that is a U.S. entity and whose single owner is a U.S. entity, as the disregarded entity is not a U.S. taxpayer (the single owner is) and, accordingly, the only FATCA status of interest to the IRS (and, as a result, of interest to the applicable IGA jurisdiction) should be FATCA status of the single owner and, therefore, a single form (the Form W-9 for the single owner) should satisfy all U.S. information reporting regimes (FATCA, Chapter 3 and Chapter 61).

Therefore, IRPAC recommends that the IRS issue guidance providing that where an FFI in an IGA jurisdiction maintains an account for a disregarded entity which would be a U.S. person but for its disregarded status and whose sole owner is a U.S. person, the FFI may treat the sole owner as the account holder absent local IGA guidance explicitly rejecting the aforesaid IRS guidance.

F. IRS FATCA Timeline

Recommendation

IRPAC recommends that the IRS update the IRS Summary of FATCA Timelines at https://www.irs.gov/businesses/corporations/summary-of-fatca-timelines to incorporate the changes listed in Appendix B to this report.

Discussion

IRPAC recommended changes to the December 3, 2015 version of the IRS Summary of FATCA Timelines. Some of these recommendations have been incorporated into the June 2, 2016 version of the IRS Summary of FATCA Timelines. IRPAC recommends further changes, which are listed in Appendix B to this report.

G. Partnership Lag Method

Recommendation

IRPAC recommends that in lieu of reporting based upon the “lag method” prescribed in Treas. Reg. §1.1441-5(b)(2)(i)(A), the IRS permit U.S. partnerships that are required to withhold on a foreign partner’s distributive share of partnership income the option to report the income and tax withheld on Forms 1042 and 1042-S for the year in which the partnership earns the income (rather than in the subsequent year) without suffering a late deposit penalty, where the withholding on the foreign partner’s distributive share is effected by the partnership on or before March 15 of the subsequent year.

Discussion

A U.S. partnership is generally required to withhold tax under Treas. Reg. §1.1441-1 as a withholding agent on an amount subject to withholding that is includible in the gross income of a partner that is a foreign person.[3] Withholding is generally required at the time a distribution of an amount subject to withholding is made.[4] However, to the extent that a foreign partner's distributive share of income subject to withholding has not actually been distributed to the foreign partner, under the so-called "lag method," the U.S. partnership is required to withhold on the foreign partner's distributive share of the income on the earlier of:

1. The date that Schedule K-1 (Form 1065) is mailed or otherwise provided to the foreign partner; or
2. The due date for furnishing Schedule K-1 (Form 1065) to the foreign partner.

If a U.S. partnership withholds on a foreign partner's share of an amount subject to withholding before the amount is actually distributed to the partner, withholding is not required when the amount is subsequently distributed to the partner.[5]

When the lag method is employed, the Instructions for Form 1042 indicate that the tax withheld on the foreign partner's distributive share should be shown as a liability on the partnership's Form 1042 for the year in which the withholding is performed (i.e., the subsequent year) rather than on the Form 1042 for the year that the partnership earns the income.

One of the draw backs of the using the lag method is that it creates a mismatch between the income shown on the foreign partner's Schedule K-1 (Form 1065) for the year in which the partnership earned the income and the income reported to the foreign partner on Form 1042-S for the year in which the partnership earned the income, as that Form 1042-S will not include the foreign partner's distributive share of income that was "lagged" into the subsequent year.

Many partnerships, as well as their foreign partners, would prefer that the foreign partner's Schedule K-1 (Form 1065) and Form 1042-S are consistent for each year. Thus, although the use of the lag method would appear to be mandatory, these partnerships will often report the tax actually withheld in the subsequent year as a liability on the partnership's 1042 for the year in which the partnership earned the

[3] Treas. Reg. §1.1441-5(b)(2)(i)(A).

[4] Id.

[5] Treas. Reg. §1.1441-5(b)(2)(v).

income, and the income and tax withholding credit on the foreign partner's Form 1042-S for the year in which the partnership earned the income.

When partnerships report in this manner, and show the liability on their Form 1042 for the year in which the partnership earns the income, the partnerships are generally subjected to a penalty for a late deposit. This is the case despite the fact that whether the partnership reports in this manner, or utilizes the lag method, the IRS will receive the deposit of tax withheld at the same point in time. Thus, while reporting in this manner rather than using the lag method the partnership creates a penalty situation for itself, reporting in this manner does not detriment the IRS with respect to the timing of the deposit.

Given that Form 1065 is due by the 15th day of the fourth month following the end of the partnership's tax year, and that a five month extension of time is available for filing and issuing Schedule K-1, it can be quite late in the subsequent tax year when the withholding is actually applied to the foreign partner's distributive share of partnership income earned in the prior year. However, partnerships that eschew the lag method and report in the manner described above are typically calendar year partnerships that make a determination of a foreign partner's distributive share of income by March 15 of subsequent calendar year – which is necessarily the case in order to reflect the income and withholding credit on the foreign partner's Form 1042-S for the year in which the partnership earned the income.

IRPAC recommends that the IRS permit partnerships that wish to report in the manner described above the option to do so where they apply the tax withholding to the foreign partner's distributive share of income on or before March 15 of the year following the year in which the partnership earns the income. In addition, Form 1042 and its instructions should allow a partnership that elects to report in this manner to include the tax withheld on its Form 1042 for the year in which the partnership earned the income without being subjected to a late deposit penalty (assuming the deposit of tax withheld was otherwise timely). This could presumably be implemented by having the partnership show the liability as an adjustment item (similar to current line 64a for adjustments for corporate distributions) rather than as a liability on lines 1 through 60 of the Form 1042.

H. Escrow Procedures

Recommendation

IRPAC recommends that the IRS issue guidance regarding the types of payments that are eligible for the escrow procedure in Treas. Reg. §§1.1441-3T(d)(1) and 1.1471-2(a)(5)(ii), the applicable rate of tax to be applied, reporting requirements for such payments on Forms 1042 and 1042-S, and the application of the escrow procedure to withholding agents that are domestic partnerships.

Discussion

Under Treas. Reg. §1.1441-3T(d)(1), where a withholding agent makes a payment and does not know at the time of the payment the amount that is subject to withholding because the determination of the source of income or the calculation of the amount of income subject to tax depends upon facts that are not known at the time of payment, the withholding agent must withhold 30% (or other applicable percentage) on the amount that could be U.S. source income or income subject to tax. A similar rule is found in Chapter 4 with respect to payments made to payees that are entities.[6]

Alternatively, a withholding agent may elect to withhold 30% of the payment in escrow until the earlier of the date that the amount of income from sources within the U.S. or the taxable amount can be determined or one year from the date the amount is placed in escrow, at which time the withholding becomes due, or to the extent that withholding is not required, the escrowed amount must be paid to the payee.[7]

In terms of reporting on Form 1042-S and Form 1042, it would appear that a withholding agent employing the escrow procedure would issue a Form 1042-S for the year in which the payment is made, showing the appropriate income code, the payment amount, the amount of tax withheld and the rate applied, and would check box 7b to indicate that the withheld tax was not deposited with the IRS pursuant to the escrow procedure. In addition, it would appear that the withholding agent would not include the tax withheld as a liability for the year of payment on Form 1042.

In the subsequent year, when the amount of income from sources within the U.S. or the taxable amount of income is determined, or where such a determination is not made and the one-year period expires, it would appear that the withholding agent would issue a Form 1042-S[8] showing income code 50 (Income previously reported under escrow procedure), the payment amount, the actual tax liability and withholding rate, the actual amount of tax due to the IRS with respect to the payment would be deposited by the withholding agent and reflected on its Form 1042 for that year, and the excess tax withheld (if any) would be returned to the payee.

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[6] Treasury Regulation §1.1471-2(a)(5)(i).

[7] Treasury Regulation §1.1441-3T(d)(1).

[8] If the escrow procedure is available for use with respect to corporate distributions, it would appear that more than one Form 1042-S may need to be issued (e.g., one to report dividend income and one to report a return of capital). See discussion supra, on the application of the escrow procedure to corporate distributions.

There has been very little guidance from the IRS in regard to the specifics of the escrow procedure. IRPAC believes that withholding agents and taxpayers would benefit from additional guidance from the IRS in regard to the escrow procedure, such as the types of payments that are eligible for the escrow procedure, as well as additional guidance regarding tax withholding on the initial payment, and with respect to Forms 1042 and 1042-S reporting with respect to the escrowed amounts.

For example, the general rule under Treas. Reg. §1.1441-3T(d)(1) indicates that a withholding agent must withhold 30% "or other applicable percentage." This implies that if a foreign payee were subject to a lower rate of withholding on the particular type of payment, the withholding agent could apply that lower withholding rate. However, the escrow provision in Treas. Reg. §1.1441-3T(d)(1) mandates that withholding under the escrow procedure be applied at 30%. It is not clear as to whether this is the intent, or whether the language "or other applicable percentage" was inadvertently omitted.

There has also been some suggestion that the escrow provision is not available for use with respect to corporate distributions, under the premise that the criteria for entry into Treas. Reg. §1.1441-3T(d)(1) cannot be met because a withholding agent has knowledge of how a payment should be treated – having been so informed by the application of Treas. Reg. §1.1441-3(c)(1) (general rule regarding withholding on corporate distributions) – and any exceptions to §1.1441-3(c)(1) are limited to those found in §1.1441-3(c)(2).

However, in private letter ruling 200552007, the IRS approved the taxpayer's proposed escrow procedure under Treas. Reg. §1.1441-3(d)(1), where taxpayer was not able to determine at the time of payment whether a payment made under a tender offer was a distribution of property to which IRC §301 applied, or a payment in part or full exchange for the stock under IRC §302. While a letter ruling can only be cited as precedent for the taxpayer that requested the ruling, the letter ruling can be pointed to as an example of where it would seem that the use of the escrow procedure was not pre-empted with respect to corporation distributions by Treas. Reg. §1.1441-3(c).

Moreover, one of the situations where it would be most helpful to have use of the escrow procedure is for corporate distributions where it is unclear how much of a distribution will be treated as a dividend versus a return of capital because there is uncertainty in regard to the amount of accumulated or current earnings and profits at the time of the distribution.

Treas. Reg. §1.1441-3(c)(2)(i)(C) provides some relief in that it permits the distributing corporation or an intermediary to withhold (or not withhold) on a distribution based upon a reasonable estimate by the distributing corporation at the time of the distribution in regard to the portion of the payment that is a dividend. While helpful, this option is imperfect in that when the estimate is too high, foreign payees will be overwithheld and generally required to file a tax return in the U.S. in order to obtain a refund of the overwithheld tax; and when the estimate is too low, the distributing corporation or intermediary is liable for the underwithheld tax.

In contrast, the escrow procedure would resolve the aforementioned problems with reliance on a reasonable estimate – and would seem to do so with minimum disruption to the timing of the deposits of withheld tax to be made to the IRS – as presumably the withholding agent would apply withholding to the portion of the payment that is known to be a dividend, and would limit application of the escrow procedure to the portion of the distribution with respect to which the treatment is in question at the time of payment.

Another area in which withholding agents and taxpayers would benefit from additional guidance is in regard to the application of the escrow procedure by U.S. partnerships with respect to distributions to foreign partners. Presumably, the escrow procedure would be available to a partnership where there was a question as to the source of income or whether a payment is taxable, to the same extent that it would be available to any other withholding agent.

However, it is unclear as to whether the escrow procedure would be available to a partnership in cases where the source and character of a payment received by a partnership was clear, but the partnership is unable to determine the amount of such payment allocable to the foreign partners at the time of distribution.

Accordingly, IRPAC recommends that the IRS issue guidance regarding the types of payments that are eligible for the escrow procedure in Treas. Reg. §§1.1441-3T(d)(1) and 1.1471-2(a)(5)(ii), the rate of tax to be applied, reporting requirements for such payments on Forms 1042 and 1042-S, and the application of the escrow procedure to withholding agents that are domestic partnerships.

SECTION II – RECOMMENDATIONS ON IRS FORMS AND INSTRUCTIONS

I. Required Usage Date of Form W-8BEN-E (Rev. April 2016)

Recommendation

IRPAC recommends delaying the date on which the (Rev. April 2016) version of the Form W-8BEN-E becomes mandatory to January 1, 2017. Under the current rules, withholding agents may continue to accept the old (February 2014) version of the Form W-8BEN-E for only six months after the April 2016 revision date. Therefore, the updated version will become mandatory on November 1, 2016.

Discussion

The November 1, 2016 mandatory date poses challenges for withholding agents collecting documentation from clients as document collection efforts generally occur during the summer for accounts with end of year expiry dates. For example, a client with a current tax document on file expiring on December 31, 2016 will be included in the withholding agent's 2016 document solicitation effort generally occurring between June – September 2016. But, to be able to process the 2016 Form W-8BEN-E, withholding agents must implement system-wide changes (e.g., the systems must be capable of storing new data on the updated form and handling the complexity surrounding the LOB requirements) and must have access to the as-yet unreleased Requestor Instructions so as to develop validation procedures. Similarly, vendors that provide W-8 validation software also need time to implement the W-8BEN-E changes. Withholding agents are not in a position to accept the new W-8BEN-E before updates to validation software are available.

Because withholding agents cannot yet process the new Form W-8BEN-E, withholding agents will generally use the old, February 2014 version of the form during their 2016 solicitation outreach. However, withholding agents frequently receive delayed responses from clients who are aware that they are properly documented through the end of the year. As such, it can be expected that many, if not most, clients will submit their updated tax documentation after the November 1, 2016 mandatory date for the new form. As such, there is a substantial risk that withholding agents will receive the old, February 2014 version of the form after the current November 1, 2016 mandatory effective date, notwithstanding that they used that old form in a solicitation during a period when that old form was still appropriate.

IRPAC's proposed January 1, 2017 effective date for the new Form W-8BEN-E also coincides with several other regulatory initiatives with an effective date of January 1, 2017, for which the new form may be used by both withholding agents and their clients. Such other regulatory initiatives include: the requirement for sponsored entities to obtain a Global Intermediary Identification Number (GIIN); the new QI agreement; sunset for use of pre-existing FATCA W-8 forms [as per Treas. Reg. §1.1471-3T(d)(1)]; withholding on collateral payments securing transactions under a collateral agreement (as per Treas. Reg. §1.1473-1T(a)(4)(vii); sunset of limited branch and limited FFI FATCA statuses; and withholding and information reporting for IRC § 871(m). It would cause less confusion for clients and the industry if the effective date for the new Form W-8BEN-E coincided with these initiatives.

In sum, to minimize the burden already placed on withholding agents in developing the procedures around the updated version, the industry requests a two month delay in the mandatory usage of the Rev. April 2016 Form W-8BEN-E.

J. Limitation on Benefits Transitional Relief

Recommendation

IRPAC recommends extending transition relief to allow withholding agents to extend treaty benefits to beneficial owners who fail to check the specific LOB box on line 14b on a Form W-8BEN-E (Rev. April 2016) provided prior to January 1, 2018. Furthermore, IRPAC requests that withholding agents be permitted to rely upon a Form W-8BEN-E (Rev. April 2016) that does not have the specific LOB box checked until that form's natural expiry.

Discussion

The Form W-8BEN-E (Rev. April 2016), Part III, line 14b introduces additional requirements for both payees and withholding agents. Part III, line 14b requires the payee's LOB code, which provides the specific justification for which the payee meets the LOB provision of the applicable tax treaty between its permanent residence jurisdiction and the United States. Failure to provide this LOB code may disqualify the payee from treaty benefits and thus result in additional withholding tax applied to payments.

Both withholding agents and payees need adequate time to manage modifications to IRS form updates, especially major changes such as the new LOB codes. Treaty claimants need time to familiarize themselves with the presentation of the LOB provisions on line 14b in order to properly complete the form under penalties of perjury. Likewise, withholding agents need adequate time to enhance validation standards and update systems. These validation standards are generally derived from the Form W-8BEN-E Requestor Instructions, which as of this time have not been published. Therefore, withholding agents are unable to thoroughly implement rules and update validation tools absent such instructions.

This major update will likely result in a high error rate among treaty claimants and the potential for disallowance of treaty benefits during the earlier stages of implementation. This will place an excessive burden on treaty claimants, withholding agents, and the IRS in order to process refunds resulting from the disallowance of such claims. In turn, withholding agents need a transitional period during which time withholding agents may accept a treaty claim for which one of the line 14b sub-boxes has not been checked.

Accordingly, IRPAC requests that the IRS allow withholding agents to accept a treaty claim on a Form W-8BEN-E on which the LOB code is not provided prior to January 1, 2018 to give the industry the time necessary to implement the new requirements. Furthermore such a form accepted prior to January 1, 2018 should be able to be relied upon to extend treaty benefits until its natural expiry.

K. February 2016 Draft Form W-8BEN-E and Draft Instructions for Form W-8BEN-E and Corresponding Instructions for Requester of Forms W-8

Recommendation

IRPAC made recommendations on the draft Form W-8BEN-E and draft Form W-8BEN-E instructions released in February 2016. Some of these recommendations were not incorporated into the final form and instructions. We request that the IRS consider these non-adopted recommendations when it makes updates to the Instructions for the Requester of Forms W-8.

Discussion

In February 2016, the IRS released a draft Form W-8BEN-E and draft Form W-8BEN-E instructions for commentary. IRPAC made several recommendations to the form based on industry concerns regarding technicality of language and ease of implementation. See Appendix C for recommendations. Final Form W-8BEN-E and final Form W-8BEN-E instructions were released in April 2016. While IRPAC appreciates that some of our recommendations were incorporated into the final W-8BEN-E, not all recommendations were incorporated.

It is understandable that not all recommendations could be incorporated due to, among other things, the short period of time between the release of the draft form, approval milestones that the form had to meet in order to be published and the actual publication of the final form. IRPAC recommends that suggested comments which were not incorporated in the final Form W-8BEN-E and Form W-8BEN-E instructions, are addressed in the Instructions for Requestor of Forms W-8, where possible, in order to provide further clear guidance to the industry.

L. TIN Requirement on Form W-8BEN-E for Foreign 501(c) Organizations

Recommendation

IRPAC recommends that the IRS issue clarifying guidance that an IRS Form W-8BEN-E submitted by a foreign 501(c) organization does not need to include a U.S. Tax Identification Number (TIN) except if a TIN is needed to claim treaty benefits.

Discussion

Treas. Reg. §1.1441-1(e)(4)(vii) provides the circumstances under which a TIN ("TIN" in this discussion means a U.S. TIN, unless otherwise stated) is required to be stated on a withholding certificate. Under Temp. Reg. §1.1441-1T(e)(4)(vii)(A), the TIN is required on a withholding certificate when the beneficial owner is claiming the benefit of a reduced rate under an income tax treaty (except if a foreign TIN is provided or for certain income on publicly traded securities). The implication left by this new rule is that a withholding certificate provided solely to establish Chapter 3 (or Chapter 4) status does not need to have a TIN as long as the beneficial owner is not using the certificate to claim the benefit of an income tax treaty.

These regulations provide two rules for foreign tax exempt organizations:

1) Treas. Reg. §1.1441-1(e)(4)(vii)(D) provides that a TIN is required on a withholding certificate on which a beneficial owner is claiming an exemption based solely on a foreign organization's claim of tax exempt status under section 501(c) or private foundation status. Given that the foreign organization is claiming exemption from withholding, this requirement that a TIN be provided is appropriate. This status is claimed on a Form W-8EXP, Certificate of Foreign Government or Other Foreign Organization for United States Tax Withholding.

2) Treas. Reg. §1.1441-1(e)(4)(vii)(G) provides that a TIN is required on a withholding certificate provided by a foreign organization that is described in section 501(c) (i.e., a tax exempt organization). In contrast to the above requirement, this requirement does not appear to be limited to any claim of exemption under U.S. domestic law, and appears to apply to entities which provide a Chapter 3 status of “Tax exempt organization” or “Private foundation” (private foundations being a subset of tax exempt organizations) on a Form W-8BEN-E. It is unclear, therefore, why a TIN is required in this circumstance. Moreover, this requirement appears to swallow the above narrow rule. That is, if TINs are required for all foreign tax exempt organizations, why is there an additional rule requiring a TIN for foreign tax exempt organizations claiming an exemption based on that status? Moreover, there does not appear to be any reason why a foreign tax exempt organization cannot use a Form W-8BEN-E to establish Chapter 3 (or Chapter 4) status without obtaining a TIN, as almost all other entities can do.

While the regulations provide seemingly conflicting rules, the requester instructions (see page 9) and the general instructions for the IRS Form W-8BEN-E (see pages 8-9) do not specify that a foreign 501(c) organization must provide its TIN for purely status purposes.

The seemingly conflicting regulatory rules create confusion for withholding agents who need to determine whether to invalidate incomplete withholding certificates. To avoid this problem, IRPAC recommends that the IRS clarify how the rules at Temp. Reg. §1.1441-1T(e)(4)(vii)(A) and Treas. Reg. §1.1441-1(e)(4)(vii)(G) are to be applied with regard to foreign 501(c) organizations. Specifically, IRPAC recommends that the IRS make clear that an IRS Form W-8BEN-E submitted by a foreign 501(c) organization need not include a TIN except if a TIN is needed to claim treaty benefits.

M. GIIN Validation

Recommendation

IRPAC recommends that visual aids, such as flowcharts, be provided by the IRS to the industry regarding proper placement of GIINs on Forms W-8.

Discussion

With the implementation of FATCA in 2014, Forms W-8 have expanded in length and complexity. New versions of these forms continue to be issued. This increase in complexity has caused payees completing the form to be confused and complete the form incorrectly. Specifically, correct placement of the payee's GIIN on the appropriate line within the form is a source of confusion due to unclear instructions and multiple locations on the form that a GIIN may be stated. For certain FATCA status types, a GIIN is required to be stated on the form and if it is not stated in the correct section of the form, can cause the form to be invalid.

Further, in accordance with IRS Notice 2015-66, beginning January 1, 2017, sponsored entities must obtain their own GIIN and cannot exclusively use the GIIN of their sponsor on a Form W-8. (There is an exception to the requirement to obtain a GIIN by January 1, 2017 for nonreporting IGA FFIs which meet the requirements to be a sponsored entity as described in Annex II of the applicable IGA and do not have reportable accounts. See, e.g., Article IV(B)(3)(c) of Annex II of the Model 1 IGA.) This requirement will further confuse payees who must list a GIIN on a Form W-8 for the first time as the Form W-8 instructions are unclear regarding sponsored entities. For example, the Instructions for Form W-8BEN-E state that the sponsored entity’s GIIN must appear on line 9a and the sponsor’s GIIN must appear on line 16, except if the sponsored entity is in an IGA country. The instructions then are contradictory for IGA sponsored entities and state that the sponsor's GIIN should appear on line 9a and if it does not, to enter it on line 26. This contradiction can be confusing to payees.

Based on the above, IRPAC recommends that a visual aid, such as a flowchart, be made available to assist payees in correctly completing the form. A flowchart would reduce the frustration and confusion of a payee trying to complete the form and would assist withholding agents in validating Forms W-8. IRPAC has submitted to the IRS a draft GIIN placement flowchart for Form W-8BEN-E and would be happy to work with the IRS to finalize this flowchart.

N. Instructions for Form W-8ECI

Recommendation

IRPAC recommends that the Instructions for Form W-8ECI, Certificate of Foreign Person's Claim That Income Is Effectively Connected With the Conduct of a Trade or Business in the United States, be modified to clarify that a foreign beneficial owner that provides Form W-8ECI to a withholding agent to claim an exemption from withholding on income that is effectively connected with a trade or business in the U.S. need not include a business address in the U.S. if the foreign beneficial owner does not have a business address in the U.S. In such cases, the foreign beneficial owner should simply be permitted to indicate that it does not have a business address in the U.S.

IRPAC further recommends inclusion of corresponding language in the Instructions for the Requestor of Forms W-8 to clarify that a withholding agent should not treat a Form W-8ECI that indicates on line 6 that the foreign beneficial owner does not have a business address in the U.S. as invalid because of the lack of a business address in the U.S.

Discussion

Form W-8ECI is used by a beneficial owner to claim an exemption from withholding where the income to be received is effectively connected with a trade or business in the U.S.

Among the information required to be provided on Form W-8ECI, line 6 of the form includes a space for the beneficial owner to enter its business address in the U.S. The Instructions for Form W-8ECI for line 6 simply provide, “Enter your business address in the United States. Do not show a post office box.”

Many withholding agents have taken the view that a Form W-8ECI will not be valid if it does not include a business address in the U.S. on line 6. The withholding agents that take this view reject the Form W-8ECI provided by the foreign beneficial owner and subject the payment to withholding. However, there are circumstances where income will be considered to be effectively connected with a trade or business conducted in the U.S. – and thereby exempt from withholding – even though the foreign beneficial owner does not have a business address in the U.S.

IRPAC believes that a clarifying modification to the instructions will alleviate this over withholding. Accordingly, IRPAC recommends that the Instructions for Form W-8ECI and Instructions for the Requestor of Forms W-8BEN, Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding and Reporting (Individuals), be modified to clarify that a business address in the U.S. need not be included on line 6 of Form W-8ECI if the foreign beneficial owner does not have a business address in the U.S.

O. Forms W-8 with Electronic Signatures

Recommendation

IRPAC recommends that the IRS issue clarifying guidance either as part of the Form W-8 Requestor Instructions or as a separate FAQ allowing withholding agents to accept a Form W-8 with an electronic signature that was not executed on the withholding agent’s electronic systems.

Discussion

Currently, it is unclear whether withholding agents have the ability to accept Forms W-8 with electronic signatures that are transmitted to the withholding agents as pdf copies via email, facsimile or other methods. Withholding agents are beginning to receive Forms W-8 that have been created and signed on electronic systems that have not been established by the withholding agents themselves. Payees will typically email or send via facsimile such electronically created W-8s containing their electronic signature. Since withholding agents may now clearly accept Forms W-8 which are scanned and received electronically (see Treas. Reg. §§1.1441-1T(e)(4)(iv)(C) and 1.1471-3T(c)(6)(iv)), it would be beneficial to the payee and the withholding agent if there was clear guidance on the withholding agent also being able to accept a Form W-8 transmitted in such a manner with an electronic signature.

IRPAC recommends the following language that may be used in a FAQ or similarly in the Form W-8 Requestor Instructions:

> Q: If a payee provides a Form W-8 to document its status for purposes of Chapters 61, 3 and/or 4 and such form is electronically signed by the payee, may the withholding agent accept such electronic signature for purposes of determining the validity of the form?
>
> A: A withholding agent may establish a system for a payee to electronically furnish a Form W-8 as set forth in § 1.1441-1T(e)(4)(iv) and § 1.1471-3T(c)(6)(iv). An electronically furnished Form W-8, which is also electronically signed under penalties of perjury by the person whose name is on this form, may be accepted by the withholding agent as an original. A payee may choose to print or create a pdf copy of such electronically signed Form W-8 created by such an electronic system and provide this form, via email or by other means, to multiple withholding agents. A withholding agent who receives a copy of an electronically signed Form W-8 from the payee or agent of the payee, may accept such form as being validly signed provided that there is an indication on the Form W-8 that the signature is an electronic signature. For example, a Form W-8 stating that it has been "Electronically signed by John Smith" may be accepted as having a valid signature.

P. Substitute Form 1042-S Payee Statements

Recommendation

IRPAC recommends that the use of substitute Form 1042-S payee statements be retained but with additional minimum requirements added to aid IRS Service Center processors. Alternatively, IRPAC recommends that any prohibition to the use of such substitute statements be confined only to those statements on which withholding is shown. Finally, to accommodate information providers' desire to use substitute payee statements in future years, IRPAC recommends that the IRS take steps to develop the capability to use the newly required Form 1042-S unique identifying number ("UIN") to match substitute payee statements to information returns electronically submitted.

Discussion

In the 2015 IRPAC Report, IRPAC recommended that the IRS modify its newly issued requirement (included in IRS Publication 1179, dated June 29, 2015) that Form 1042-S payee statements be "identical" to the IRS form. Substitute versions of payee statements have been in place for decades, and offer a more streamlined and less confusing alternative to official forms, which results in many practical and business advantages to form filers as well as to payees. The IRS Form 1042-S, in contrast, typically contains boxes for information that is not only not relevant to the taxpayer, but also makes the form exceedingly confusing. As a result, IRPAC argued that the IRS's dramatic departure from the prior substitute standard was unwarranted. IRPAC asked the IRS to reevaluate this mandate and, if necessary, to work with IRPAC to develop more specific and focused amendments to the substitute form specifications so as to address the problems IRS was having with the substitute forms.

During 2016, IRPAC and the IRS had several follow-up meetings regarding this issue. IRPAC explained to the IRS that information reporters are resistant to using the official Form 1042-S payee statements because that form is confusing and inefficient and, as such, negatively impacts communications between information reporters and their customers. The IRS, in turn, explained that its effective elimination of the use of substitute Form 1042-S payee statements was based on the difficulty that IRS Service Center processors were having identifying and transcribing key information from all the substitute Form 1042-S payee statements in processing refund or credit claims. To address the IRS concerns, IRPAC proposed a more standardized substitute form, which would allow for the elimination of irrelevant boxes in a standardized manner. See Appendix D.

While IRPAC hopes the IRS would adopt these minimum requirements for all such statements, IRPAC recommends that the IRS *at a minimum* allow withholding agents to furnish substitute Form 1042-S payee statements for those statements on which no withholding is shown. Many Form 1042-S payee statements report no withholding due to numerous exemptions from withholding for various types of income (e.g., portfolio interest). As a result, those statements in these cases are not used to make refund or credit claims – but instead are used merely to report certain payments made to the payees. This recommendation would be particularly helpful with respect to bank deposit interest paid to nonresident alien (NRA) individuals. The required Form 1042-S reporting of bank deposit interest paid to NRA individuals has been greatly expanded due to the need of the U.S. Treasury to report this information for purposes of meeting its reciprocal reporting obligations under many FATCA intergovernmental agreements (IGAs). Bank deposit interest paid to NRA individuals is not subject to Chapter 3 withholding. Although bank deposit interest is technically subject to Chapter 4 withholding, in the case of a putative NRA individual, backup withholding and Form 1099 reporting, not Chapter 4 withholding and Form 1042-S reporting, would generally apply if the individual is not properly documented. Therefore, the greatly expanded number of Form 1042-S payee statements furnished to NRA individuals with respect to bank deposit interest will neither reflect withholding nor generate associated refund or credit claims, which are the claims that triggered the IRS effectively eliminating substitute payee statements.

Moreover, allowing substitute Form 1042-S payee statements in the case of payments that were not subjected to withholding would greatly enhance the ability of withholding agents to deliver a simpler payee statement that can be easily understood by its customers. Where applicable, the substitute form would not contain information that is not relevant to the taxpayer and could combine multiple reportable accounts held by payees on a single payee statement. For example, if the NRA individual has multiple CDs and a savings account, all reportable accounts should be allowed to be reported on a single substitute Form 1042-S payee statement. This would be an efficient way to accomplish this reporting to the customers without running afoul of the Service's processing issues noted above. Of course, notwithstanding the allowance for a substitute payee statement, the withholding agent would continue to report the required information with respect to each account separately to the IRS, allowing the Treasury to report such information to partner countries as appropriate on an account by account basis.

Finally, regardless of the IRS position with respect to the above requests, looking ahead, beginning in 2017, withholding agents will be required to assign a UIN to each filed Form 1042-S. IRPAC recommends that the IRS develop the capacity to use this UIN to allow Service Center processors to match refund claims to electronically submitted information reports by withholding agents detailing the tax that has been withheld. This matching method of processing refund claims should completely eliminate the need to read *any* information from payee statements other than the UIN. As a result, this matching method of processing refund claims would not only save the IRS time and money in processing such claims, but it would help to prevent fraud perpetrated through the use of fraudulent payee statements. Importantly, the use of the UIN in this manner should also allow information providers the ability to send substitute payee statements in the most practical and customer-friendly way possible.

Q. Truncated TINs for Form 1042-S Payee Statement

Recommendation

IRPAC recommends that the Instructions for Form 1042-S payee statements be revised to make it clear that truncated TINs (“TTIN”) are permitted for all substitute Form 1042-S payee statements.

Discussion

Under Treas. Reg. § 301.6109-4(b)(1) a truncated TIN may be used to identify any person on any statement that the internal revenue laws require to be furnished to another person. Under this provision, a withholding agent may truncate the TIN of the payee on a Form 1042-S payee statement. Rev. Proc. 2015-35 confirms that TTINs are permitted on Form 1042-S payee statements and that none of the exceptions under §

301.6109-4(b)(2) to the general rule permitting TTINs apply to Form 1042-S payee statements:

> Truncating taxpayer identifying numbers on payee statements. Final regulations have been issued that allow issuers to truncate payee identifying numbers on all payee statements covered by these instructions [Form 1042-S is "covered by these instructions"], except for Form W2-G.

If TTINs are permitted on a Form 1042-S payee statement, they should similarly be permitted on a substitute Form 1042-S payee statement. The 2016 Instructions for Form 1042-S payee statements, however, appear to limit the use of truncated TINs to only substitute Form 1042-S payee statements that report bank deposit interest:

> Substitute Forms
> …. Also, if you are reporting bank deposit interest to certain nonresident aliens (see Revenue Procedure 2014-64 or any superseding revenue procedure), you may truncate the recipient's TIN on the substitute form.

IRPAC recommends that the Instructions for Form 1042-S regarding payee statements be revised to conform to the regulations which allow TTINs for all substitute Form 1042-S payee statements.

R. Instructions for Form 8966

Recommendation

IRPAC recommends that the IRS modify the Instructions for Form 8966, FATCA Report, to provide more detail regarding a withholding agent's Form 8966 reporting obligations with respect to passive NFFEs with substantial U.S. owners, where the passive NFFE is an indirect payee of the withholding agent.

Discussion

On page 2 of the 2015 Instructions for Form 8966 under the section titled, "Special Rules for Certain Form 8966 Filers" there is a subsection titled, "U.S. withholding agents," wherein the first paragraph of that subsection discusses Form 8966 reporting requirements for U.S. withholding agents with respect to withholdable payments made to passive NFFEs with substantial U.S. owners. However, this paragraph does not address the requirement for reporting where the NFFE is an underlying payee of a passive NFFE that is an intermediary or flow-through entity.

On page 7 of the instructions, under the section titled, "Withholding Agent Reporting" there is a subsection titled, "Amounts paid to a passive NFFE" that explains that a withholding agent is not required to report information on a passive NFFE with substantial U.S. owners where: 1) the NFFE is an underlying payee of an FFI that is an intermediary or flow-through entity; 2) the FFI certifies on its withholding statement that it will perform the reporting; and 3) the withholding agent has no reason to know that the certification is incorrect or unreliable. This description of the exception from reporting where the FFI makes the requisite certification implies that reporting is required by the withholding agent where the FFI fails to make the requisite certification.

IRPAC believes that the Form 8966 reporting requirements for withholding agents making payments to passive NFFEs with substantial U.S. owners where the NFFE is an underlying payee of an FFI or passive NFFE that is an intermediary or flow-through entity may not be readily apparent to withholding agents.

Accordingly, IRPAC recommends that the IRS modify the Instructions for Form 8966 to provide more detail regarding a withholding agent's Form 8966 reporting obligations with respect to passive NFFEs with substantial U.S. owners, where the passive NFFE is an indirect payee of the withholding agent.

S. FATCA Reporting by Branch of U.S. Financial Institution in Model 2 Jurisdiction

Recommendation

IRPAC recommends that the IRS provide guidance on the Form 8966 and/or Form 1099 reporting requirements for a foreign branch of U.S. financial institution in a model 2 IGA country, where the foreign branch has an account holder that is a U.S. non-publicly traded corporation, such that it is a specified U.S. person for Form 8966 reporting purposes, and is a U.S. exempt recipient for Form 1099 reporting purposes. IRPAC also recommends that IRS provide penalty relief for any incorrect or late filings by such branches for tax years prior to the year such guidance is issued.

Discussion

The IRS has issued Rev. Proc. 2014-38, which contains the FFI agreement for PFFIs and Reporting Model 2 FFIs. Section 6.02(B) of the agreement provides that a PFFI (which would include a reporting Model 2 FFI) may report its U.S. accounts on Form 8966, or alternatively, may elect to perform modified Form 1099 reporting as provided in section 6.02(B)(1) of the agreement.

Section 6.02(B)(1) provides that where an election is made to perform modified 1099 reporting, an FFI that is a non-U.S. payor must determine the payments that are subject to reporting as if it were a U.S. payor, and more broadly, 1099 reporting is required with respect to exempt recipients that are specified U.S. persons. Moreover, reporting is required for each U.S. reportable account regardless of whether the FFI makes a reportable payment to the account during the calendar year. Where no payment is made, the FFI is required to report on Form 1099-MISC. The election to perform Form 1099 reporting described in section 6.02(B)(1) appears to be taken from Treas. Reg. §1.1471-4(d)(5).

However, Treas. Reg. §1.1471-4T(d)(2)(iii)(A) provides special U.S. account reporting rules for U.S. payors, whereby an FFI that is a U.S. payor will be treated as having satisfied its Form 8966 reporting obligations with respect to a U.S. account if it performs the required Form 1099 reporting for the account. In contrast to the election to perform Form 1099 reporting, the U.S. payor rule would not seem to require Form 1099 reporting for exempt recipients, nor require Form 1099-MISC reporting in cases where no payment is made. It would appear however, that whether intentional or unintentional, the FFI agreement does not pick up this special reporting rule for U.S. payors.

Given these various rules, it is unclear the manner in which a foreign branch of a U.S. financial institution in a Model 2 IGA country would report (if at all) when it has a U.S. account holder that is a non-publicly traded corporation. The U.S. non-publicly traded corporation would be a specified U.S. person for purposes of Form 8966 reporting, but a U.S. exempt recipient for purposes of Form 1099 reporting.

Under the U.S. payor rule, the foreign branch of the U.S. financial institution arguably would not have to report the account. Form 1099 reporting would not be required because the account holder is an exempt recipient, and Form 8966 reporting would not be required because the U.S. payor complied with its Form 1099 reporting obligations (which is this case did not require reporting) with respect to the account.

However, under the election rule it would seem that Form 1099 reporting would be required despite the exempt recipient status of the account holder (with Form 1099-MISC reporting required if there were no payments to the account).

Given the lack of clarity, IRPAC recommends that the IRS provide guidance on the Form 8966 and/or Form 1099 reporting requirements for a foreign branch of U.S. financial institution in a model 2 IGA country under these facts. IRPAC also recommends that IRS provide penalty relief for any incorrect or late filings by such branches for tax years prior to the year such guidance is issued.

T. Authorized Foreign Agents

Recommendation

IRPAC recommends that the IRS issue guidance highlighting that the regulatory requirements to establish an agent as an authorized foreign agent for Chapter 3 and Chapter 4 purposes are only required to be met when the agent is acting on the principal's behalf under the *agent's EIN* and not when the agent is acting on the principal's behalf under the *principal's EIN*.

Discussion

Treas. Reg. §§ 1.1441-7T(c)(2) and 1.1474-1(a)(3) set forth the circumstances (and requirements) under which a principal may authorize an agent to fulfill its obligations under Chapter 3 and Chapter 4. Specifically, a Form 8655, “Reporting Agent Authorization,” must be filed with the IRS by a principal if, in the context of hiring an authorized foreign agent (such as a transfer agent), that principal directs the agent to fulfill the principal's Form 1042 filing obligations or tax deposit and payment obligations under Chapter 3 and Chapter 4.

There has been some confusion in the tax community as to whether these requirements must be satisfied both: (i) when a principal requests an agent to fulfill the principal's Form 1042 filing obligations or tax deposit and payment obligations using the *principal’s EIN*; and (ii) when a principal requests an agent to fulfill the principal's Form 1042 filing obligations or tax deposit and payment obligations using the *agent’s EIN*.

We understand that the intent of the regulation was to require that the Form 8655 be filed only when the Form 1042 is to be filed by an agent (or the agent makes a tax deposit or payment) under the *agent's EIN*. It is our understanding that this filing of Form 8655 is required whether or not the authorized foreign agent is a withholding agent in its own right. In contrast, if the agent is asked to fulfill the principal's Form 1042 filing obligations (or tax deposit and payment obligations) using the *principal’s EIN*, then the Form 8655 is not required, though it may be likely that the agent in such event should sign the Form 1042 as a paid preparer.

To clear up the confusion in the tax community, IRPAC recommends that the IRS issue some type of guidance – or even an FAQ – that highlights that the regulatory requirements (and Form 8655) are only required when an agent is acting on the principal's behalf under the agent's EIN and not when it is acting on the principal's behalf under the principal's EIN. If the IRS wishes to issue an FAQ addressing this issue, IRPAC suggests the following language:

> **Q: Must a Form 8655, “Reporting Agent Authorization,” be filed with the IRS by a principal if, in the context of hiring an agent (such as a transfer agent), that principal directs the agent to fulfill the principal's Form 1042 filing obligations or tax deposit and payment obligations under Chapter 3 and Chapter 4 using the agent’s EIN?**
>
> A: Yes. A Form 8655 must be filed when the Form 1042 is filed by an agent (or the agent makes a tax deposit or payment) under the agent's EIN. This filing is required whether or not the agent is a withholding agent in its own right. See Treas. Reg. §§ 1.1441-7T(c)(2) and 1.1474-1(a)(3) for the circumstances under which a principal may authorize an agent to fulfill its obligations under Chapter 3 and Chapter 4. In contrast, if the agent is asked to fulfill the principal's Form 1042 filing obligations or tax deposit and payment obligations using the principal’s EIN,

then the Form 8655 is not required, though it may be likely that the agent in such event should sign the Form 1042 as a paid preparer.

U. Presumption Rules for Pension Payments, Form 1040 General Instructions

Recommendation

IRPAC recommends a new paragraph be added to the end of the instructions for line 64 of Form 1040 as follows, “Also include on line 64 any federal income tax withheld and reported to you on Form 1042-S for income included in this return.”

Discussion

There are instances when non-resident alien tax withholding is applied by a withholding agent based on the applicable presumption rules in the case of pension payments. The taxpayer may have received pension payments for which the withholding agent was required to presume foreign status due to lack of a proper tax certification. This presumption of foreign status for recipients of pension payments can cause withholding and Form 1042-S reporting notwithstanding that the recipient may actually be (and often is) a U.S. citizen or resident alien at the time of the payment.

In addition, withholding and Form 1042-S reporting can occur when a non-resident alien taxpayer has a change of circumstances event (to become a resident alien), but fails to notify the withholding agent on a timely basis.

The taxpayer should be able to claim the non-resident alien tax withholding as “Federal Income Tax Withheld” on line 64 of the Form 1040, U.S. Individual Income Tax Return, if the income reported on the Form 1042-S is includable in the return. The 2015 Form 1040 instructions for line 64 contain no reference to tax withheld and reported on Form 1042-S.

The 2015 Instructions for Form 1040-NR, U.S. Nonresident Alien Income Tax Return, line 62 contain helpful information about all federal income tax withheld including from Forms W-2, 1099 and 1042-S. Adding a new paragraph to the bottom of the instructions for line 64 of Form 1040 will help clarify that taxpayers may claim credit for non-resident alien tax withheld from income reportable on Form 1040. Due to space limitations, the description for line 64 on page 2 of Form 1040 should continue to reference only Forms W-2 and 1099.