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. For convenience, the recommendations have been grouped according to topic.

A. Qualified Intermediary Agreement (Rev. Proc. 2017-15)

Recommendation A.1 - Validity Period of Documentary Evidence

IRPAC recommends that the IRS provide further details regarding its consideration of applying a three-year validity period to documentary evidence obtained by a Qualified Intermediary (QI) in support of an account holder's claim for treaty benefits to allow industry time for further comment regarding appropriate recommendations.

Discussion

Section 4.08 of the preamble to the QI Agreement provides, "The Treasury Department and the IRS are considering applying the same three-year validity period to documentary evidence obtained (by) QIs supporting an account holder's claim for treaty benefits to align with the validity period of the treaty statement."

To support an account holder's claim for treaty benefits, a QI may obtain either documentary evidence detailed on the KYC jurisdiction attachment to the QI agreement or under Treas. Reg. §1.1441-6. Such documentary evidence includes passports or other governmental issued identification documents for individuals and formation documents for entities.

Certain forms of documentary evidence, such as certificates of incorporation, lack natural expiration dates, while other forms of documentary evidence, such as passports, have extended periods of validity. For example, a passport is generally valid for ten years. Under the existing QI Agreement, the treaty statement is only valid for three years.

It is unclear as to the benefit the IRS would obtain by requiring the account holder to resubmit, every three years, new copies of the documentary evidence previously provided to the withholding agent in scenarios where such documentary evidence either does not have a prescribed expiration period or where such expiration date has not been reached. In addition, under Treas. Reg. §1.1441-1(e)(4)(ii)(B), there are certain circumstances where documentary evidence will remain valid indefinitely. It would seem contradictory to apply an expiration period to documentary evidence within the QI agreement when the regulations specifically provide indefinite validity for those forms of documentary evidence lacking a natural expiration date. Expiring otherwise valid documentation creates an undue burden on both the account holder and the withholding agent. As such, IRPAC recommends that the IRS provide additional insight into its consideration of applying a three-year validity period to documentary evidence and further requests the opportunity to make additional recommendations as applicable.

Recommendation A.2 - Validity Period of Treaty Statement

IRPAC recommends that the IRS provide further details regarding its consideration of applying a three-year validity period to treaty statements provided by entities so that there is greater understanding as to the reasoning of the IRS for imposing such a timeframe and the opportunity to comment further regarding appropriate recommendations.

Discussion

Section 5.11(A) of the QI Agreement provides that a three-year validity period is established for treaty statements associated with documentary evidence. Specifically,

> "QI may only rely on statements regarding entitlement to treaty benefits described in §1.1441-6(c)(5)(i) or the representations described in section 5.03 of this Agreement until the validity expires under §1.1441-1(e)(4)(ii)(A)(2)."

Generally, it is not expected that an entity's claim of treaty benefits would change once initially collected by the QI. If there is a change which would impact an entity's claim for treaty benefits, existing regulatory requirements for managing changes in circumstance require the solicitation of updated documentation to resolve the change. While the preamble to the QI Agreement indicates that the establishment of a three year validity period is necessary to maintain consistency with the validity period of a withholding certificate including a claim of treaty benefits, it is confusing as to why the IRS is looking for such consistency as the QI Agreement has traditionally made fairly significant distinctions between the use of withholding certificates containing treaty claims versus the use of treaty statements associated with documentary evidence.

In consideration of the above, IRPAC requests further details to understand why the treaty statement associated with documentary evidence would require being renewed every three years.

Recommendation A.3 – Interbranch Transactions

IRPAC requests clarification of the treatment of interbranch transactions for a QI acting as a Qualified Derivatives Dealer (QDD) and recommends the aggregation of separate branch liabilities for purposes of calculating the QDD tax liability.

Discussion

As part of calculating its QDD tax liability, a QDD may use its net delta exposure for purposes of such calculation. The QI agreement defines net delta exposure in Section 2.47 specifically stating,

> "Each QDD must determine its net delta exposure separately only taking into account transactions that exist and are attributable to that QDD for U.S. federal income tax purposes."

Based on this language in Section 2.47, it would appear that interbranch transactions would be disregarded for purposes of calculating the QDD liability. Disregarding interbranch transactions for purposes of calculating the QDD tax liability will result in the net delta component of the QDD tax liability being distorted because when net delta is calculated for business purposes interbranch transactions are recognized. Therefore, disregarding interbranch transactions would force a QDD to distort the net delta it typically uses for business purposes in order to calculate a net delta that disregards interbranch transactions specifically for the QDD tax liability calculation.

In addition, disregarding interbranch transactions for purposes of the QDD tax liability would also create a different standard for purposes of the combination rule. Interbranch transactions would be recognized for purposes of the combination rule but not for net delta purposes which creates an operational contradiction for QDDs and becomes more difficult to implement systemic logic within the QDD's systems. Disregarding interbranch transactions for the combination rule seems to be inconsistent with the intent of the combination rule.

IRPAC requests that the IRS provide additional clarification regarding the calculation of QDD tax liability in relation to interbranch transactions. Specifically, IRPAC recommends that QDD tax liability is allowed to be consolidated for an entity as a whole such that the separate branch QDD liabilities will be aggregated. With regards to aggregation, IRPAC recommends that Section 7.01(C) of the QI Agreement is adjusted to read as follows:

> "In addition to its requirements under section 7.01(A) of this Agreement, a QI that is acting as a QDD (other than a foreign branch of a U.S. financial institution) also must report its QDD tax liability on the appropriate U.S. tax return (to be prescribed by the IRS) and for purposes of calculating and reporting such QDD tax liability, may aggregate the amounts which would otherwise be considered separately for the home office and each branch that is acting as a QDD (if applicable). A QDD must also report any other information required by the appropriate return with respect to its QDD tax liability (including any part thereof)."

Recommendation A.4 - Event of Default

IRPAC recommends that the IRS revise the language of Section 11.06(C) of the QI Agreement which speaks to when the "QI makes excessive refund claims," in order to allow for necessary refund claims due to the implementation of IRC §871(m).

Discussion

The implementation of IRC §871(m) for exchange traded notes has created several challenges for QIs. Many issuers are contemplating what the industry has begun referring to as an "issuer solution" to address challenges in applying the required IRC §871(m) withholding tax to exchange traded notes held through a foreign Central Securities Depository such as Euroclear or Clearstream.

Transactions involving exchange traded notes can include multiple parties such as principals and agents, as well as intermediaries such as clearing organizations and custodians, (all of whom meet the definition of withholding agent), on behalf of the long party to the transaction. In certain cases, custodians for the long party may be QIs.

Given the multiple parties as well as insufficient communication channels to orchestrate accurate withholding (including the application of treaty benefits) on each beneficial owner in a timely manner, issuers anticipate having insufficient details to withhold appropriately. Therefore, industry has effectively developed an "issuer solution" whereby issuers retain withholding responsibility and assess 30% withholding on each payment made to a foreign payee with respect to underlying U.S. equities paying dividends.

While the issuer would perform the withholding, custodians who directly face the underlying beneficial owners will be required to offer a refund mechanism to their eligible account holders. As mentioned previously, a number of these custodians will be acting as QIs. However, Section 11.06(C) of the QI Agreement provides that making an "excessive refund claim" is an event of default of the QI Agreement.

Thus, if the QI applies for a collective refund due to this "issuer solution" for multiple consecutive years, there is a risk that this could be considered "excessive" and as such trigger an event of default. However, the QI will of necessity be required to provide account holders with a refund solution given the over-withholding of tax. In consideration of this point, IRPAC recommends that the IRS revise the language of Section 11.06(C) to read, "…QI makes excessive and unnecessary refund claims."

Recommendation A.5 – QI Reliance on Electronically Provided Documentary Evidence

IRPAC recommends that the IRS review the various QI Attachments to consider whether the requirement that documentary evidence provided remotely by an account holder be a certified copy is still necessary; and to modify the QI Attachments to incorporate the electronic delivery provisions included in the regulations.

Discussion

Treas. Reg. §1.1441-1T(e)(4)(iv)(D) generally permits a withholding agent to rely on a Form W-8 and/or documentary evidence that is provided by facsimile or email.

With respect to documentary evidence obtained from account holders by a QI, the rules associated with the receipt and reliance of such documentary evidence for purposes of the QI Agreement are governed by the applicable QI Attachment for the specific country in which the QI operates.

While each QI Attachment is country specific, the various attachments generally contain similar requirements in regard to collection and reliance on documentary evidence provided by an account holder other than in person. For example, item 5(ii) of the QI Attachment for the United Kingdom reads as follows:

> "QI may obtain a photocopy of the specific documentary evidence listed in item 4 by mail or otherwise remotely from the account holder or a person acting on behalf of the account holder, provided that the photo copy has been certified as a true and correct copy by a person whose authority to make such certification appears on the photocopy, and provided that the laws and regulations listed in item 1 permit QI to rely on the certified photocopy to identify the account holder."

The phrase, "by mail or otherwise" could possibly be interpreted to permit electronic delivery in a manner consistent with the regulations, though it would be helpful to have greater clarity on the point. Moreover, the requirement for a certified copy of the documentary evidence seems to go beyond the requirements of the regulations, and thereby impose a greater burden on a QI in regard to the collection of documentary evidence than for other withholding agents. While IRPAC realizes that a modification of the provisions may be limited by local law, our understanding is that there may have been modifications to local law and local practice since the time that the QI Attachments were originally issued and/or subsequently modified.

Given this passage of time, IRPAC recommends that the IRS review the QI Attachments to consider whether the certified copy requirement is still necessary; and to modify the QI Attachments to incorporate the electronic delivery provisions of the regulations.

B. IRC §871(m)

Recommendation B.1 - Elimination or Delay for Non-Delta 1 Transactions

IRPAC recommends that the IRS revise IRC §871(m) regulatory requirements to limit withholding to delta 1 transactions and those transactions captured by the anti-abuse rule in the regulations. Absent elimination of withholding on non-delta 1 transactions, IRPAC recommends that the IRS provide other relief in the regulations to make the implementation less costly to implement and maintain on an ongoing basis.

Discussion

IRPAC would like to thank the IRS for responding to IRPAC's request for delay in the implementation of certain IRC §871(m) requirements by issuing Notice 2017-42, Extension of the Phase-in Period for the Enforcement and Administration of Section 871(m).

This Notice was extremely helpful in allowing withholding agents to spend 2017 focusing on implementing withholding on delta 1 transactions which are expected to generate the overwhelming majority of withholding tax due under the IRC §871(m) regulations. Even though the majority of withholding will be collected on these transactions, withholding agents will need to spend significant resources both upfront and ongoing to implement the delta 0.8 standard required by the regulations, primarily in order to be able to prove on audit that no withholding tax was due on the thousands of transactions entered into each year. Given the cost to withholding agents is expected to exceed the benefit to the IRS, IRPAC recommends that the IRS should eliminate the delta 0.8 standard.

If the IRS is unwilling to eliminate withholding on trades covered by the delta 0.8 standard, IRPAC recommends that the IRS should provide other relief for withholding agents to make the implementation less costly to implement and maintain on a go forward basis. Potential relief measures the IRS should consider include: a) elimination of the combination rule for listed transactions for withholding agents and maintenance of the current combination rule approach for over the counter transactions (for listed transactions, taxpayers should only have to combine trades done on the same day and with the same maturity); b) given withholding agents normally run risk systems at the end of the day, allow withholding agents to run end of the day processes with a delta 0.75 or other reasonable standard, and only review those trades above the lower delta threshold using real time data to test for substantial equivalence or delta 0.8 standard; and c) allow withholding agents to set upfront parameters for a product structure to conclude that transactions won't meet the substantial equivalence test or delta 0.8 standard and use this analysis as proof that no withholding is required.

Another relief item that applies to delta 1 and delta 0.8 standard transactions is withholding on cash equities held by a Qualified Derivatives Dealer (QDD). IRPAC recommends that QDD's continue to be able to avoid withholding on cash equities held in their dealer business provided the QDD is able to show that, in aggregate, the QDD withheld an equal or greater amount from client transactions. Thus, the QDD would determine the aggregate amount of withholding it would have been subject to on its cash equities positions, and would only pay withholding to the extent that sum is greater than the sum of all IRC §871(m) withholding the QDD collected from clients and paid over to the IRS.

Recommendation B.2 - MLP Withholding

In light of the complexities in determining dividend equivalent amounts (DEAs) with respect to derivatives referencing master limited partnerships (MLPs), IRPAC recommends that the IRS amend the appropriate regulations to extend the time allowed to perform withholding and reimbursement / setoff procedures with respect to these transactions to September 15th of the year following the year the DEA is determined (i.e., September 15, 2018 for 2017 DEAs) for all withholding agents, including QDDs. In addition, IRPAC recommends that the IRS ensure that interest or penalties will not be charged on any withholding payments made by September 15th.

Discussion

Treas. Reg. §1.871-15(m) treats derivatives on covered partnerships as having a DEA on a look-through basis to the extent the covered partnership is holding investments that receive a payment of a dividend or a DEA. The most common derivatives linked to covered partnerships are derivatives referencing MLP units. Unfortunately, it will often not be possible for withholding agents to determine the proper DEA amount with respect to a derivative on an MLP by the March 15th withholding deadline in the current regulations.[1] Withholding agents are expecting to rely on MLP K-1 data to make the DEA determination, and this data will not be received in time to do the necessary calculations required by March 15th. IRPAC understands that K-1's are often not issued until March 15th or shortly beforehand, which is not enough time for withholding agents to complete the complex calculations required to determine the DEA amount for each MLP derivative transaction the withholding agent has entered into. The K-1 data is only the starting point of a very complex allocation process that has to take place to allocate the K-1 result among the various trades the withholding agent had outstanding during the year.

Without the proper data, withholding agents simply cannot withhold the proper amount by the March 15th deadline. This results in either under-withholding or over withholding on taxpayers; however unintentional. Consequently, IRPAC recommends extending the withholding and reimbursement/setoff deadline from March 15th to the extended Form 1042 filing deadline of September 15th. The 2016 Form 1042 appears to accommodate this change as an operational matter.

C. Foreign Taxpayer Identification Number Requirements

Recommendation C.1 – Foreign Taxpayer Identification Number Relief

IRPAC thanks the IRS for the publication of transitional relief on foreign taxpayer identification number (FTIN) requirements. Over the course of the year, IRPAC had numerous discussions with the IRS regarding FTIN requirements where IRPAC recommended that the IRS provide the following relief and guidance with respect to the FTIN requirements included in Temp. Reg. §1.1441-1T(e)(2)(ii)(B):

1. Only Forms W-8 received on or after January 1, 2018 are required to have an FTIN, or reasonable explanation for the absence of an FTIN;
2. FTINs can be received separately from the Form W-8 either orally or in writing and FTINs currently in account files can be relied upon;

[1] See Treas. Reg. §1.1441-2(e)(7)(vii).

3. A checklist can be utilized to obtain a reasonable explanation for the absence of an FTIN and this checklist can either be attached to the Form W-8 or separately provided including by email or facsimile;
4. A withholding agent can accept an FTIN or a reasonable explanation for the absence of an FTIN absent actual knowledge exists that the FTIN or explanation is not valid; and
5. Eliminate the requirement to obtain a reasonable explanation for not having provided an FTIN where the payee's country of residence is known to not issue FTINs.

Discussion

Effective January 1, 2018, Temp. Reg. §1.1441-1T(e)(2)(ii)(B) requires an FTIN, or a reasonable explanation in its absence, be provided with a Form W-8 documenting an account holder of an account maintained at a U.S. office or branch of a financial institution that is a withholding agent, in order for the Form W-8 to be valid after December 31, 2017. Both IRPAC and the financial services industry have provided extensive commentary to the IRS with respect to the significant burdens that this FTIN requirement imposes given the limited implementation time, system and operational impacts, as well as the potential for substantial over-withholding on payments to otherwise documented foreign customers that are only noncompliant with respect to the FTIN requirements.

As a result of the significant implementation issues and impacts, IRPAC recommends that only new Forms W-8 received on or after January 1, 2018 be required to have an FTIN, or reasonable explanation for its absence. Valid Forms W-8 received prior to January 1, 2018 (pre-existing Forms W-8) should not be treated as invalid after December 31, 2017 due solely to a missing FTIN or reasonable explanation for the absence of an FTIN. IRPAC further recommends that pre-existing Forms W-8 should remain valid until they expire under the normal validity period or change in circumstance rules, and FTINs or a reasonable explanation for the absence of an FTIN, should only be required for Forms W-8 received after Dec. 31, 2017 as renewals occur for expiring pre-existing Forms W-8s.

Based on discussions with the IRS, IRPAC understands that Treasury and the IRS plan to provide transition relief and additional time to obtain FTINs or reasonable explanations for the absence of an FTIN for pre-existing Forms W-8 and intends to only require an FTIN or reasonable explanation for new Forms W-8 received on or after January 1, 2018. IRPAC would like to thank the IRS for this planned action and much needed relief. However, currently it is unclear how much additional time the IRS will provide withholding agents to obtain an FTIN or reasonable explanation for pre-existing Forms W-8. IRPAC requests that the IRS not require any accelerated receipt of an FTIN or reasonable explanation for pre-existing Forms W-8 and the IRS clarify that FTINs or explanations are only required for new Forms W-8 received on or after January 1, 2018 for new accounts or for renewals of pre-existing Forms W-8 as they expire under existing rules.

IRPAC understands the purpose of the new FTIN requirement is to allow the U.S. Government to satisfy reciprocal reporting obligations under the FATCA Intergovernmental Agreements (IGAs). Accordingly, IRPAC believes there should be a great deal of flexibility in the method in which the FTIN or explanation for its absence is obtained. IRPAC recommends that the IRS clarify that a withholding agent can obtain the FTIN separately from the Form W-8, not only on a written statement or via email, as outlined in the FATCA General Compliance FAQs #22, but that the FTIN can also be obtained orally (similar to the rule for obtaining a global intermediary identification number (GIIN) as outlined in Notice 2015-66). Further, IRPAC requests that the IRS continue to allow a withholding agent to rely on an FTIN that is currently in its account files as provided in the existing guidance for FTIN requirements on Form W-8BEN-E, found on page 7 of the "Instructions for the Requester of Forms W-8BEN, W-8BEN-E, W-8ECI, W-8EXP, and W-8IMY (Rev. July 2014)."

The methods for obtaining a reasonable explanation for the absence of an FTIN should likewise be flexible. IRPAC appreciates the IRS's guidance in the Forms W-8 instructions that indicate an explanation may be either written on the form in the line provided for the FTIN, written in the margins of the form, or provided on a separate attached statement associated with the form. In addition, FATCA General Compliance FAQs #22 provides that the explanation can be provided on a written statement via email. IRPAC recommends that the IRS also confirm that a withholding agent can utilize a checklist for a reasonable explanation for the absence of the FTIN, similar to the current allowance of a checklist for a reasonable explanation supporting a claim of foreign status as provided in Treas. Reg. §1.1441-7(b) (12). Furthermore, IRPAC recommends that the IRS confirm that withholding agents are allowed to provide non-U.S. customers with a checklist to complete in the absence of an FTIN similar to that included as Appendix B. IRPAC views the reasonable explanation checklist template included in Appendix B as being consistent with the reasonable explanations contained in the Form W-8 instructions and in Temp. Reg. §1.1441-1T(e)(2)(ii)(B).

Withholding agents are currently uncertain of their obligations with respect to the validation requirements of an FTIN or an acceptable reasonable explanation for the absence of an FTIN. IRPAC recommends that the IRS confirm a withholding agent can rely on an FTIN or reasonable explanation for the absence of an FTIN absent actual knowledge that the FTIN or explanation is not valid. Withholding agents are not in a position to know the composition or length of FTINs issued by the large number of foreign countries. Likewise, withholding agents do not know which countries do and do not issue FTINs, and the numerous laws that may exist in foreign countries that would require a resident to obtain an FTIN or would provide for an exception from obtaining an FTIN.

IRPAC also recommends that the IRS eliminate the requirement for a withholding agent to obtain a reasonable explanation from a payee that does not provide an FTIN where the payee resides in a country that is known not to issue FTINs. For example, it is well known that the Cayman Islands does not issue taxpayer identification numbers to its residents. IRPAC believes that it would be a tremendous waste of time and resources to require withholding agents to obtain an explanation from each payee resident in the Cayman Islands that simply provides what is already common knowledge – that the Cayman Islands does not issue taxpayer identification numbers. It would be helpful for the IRS to provide guidance identifying those countries that are well known not to provide taxpayer identification numbers where an explanation for a missing FTIN would not be required. The reasonable explanation requirement would remain in place for those countries that have not been so identified by the IRS.

IRPAC understands and supports the purpose of the new FTIN requirement to satisfy U.S. reciprocal reporting obligations under the IGAs. However, the FTIN requirements as currently applicable create substantial challenges and costs for withholding agents with substantial consequences for noncompliance for both non-U.S. customers and withholding agents. Accordingly, IRPAC very much appreciates the IRS's guidance to date and informal indication of additional planned transition relief and requests that the recommendations outlined above be incorporated in this additional planned IRS transition relief or subsequent guidance.

D. IRC §305(c)

Recommendation D.1 – IRC §305(c) Retroactive Application

IRPAC recommends that the IRS publicly announce that it will not impose withholding tax liability, penalties, or interest on withholding agents for IRC §305(c) events occurring in tax years prior to 2016.

Discussion

As part of the October 2016 IRPAC report, IRPAC recommended that the IRS "publicly 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." This recommendation was presented as proposed IRC §305(c) regulations were only released in April 2016. As such, it would be unfair to penalize withholding agents for events occurring prior to the release of these proposed regulations by applying withholding tax liability, penalties, or interest on a retroactive basis.

As indicated in the October 2016 IRPAC report, IRPAC appreciates the IRS efforts to clarify the applicable rules by issuing the 2016 Proposed Regulations. However, the proposed regulations serve as an acknowledgment by the IRS that additional guidance was needed in order to appropriately administer the IRC §305(c) withholding obligations. Accordingly, IRPAC does not believe withholding agents can reasonably be expected to have put a withholding process in place for years prior to 2016. Therefore, IRPAC again requests public acknowledgement from the IRS that withholding agents will not be held liable with respect to IRC §305(c) events occurring prior to 2016.

Recommendation D.2 - Reporting IRC §305(c) Deemed Dividends:

IRPAC recommends that the regulations under IRC §6042 be amended to include coordination rules under which the timing and amount of an IRC §305(c) deemed dividend reported on Form 1099-DIV (Dividends and Distributions) would be governed by the issuer's reporting of the timing and amount of the IRC §305(c) deemed dividend on Form 8937 (Report of Organizational Actions Affecting Basis of Securities), as required by IRC §6045B.

IRPAC further recommends that the IRS defer Form 1099-DIV reporting for IRC §305(c) deemed dividends until such time as regulations are issued and adequate time is provided to implement the new reporting requirements.

Discussion

IRC §6042 generally requires Form 1099-DIV reporting when a dividend is paid. Currently, it does not appear that reporting on Form 1099-DIV would be required under IRC §6042 for deemed dividends under IRC §305(c), because while a deemed dividend constitutes a "dividend" for this purpose, there is no "payment" of the dividend that triggers reporting. The preamble to the proposed regulations under IRC §305(c) requests comments on the implementation of Form 1099-DIV reporting of deemed dividends under IRC §305(c) and indicates that "similar principles" for reporting deemed dividends under Treas. Reg. §1.6045B-1 with respect to reporting of deemed dividends that affect the basis of a security are to be applied in reporting IRC §305(c) deemed dividends on Form 1099-DIV under IRC §6042.

IRPAC recommends that the regulations under IRC §6042 be amended to include coordination rules under which the timing and amount of a IRC §305(c) deemed dividend reported on Form 1099-DIV would be governed by the issuer's reporting of the timing and amount of the IRC §305(c) deemed dividend on Form 8937 (Report of Organizational Actions Affecting Basis of Securities), as required by IRC §6045B.

In addition, IRPAC further recommends that the IRS defer Form 1099-DIV reporting for IRC §305(c) deemed dividends until such time as regulations are issued and adequate time is provided to implement the new reporting requirements. Likewise, similar coordination would be required with respect to Form 1099-B reporting under Treas. Reg. §1.6045-1(d) in regard to the required basis adjustment resulting from the deemed dividend.

E. Form W-9

Recommendation E.1 – Third-Party Repositories

IRPAC recommends that the IRS expand the use of the third-party repository concept as included in Treas. Reg. §1.1441-1(e)(4)(iv)(E) to include Forms W-9 (Request for Taxpayer Identification Number (TIN) and Certification). IRPAC recognizes that given the introductory language of Treas. Reg. §1.1441-1(e)(4) modification of IRC §3406 regulations would be required to incorporate the third-party repository concept.[2]

Discussion

Treas. Reg. §1.1441-1(e)(4)(iv)(E) provides that a withholding agent may rely on an otherwise valid Form W-8 received electronically from a third-party repository provided there are processes in place to ensure that the withholding certificate can be reliably associated with a specific request from the withholding agent and a specific authorization from the person (or agent) providing the certificate.

While the third-party repository is a relatively recent construct, withholding agents have found these repositories to be useful tools for efficiently and effectively documenting large volumes of account holders and / or remediating existing documentation through the collection of documentary evidence such as formation documents. Third-party repositories generally validate documentation on its face; with withholding agents being ultimately responsible for validating documentation against their own books and records. As such, account holders have also found the third-party repository concept useful as it enables them to provide one set of documentation which can be permissioned out across multiple withholding agents. This is particularly useful in the asset management space where one fund may be invested with hundreds, if not thousands, of various withholding agents. Likewise, it benefits withholding agents as they can obtain documentation which is valid on its face versus having to conduct extensive back and forth discussions with account holders to cure various foot faults which would otherwise invalidate the withholding certificate.

On its face, there are no clear explanations for why it is not acceptable for withholding agents to collect Forms W-9 from a third-party repository. Certain repositories have attempted to manage this by entering into agency agreements whereby the repository functions as an agent and is therefore able to provide the Form W-9 to the withholding agent. Identity theft should not be a consideration given withholding agents must be permissioned access to a particular form by a client as opposed to being granted blanket access to all collected documentation. Furthermore, entity documentation predominates over individual documentation included to date in third-party repositories and is expected to continue to do so.

[2] Treas. Reg. §1.1441-1(e)(4) provides that "These provisions do not apply to Forms W-9 (or their substitutes). For corresponding provisions regarding Form W-9 (or a substitute form), see section 3406 and the regulations under that section."

Essentially, the Form W-9 is a U.S. person's confirmation, under penalties of perjury, that it is providing its correct taxpayer identification number. If the IRS has concerns regarding the quality of the data collected, there are means in place to help police this such as the IRS TIN Matching system. Likewise, name and taxpayer identification number mismatches are also subject to information return penalties as well as the CP-2100 and CP-2011A "B" Notice process which would ultimately ensure the data being provided can be relied upon.

Information returns function as the bedrock of the U.S. tax system. These filings increase voluntary compliance and assist the IRS in verifying the accuracy of tax returns.[3] In order for tax administration to function as intended, withholding agents must have efficient means for collecting and validating the information which underlies these information returns – e.g., Forms W-8 and W-9. For these reasons, IRPAC recommends the IRS expand the use of the third-party repository concept as included in Treas. Reg. §1.1441-1(e)(4)(iv)(E) to include Forms W-9 via amending IRC §3406 regulations.

Recommendation E.2 – Electronic Signatures

IRPAC recommends that the IRS extend the electronic signature provisions included in Treas. Reg. §1.1441-1T(e)(4)(i)(B) to include Forms W-9. IRPAC recognizes that given the introductory language of Treas. Reg. §1.1441-1(e)(4), this change would require modification to IRC §3406 regulations.[4]

Discussion

The IRS has traditionally allowed withholding certificates to be provided electronically if the withholding agent maintained an electronic collection system meeting the requirements of Treas. Reg. §1.1441-1(e)(4)(iv)(B). These requirements included the ability for the system to authenticate the user and for the user to sign the form electronically under penalties of perjury.

In 2016, IRPAC recommended the IRS issue clarifying guidance allowing withholding agents to accept a Form W-8 with an electronic signature that was not executed on the withholding agent's electronic systems. IRPAC would like to thank the IRS for its action on the recommendation as well as the burden relief this has provided withholding agents as in Treas. Reg. §1.1441-1T(e)(4)(i)(B), the IRS clarified that such

[3] When queried, 62% of the public indicated that information reporting has either a great deal of influence or somewhat of an influence on whether they honestly report and pay their taxes, according to the IRS Oversight Board 2014 Taxpayer Attitude Survey. Similarly, as per TAX REFUNDS - IRS Is Exploring Verification Improvements, but Needs to Better Manage Risks, GAO-13-515, Report to the Committee on Finance, U.S. Senate (June 2013), "An IRS study of individual tax compliance found that in tax year 2006, taxpayers accurately reported over 90 percent of income with substantial information reporting requirements, such as interest and dividend income. In contrast, the same study found taxpayers accurately reported only 44 percent of income subject to little or no information reporting, such as nonfarm sole proprietor income."

[4] See id.

electronically signed forms may be accepted by the withholding agent, provided that the form reasonably demonstrates that the person whose name is on the form has signed it electronically via a signature block or other means including a time and date stamp and statement to the effect that the form has been electronically signed and the name of the signatory.

IRPAC would now recommend that the IRS extend this acceptance of electronic signatures to the Form W-9. For various reasons, but primarily driven by client demand and various sustainability initiatives, institutions are prioritizing online account opening channels where the end to end account onboarding process can be managed by a client sitting at his or her computer, tablet, or other mobile device. Furthermore, even in more traditional account opening channels, account holders are looking to provide a digitally signed Form W-9 electronically via scan or facsimile.

Accepting a digitally signed Form W-9 poses minimal risk to the IRS particularly given initiatives such as IRS TIN Matching which can validate that the name and taxpayer identification number provided on the Form is correct. Likewise, CP2100 and 2100A "B" Notices will flag those situations where there is a mismatch between the name and the taxpayer identification number. For these reasons, IRPAC recommends the IRS extend the electronic signature provisions included in Treas. Reg. §1.1441-1T(e)(4)(i)(B) to include Forms W-9 via amending IRC §3406 regulations.

Recommendation E.3 – FATCA Jurat

IRPAC recommends that the IRS provide a limited exception to the substitute Form W-9 guidance included in the Instructions for the Requester of Form W-9 to allow onshore withholding agents providing payees with a substitute Form W-9 to remove the fourth jurat which states "The FATCA code(s) entered on this form (if any) indicating that I am exempt from FATCA reporting is correct."

Discussion

The FATCA exemption code field and associated fourth jurat debuted with the August 2013 version of the Form W-9 in anticipation of the reporting required by the Foreign Account Tax Compliance Act (FATCA). However, U.S. withholding agents do not complete Form 8966 (FATCA Report) or local Intergovernmental Agreement (IGA) reporting, rather they continue to complete Form 1099 reporting for certain payments made to U.S. persons. Therefore, the FATCA exemption code field is not applicable to accounts maintained onshore in the U.S. This is clearly noted in the instructions to the Form W-9 which state "These codes apply to persons submitting this form for accounts maintained outside of the United States by certain foreign financial institutions. Therefore, if you are only submitting this form for an account you hold in the United States, you may leave this field blank."

The Instructions for the Requester of Form W-9 were updated with the publication of the December 2014 version to provide "If you are not collecting a FATCA exemption code by omitting that field from the substitute Form W-9 (see Payees and Account Holders Exempt from FATCA Reporting, later), you may notify the payee that item 4 does not apply." Thus, while a withholding agent can inform a payee completing the Form W-9 that this fourth jurat is not applicable; the withholding agent cannot remove the jurat as a change to any of the penalties of perjury certifications would render the substitute form invalid.

IRPAC would therefore request the IRS allow this jurat to be removed from substitute Forms W-9 being used to document accounts maintained in the U.S., particularly given the IRS' documented position that this field is not relevant for these accounts.

F. Withholding Statements:

Recommendation F.1 – Chapter 4 Status Code Requirement

IRPAC recommends that the IRS eliminate the requirement that an FFI withholding statement, a chapter 4 withholding statement, and an exempt beneficial owner withholding statement that includes payee specific information for purposes of chapter 4, include the chapter 4 status code used for Form 1042-S (Foreign Person's U.S. Source Income Subject to Withholding) reporting; or alternatively, publish a mapping of the chapter 4 statuses on the several Forms W-8 to the chapter 4 status codes used for Form 1042-S reporting.

Discussion

Treas. Regs. §§1.1471-3(c)(3)(iii)(B)(2), (3) provide generally that an FFI withholding statement, a Chapter 4 withholding statement, or an exempt beneficial owner withholding statement with payee specific information provided by a nonqualified intermediary or flow-through entity to a withholding agent must include the chapter 4 status of the underlying payees using the applicable status codes for Form 1042-S reporting.

While the requirement to include the Form 1042-S status codes would seem a sensible one on its face, in practice this requirement creates issues in regard to the validity of the withholding statement as it is often difficult for the nonqualified intermediary or flow-through entity to accurately determine the applicable status codes to be used for purposes of filing Form 1042-S, even though it is aware of the chapter 4 status of the underlying payee.

As it stands now, there is no document published by the IRS that maps the chapter 4 statuses available on the several Forms W-8 to the chapter 4 status codes used for Form 1042-S reporting. Withholding agents that file Forms 1042-S have had to make their own determinations in regard to this mapping. However, a nonqualified intermediary or flow-through entity that is passing up Forms W-8 and a withholding statement to another withholding agent generally isn't issuing Forms 1042-S, and thus is unlikely to have the same level of experience or have spent as much time as its withholding agent in considering the mapping of chapter 4 statuses on the several Forms W-8 to the status codes used for Form 1042-S reporting. Consequently, as between the nonqualified intermediary or flow-through entity and its withholding agent, it is the withholding agent that would be in a better position to determine the applicable chapter 4 status code to use when preparing Forms 1042-S.

Requiring the intermediary or flow-through entity to provide the status codes used for Form 1042-S reporting creates the potential for situations where the nonqualified intermediary of flow-through entity provides the correct chapter 4 status, but fails to provide the correct Form 1042-S status code. From a reporting perspective, since the withholding agent is also receiving the Form W-8 for the underlying payee it can determine the chapter 4 status code without having it included on the withholding statement. However, the question then becomes whether a withholding agent that receives a withholding statement with an incorrect chapter 4 status code must treat the withholding statement as invalid when the Form 1042-S status code would be obvious to the withholding agent based upon the chapter 4 status on the Form W-8? Moreover, as there have been many changes to the numbering of the chapter 4 status codes for Form 1042-S reporting purposes in recent years, presumably a nonqualified intermediary or flow-thru entity would be required to update its withholding statement when such changes occur even if correct when provided.

Accordingly, IRPAC recommends that the IRS eliminate the status code requirement for an FFI withholding statement, Chapter 4 withholding statement and exempt beneficial owner withholding statement; or alternatively, publish a mapping of the chapter 4 statuses on the several Forms W-8 to the chapter 4 status codes used for Form 1042-S reporting.

Recommendation F.2 – Incorporating Nonqualified Intermediary Certifications into Form W-8IMY

IRPAC recommends that the IRS incorporate the alternative withholding statement certification language into the nonqualified intermediary (NQI) certifications as part of the next update to the Form W-8IMY (Certificate of Foreign Intermediary, Foreign Flow-Through Entity, or Certain U.S. Branches for United States Tax Withholding and Reporting).

Discussion

IRPAC thanks the IRS for its response to IRPAC's 2016 recommendation in allowing the use of an alternative withholding statement. The Temporary and Final chapter 3, 4 and 61 regulations allow withholding agents to rely on a simplified alternative withholding statement from a NQI (including a non-withholding foreign partnership or trust). The alternative withholding statement must contain enough information for a withholding agent to meet its information reporting and withholding requirements under chapters 3, 4 and 61. The alternative withholding statement is not required to include information that is also included on the tax forms and is not required to specify the rate of withholding applicable to each payee for each type of income it receives as long as the withholding agent is able to determine the appropriate rate from the information on the withholding certificate. The alternative withholding statement must also be accompanied by Forms W-8 and/or W-9 for all of the underlying beneficial owners. Additionally, the alternative withholding statement is required to contain a certification from the intermediary that none of the information on the underlying payees withholding certificates is inconsistent with the information in the intermediary's files. While IRPAC appreciates the IRS allowance for the alternative withholding statement, IRPAC requests the inclusion of such certification language on the Form W-8IMY; thereby signed under penalties of perjury by the intermediary.

Recommendation F.3 – Alternative Withholding Statement and Minor Inconsistencies

IRPAC recommends additional language to the Requestor of Forms W-8 Instructions to clarify the use of an alternative withholding statement with minor inconsistencies to address the questions raised below:

Q: When can an alternative withholding statement for an NQI be used despite inconsistencies between the NQI's files and the underlying beneficial owner documentation?

A: An alternative withholding statement for an NQI can be used despite current, inconsequential inconsistencies that do not substantially affect the rate of withholding provided the following statement appears on the withholding statement, "Except as otherwise noted on this withholding statement, the information contained herein is consistent with the information contained in the records of the nonqualified intermediary providing this withholding statement."

Discussion

The regulations addressing the alternative NQI withholding statement provide that "the withholding statement must contain a representation from the nonqualified intermediary that the information on the withholding certificates is not inconsistent with any other account information the nonqualified intermediary has for the beneficial owners for determining the rate of withholding with respect to each payee."

In addition, the preamble to the regulations also provide an example of the alternative withholding statement rule by citing to a non-withholding foreign partnership that provides an inconsistent Form W-8 in relation to the information contained in the foreign partnerships files. The example states that due to the inconsistency, the foreign partnership would not be able to provide the representation and the withholding agent would not be allowed to rely on an alternative withholding statement.

The preamble example and language in the regulations seem to counter the initial intent of an alternative withholding statement being widely used by NQIs. As the preamble example and regulatory language are written, the language suggests that even historical information is subject to causing the NQI to not use the alternative withholding statement because the historical information would cause an inconsistency. If none of the underlying beneficial owners' tax documentation can contain information that conflicts with the NQI's files, then an NQI, for example, with 100 different beneficial owners would not be able to use the alternative withholding statement which could be helpful to them.

IRPAC believes allowance for such minor non-material inconsistencies poses no harm to the government and should not prohibit the NQI from using the alternative withholding statement.

G. Additional Topics

Recommendation G.1 – Treaty Rates for Pension Distributions

IRPAC recommends that the IRS provide guidance on specific countries with which the U.S. has an income tax treaty where pension payments are subject to a specialized treatment depending upon the type of payment. IRPAC further recommends that Publication 515 (Withholding of Tax on Nonresident Aliens and Foreign Entities) be updated to reflect this specialized treatment for the specific payment types; or at a minimum be updated to include a footnote highlighting that the rate of withholding may vary depending upon whether the pension payment is a periodic payment or a lump sum distribution.

Discussion

Withholding agents rely heavily upon the tax treaty tables associated with Publication 515 in order to develop their withholding logic. The current treaty tables associated with Publication 515 indicate a 0% or other reduced treaty withholding rate on pension payments without any footnote or caveat regarding whether the payment is a periodic payment or a lump-sum distribution. However, the IRS examination teams are raising as an issue on U.S. withholding agent Form 1042 audits that the liability to withhold on pension payments where a treaty exists is based in some countries, such as the United Kingdom, the Netherlands, and Italy, on whether the payment is a periodic payment or a lump-sum distribution as defined by the applicable treaty. IRPAC recommends that the IRS provide written guidance on which specific countries have specialized treatment of withholding on pension payments depending upon the type of payment or distribution.

In notable cases, such as the UK, Netherlands, and Italy the Publication 515 treaty table withholding rate indicated is 0%, when the actual treaty withholding rate on certain lump-sum distributions is 30%. The Publication 515 treaty tables are misleading and could result in U.S. withholding agents withholding at 0% or other applicable treaty rate when 30% withholding is required on lump-sum distributions. Footnotes should be added to the Publication 515 treaty tables to indicate when 0% or reduced treaty withholding rates do not apply to lump-sum distributions. Form 1042 audits have included substantial debate over treaty language and withholding agents have generally been unable to obtain confirmation from the IRS as to which countries do require specialized treatment. In the interest of effective, efficient, and transparent tax administration, IRPAC recommends that the IRS provide written guidance on the effective withholding rates. As such, IRPAC has provided the IRS with suggested language for the Publication 515 treaty tables in Appendix C.

Recommendation G.2 – Sponsored Investment Entities in Model I IGA Jurisdictions

IRPAC recommends that the IRS revise the proposed FATCA regulations on sponsored entities to allow Foreign Financial Institutions (FFIs) claiming a FATCA status of Sponsored Investment Entity per the FATCA regulations to report to their local tax authority as would normally be the case for FFIs located in a FATCA Model 1 Intergovernmental Agreement (IGA) jurisdiction.

Discussion

The preamble to the proposed FATCA regulations on sponsored entities includes the following statement "Thus, a financial institution covered by a Model 1 or Model 2 IGA may choose to qualify as a sponsored investment entity, controlled foreign corporation, or closely held investment vehicle pursuant to §1.1471-5(f) instead of Annex II of the Model 1 or Model 2 IGA. In such a case, the financial institution must satisfy all of the requirements applicable to such an entity in the regulations, including the requirement for the sponsoring entity to report information directly to the IRS, even in the case of a financial institution covered by a Model 1 IGA."[5]

This issue arises due to the fact that some of the early IGAs (e.g., the UK and Ireland) do not have Sponsored Investment Entity ("SIE") provisions in their Annex II which outlines non-reporting local jurisdiction institutions and products. Consequently, SIE's from those countries can get that status only under the IRS FATCA regulation, §1.1471-5(f). This IRS requirement is causing confusion in the marketplace as the local governments think the SIE's should report directly to them. Moreover, there should not be a compliance concern for the IRS given reporting would be happening to their local government like all other Model 1 FFI's, and to have these sponsored entities report to the IRS creates the same problems in regard to local law prohibitions on information sharing that the IGAs were designed to address in the first place. IRPAC recommends

[5] See Preamble to Chapter 4 Regulations Relating to Verification and Certification Requirements for Certain Entities and Reporting by Foreign Financial Institutions, 82 FR 1629 (Jan. 6, 2017).

that the IRS eliminate this requirement in the proposed regulations so that these SIE's located in Model 1 jurisdictions are not required to report information directly to the IRS, provided the FFI properly reports to their local jurisdiction.

Recommendation G.3 – Professional Management Standard

IRPAC recommends that the IRS modify the FATCA regulations to allow certain professionally managed investment entities to be treated as a Passive Nonfinancial Foreign Entity (PNFFE), rather than a Foreign Financial Institution (FFI). IRPAC recommends that these entities be treated consistently as PNFFE's and that the FI's holding accounts for the PNFFE's perform the required reporting to the IRS with respect to the substantial U.S. owners or controlling U.S. persons of the PNFFE.

The recommendation applies to situations where the following requirements are met by the entity: 1) the entity's equity is closely-held by a family or limited number of individuals (if the entity is a trust without an FI trustee, the trust beneficiaries are a family or limited number of individuals); 2) the entity's equity or trust certificates are not offered to the public for investment; and 3) the management of the entity's corporate/trustee activities (such as deciding where to open a bank account, ability to authorize a power of attorney, or make decisions about distributions) are not managed by a Financial Institution (FI), such as a FI trustee of a trust.

These requirements to maintain PNFFE status will also be met if the entity's equity is held by one or more commonly controlled entities that collectively meet all 3 requirements. The controlling entity has to meet all 3 requirements and the controlled entities have to meet requirements 2 & 3. For example, this rule would be met if individuals' A and B collectively own 100% of controlling entity 1, which owns 100% of controlled entity 2 (which has the financial account at the FI) and both entity 1 and entity 2 meet requirements 2 & 3 above. Requirement 1 is met because individuals' A and B collectively own 100% of the commonly controlled entities.

Discussion

Treasury Regulation §1.1471-5(e)(4) seems to define an Investment Entity FFI as any PNFFE that has part or all of its assets managed by a professional money manager. FI's routinely sell investment products to personal investment company clients where the FI has discretionary authority to trade for the client's account after the client has picked the investment structure they are interested in owning. These agreements are sometimes referred to as discretionary mandates (DM). Similar to mutual fund investments, clients have the ability to terminate the DM on very short notice. Thus, it is quite possible that an entity could flip between being professionally managed and not being professionally managed more than once during a year, depending on whether the client cancels a DM or cancels a DM and then enters into a new DM at a later date. A legal entity's FATCA status should not hinge on whether the legal entity has entered into or terminated a DM. Rather, IRPAC recommends that a legal entity's FATCA status be based on more permanent facts. The operational complexity of changing the reporting status of a legal entity based on transitory facts is very difficult to implement for FI's. In addition, these personal investment company entities typically don't have any employees or infrastructure to do reporting and register as an FFI, so this approach creates operational complexity for the entity as well.

Besides the operational complexity of changing an entity's FATCA status based on transitory facts, IRPAC believes the IRS has a serious compliance risk with allowing these personal investment company entities to report on themselves for FATCA. Personal investment companies are the types of entities that historically created the need for FATCA because they were sometimes used to avoid QI reporting on the beneficial owners and some beneficial owners didn't properly report their income to the IRS. Allowing these entities to decide whether they need to report to the IRS and what the amount should be is much riskier than having a third party FI do the reporting.

Moreover, local governments are going to be challenged to enforce the reporting requirement because they may not know that the entity is professionally managed so the local government may accept PNFFE status for the entity. In fact, the entity may be giving different tax forms to the various FI's where it holds accounts, and FI's where the entity doesn't have a DM won't know to challenge the client's claim of PNFFE status. For these reasons, all parties involved are better off operationally if these entities are treated consistently as PNFFE's and the FI's holding accounts for the PNFFE's do the required reporting to the IRS with respect to the PNFFE's substantial U.S. owners or controlling U.S. persons.

Recommendation G.4 – Extension of Time to File Form 1042 Where Reimbursement Procedure is applied across Calendar Years

IRPAC recommends that the IRS modify Treas. Reg. §1.1461-2(a)(2)(i)(B) to remove the limitation on obtaining an extension of time to file Form 1042 (Annual Withholding Tax Return for U.S. Source Income of Foreign Persons) where the withholding agent applies the reimbursement procedure to make itself whole following a refund of over withheld tax to a payee in the year following the year in which the tax was withheld.

IRPAC further recommends that IRS clarify the Form 1042-S instructions (whether the regulations are modified for our first point or not) in regard to the time for filing Form 1042 when using the reimbursement or set-off procedure across calendar years, and in regard to the need for an attachment to Form 1042 in order to claim a credit for over-withheld tax.

Discussion

Under Treas. Reg. §1.1461-2(a)(2)(i), a withholding agent that repays over-withheld tax to a beneficial owner or payee, may reimburse itself for the amount repaid by reducing future deposits to the IRS. However, a reduction of a deposit in the calendar year subsequent to the calendar year of withholding is only permitted if: 1) the repayment to the beneficial owner or payee is made before the due date (without extensions) for filing Form 1042-S for the calendar year of the over-withholding (or prior to actual filing of Form 1042-S if earlier); and 2) the withholding agent states on a timely filed (not including extensions) Form 1042 for the calendar year of over-withholding, that the filing of Form 1042 constitutes a claim for credit in accordance with Treas. Reg. §1.6414-1. Consequently, a withholding agent that wishes to utilize the reimbursement procedure across calendar years is prohibited from obtaining an extension of time to file Form 1042, and thus must file the form by March 15th. In contrast, the regulations do not provide the same limitation for filing Form 1042 when the set-off procedure is utilized across calendar years, and therefore a withholding agent is permitted to obtain an extension of time to file Form 1042 when using the set-off procedure across calendar years.

It is unclear as to why a withholding agent would be denied the opportunity to extend the due date for filing Form 1042 when utilizing the reimbursement procedure across calendar years – particularly when such a limitation does not apply when utilizing the set-off procedure across calendar years. The beneficial owner or payee will have been made whole prior to the filing of Form 1042-S, and the repayment would be reflected on the Form 1042-S provided to the beneficial owner/payee and filed with the IRS. Likewise, the withholding agent would have been made whole. There doesn't seem to be any obvious reason as to why it would be critical for the withholding agent to file its Form 1042 by March 15th as opposed to filing by the extended due date.

Withholding agents are often in need of the extension of time to file Form 1042 in order to accurately complete the form and properly reconcile its withholding, reporting, and deposits. Accordingly, IRPAC recommends that the IRS modify the regulations to remove the limitation on obtaining an extension of time to file Form 1042 when the withholding agent utilizes the reimbursement procedure across calendar years.

In addition, the instructions to box 11 in the 2017 Instructions for Form 1042-S provide that in order to claim a refund where the withholding agent applied the reimbursement or set-off procedure across calendar years, the withholding agent must: 1) timely file a Form 1042; and 2) attach a statement that the filing of Form 1042 constitutes a claim for credit.

The instructions do not include the "without extension" language in regard to the reimbursement procedure, and consequently the instructions read as if the Form 1042 filing requirement is the same when both reimbursement and set-off are used. Moreover, the instructions require an attachment to Form 1042 in order to claim the credit, when it would seem clear from the face of Form 1042 that the withholding agent is claiming a credit.

Accordingly, IRPAC further recommends that IRS clarify the Form 1042-S instructions (whether the regulations are modified for our first point or not) in regard to the time for filing Form 1042 when using the reimbursement or set-off procedure across calendar years, and in regard to the need for an attachment to Form 1042 in order to claim a credit for over withheld tax.

Recommendation G.5 – Liability Calculations for Form 1042 Audits

IRPAC understands that the IRS is currently in the process of reviewing its policies with respect to the disallowance of remediation efforts and application of cure documentation to extrapolated liability calculations as part of statistical samples in both QI audits as well as U.S. withholding agent audits. IRPAC recommends that the IRS allow for consultation with industry prior to finalizing any directives regarding the disallowance of cure documentation in an extrapolated audit liability calculation resulting from a statistical sample.

Discussion

As part of the 2016 report, IRPAC recommended 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. IRPAC further recommended that the IRS not extend this disallowance of remediation efforts and cure documentation broadly to U.S. withholding agent audits. As part of the final QI Agreement as published in Rev. Proc. 2017-15, the IRS scaled back these provisions to provide that a QI will "pay any under-withheld tax without regard to projection and that the IRS will determine if a projection of any under-withholding from a sample is required at the time of the IRS's review of the QI's periodic certification (and, if so, will direct the reviewer in performing the projection)." IRPAC thanks the IRS for its consideration of this recommendation.

Given this issue is still in discussion within the IRS, it is an ideal opportunity for the IRS to consult with industry on the implications. 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 Owner 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 a withholding agent.

Furthermore, IRPAC recommends that any guidance allow for different resolutions for different issues, not just extrapolation, as an equitable solution to most accurately reflect the under-withholding 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 under-withheld 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 under-withholding. 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. Furthermore, 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.

Given this, IRPAC recommends that the IRS provide sufficient time to allow for adequate consultation with industry on the implications of disallowing cures to be extrapolated as part of a liability projection on audit.

Recommendation G.6 – Form 1042-S Income Codes – Interest Related Dividends and Short-term Capital Gain Dividends

IRPAC recommends that the IRS provide guidance as to the proper income codes to be used in reporting interest related dividends described in IRC §871(k)(1) and short-term capital gain dividends described in IRC §871(k)(2) on Form 1042-S.

Discussion

There is no specific income code listed or guidance provided in the Form 1042-S instructions for reporting interest-related dividends or short-term capital gain dividends exempt from withholding under IRS §871(k). Consequently, there is inconsistency among withholding agents in the manner in which these income payment types are reported. Some withholding agents report these payments using income code "06 – Dividends paid by U.S. corporations – general," (under the rationale that they payments are dividends), while others are using code "01 - Interest paid by U.S. obligors – general" (similar to reporting for exempt interest dividends). Publication 515 has a brief discussion of interest-related dividends and short-term capital gain dividends under the heading for income code "06 – Dividends paid by U.S. corporations – general," which would seem to suggest that such payments should be reported as dividends, but does not provide any specific direction on how such payments should be reported. Given the disparate approach by withholding agents, it would be helpful for the IRS to clarify which code(s) should be used.

Recommendation G.7 – Form 1042-S Income Codes – IRC §305(c) Deemed Distributions

IRPAC recommends that the IRS provide guidance as to the proper income code to be used in reporting deemed distributions described in IRC §305(c) on Form 1042-S

Discussion

There is no specific income code listed or guidance provided in the Form 1042-S instructions for reporting deemed distributions under IRS §305(c). Consequently, there is uncertainty and inconsistency among withholding agents in regard to the manner in which this income is being reported. Some withholding agents report these payments using income code "06 – Dividends paid by U.S. corporations – general," while others use code "34 – Substitute payment – dividends," based upon the definitional language in Treas. Reg. §1.861-3(a)(6). Given the disparate approach by withholding agents, it would be helpful for the IRS to clarify which code should be used.

Recommendation G.8 – Loan Syndication Fees

IRPAC requests the IRS issue written guidance on the source and character of cross border fee payments such as securities loans, repo, and loan syndication transactions.

Discussion

The IRS and withholding agents have a unique partnership in which the IRS heavily relies on withholding agents to ensure proper tax collection and administration. As part of this partnership, withholding agents require clear guidelines to effectively administer withholding on outbound payments. Lack of clear guidance and ambiguity pose both audit risk and competitive disadvantage to a withholding agent as well as a loss of revenue to the Treasury.

In order to ensure compliance with IRS requirements, withholding agents have requested that the IRS issue guidance on fee payments for several years, specifically with respect to securities loan and repo fees such borrow fees and rebate fees as well as the many fees involved in loan syndication transactions. However, the IRS has not provided such guidance which has resulted in inconsistent treatment of similar transactions by both withholding agents and IRS examiners.

These fees have become a focus area on recent IRS audits, particularly in the area of loan syndication. Given this, the IRS must have a view on the treatment of these fees. Therefore, IRPAC requests written guidance and additional transparency on the proper treatment of these fees so as to enable withholding agents to continue to effectively support the IRS in the collection and administration of these taxes.

Recommendation G.9 – Extension of Qualified Securities Lender Regime

IRPAC recommends maintaining a modified version of the current QSL regime for entities engaging in traditional agency lending.

Discussion

In the 2016 IRPAC report, IRPAC recommended maintaining a modified version of the current Qualified Securities Lender (QSL) regime for entities engaging in traditional agency lending. At the time, the Proposed QI Agreement as published in Notice 2016-42 stated that a QI cannot act as a QDD when acting in an intermediary capacity, which appeared to indicate that entities acting as agent lenders in a securities loan transaction do not qualify for QDD status as they are acting in an agent capacity rather than principal. While this language was further clarified in Rev. Proc. 2017-15, the complex requirements of QDD compliance continue to place 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 G.10 – Reinstatement of Substitute Form 1042-S Payee Statements

IRPAC recommends that the use of substitute Form 1042-S payee statements be reinstated but with additional minimum requirements added to assist IRS Service Center personnel in processing. Alternatively, IRPAC recommends that these substitute statements be reinstated with any prohibition to the use of such statements being confined only to those statements on which withholding is shown. Finally, assuming the IRS would reinstate the use of these statements, 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

As part of its 2016 report, IRPAC highlighted the dialogue between its membership and the IRS as related to the use of substitute Form 1042-S payee statements. As noted by IRPAC, withholding agents are resistant to using the official Form 1042-S because the form is confusing and inefficient and, as such, negatively impacts communications to customers. The IRS, in turn, explained that its effective elimination of the use of substitute Form 1042-S 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 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.

IRPAC continued this dialogue during 2017. As a result, IRPAC recommends that the IRS at a minimum allow withholding agents to furnish substitute Form 1042-S payee 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, bank deposit interest, etc.). As a result, those statements in these cases are not used to make refund or credit claims, but rather used merely to report certain payments made to 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 given reciprocal reporting obligations under FATCA.

Moreover, allowing substitute Form 1042-S payee statements in the case of payments that are not subject to withholding would greatly enhance the ability of withholding agents to deliver a simpler payee statement that can be easily understood by its customers. The substitute form would be able to eliminate irrelevant information and would allow for the combination of a single customer's reportable accounts onto a single payee statement.

Finally, regardless of the IRS position with respect to the above requests, withholding agents are required to assign a UIN to each filed Form 1042-S beginning with tax year 2017. IRPAC recommends that the IRS develop the ability 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 eliminate the need to read any information from payee statements other than the UIN. This would minimize both the time and expense required for the IRS to process such claims, as well as minimize refund fraud.

Recommendation G.11 – FATCA Gross Proceeds Withholding

IRPAC requests a delay in the implementation of the Treas. Reg. §1.1473-1(a)(1)(ii) requirement to deduct and withhold tax on gross proceeds for two years following the issuance of guidance on FATCA gross proceeds withholding.

Discussion

Treas. Reg. §1.1473-1(a)(1)(ii) provides that a withholdable payment includes "for any sales or other dispositions occurring after December 31, 2018, any gross proceeds from the sale or other disposition of any property of a type that can produce interest or dividends that are U.S. source FDAP income." Industry standard generally holds that withholding systems require approximately two years to design, build, test, and implement. Given it is less than two years until this December 31, 2018 date, IRPAC requests the IRS delay the implementation of FATCA gross proceeds withholding for a minimum of two years following the issuance of applicable guidance.

Recommendation G.12 – FATCA Foreign Passthru Payment Withholding

IRPAC requests a delay in the Treas. Reg. §1.1471-4(b)(4) requirement to deduct and withhold tax on foreign passthru payments for a minimum of two years following the issuance of guidance defining the term foreign passthru payment.

Discussion

Treas. Reg. §1.1471-4(b)(4) provides that "A participating FFI is not required to deduct and withhold tax on a foreign pass-thru payment made by such participating FFI to an account held by a recalcitrant account holder or to a nonparticipating FFI before the later of January 1, 2019, or the date of publication in the Federal Register of final regulations defining the term foreign pass-thru payment." Industry standard generally holds that withholding systems require approximately two years to design, build, test, and implement. Given it is less than two years until this January 1, 2019 date, IRPAC requests the IRS delay the implementation of foreign pass-thru payment withholding for a minimum of two years following the issuance of guidance further defining the term foreign pass-thru payment.