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March 13, 2023

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Re: 2023 Qualified Intermediary Agreement

Dear Ladies & Gentlemen:

The Securities Industry and Financial Markets Association ("SIFMA")[1] would like to thank the Internal Revenue Service (the "IRS") for issuing Revenue Procedure 2022-43, providing the final qualified intermediary ("QI") withholding agreement (the "Agreement"). SIFMA takes this opportunity to propose several recommendations for the Treasury Department and the IRS to consider in order to clarify certain provisions in the Agreement.

(1) Clarification Regarding Reliance on Good Faith for IRC Section 871(m)

SIFMA requests clarification regarding the requirements for a QI and a QI acting as a qualified derivatives dealer ("QDD") to disclose in its periodic certification any IRC Section 871(m) transactions for which the QI or QDD relied on the good faith standard under section 10.01(C) of the Agreement. Section 10.01(C)

[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's one million employees, we advocate on legislation, regulation and business policy affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

of the Agreement sets forth the requirements for a QI and QDD to comply under a good faith effort standard with IRC Section 871(m) during the extended phase-in period for calendar years 2023 to 2025. With respect to a QDD, the Agreement provides that a QDD is only required to certify that it made a good faith effort to comply with the IRC Section 871(m) regulations and the relevant provisions of the Agreement. However, in closing, section 10.01(C) of the Agreement states, "For any reliance on the good faith standard, the QI must disclose any Section 871(m) transactions included in the review that the QI believes should be subject to the good faith standard for purposes of reporting the factual information with its periodic certification and include a brief description of the reason QI relied on the good faith standard, how the QI will address it, and why the good faith standard should apply." SIFMA requests confirmation that the requirement to disclose and describe any IRC Section 871(m) transactions for which the good faith standard was relied upon applies only to a QI, but not a QI acting as a QDD, and clarification as to whether that disclosure must be made on a transaction-by-transaction basis or should more generally identify the type of activity (e.g., documentation, reporting) for which good faith efforts applied.

(2) IRC Section 1446(f) Withholding and Nonqualified Intermediaries ("NQIs")

Section 5.13(B)(1) of the Agreement provides that a QI may not look through an NQI for purposes of IRC Section 1446(f) withholding, but must withhold 10% tax under IRC Section 1446(f) on payments to an NQI regardless of the information and the income allocation contained in the NQI's withholding statement and the tax statuses of its account holders. However, the provision, as written, applies only to "QI's payment of an amount realized from the sale of a publicly traded partnership ("PTP") interest made to a nonqualified intermediary." Although "amount realized" is defined in section 2.91(A) of the Agreement as including PTP distributions, section 5.13(B)(1) of the Agreement qualifies the phrase "amount realized" with the words "from the sale of a PTP interest", indicating that the provision applies only to PTP sales, but not to PTP distributions. On the other hand, section 5.07 of the Agreement states that "Notwithstanding the previous provisions of this section 5.07, for an amount realized paid to a nonqualified intermediary, QI is required to apply the presumption rule provided in section 5.13(C)(5) of this Agreement regardless of whether the nonqualified intermediary provides a valid Form W-8IMY and documentation with respect to the account holders receiving the amount realized", and does not qualify the phrase "amount realized" with the words "from the sale of a PTP", implying that the requirement to always withhold 10% tax under IRC Section 1446(f) on payments to an NQI applies to PTP distributions in excess of cumulative net income as well as PTP sales. The IRS should amend the Agreement (or provide other guidance) to clarify whether a QI may look through an NQI to its account holders for purposes of IRC Section 1446(f) withholding on a PTP distribution or whether the requirement to always withhold 10% tax under IRC Section 1446(f) on payments to an NQI applies to PTP distributions as well as to PTP sales.

In addition, clarification is needed regarding how to report amounts subject to IRC Section 1446(f) withholding when paid to an NQI. The QI Agreement (Section 8.02 (M)) provides that if a QI makes a payment of a PTP distribution to an NQI, QI must file a separate Form 1042-S for each foreign partner or beneficial owner of the distribution that is an account holder of the NQI. That section further provides that if "QI makes a payment of an amount subject to reporting under IRC Section 1446(f) to a nonqualified intermediary, *QI shall file the Form 1042-S for an unknown recipient of the nonqualified intermediary*….", except in cases where the QI and NQI agrees that the QI will report at the beneficial owner level. Furthermore, the recently released final Instructions to Form 1042-S for 2023 provide that "A QI making a payment to an NQI of an amount realized subject to reporting for purposes of Section 1446(f) should generally treat the recipient as an unknown recipient because Section 1446(f) withholding applies to an NQI without regard to the statuses of its account holders receiving the amount realized."

It is not clear from this guidance whether the QI should issue a single Form 1042-S to the NQI (as "unknown recipient") or whether the QI should issue a *separate* Form 1042-S for each underlying account holder of the NQI (each, to an "unknown recipient") to the extent the NQI has provided a valid withholding statement with sufficient allocation information of amounts realized under IRC Section 1446(f). The IRS should clarify the requirements in the QI Agreement or in other guidance such as the Instructions for Form 1042-S.

(3) Best Efforts to Obtain a U.S. TIN

Section 5.01(A) of the Agreement provides that "If QI makes a payment of an amount realized on a sale of a PTP interest or a payment of a PTP distribution, QI also agrees to use its best efforts to obtain the documentation that is described in section 5.02 of this Agreement." Generally, the documentation described in Sections 5.02(B) and (C) of the Agreement is a valid Form W-8 that includes the account holder's U.S. TIN. Section 5.01(A) of the Agreement also provides that a QI is treated as using its best efforts when QI meets certain requirements regarding written solicitation for the account holder's U.S. TIN. The Agreement does not specify whether or not the QI must solicit the account holder's U.S. TIN on a Form W-8, or whether an account holder's U.S. TIN provided pursuant to the QI's solicitation may be included on a separate statement or even provided verbally. The Instructions for the Requester of Forms W-8BEN, W-8BEN-E, W-8ECI, W-8EXP, and W-8IMY (Rev. June 2022) provide on page 4 that, in general, a Form W-8 provided by a partner for Section 1446(a) or (f) purposes must include the partner's U.S. TIN, but that a withholding agent may rely on a U.S. TIN included on a separate statement associated with an otherwise valid Form W-8 indicating that it relates to the applicable Form W-8. It is reasonable to assume that the permission to rely on a U.S. TIN provided on a separate statement associated with a Form W-8 applies to U.S. TIN solicitations by a QI as well, but we ask the IRS to make this explicitly clear in the Agreement (or in other guidance).

(4) U.S. TIN Solicitation Requirement for PTP Distributions

Section 5.01(A) of the Agreement includes a new requirement for QIs to use "best efforts" to obtain documentation from account holders that receive either: (1) an amount realized from a PTP sale, or (2) a payment of a *PTP distribution*. Section 5.02(B) of the Agreement provides that the required documentation – either Form W-8 or documentary evidence – must include the account holder's U.S. TIN. Presumably, the U.S. TIN requirement relates to the filing requirements for non-U.S. persons receiving effectively connected income ("ECI") from the PTP.

Section 2.91(J) of the Agreement defines a "PTP Distribution" simply as a distribution made by a PTP. The definition is *not* limited to distributions of ECI. Consequently, PTP distributions of only U.S. source FDAP income (e.g., interest and dividends) that are not ECI still trigger, based on the current wording of the agreement, the "best efforts" U.S. TIN solicitation requirement. This rule is overbroad, and the IRS should clarify that only PTP distributions of ECI subject to IRC Section 1446(a) and/or 1446(f) will trigger the U.S. TIN solicitation requirement. This approach would be consistent with the Form 1042-S instructions (income code 27).

(5) Due Date of Certifications

The time period after the year chosen for the Periodic Review in which to make a Certification of Internal Controls is shorter for QIs who choose the third year for the Periodic Review than for QIs that choose the first or the second year. Pursuant to section 10.03 of the Agreement, QIs choosing the first year have,

from the beginning of the tax year following the year of the Periodic Review, two and a half years to complete the Periodic Review and Certification of Internal Controls. QIs choosing the second year have a year and a half. QIs choosing the third year have only one year to complete both the Periodic Review and the Certification of Internal Controls. The effect of these rules is that it is very challenging for QIs choosing the third year of the cycle as the Periodic Review year to complete the Periodic Review and the Certification of Internal Controls in a timely manner. The Periodic Review cannot begin until the Forms 1042-S and 1042 have been filed, which in most cases means that there are only a few months left to conduct the Periodic Review. For larger QIs with multiple branches, this is particularly challenging. SIFMA proposes that for QIs that choose the third year of the cycle as the year of the Periodic Review, the deadline for Certification of Internal Controls and the submission of factual information by the Responsible Officer be changed to July 1 of the second year following the Periodic Review year. For example, for QIs that choose year 2023 as their year of Periodic Review, the deadline would be July 1, 2025. In addition, due to the introduction of increased reconciliation requirements imposed by Appendix III for each year of the Periodic Review cycle, additional time may be necessary for all QIs regardless of the year the QI selects for the Periodic Review.

(6) Reconciliation of Forms 1042-S

Appendix III, Part 3 of the Agreement requires an explanation of variances between Forms 1042-S filed and received. For large QIs and/or QIs with more complex activities, it is highly challenging to arrive at an explanation of all variances. In some instances, despite best efforts, a reason for discrepancies between Forms 1042-S issued and received cannot be found. This is a common industry issue that affects many QIs. The amount of time and resources that is required to investigate minor differences is often disproportionate when compared to the amounts required to be explained. For example, there can be a difference with a custodian of $1,000 consisting of several hundred transactions for minimal amounts with a range of different root causes. SIFMA proposes that the IRS allow for a de minimis threshold of total tax withheld and gross income amounts reported on Forms 1042-S for unexplained differences such that as long as the unexplained reconciliation differences are under a de minimis threshold, these amounts would not be considered for the purposes of projection and would not trigger other punitive consequences, such as penalties.

(7) Nominee Reporting and Foreign PTPs

Section 8.07(A) of the Agreement includes a new requirement for QIs to perform nominee reporting under Treas. Reg. §1.6031(c)-1T. However, nominee reporting is required by the applicable Treasury Regulations only if the partnership itself is required to file a U.S. tax return. Treas. Reg. §1.6031(c)-1T(a)(1)(i).

With very few exceptions, all U.S. partnerships are required to file U.S. tax returns (Form 1065), so these partnerships are also subject to Schedule K-1 and nominee reporting. In contrast, foreign partnerships are frequently exempted from filing a U.S. tax return, and the Schedule K-1 and nominee reporting rules do not apply. The filing exception for non-U.S. partnerships may be summarized as follows:

- In general, a U.S. tax return is not required from a foreign partnership with no ECI and no U.S. source income. Treas. Reg. §1.6031(a)-1(b)(1)(i). Consequently, Schedule K-1 and related nominee reporting do not apply in those cases.

- In addition, a U.S. tax return is not required from a foreign partnership that receives less than a de minimis amount of U.S. source income ($20,000), has no ECI, and de minimis ownership by U.S. partners. Treas. Reg. §1.6031(a)-1(b)(2).

- Furthermore, a U.S. return is not required if the foreign partnership has no ECI and no U.S. partners and (i) files Forms 1042 and 1042-S for the non-U.S. partners (unless such forms are filed by another withholding agent); (ii) all required withholding under chapter 3 has been applied; and (iii) the partnership is not a withholding foreign partnership. Treas. Reg. §1.6031(a)-1(b)(3)(i)-(ii).

- Finally, a modified filing rule applies to non-U.S. partnerships with U.S. source income, but no ECI, and U.S. partners. In such cases, Schedule K-1 reporting (and presumably nominee reporting) generally apply only to the U.S. partners. The conditions described immediately above in (i)-(iii) also apply. Treas. Reg. §1.6031(a)-1(b)(3)(i) and (iii).

This list of exceptions and conditions present QIs with a dilemma: how can a QI identify those foreign PTPs exempted from filing Form 1065? The Qualified Notices ("QNs") issued by foreign PTPs do not address, and were not designed to address, this issue.

The IRS should provide much needed clarity to QIs facing new nominee reporting requirements. Similar to the presumption in Notice 2023-8 that foreign entities generally are not PTPs, the IRS should allow QIs to presume that foreign PTPs are not subject to Form 1065 or Schedule K-1 filing – so nominee reporting also would not apply – provided that the foreign PTP issues a QN covering the relevant period that it is not subject to IRC Section 1446(f) withholding. Consistent with Notice 2023-8, however, the presumption would not apply if the QI has actual knowledge the QN is incorrect.

(8) Substitute Dividends

Section 3.03(A) of the Agreement includes the following new statement regarding substitute dividends:

> A QI not acting as a QSL and acting as an intermediary under this Agreement for a U.S. source substitute dividend payment *must also assume primary withholding responsibility for all U.S. source substitute dividends* received and paid by QI as intermediary (emphasis added).

By itself, the passage above may suggest that if a QI does not assume primary withholding responsibility for chapters 3 and 4 purposes, that QI is still obligated to assume primary withholding responsibility for U.S. source substitute dividends. This interpretation, however, contradicts the premise that QIs *may elect* primary withholding responsibility, but never are *required t*o make that election.

We believe a better reading of the quoted passage, and one that is consistent with the notion that primary withholding responsibility is *elective*, is that the passage only addresses QIs that assume primary withholding responsibility for substitute dividends. The IRS should clarify that a QI is not required to assume primary withholding responsibility for substitute dividends unless that QI is a QDD or QSL.

(9) QDD Reconciliation Table

The Agreement continues to require all QDDs to maintain, and make available to the IRS upon request, a detailed reconciliation schedule. The schedule requires extensive information about each specific

transaction that the QDD enters into with respect to each underlying security. See section 7.01(C) of the Agreement.

This amount of detail is simply not warranted for QDDs that calculate their tax liability on a net delta basis. It will impose a significant burden on QDDs and is not necessary or relevant to substantiate the tax that is due. Instead, the QDD should only be required to maintain records relevant for the net delta calculation (plus any adjustments for tax purposes). The IRS should delete the reconciliation requirement under section 7.01(C) of the Agreement for QDDs that calculate tax on a net delta basis.

(10) Requirement to Include a U.S. TIN on a Request for a Payee-Specific Form 1042-S

SIFMA appreciates the administrative relief provided in the Agreement which limits the time frame and expands the instances in which an account holder can request a payee-specific Form 1042-S from the QI. Section 8.02(P) of the Agreement introduces a new requirement for account holders to include their U.S. TIN when making a payee-specific Form 1042-S request, presumably, based on the assumption that payee-specific Forms 1042-S are used for filing a U.S. tax return. Although some account holders may request a payee-specific Form 1042-S for purposes of filing a U.S. tax return, in practice, many non-U.S. account holders request a payee-specific Form 1042-S to claim a credit or a refund for *non-U.S.* tax filing purposes.

Imposing a requirement to obtain an account holder's U.S. TIN creates an undue burden on non-U.S. owners of U.S. securities who are required by their local tax authority to provide account information substantiation on an original Form 1042-S.[2] As such, SIFMA requests that the IRS clarify that a QI is permitted, but not required, to issue a payee-specific Form 1042-S without a U.S. TIN, if the client's request otherwise complies with the requirements set forth in section 8.02(P).

(11) Certification of Compliance with IRC Sections 1446(a) and 1446(f)

Pursuant to the Preamble to the Agreement,[3] a QI is required to certify that "the QI has acted only to the extent permitted under the QI agreement." In this regard, the Preamble provides an example that "a QI would not be able to make this certification if it represents its status as a QI with respect to an amount realized paid to an account holder for an interest in a partnership that is not a PTP."

The Agreement (see, e.g., sections 3.01(C); 3.03(C)) and the current version of Form W-8IMY permit a QI to certify a QI status only with respect to an amount realized from a PTP, and not with respect to non-PTPs. In addition, QIs are already required to certify their compliance with IRC Sections 1446(a) and 1446(f) in section 10.03 and Part II of Appendix I of the Agreement. Accordingly, SIFMA requests confirmation that the additional language in the Preamble referenced above does not introduce a separate certification regarding compliance with IRC Sections 1446(a) and 1446(f), beyond what it already included in the Agreement.

We appreciate your consideration of our recommendations. If you have questions and would like to discuss this matter, please do not hesitate to contact me at jsok@sifma.org or (202) 962-7399.

Respectfully submitted,

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[2] Cf. Treas. Reg. Section 1.905-2(a)(2), which generally requires an original non-U.S. tax receipt for a U.S. taxpayer to claim a foreign tax credit against its U.S. federal income tax liability.
[3] See Page 44 of the Preamble to Rev. Proc. 2022-43.

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