

Qualified Intermediaries US reporting and compliance alert Proposed changes to QI agreement and QI audit guidelines

dated 21 October 2008

On October 14, 2008, the US tax authorities (IRS) announced changes to the QI agreement as well as to the QI audit guidelines. At a conference organized by the British Bankers' Association on October 16, 2008, Senior Executives of the IRS explained the proposed rules and provided further information on current discussions. In addition, the IRS announced the release of new draft rules on reporting and withholding before the year end.

General Background

The Qualified Intermediary (QI) program established in 2001 is a key element of the US tax regulations intending to enhance adequate taxation of US citizens who operate accounts outside the US. Based on the experience made on past QI audits, the IRS got the impression that not all QIs have taken all necessary steps to ensure full compliance with their obligations under the QI agreement. Therefore, the IRS wants to enhance transparency, communication and accountability, and with Announcement 2008-98 it proposed amendments to the QI agreement as well as to the QI audit guidelines.

The IRS proposes that these amendments should be effective as from December 31, 2009. Comments from the public should be submitted on or before February 28, 2009.

Proposed Amendments to the QI Audit Guidelines

Internal Controls

Under the current audit rules (i.e. Revenue Procedure 2002-55), the audit is a fact finding process to be performed in maximum three phases. Based on the report submitted by the QI on Phase 1 findings, the IRS makes an assessment whether or not to enter in Phase 2. In Phase 2, the IRS would ask the QI auditor to perform further audit steps and to provide additional information e.g. on the QI's internal controls.

Under the proposed new audit guidelines, the QI should already in Phase 1 identify and report on:

- the QI personnel charged with the oversight of performance under the QI agreement, their posts of duty, job descriptions and the reporting chain and authority;
- any significant actions to prevent, deter, detect and correct errors in performance of the QI agreement taken by such personnel;
- whether the QI has any procedures in place for receiving and investigating allegations of material failures of internal control by QI employees.

In addition, the QI auditor should review whether any facts or circumstances observed in the course of its audit reasonably relate to the evaluation by the IRS of the risk of a material failure of internal controls.

With respect to such internal controls, the IRS recognizes that the extent of internal controls might vary depending on the size of the QI.

Associating US Auditor

The IRS intends to involve US auditors in the QI audits, in addition to the locally acting QI audit firm. Therefore, the proposed rules include that any external auditor that is a non-US person or a non-US accounting firm that conducts a QI audit must associate an US accounting firm with the QI audit. The US accounting firm must cosign the auditors report and accept joint and several liability for the conduct of the QI audit.

Identify Accounts for which US Person has Authority

In order to be better positioned for its risk evaluation, the IRS asks for further information to be obtained during Phase 1 of the QI audit.

Under the current audit guidelines, the QI auditor has to verify the existence and validity of the documentation (i.e. US-forms or Know-Your-Customer documentation). According to the proposed amendments, the QI auditor shall also examine any account information. This includes other forms or memoranda, documents, reports or other information generated or received for purposes of anti-money laundering, tax or other laws.

The auditor has to determine whether these information show that a US person has signature or any other authority (including authority to withdraw funds, give instructions, or receive account statements, confirmations or other information). The number of such accounts has to be reported in the QI auditors' report, and the IRS will, based on this, make an assessment whether or not to proceed to Phase 2 of the QI audit.

The IRS explained that it will not require the QI to collect more information from the client. The IRS will only ask the auditor to perform additional steps and to report on the findings.

Proposed Amendments to the QI Agreement

The QI agreement may be terminated in case of a significant change of circumstances. According to the proposed amendments, this will include a material failure of internal controls relating to its performance under the QI agreement, any employee allegations relating to such material failures, or any investigation by any regulatory authorities relating to such material failures.

If the QI fails to notify the IRS of any material failure of internal controls within 60 days of discovery of its occurrence, this will be considered an event of default.

New Rules on Reporting and Withholding

The IRS did not comment on expected changes in the reporting and withholding rules. New draft rules however will be announced before the end of this year.

Other Comments made by the IRS

The IRS expects comments on the proposed amendments on or before February 28, 2009. In addition, the IRS encourages the QI community to also submit comments on other experience made with the QI regulations.

The IRS recognizes that QIs face difficulties in contacting the IRS or determining the competent contact person within the IRS. Thomas Chillemi (IRS QI Team Manager) announced that QIs experiencing such problems may directly call, mail or fax him. In this respect, the IRS asks the QIs' to improve communication with the IRS, in particular not to ignore letters received from the IRS and to update contact details of the personnel responsible for QI.

The IRS encourages QIs to ask for audit waivers wherever applicable. In this respect, the most common reason for the IRS to deny such waiver requests are merely due to formal failures (e.g. incorrect 1042/1042-S reporting, deadline for requesting waiver exceeded).

According to the IRS, reporting in paper copies is proceeded manually and leads often to errors. Therefore, the IRS strongly recommends to use electronic filing.

Based on previous experience, the IRS strongly suggests that QIs insist on getting their appropriate copies 1042-S from the withholding agents. Otherwise, the QI will not be in the position to prove that a withholding has been made by the withholding agent.

Contacts

For further information, please contact the PricewaterhouseCoopers Luxembourg Qualified Intermediaries experts:

Kerstin Thinnes

Tax, Partner
+352 49 48 48-2537

kerstin.thinnes@lu.pwc.com

Marianne Weydert

Audit, Partner
+352 49 48 48-2566

marianne.weydert@lu.pwc.com

PricewaterhouseCoopers

400, route d'Esch, B.P. 1443
L-1014 Luxembourg
Telephone +352 49 48 48-1
Facsimile +352 49 48 48-2900

PricewaterhouseCoopers cannot be held liable for mistakes, omissions, or for possible results obtained further to the use of this document, which is issued for information purposes only. No reader should act on or refrain from acting on the basis of any matter contained in this publication without considering and, if necessary, taking appropriate advice upon their own particular circumstances.

© 2008 PricewaterhouseCoopers S.à r.l. All rights reserved. PricewaterhouseCoopers refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.