



## Qualified Intermediary Program

### Impact of Contemplated Changes on the Finance Industry

ITEMS OF INTEREST JULY 2009

In May 2009, President Obama and Treasury Secretary Geithner announced the Administration's international tax reform plan. The changes, if enacted, are said to be the most comprehensive tax reform since 1986.<sup>1</sup> The tax reform plan is primarily aimed at curbing international tax avoidance by both US multinationals and individuals.<sup>2</sup> Details of the proposed tax reform were unveiled on May 11, in the US Treasury Department's Green Book explaining President Obama's fiscal 2010 budget,<sup>3</sup> however at the time of this writing, draft legislation has not yet been released. The proposed changes includes an extensive reform of the Qualified Intermediary Program, which was established in 2001 to improve the withholding and reporting of US-source income sent to foreign financial institutions receiving it on behalf of their account holders.<sup>4</sup>

#### Background

Recent events, most notably the UBS case, have exposed weaknesses in the Qualified Intermediary Program.<sup>5</sup> American clients of UBS' North American Private Banking business unit masqueraded as foreign persons behind sham entities domiciled in offshore jurisdictions in order to avoid paying US taxes on assets held in their offshore accounts.<sup>6</sup> Under the current Qualified Intermediary Agreement the qualified intermediary is, in principle, not obligated to look behind corporations to see whether the beneficial

owner is American.<sup>7</sup> The Agreement also did not require foreign financial institutions to collect Form W-9, the reporting form for US persons, if a US account earned only foreign-source income paid to and held in accounts outside the United States.<sup>8</sup>

This is all set to change if President Obama's international tax reform proposals are enacted into law. The proposals seek to strengthen the Qualified Intermediary Program by increasing reporting required of qualified intermediaries, increasing tax withholding on transactions involving non-qualified intermediaries and imposing a legal presumption against users of non-qualifying intermediaries and increased penalties for failing to report overseas investments.<sup>9</sup>

#### Increased Reporting Requirements for Qualified Intermediaries

Foreign financial institutions will face increased compliance costs, as qualified intermediaries will no longer benefit from certain reporting exceptions based on their foreign status.<sup>10</sup> Under the proposed tax reform, qualified intermediaries would be required to report information on their US clients to the same extent that US financial intermediaries must.<sup>11</sup> Therefore, qualified intermediaries would be required to report US and foreign-source dividends paid to a US person.<sup>12</sup> Qualified intermediaries will also be required to collect information about beneficial owners of foreign entity account holders and specifically report US persons who are beneficial owners to the Internal Revenue Service ('IRS').<sup>13</sup>

Qualified intermediaries will also be required to report transfers of money or property with a value of more than USD 10,000 to a foreign bank, brokerage or other

<sup>1</sup> The Tax Reform Act of 1986 drastically reduced the number of deductions and number of tax brackets; See also Martin A. Sullivan, *Obama Launches International Reform: The Battle Begins*, Tax Notes Today (May 8, 2009).

<sup>2</sup> Press Release, Office of the Press Secretary, The White House, *Leveling the Playing Field: Curbing Tax Havens and Removing Tax Incentives for Shifting Jobs Overseas* (May 4, 2009).

<sup>3</sup> US Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals* (May 2009).

<sup>4</sup> Application Procedures for Qualified Intermediary Status Under Section 1441; Final Qualified Intermediary Agreement, Rev. Proc 2000-12.

<sup>5</sup> Meg Schreve, *IRS Examining Methods to Strengthen QI Program, Shulman Says*, Tax Notes Today, (April 1, 2009).

<sup>6</sup> Janet P. Levaux, *UBS Admits to Tax Evasion, to Pay \$780 Million*, Research Magazine (Feb. 19, 2009).

<sup>7</sup> *Banking Secrecy Practices and Wealthy American Taxpayers*, House Ways and Means Select Revenue Measures Subcommittee, (Mar. 31, 2009) (statement of Rep. Richard E. Neal); See generally Final Qualified Intermediary Withholding Agreement.

<sup>8</sup> Final Qualified Intermediary Withholding Agreement, §2.44(B); See also *IRS Examining Methods to Strengthen QI Program* at 2.

<sup>9</sup> Press Release, Office of the Press Secretary, The White House, *Leveling the Playing Field: Curbing Tax Havens and Removing Tax Incentives for Shifting Jobs Overseas* (May 4, 2009).

<sup>10</sup> General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals at 42.

<sup>11</sup> Id.

<sup>12</sup> Id.

<sup>13</sup> Id.

financial account on behalf of a US person or on behalf of any entity owned by a US person.<sup>14</sup>

A US person or any qualified intermediary that forms or acquires a foreign entity on behalf of a US person (of which the US Person holds more than 50% of the ownership interest) will be required to report the foreign entity that is formed or acquired to the IRS.<sup>15</sup>

### Withholding Tax on Payments Made Through Nonqualified Intermediaries

US financial institutions will be required to treat reportable payments<sup>16</sup> made to nonqualified intermediaries as though they were made to an unknown foreign person and therefore withhold tax at a rate of 30%.<sup>17</sup> Investors must disclose their identities and demonstrate they are not evading US taxes in order to obtain a refund for the amount withheld.<sup>18</sup>

Under the proposal, a withholding agent would also be required to withhold tax at a rate of 20% on gross proceeds from the sale of any reportable security, when paid to a nonqualified intermediary that is located in a jurisdiction in which the United States does not have an income tax treaty with a satisfactory exchange of information program.<sup>19</sup> Given that Switzerland agreed to a revised double taxation agreement with the United States on 18 June 2009, it is unlikely that Swiss financial institutions which are not qualified intermediaries would be implicated by this provision of the tax reform.

### Legal Presumptions Against Users of Nonqualified Intermediaries

The Administration's tax reform plan would create a negative presumption that any foreign bank, brokerage or other financial account held by a US person at a nonqualified intermediary contains enough funds (USD 10,000) to trigger FBAR (Foreign Bank Account Report) filing requirements to the IRS.<sup>20</sup> Any failure to file an FBAR will be considered willful if an account at a nonqualified intermediary contains an amount greater than USD 200,000 at any point during the year.<sup>21</sup>

<sup>14</sup> Id. at 48.

<sup>15</sup> Id. at 50.

<sup>16</sup> Payments of US source fixed or determinable annual or periodical gains, profits or income. Id. at 43.

<sup>17</sup> Id. at 43.

<sup>18</sup> White House Press Release (May 4, 2009).

<sup>19</sup> Id. at 44.

<sup>20</sup> Id. at 52.

<sup>21</sup> Id.

### Increased Penalties

The Administration intends to give the proposed changes force by increasing penalties for failing to report overseas investments for US Persons. In order to deter the use of overseas accounts to evade US taxes, the changes would double the penalties (against US Persons) applicable to understatements from transactions that involve foreign accounts held by US Persons.<sup>22</sup> However, it is not clear whether the proposed plan would also include increased penalties for qualified intermediaries for insufficient reporting.

The Administration's plan would also extend the statute of limitations on international tax enforcement from 3 years to 6 years after the taxpayer reports required information.<sup>23</sup>

### Effective Date

The proposed tax reform would be effective beginning in the calendar year after they are enacted. If enacted this year, the proposals would apply for the 2010 tax year.<sup>24</sup>

### lecocqassociate's Experience

lecocqassociate provides legal advice on U.S. financial regulatory laws including SEC and CFTC rules and regulations.

This article is a summary of the U.S. Treasury Department's Green Book explaining President Obama's fiscal 2010 budget. It is for information purposes only and should not be considered legal advice. Please contact Dominique Lecocq or Leah Vu for any questions:

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<sup>22</sup> Id. at 56.

<sup>23</sup> Id. at 54.

<sup>24</sup> See generally General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals.