

Question and Answer Session

Questions

1. As the implementation date draws near much has been said about the backlog at the IRS with regards to QI approvals, KYC country specific attachment approvals, the distribution of EIN numbers and the approval of QI master agreements.

The market place would like to understand what contingencies the IRS has in place to accommodate those in the market place that have submitted all the necessary documentation with systems ready to go come the 1st January?

Is there a deadline to obtain QI status, what are the steps and how long will it take?

2. As we understand it the spirit of the law in very simple terms is to identify and tax US source income held by foreign intermediaries on behalf of US persons, formalize the address rule based on IRS criterion and to put an end to treaty shopping.

However, one issue that appears to target institutional agency business is the position that the IRS has taken on fails. The ability to accurately withhold and report, the ability to enhance agency systems that are not geared towards corporate events is making it very difficult for market participants to comply. The IRS has stated that this issue is not on the high end of your priorities so the market would appreciate the IRS view in this regard as we concentrate on complying with the spirit of the law.

3. Another issue that targets institutional agency business is securities lending and coupon payments across open repos which require the selling broker over ex date to act as the paying agent. The ability to accurately withhold and report, the ability to enhance proprietary and agency systems that are not geared towards corporate actions will make it very difficult for the market to comply. The market would be interested in the IRS view in this regard.

Answers

The IRS response was as follows:

- The IRS is considering applying interim QI status to countries that have been approved as QI's and whose KYC country specific attachments have been approved as well.
- The IRS also advised the group that they would prioritize institutions who are looking to become primary withholding agents as primary withholding agents require an EIN number to effect direct payments to the US Treasury
- In addition for those institutions who have submitted their QI application the IRS is agreeable to accept the phrase "Awaiting QI EIN approval" on the W-8IMY's that are submitted to their US custodian as an interim measure.
- The IRS went on to add that there are no deadlines to submitting your agreement but urge those institutions that have not yet done so to do so now.
- Lastly the IRS advised the group that they will issue a circular covering contingencies sometime in early December 2000

- The IRS corrected our first paragraph and advised the group that the aim of the IRS was actually to eliminate the address rule
- The IRS recognize the complexities of this issue but will not be prepared to address this issue until after the end of this year. The technical rules as they are written stand as they are. Selling brokers will need to ensure that W-8's are collected from their counterparts and will be required to maximum withhold for those brokers absent documentation.

- The IRS recognizes that they are lumping together abusive behavior and proper business but any changes will not be forthcoming before the end of the year. Any changes would require a change in tax law so this is a complex issue
- The technical rules as they are written stand as they are. Brokers who pay coupons over a coupon date will need to ensure that W8's are collected from their counterparts to ensure proper withholding and will be required to maximum withhold for those brokers absent documentation.

Questions

Answers

4. As you may be aware there are a variety of account structures available in the market to accommodate the new rules for QI's minus withholding responsibilities.
Some examples are;
- 1/ an asset based account structure where NRA withholding rates represented in your client base will dictate the number of NRA accounts, a segregated US non-exempt account and a non-disclosed account will be maintained by the QI;
- 2/ a payment based allocation structure where omnibus accounts per an aggregate NRA client base and an omnibus account per an aggregate US persons client base will be maintained to be followed by a withholding /payment allocation statement per corporate event;
- 3/ a blended rate omnibus account structure that requires under and over recovery as well as miscellaneous hybrid account structure options are available in the market.

Some custodians have permitted the use of one omnibus account for QI's without withholding responsibilities for both their aggregate NRA and their aggregate US persons by turning off the 1099 reporting on the account with a replacement manual process in place to cover their 1099 reporting requirements. Some custodians have declined to offer this service citing the difficulties that the separate reporting requirements represent per reporting regime. As the IRS changes have never insisted on a segregation of NRA and US non-exempt holdings in US securities, the market is looking for your views on how best the IRS can simplify this process. This will allow US custodians the ability to provide a one omnibus account service for QI's without withholding responsibility minus the manual workarounds.

5. Current descriptions of US securities include US issued registered Euro-clear or Clearstream eligible fixed income product. There are even cases of bearer US issued Euro-clear eligible product on a selective basis defined as US product. There will be cases where market participants will need to eyeball these issues on a case by case basis?
- Will there be any consideration by the IRS to simplify the definition of a US security as it relates to Euro-clear eligible product as the case by case inspection process will prove very difficult?
- Does the IRS maintain a list of what constitutes a US security?

- The IRS advised the group that the Rules were designed with flexibility in mind. The account structure chosen should be based on your requirements as a business and the subsequent relationship you have with your custodian. In short there is no one absolute account structure.

- The IRS advised the group that they did not maintain a list of US securities. However a real simple rule of thumb is; " if the income is issued by a US person it is a US security"

US securities can be defined as :

- US issuers issuing common or preferred equity traded or deposited in the US or a foreign exchange
- US issuers issuing warrants and rights
- US issuers issuing GDR's , IDR's etc...
- US mutual funds (open and closed)
- Securities settled options and derivatives with US issuer as underlying
- US government agency securities (UST's , Freddie's, Fannies, Ginnies etc....)
- US issuers issuing corporate bonds
- US companies issuing overseas in a foreign currency

Questions

Answers

- A US Branch of a foreign bank, a US affiliate or subsidiary of a foreign company issuing in the US
- A US issued registered Eurobond
- US treasury Bills, Commercial paper, Bankers Acceptances and Fiduciary Deposits

The following are NOT US securities:

- ADR's
- Yankee bonds
- Supranational Bonds (World Bank, IBRD's, ABD's etc....)
- Brady bonds
- US issued bearer Eurobonds (please note that there are exceptions to this depending on the prospectus)
- Foreign incorporated mutual funds
- Cash settled options and derivatives with US issued underlying
- A Non-US affiliate of a US company issuing bonds overseas

PLEASE ENSURE THAT YOU CHECK THE ABOVE WITH YOUR TAX ADVISOR AND CUSTODIAN AS IT IS MEANT TO BE GUIDELINE NOT AN ABSOLUTE COMPREHENSIVE LIST

6. Current descriptions of US securities also include US issued cross-listed securities. Our due diligence has proven that the current markets in these securities in Asia Pacific are fairly thin and the IRS changes knowledge base amongst market participants in these securities to be a bit behind the part of the market that custodizes cash US products. The response to the IRS changes in these markets have been varied with one option being to discontinue to offer these securities to their client base?

- The IRS restated their view that US issued cross-listed or cross-traded securities on foreign exchanges are US securities for the purpose of the rules
- The IRS went on to state that depositories should seriously look to become QI's. Foreign depositories cannot resort to wholesale maximum withholding minus the reporting requirements

What is the IRS view/approach in dealing with a possible scenario where a depository custodises US securities but have not set out clear guidelines to their participants who hold US securities as intermediary?

How can a participant mitigate its exposure whilst the depository clarify its process flow?

How will IRS ensure that no two tax authorities claim 'ownership' of the same security?

Questions

Answers

7. One of the approaches used to accommodate the IRS changes will require a withholding/payment allocation statement to be passed to the US custodian by payment date minus one. Current record /ex date/payment date relationships fixes the record date to two days after ex date with the payment date two to three weeks after the record date.
- Announcements by issuers do not seem to be regulated or fixed. The market would like the announcement process to be fixed prior to record date where possible to allow for a more seamless allocation process. What is the IRS view on this issue?
8. As it has been made clear that QI's are required to disclose their US persons client base the subject of W-9's and the ability to transmit the W-9 cross border has been an issue. Is it possible for the IRS to consider permitting our US custodian to accept the withholding statement as proof of documentation before the payable date contingent on the receipt of the W-9 after the payable date?
9. Issues around drill down entities i.e. grantor/simple trusts who do not contain US persons have been circulated in the market over the last several weeks. Please advise if the IRS is seeking to provide dispensation to QI's permitting them to report on the trust level rather than on the beneficiary level?
- The IRS advised the group that the standardisation of issuer announcements are the forte of the SEC. The IRS has zero control over this issue
 - This issue will need to be raised through industry groups in the US in order to get this on the SEC's radar screen
 - The IRS advised the group that the new rules were not meant to disrupt the domestic tax withholding regime and they were disinclined to provide any dispensation in this regard.
 - The IRS advised the group that it is indeed considering relief for drill down entities limited to simple and grantor trusts that do NOT contain US persons from 1042-S reporting on the bene owner level. The reporting would accommodate the drill downs rolled up as aggregate in reporting pools. The IRS took pains to clarify that the QI is still required to collect the underlying W-8BEN's but would only be required to keep them on file
 - The IRS advised the group that written clarification on this topic would be forthcoming in their December notice
 - The IRS went to add that it would be highly unlikely that trusts could be considered the bene for DTA relief purposes as the trust would in most cases not meet the requirements spelled out under most treaties (i.e. resident under the treaty, the origin of the trust needs to be fiscally transparent etc...)
 - The IRS went to add that one needs to perform analysis on the definition of a trust as often they find that their definition of a trust and the local definition of the trust can be far apart. For instance collective investment vehicles such as unit trusts under IRS definition would not be able to maintain different ownership classes or buy/sell US securities.

Questions

Answers

10. The treatment of BVI companies and their treatment as corporations has been a topic of discussion for several months. The IRS view on BVI's has been to treat them as a corporation as long as the proper corporate governance is in place. If a BVI provides you with a W-8BEN but your client files show that the beneficial owner of the BVI is a US person or are US persons what if any are the actions a QI should take in this regard?
11. Please advise the steps that the IRS will take with QI's who are unable to document clients? Are there time frames or penalties that the IRS is in a position to clarify?
12. Do we have to renew W9 annually?
13. Do we have to renew W8 annually?
14. Does the IRS foresee near or long-term changes in the current NQI status?
15. What are the near term and long-term changes to the QI rules that are currently under consideration?
16. "Consider the case of a Singapore incorporated company traded in the US stock exchange.
- Is the Singapore custodian bank an intermediary if its' customers own such Stocks?
- What is the determining factor for the Singapore custodian bank to be treated as an intermediary?
17. What is the proper definition of US securities according to IRS?
- The IRS reaffirmed the view presented in our question but pointed out that a QI must be clear that the BVI is indeed a proper corporation. The IRS made it a point to state that a US person has reporting responsibilities as well. The QI should accept the W-8BEN as long as the BVI is clearly a proper corporation under the rules.
 - The IRS advised the group that no one QI will suffer from an external audit the first year. If in the second year there are a few accounts that the QI made attempts to document without success the IRS will consider the overall compliance picture. If the IRS discovers or identifies a pattern or a significant number of non-documented clients it would look to terminate the agreement, apply penalties and in the worse case seize US assets minus compliance.
 - W-9's do not require renewal unless information on the form changes i.e. change of address etc
 - W-8BEN's require renewal every 3 years plus the remainder of the calendar year.
 - W-8IMY's don not require renewal
- In the interest of time this question was not passed to the IRS
- The IRS did say that the December memo would provide some guidance on the transition period
 - ADRs are not considered US securities for tax purposes.
 - If Singapore custodian banks are holding ADRs on behalf of clients, they would not be considered Intermediaries. If Singapore custodian banks are holding US securities for their clients they are impacted
 - This is covered in the QI agreement which is obtainable on www.irs.gov
- (Pls refer to Q5)

Questions

Answers

18. Could IRS provide a list of US securities? *(Pls refer to Q5)*
19. Going forward, is IRS going to introduce measures to make NQI option impossible to manage? *(Pls refer to Q14)*
20. Could an Intermediary who had submitted their QI application obtained the QI status within this year? If not, will there be an interim solution? *(Pls refer to Q1)*
21. What is IRS stance in allowing a QI to maintain undocumented account on a permanent basis? *(Pls refer to Q11)*
22. How does IRS intend to deal with NQI who maintain undocumented pooled account? *(Pls refer to Q11)*
23. Much has been made of the reporting requirements as a QI. For Asia this is a paradigm shift as only six months ago most of us were unfamiliar with terms such as 1099 and 1042-S reporting.
- Please advise in general terms a recap of the basic QI reporting requirements with a focus on how a QI can adjust their reporting.
- Please also include the possible timing and penalties that would be inter-connected to those adjustments.
- The IRS gave a brief outline as follows: as QI you are responsible to collect W-9's on behalf of your US client base and 1099 reporting is the responsibility of your US custodian. If you become a QI with withholding responsibility typically the QI in this case would perform the 1099 reporting. The 1099 reporting regime cut off is 31st January of each year.
 - As QI a QI is responsible for 1042-S reporting on a pooled aggregate basis , a QI must report other QI's , NQI's and partnerships on a line by line basis. The 1042-S reporting regime cut off is the 31st March of each year.
24. For non-US customers whose account has been classified as "Whereabouts Unknown", should the bank classify the account as "undocumented US Person" and invoke backup withholding? Customer records reflect that they are Non-US persons and the last address on record is a non-US address.
- The IRS advised the group that a QI in this case should apply the presumption rules against dividend/interest/OID. An undocumented foreign person should attract a maximum withholding at 30%
25. If the bank backup withholds a customer's interest wrongly and makes the payment to IRS New York and later, realises the error, how can the claim from IRS be made? *(Pls refer to Q23)*
- (a) By customer to IRS or
- (b) bank to IRS on behalf of customer.

Questions

Answers

26. How do we ascertain whether a corporate client is a corporate or flow-through entity?

How do you define personal investment companies set up for the purpose solely for investment holding?
27. What is the IRS definition of country of residence for Trustees and Fund Management Companies in the context of the withholding tax?
28. What is IRS's guidelines in the respect of Securities Borrowing and Lending?
29. Is withholding tax on USD bank deposits applied to on-shore USD deposits only, off-shore US deposits or both?
30. Is the withholding tax extended to off-shore USD deposit?
31. Is there a deadline for applying for QI status?
32. How long does it take to process the application?
33. What is the criterion to be fulfilled before approval will be granted?
34. Since US securities are impacted by these new regulations, is there a comprehensive definition of what would constitute US securities?

Apart from securities issued by US corporations, would it include foreign issuers whose securities are listed in the US?

What about US\$ foreign issues?
35. Does a QI's obligations extend themselves to reporting on US customers non-US securities holdings?
- In the interest of time this question was not asked of the IRS
- In the interest of time this question was not asked of the IRS
- (Pls refer to Q3)*
- The new rules apply to on-shore US deposits only
- (Pls refer to Q29)*
- (Please refer to Q1)*
- (Please refer to Q1)*
- (Please refer to Q1)*
- (Please refer to Q5)*
- The IRS advised the group that if the foreign source payment is made to a US person inside the US this would be considered as covered by the rules
 - The IRS advised if foreign source income is paid outside of the US to a US person it is NOT considered to be covered by the rules
 - The IRS advised that if a US customer communicated to a foreign intermediary from the US a sales order of foreign source income it was considered covered by the rules
 - The IRS advised the group that if a US person communicated to a foreign intermediary outside of the US this would not be covered under the rules

Questions

Answers

36. Does the IRS post changes in DTA rates on the IRS website and what is the timing? In the interest of time this question was not asked of the IRS
37. What if customers do not provide us documentation – do we automatically subject them to maximum withholding?

Would we still have to do reporting of payments even if we are bound by banking secrecy? (Pls refer to Q11)
38. What are the penalties if we cannot comply with QIA (apart from termination of QIA)? (Pls refer to Q11)