



LAWRENCE R. UHLICK
Chief Executive Officer
E-mail: luhlick@iib.org

299 Park Avenue, 17th Floor
New York, N.Y. 10171
Telephone: (212) 421-1611
Facsimile: (212) 421-1119
www.iib.org

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Internal Revenue Service
CC:PA:LPD:PR (Announcement 2008-98)
Room 5203
P.O. Box 78604
Ben Franklin Station
Washington, DC 20044

Re: Announcement 2008-98

Ladies and Gentlemen:

The Institute of International Bankers appreciates the opportunity to comment on Announcement 2008-98 (the “Announcement”), containing proposed amendments to the Qualified Intermediary (“QI”) agreement and to the audit guidance for external auditors of QIs.

The Institute represents internationally headquartered financial institutions from over 30 countries. These institutions and their affiliates include banks, securities firms and investment managers, many of whom are QIs. The Institute has been an active participant in discussions with the Treasury Department and the Internal Revenue Service (the “IRS”) regarding the QI regime and its implementation since the conception of this regime.

A cardinal consideration that has influenced the formulation of the QI regime has been the goal of achieving a balance between the IRS’ need to ensure that there is a sufficiently high level of compliance with U.S. withholding obligations, on the one hand, and the need to avoid imposing unreasonable burdens and costs on QIs, which are merely performing custodial services and operate at small profit margins, on the other hand. Particularly in the current challenging financial environment, it is important to recognize that if the costs of compliance become too high, financial institutions may cease being QIs, which could adversely impact foreign investments in U.S. securities.

The Institute’s mission is to help resolve the many special legislative, regulatory and tax issues confronting **internationally headquartered** financial institutions that engage in banking, securities and/or insurance activities in the United States.

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With this consideration in mind, set forth below are our comments regarding the specific changes that the Announcement proposes to make to the QI agreement and to the audit guidance for external auditors of QIs.

1. Notice of Material Failure of Internal Controls.

The Announcement indicates that the QI agreement will be amended to provide that a QI must notify the IRS whenever the QI becomes aware of “a material failure of internal controls” relating to its performance under the QI agreement, any employee allegations of such failures, or any investigation by regulatory authorities of such failures. A QI’s failure to notify the IRS within 60 days of its discovery of such a material failure of internal controls is an Event of Default under the QI agreement.

We understand the rationale behind this new requirement. However, the proposed definition of a material failure of internal controls is vague and potentially overbroad. Notwithstanding the fact that the notification requirement applies only to what is called a *material* failure of internal controls, there is no materiality condition in the actual operative definition of “material failure of internal controls.” This is particularly troubling when applied to (i) “any employee allegations” and to (ii) “unintentional errors detected by such personnel [*i.e.*, QI personnel charged with oversight of performance under the QI agreement] that appear to have originated with or been initiated by operational personnel charged with directly conferring with and providing financial services to customers.” For example, if an employee determines that a single account was mis-categorized due to an inadvertent keying error on the account opening form by the account representative, and therefore was not reviewed by QI personnel, does this constitute an employee allegation or an unintentional error that originated with customer relations personnel and that relates to the QI’s performance under the QI agreement? We would have thought that such an isolated error regarding an individual account is not within the intended scope of this provision.

Accordingly, we recommend that the definition include a materiality condition that is directly tied to internal control processes affecting the integrity of a material amount of data relating to the QI agreement or that results in a material amount of under-withholding or under-reporting.

In addition, we recommend that the notice time be extended at least to 90 days, as in Section 11.04(K) (dealing with notification of significant changes in a QI’s business practices affecting its obligations under the QI agreement), since 60 days is an unreasonably short period for most large business enterprises. Indeed, even 90 days is probably too short, and a notice period closer to 180 days would be more appropriate.

2. Associating a U.S. Auditor.

The Announcement states that “the QI audit guidance will be amended to require the external auditor to associate a U.S. auditor with the audit and to require the

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U.S. auditor to accept joint responsibility for performance of the procedures under the audit guidance. The aim in joining a U.S. auditor is to assure appropriate application of U.S. withholding rules and to enhance accuracy and accountability in the audit process.”

We respectfully request that the IRS reconsider this new requirement. Our member institutions report that the external audits are virtually invariably conducted and reviewed by knowledgeable personnel acting in accordance with high professional standards. Certainly in the case of the large international accounting firms, the QI audits – wherever conducted – are supervised by a team of experts, who are responsible for the work product and the final report. In the case of some of these firms, these experts are based outside the United States.

The requirement to associate a U.S. auditor that must accept joint and several liability and must co-sign the audit report will add unnecessary additional costs to the QI audits, with no apparent benefit to the IRS. Under the QI agreement, the IRS has the ability to control the selection of the external auditor. If the IRS believes that certain external auditors are not performing their functions at the desired standard, it should exercise its control right to impose appropriate conditions in those limited circumstances (which may if appropriate require the association of a U.S. auditor), but it should refrain from imposing such an additional costly burden on all QI audits.

3. Phase 1 Fact Finding to Identify Control by U.S. Persons.

The Announcement states that “the QI audit guidance will be amended to add an audit procedure testing certain accounts for characteristics that suggest that a U.S. person has authority over the account.” In this regard, the definition of “the account holder’s file” – which must be examined by the external auditor – has been expanded to include “any documents, reports or other information generated or received for purpose of anti-money laundering, know-your-customer, tax or other laws, and any other account information.”

We understand the IRS’ desire to obtain such information regarding control by U.S. persons as well as the general appropriateness of taking account of AML and KYC information. However, each expansion of the scope and number of examinations required by the external auditors adds potentially substantial cost to the audit, especially where the materials to be examined are not in electronic form but instead are in paper form and may be dispersed in different locations. Consequently, we urge the IRS to consider permitting the external auditor to determine, based on the manner in which a QI maintains and accesses account data, that it is appropriate to limit its examination in the manner described in its audit report (for example, to identified electronic data bases only). In addition, as noted in paragraph 4 below, it is very important that the additional tasks being imposed on the external auditors be delineated in a manner that render them suitable for an “agreed upon procedures” (“AUP”) audit.

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4. Phase 1 Fact Finding to Evaluate the Risk of a Material Failure of Internal Controls.

The Announcement states that the QI audit guidance requires the external auditor “to add additional procedures for fact gathering by the external auditor relating to the IRS's evaluation of the risk of a material failure of internal controls. These procedures will include, for instance, identifying the persons charged with oversight of performance under the QI agreement and the authority given them to prevent, deter, detect and correct such failures on the part of other operational personnel. The external auditor will be required to report any facts or circumstances observed in the course of its audit that reasonably relate to the evaluation by the IRS of the risk of a material failure of internal controls.”

We note that, after considerable discussions with the major accounting firms, the Institute and other industry representatives, the IRS agreed that the QI external audits will be performed under accounting profession standards regarding AUP audits, due to professional constraints on what sort of an audit could be conducted outside the scope of AUP. We defer to the accounting firms as to whether they are able to perform all of the additional procedures described in the Announcement under an AUP, but it would appear to us that at least some of these procedures call for the exercise of judgment beyond the scope of AUP.

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Please contact the undersigned (212-421-1611; luhlick@iib.org) or the Institute's tax counsel, Yaron Z. Reich at Cleary Gottlieb Steen & Hamilton, LLP (212-225-2540; yreich@cgsh.com) if we can provide further assistance regarding this matter.

Very truly yours,



Lawrence R. Uhlick
Chief Executive Officer