

## Part III

### Administrative, Procedural, and Miscellaneous

#### Audit Guidance for External Auditors of Qualified Intermediaries

##### Revenue Procedure 2002-55

### **SECTION 1. PURPOSE AND SCOPE**

This Revenue Procedure contains final Audit Guidance for an external auditor engaged by a qualified intermediary (QI) to verify the QI's compliance with the withholding agreement entered into with the Internal Revenue Service (IRS) pursuant to Rev. Proc. 2000-12, 2000-4 I.R.B. 387 and Treasury Regulation §1.1441-1(e)(5) (QI Agreement). Under its QI Agreement, the QI generally must report annually certain aggregate information concerning the beneficial owners of U.S. source payments and make any necessary tax payments to the IRS. In lieu of an IRS audit, the QI may engage an external auditor to conduct an audit to determine whether it is complying with the withholding and reporting obligations covered by the QI Agreement. The external auditor must conduct its audit in accordance with the procedures described in section 10 of the QI Agreement. This Revenue Procedure is intended to assist the external auditor in understanding and applying those procedures. This Revenue Procedure does not amend, modify, or interpret the QI Agreement.

### **SECTION 2. BACKGROUND**

.01 Comments on Proposed Guidance. The IRS issued proposed audit procedures for external auditors in Notice 2001-66, 2001-44 I.R.B. 396. Because the IRS and Treasury recognize that the audit process must be implemented in a manner that maintains the cooperative nature and effectiveness of the QI system, the IRS engaged in a lengthy dialogue with the financial community following the issuance of Notice 2001-66 to consider ways to implement the audit procedures so as to minimize cost to the QI while preserving the compliance goals of the withholding regulations.

.02 IRS Response to Five Areas of Concern. The majority of the comments on Notice 2001-66 reflected concerns about cost in the context of one or more of the following areas: availability of waivers, scope of audit coverage, statistical sampling, projection of underwithholding over the QI's account population based on the statistical sample, and use of an internal audit. The following is a brief overview of the modifications reflected in the attached Audit Guidance in response to these comments. A more complete discussion is set forth in Section 4 of this Revenue Procedure.

(i) Waivers.

The financial community commented that the criteria for obtaining a waiver from an external audit were too stringent. In response, the following changes have been made:

- The monetary threshold in Waiver One has been increased in the attached Audit Guidelines from \$250,000 to \$1,000,000 and is based on reportable amounts.
- Waiver Two (which in Notice 2001-66 was based on number of accounts) now is based on whether the QI received between \$1,000,000 and \$4,000,000 in reportable amounts.
- With respect to the reconciliation of Forms 1042-S and 1099 issued to and by the QI, which are required to request Waivers One and Two, variances are permitted within reasonable limits based on the facts and circumstances.
- Waiver Three (which is available to QIs with a substantial and independent audit staff) is clarified to reflect that the annual internal reviews required for eligibility are not the comprehensive audit described in this Audit Guidance but, rather, those tests and checks that the internal staff deems appropriate.

(ii) Scope of Audit Coverage.

Comments from the financial community stated that the scope of audit coverage required by the proposed audit guidance was overly broad and would prove to be prohibitively expensive for QIs. In response, to those comments, the following changes have been made:

- The accounts subject to audit are changed from those that receive reportable *payments* (generally, reportable amounts plus certain broker proceeds and certain foreign source income) to those that receive reportable *amounts* (generally U.S. source fixed or determinable annual or periodical income). However, for accounts of U.S. non-exempt recipients that receive reportable amounts, the external auditor must take reportable payments into account when performing certain procedures.
- Certain procedures and reports are deferred to Phase 2 of the audit.
- In Phase 1 of the audit, the review of withholding rate pools, underwithholding, and reporting in Audit Guidance (“AG”)10.03(B), (C), and (D) may be performed on a “spot check” rather than full sample basis.

- Consolidated audits are allowed for certain related groups.

(iii) Sampling.

Some commentators asserted that the proposed audit guidance required examination of an excessively large number of accounts, which would greatly increase the cost of the audit. In response to these comments, the following changes have been made:

- The maximum number of accounts sampled has been reduced from 1368 accounts to 321 accounts. This reduction results from (1) reducing the number of required samples from three to one with the one sample including all account holders (i.e., direct account holders that are not U.S. non-exempt recipients, direct account holders that are U.S. non-exempt recipients, and indirect account holders), and (2) reducing the maximum sample size from 456 to 321.
- With respect to accounts reviewed for purposes of withholding rate pools, withholding, and reporting under Phase 1 of the audit, described above, the number of accounts reviewed will be limited to a “spot check.”

(iv) Projection.

Some commentators expressed concern that the proposed audit procedures appeared to require “automatic” projection of underwithholding in a sample across the QI’s account population, which they believed could result in very large, and potentially unfair, tax assessments being imposed on the QI. In response to these comments, the following changes were made:

- The issue of projection is deferred to Phase 2 of the audit, but in Phase 1 the QI must pay any underwithholding that is discovered in the spot check for underwithholding (AG10.03(C)).

(v) Use of Internal Audit.

Some commentators asserted that requiring the external auditor to certify that the use of internal audit staff did not affect the accuracy of its report would severely limit the use of internal audit staff, thereby increasing the cost of the audit for the QI. In response to these comments, the following change was made:

- A QI’s external auditor that uses the QI’s internal audit staff and internal audit reports will not be required to certify that such use has not affected the accuracy of its report, but the external auditor will remain responsible for the conduct of the entire audit.

### **SECTION 3. OVERVIEW OF AUDIT GUIDANCE - THREE PHASE AUDIT**

## PROCESS

The Audit Guidance included in this Revenue Procedure reflects a three phase audit process. As described further below, whether a particular QI's audit will progress through all three phases generally will depend upon the IRS analysis of the facts reported in each phase. For example, the IRS expects that, if the facts reported in each preceding phase of the audit process do not raise significant concerns for the IRS, the QI will not be required to complete any further phase of the process during that audit cycle.

.01 PHASE 1: Basic Fact Finding. Phase 1 consists of basic fact finding. The external auditor performs those tasks detailed in the attached Audit Guidance for Phase 1 of the Audit. Generally, this consists of -

- documentation review for all accounts (or the sample), under AG10.03(A)(4) through (A)(7), and (A)(10);
- a spot check review of withholding rate pools, underwithholding, and reporting, under AG10.03(B)(4) through (B)(6), (C)(1), (C)(3), and (D)(2); and
- the completion of the procedures in AG10.03(A)(8) and (A)(9), (C)(2), (C)(4) through (C)(7), (D)(1) and (E).

From these fact finding activities, the auditor will develop a report of numerical results. The attached Audit Guidance contains precise directions on what numerical information must be included in the auditor's report. The auditor will send a hard copy of this initial report to the IRS. The IRS intends to develop a standard report form.

Based on the IRS analysis of the numerical report for Phase 1 of the QI's audit, the IRS will notify the QI whether the audit is complete or whether additional fact finding must be undertaken to resolve concerns. If the audit is complete after Phase1, the QI must pay any underwithholding that is discovered as a result of the spot check for underwithholding (AG10.03(C)). If the numerical reports suggest that the QI has experienced difficulties in meeting its obligations under its QI Agreement, the IRS will notify the QI that it is proceeding to Phase 2 of the audit process.

.02 PHASE 2: Follow Up Fact Finding. In Phase 2 of the audit process, the IRS will contact the auditor to ask about facts and circumstances associated with certain numerical results in the auditor's report. If additional information is needed, the IRS will direct the auditor to perform additional procedures and to report on the results. Phase 2 of the audit process may include some or all of the procedures in AG10.03 that were not performed in Phase 1 of the audit process, including a full sample review for those procedures for which a spot check review was performed in Phase 1. If, after completion of the full sample review, the external auditor determines that underwithholding under AG10.03(C)(1), (2), (3), (4) or (5) occurred with respect to the

sample, the IRS will determine the total amount of underwithheld tax by projecting the underwithholding as provided in AG10.04.12.

The goal of this step of the audit process is to identify the cause for the numerical results and to determine whether corrective action readily can be devised. For example, the audit report may show that the auditor was unable to associate beneficial owner information with a specified percentage of the QI's accounts. Through discussion of facts with the auditor, the IRS then determines that the problem was attributable to deficient account opening procedures in one of the QI's branches. If the IRS were satisfied that the QI had taken steps to ensure that the branch had appropriately corrected procedures for opening new accounts, and if the QI had otherwise shown a high level of compliance with the QI Agreement, the IRS generally would not proceed to Phase 3 of the audit process.

.03 PHASE 3: Audit Meeting with QI. If the concerns arising from the numerical results reported in Phase 1 of the audit process cannot be resolved by directed fact finding in Phase 2, the IRS will propose to meet with the QI to attempt to clarify and resolve those concerns. This phase is designed specifically to provide a forum where a productive dialogue between the IRS and the QI can occur. Treasury and the IRS continue to believe that the QI system, which is intended to allow the IRS's compliance goals to be met while minimizing the administrative burdens on financial institutions, is a critical component of the withholding regulations. Accordingly, the IRS will seek to develop mutually acceptable solutions to the issues that arise in the course of administering the QI Agreements so that it will not become necessary to terminate a QI Agreement.

## **SECTION 4. MODIFICATIONS TO THE PROPOSED AUDIT GUIDANCE**

As mentioned in Section 1, above, the concerns arising from the proposed Audit Guidance published in Notice 2001-66 generally related to the following five areas--waivers, scope of audit coverage, sampling, projection, and use of internal audit staff and reports. This section discusses, in greater detail, the modifications the IRS made to the Audit Guidance in response to those comments.

.01 Discretionary Waivers of External Audit. The Audit Guidance allows QIs to request that the IRS waive the performance of an audit by an external auditor in three cases. As a result of the dialogue with the financial community, and continued analysis of the information available to the IRS, the waiver provisions have been revised to increase the availability of waivers while allowing the IRS to continue to manage effectively its compliance objectives. In general, the waiver provisions have been liberalized and simplified. For instance, the waiver based on a threshold number of accounts has been replaced with a waiver based on a dollar threshold, the waiver based on a dollar threshold has been modified to raise the dollar threshold, the dollar thresholds are based upon reportable amounts rather than reportable payments, and with respect to the reconciliation information that must be included in the waiver request, variances are permitted within reasonable limits based on the facts and

circumstances. Whether the IRS will waive the external audit in any case is discretionary. The IRS will not agree to waive the performance of an audit for a Private Arrangement Intermediary (“PAI”) or for a group of QIs for which the IRS permits a consolidated audit. The revised waiver provisions are outlined below.

(i) Waiver One - \$1,000,000 Threshold. A QI may request a waiver of the external audit if it has received not more than \$1,000,000 in reportable amounts during the audit year. A QI requesting Waiver One must submit a reconciliation (for the audit year) of the Forms 1042-S and 1099 issued to the QI and issued by the QI and information about the number of its account holders in various classes.

(ii) Waiver Two - \$1,000,000 to \$4,000,000 Threshold. A QI may request a waiver of the external audit if it has received reportable amounts exceeding \$1,000,000 but not exceeding \$4,000,000 during the audit year, and the QI has been audited by an external auditor under the QI Agreement for the immediately preceding required audit. Thus, the IRS will not agree to waive the external audit, under Waiver Two, for the first audit year of the first term or any renewal term of the QI Agreement. Waiver Two will be available only for the second audit year of any term of the QI Agreement. As under Waiver One, a QI requesting Waiver Two must submit a reconciliation (for the audit year) of the Forms 1042-S and 1099 issued to the QI and issued by the QI and information about the number of its account holders in various classes.

(iii) Waiver Three - Annual Internal Review Program. A QI may request a waiver of the audit by an external auditor if it has a substantial and independent internal audit department that has reviewed the QI’s compliance under the QI Agreement for each of the three years preceding the year to be audited. The internal audit department is not required to perform the annual reviews according to the procedures in this Audit Guidance. Instead, it may perform any tests, checks or other procedures that it determines to be appropriate. The internal audit department may request IRS clearance of any proposed program of tests, checks or other procedures by submitting a written description of the proposed program. If this waiver is granted, instead of the required audit by an external auditor, the QI’s internal audit department may perform the audit and report to the IRS in accordance with the attached Audit Guidance. The IRS will not agree to grant this waiver for the first audit year of the first term of the QI Agreement. Waiver Three will be available for any subsequent audit year of any term of the QI Agreement.

02. Scope of Audit. In response to comments from the financial community, the IRS has revised the scope of the audit and, in particular, the procedures required for Phase 1 of the audit process. The revised procedures accommodate mutual concerns relating to cost, efficiency and compliance by (i) limiting the accounts initially selected for examination to accounts that have received reportable amounts, (ii) deferring certain tasks to Phase 2 of the audit process, (iii) adopting exploratory “spot check” techniques for certain tasks; (iv) allowing explanatory footnotes or addenda; and (v) allowing consolidated audits for certain groups of related QIs. Set forth below is a discussion of the changes to each of these five areas of the audit.

(i) Reportable Amounts. The revised procedures included in the attached Audit Guidance limit the accounts initially selected for examination to those accounts that have received reportable *amounts*. Under the proposed Audit Guidance, the accounts initially selected for examination would have included accounts that had received reportable *payments*. Under the QI Agreement, “reportable amounts,” generally consist of U.S. source fixed or determinable, annual or periodical income. “Reportable payments” generally consist of reportable amounts plus certain broker proceeds and certain foreign source income. The financial community expressed concern about the difficulty of making an initial selection of accounts based on reportable payments. The IRS agrees that efficiency may be served by the initial selection of accounts based on receipt of reportable amounts, provided that reportable payments received in those accounts may be examined when required under the Audit Guidance. Accordingly, the revised procedures under this Audit Guidance require the external auditor initially to select for examination only those accounts that have received reportable amounts, and then to examine reportable payments made to accounts within that group when required in Phase 1 of the audit.

(ii) Deferral of Certain Tasks to Phase 2 of the Audit Process. During the audit, the external auditor must perform tasks designed to gather certain basic facts about the QI’s compliance with the QI Agreement. The revised procedures included in the attached Audit Guidance defer certain of these tasks to Phase 2 of the audit process. The revised procedures reflect the view that the most accurate facts relating to a QI’s compliance may be obtained by examining how a QI has (a) documented, (b) pooled, (c) withheld on and (d) reported on particular accounts. Accordingly, tasks that require the examination of particular accounts have been retained in Phase 1 of the audit and tasks that do not relate to examination of particular accounts, generally, have been deferred to Phase 2. For example, tasks requiring interviews of QI employees have been deferred to Phase 2.

(iii) Spot Check Review under AG10.03(B), (C), and (D). The IRS recognizes that the withholding system is based on information drawn from account holder documentation and that account holders open and close accounts periodically. It also recognizes that pooling, withholding and reporting depend in large part on the procedures and systems the QI uses to process the information obtained from account holder documentation. The revised procedures reflect the view that a thorough examination of how a QI has documented all, or a representative sample of, its account holders may provide a reliable indication of the QI’s overall compliance, and that its reliability may then be tested by exploratory examination of how the QI has pooled, withheld, and reported based on information drawn from the documentation of a smaller number of account holders.

Accordingly, the revised procedures in this Audit Guidance generally require that in Phase 1 of the audit, the external auditor must use all accounts covered by the QI Agreement, or a statistical sample representing all such accounts, in performing the account based tasks that relate to how the QI has documented its account holders. In

performing the account based tasks that relate to how the QI has pooled, withheld, and reported, the revised procedures provide the external auditor with the option of using a smaller number of accounts. The number of accounts to be reviewed for a spot check must include all accounts required to be reported as undocumented or as not satisfying documentation criteria under AG10.03(A), and must in any case include at least 20 accounts from each of the following categories of account holders (assuming there are 20 or more accounts in each such category): QI's direct account holders that are not U.S. non-exempt recipients; QI's direct account holders that are U.S. non-exempt recipients; and QI's indirect account holders.

(iv) Explanatory footnotes or addenda. This Audit Guidance has been modified to include a provision permitting the external auditor to perform or to propose additional procedures or other fact finding and report the results by way of footnotes or addenda to its report for Phase 1 of the audit. This provision offers the opportunity to clarify problematic results reported for Phase 1 of the audit, which may obviate the necessity for follow up in Phase 2.

(v) Consolidated Audits for Certain Related QIs. The financial community has also suggested that cost and efficiency concerns could be mitigated by consolidating the audits of related QIs. In response, the IRS has modified the Audit Guidance to permit a consolidated audit of two or more QIs in circumstances when the consolidated audit may achieve the objectives of separate audits of those QIs. Specifically, the Audit Guidance provides that the IRS, in its discretion, may permit a consolidated audit of two or more QIs when (1) the QIs are members of a group under common ownership, (2) they operate with uniform practices and procedures and shared systems for performing the functions audited, (3) those practices and procedures and shared systems are subject to uniform monitoring and control, and (4) under the terms of the QI Agreement for each QI, the year to be audited for each QI is the same calendar year. The external auditor must submit an audit plan requesting IRS approval of any proposed consolidated audit.

.03 Sampling. The Audit Guidance permits an external auditor to use a statistical sample of the QI's accounts in performing the Phase 1 account based tasks. If the external auditor constructs the sample in accordance with the Audit Guidance, it need not submit an audit plan to obtain IRS approval for use of the sample. A sample constructed under the proposed Audit Guidance would have consisted of a maximum of 456 accounts for each of three populations (direct account holders that are not U.S. non-exempt recipients, direct account holders that are U.S. non-exempt recipients, and indirect account holders), or a total of 1368 accounts.

Commentators stated that the cost burdens could be significantly reduced by limiting the overall number of accounts to be selected for statistical sampling. The final Audit Guidance reduces the overall number of accounts to be selected for statistical sampling by allowing a single sample that represents the three groups of account holders. Also, the revised procedures permit the use of a one-sided confidence level in the sample formula. The single sample constructed under the revised procedures of



this Audit Guidance will consist of a maximum of 321 accounts.

.04 Projection of Underwithholding. The QI Agreement provides that if statistical sampling has been used and the auditor determines that underwithholding has occurred with respect to the sampled accounts, the IRS will determine the total amount of underwithheld tax by projecting the underwithholding over the entire population of similar accounts.

The proposed audit procedures would have provided that if the auditor used a sample and found that underwithholding had occurred with respect to an account in the sample, the auditor was required to report the underwithholding in the report for Phase 1 of the audit. In Phase 2 of the audit, the IRS would direct the external auditor to perform any additional procedures necessary to collect the information required to determine whether it was appropriate to project the underwithholding and any information required to make a projection. Finally, in Phase 3 of the audit, the QI could address whether projection was appropriate and could propose a projection using another amount of underwithholding based on a more accurate population, a more accurate projection technique, or an examination of all similar accounts.

The financial community expressed concern that the projection of underwithholding under the proposed guidance appeared to be automatic. Although the revised procedures under the attached Audit Guidance continue to follow the pattern adopted in the proposed Audit Guidance, they make clear that the issue of projection is deferred to Phase 2 of the audit. Under Phase 1 of the audit, the QI will be liable for any underwithholding discovered for the particular accounts examined in Phase 1. Whether an entire sample has been examined or the exploratory spot check option has been used, no projection of underwithholding will be required based on the external auditor's report for Phase 1 of the audit. If, after review of the external auditor's report for Phase 1, the IRS has concerns about underwithholding, the audit will proceed to Phase 2. Based on the follow up fact finding in Phase 2, the IRS will determine whether projection is appropriate and how to make a projection under the facts and circumstances of the particular case. An external auditor may use the footnote or addendum procedure explained previously to report facts relevant to a potential issue of projection of underwithholding as part of its report for Phase 1 of the audit to help the IRS to review the issue as efficiently as possible.

.05 External Auditor's Reliance on Internal Auditors. The final Audit Guidance, like the proposed guidance, allows the external auditor to use a QI's internal audit staff and internal audit reports to any extent the external auditor chooses. Nevertheless, the external auditor remains responsible for the conduct of the audit. The external auditor must disclose in the audit report specifically how and when it has used the QI's internal audit staff and reports.

The proposed Audit Guidance would have required the external auditor to certify that the use of a QI's internal audit personnel and reports has not affected the accuracy of the external auditor's report. Auditing firms have claimed that such a certification

cannot be made without duplicating the efforts of the QI's internal auditors. To accommodate this concern, this final Audit Guidance has dropped the certification requirement. Based on the external auditor's disclosure in its report for Phase I of the audit, the IRS will review how the use of a QI's internal audit personnel and reports may have affected the accuracy of the external auditor's report, and will take that review into account in determining whether any follow up in Phase 2 of the audit is appropriate.

## **SECTION 5. COMMENTS**

The IRS and Treasury recognize that the QI system requires an innovative approach to the audit process and that the process will evolve as experience is gained. The IRS and Treasury will consider further modification of the Audit Guidance in light of experience and encourage further dialogue with the financial community.

## **SECTION 6. CONTACT INFORMATION**

For further information regarding this Revenue Procedure, contact Carl Cooper or Laurie Hatten-Boyd of the Office of the Associate Chief Counsel (International), Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. Mr. Cooper and Ms. Hatten-Boyd may be contacted by telephone at 202-622-3840 (not a toll-free call). For general information relevant to qualified intermediaries, see the QI web site at : [www.irs.gov/](http://www.irs.gov/) and search the IRS site for "QI."

## **APPENDIX**

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- 10.05.3. Report Due Dates.

**Audit Guidance 10.06:**

- 10.06.1. IRS Review of Audit Report.
- 10.06.2. Audit Phase 2: IRS Directed Procedures.
- 10.06.3. Audit Phase 3: Audit Meeting.

## GUIDANCE

### FOR EXTERNAL AUDITORS OF QUALIFIED INTERMEDIARIES

The following Audit Guidance is provided for an external auditor engaged by a qualified intermediary ("QI") to verify compliance with its Qualified Intermediary Agreement ("QI Agreement")<sup>1</sup>. The QI Agreement is an agreement between the QI and the Internal Revenue Service ("IRS") under which, generally, the QI agrees to report annually certain aggregate information concerning the beneficial owners of U.S. source payments and to make any necessary tax payments to the IRS. In section 10 of the QI Agreement, the IRS agrees not to conduct an on-site audit of the QI provided the QI engages an external auditor to conduct an audit to determine whether the QI is in compliance with the QI Agreement and to make a report to the IRS. The external auditor must conduct its audit and provide its report in accordance with the procedures detailed in section 10 of the QI Agreement.

For reference, section 10 of the QI Agreement is reproduced below in bolded text. Following each paragraph of section 10, Audit Guidance is provided that is specific to, and numbered to correspond to, that paragraph. This Audit Guidance does not amend, modify, or interpret the QI Agreement.

This Audit Guidance reflects a three-phase audit process. Phase 1 consists of basic fact finding. After examination of the facts reported in Phase 1, the IRS will determine whether it is necessary to progress to Phase 2 of the Audit. If so, the external auditor will be asked to conduct follow up fact finding. The audit will move to Phase 3 only if the concerns of the IRS arising from the numerical results reported in

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<sup>1</sup> For the text of the QI Agreement, see Section 4 of Rev. Proc. 2000-12, 2000-4 I.R.B. 387.

Phase 1 cannot be resolved by the additional fact finding in Phase 2. Under Phase 3, the IRS will meet with the QI to attempt to resolve those concerns.

The Audit Guidance under sections 10.01 to 10.03 includes procedures that a QI may follow to request an IRS audit or a waiver of audit. Section 10.03(A) through (E) describes the procedures that an external auditor should follow in examining the QI and the information to be included in the external auditor's report to the IRS in Phases 1 and 2 of the audit. Section 10.04 provides guidance on the use of statistical sampling and projection of underwithholding. Section 10.05 provides further guidance on the form, content and submission of the external auditor's report. Section 10.06 provides guidance on Phases 2 and 3 of the audit process.

In Phase 1 of the audit, only certain procedures in section 10.03(A) through (E) must be completed, as described in more detail in AG10.03.2 below. The provisions that must be completed in Phase 1 are labeled either **"Phase 1," "Phase 1-All Accounts (or Sample),"** or **"Phase 1- Spot Check."** The procedures labeled **'Phase 1-All Accounts (or Sample)'** require the external auditor to examine all accounts identified in AG10.04.4(a) through (c) or the accounts selected as a sample from those identified accounts. The procedures labeled **"Phase 1- Spot Check"** require the external auditor to examine only those accounts selected for testing, in accordance with AG10.04.7, in performing the procedures. Those procedures that must be completed in Phase 1 but either do not require a review of accounts or do not require a review of documentation are labeled **'Phase 1.'** Those procedures that are not required to be performed in Phase 1 are labeled **"Phase 2 only."**

In Phase 2, the IRS will conduct follow up fact finding under which it may require the external auditor to complete and report on some or all of the remaining procedures in section 10.03(A) through (D) or additional procedures, as it deems appropriate. Thus, for example, in Phase 2 the IRS may direct that procedures that were performed on a spot check basis under Phase 1 must be performed based on an examination of all accounts identified or selected as a sample.

**QI Agreement Sec. 10.01. In General . Unless QI requests an IRS audit in lieu of an external audit, the IRS agrees not to conduct an on-site audit of QI, or any PAI with which QI has an agreement, with respect to withholding and reporting obligations covered by this Agreement provided that an external auditor designated in Appendix B of this Agreement conducts an audit of QI, and any PAI, in accordance with this section 10. QI shall permit the external auditor to have access to all relevant records of QI for purposes of performing the external audit, including information regarding specific account holders. QI shall permit the IRS to communicate directly with the external auditor and to review the audit procedures followed by the external auditor. QI represents that there are no legal prohibitions that prevent the external auditor from examining any information relevant to the external audit to be performed under this section 10 and that there are no legal prohibitions that prevent the IRS from communicating directly with the auditor. QI shall permit the IRS to examine the external auditor's work papers**

**and reports. However, the external auditor is not required to divulge the identity of QI's account holders to the IRS.**

Audit Guidance Sec. 10.01:

10.01.1. Accounts and Account Holders Covered by the QI Agreement. For purposes of this Audit Guidance, the following definitions shall apply. "Accounts covered by the QI Agreement" means accounts maintained by the QI for its direct account holders (which include intermediaries and flow-through entities) to which the QI has made payments of reportable amounts during the audit year from the QI's accounts with withholding agents that the QI has designated as QI accounts. "Indirect account holders covered by the QI Agreement" means indirect account holders for which recipient specific reporting by the QI is required under section 8.02(B) or (C) or section 8.04 of the QI Agreement.

10.01.2. IRS Audit. A QI that is not prohibited by law from disclosing account holder information may request an IRS onsite audit instead of an external audit. To request an IRS audit, the QI must submit a written request to the IRS before September 30 of the year to be audited ("audit year"). The QI must send the request to the following address:

Internal Revenue Service  
LMSB:FS:QI  
290 Broadway- 12<sup>th</sup> Floor  
New York, NY 10007-1867  
USA

The IRS will send the QI written confirmation that it has received the request. In some cases, the IRS will conduct an audit by correspondence. For instance, in the case of a QI that has made payments of reportable amounts to no more than 50 accounts covered by the QI Agreement, the IRS may decide to conduct an audit by correspondence.

10.01.3. Consolidated Audit of QIs. The IRS, in its discretion, may permit a consolidated audit of two or more QIs when (i) the QIs are members of a group under common ownership, (ii) they operate with uniform practices and procedures and shared systems for performing the functions audited under AG10.03, (iii) those practices and procedures and shared systems are subject to uniform monitoring and control, and (iv) under the terms of the QI Agreement for each QI, the audit year for each QI is the same calendar year. To request a consolidated audit, the external auditor must submit an audit plan in accordance with AG10.03.5. The external auditor must make a separate request for a consolidated audit for each audit year. The request must explain (i) the ownership of all related entities (including those that are not QIs), (ii) which QIs are proposed to be included in the consolidated audit, (iii) how their practices and procedures are uniform and how their systems are shared and (iv) how their practices, procedures and systems are monitored and controlled. The IRS, in its discretion, may



also require that the consolidated audit include or exclude certain QIs. The IRS will not permit a Private Arrangement Intermediary (“PAI”) to be included in a consolidated audit.

10.01.4. External Audit Waiver (\$1,000,000 Threshold). A QI may request that the IRS waive the performance of the audit by an external auditor for an audit year if the QI has received reportable amounts during that year that do not exceed \$1,000,000. To calculate the \$1,000,000 threshold, the QI must aggregate all reportable amounts (including (i) payments of reportable amounts beneficially owned by the QI and (ii) payments of reportable amounts received by all branches of the QI that use the same QI-EIN) made to its accounts with withholding agents that the QI has designated as QI accounts. A QI succeeding to the responsibilities of another QI must aggregate all reportable amounts received by its predecessor for the audit year. The QI must submit its request for a waiver to the IRS before June 30 of the year following the audit year at the address in AG10.01.2.

The QI should include in its request:

- (a) A reconciliation for the audit year of the Forms 1042-S and 1099 issued to the QI and the Forms 1042-S and 1099 issued by the QI which identifies the reasons for any variances and shows the amount of any unreconciled variances (unreconciled variances are permitted within reasonable limits based on the facts and circumstances); and
- (b) A statement made under penalties of perjury by a person named as a responsible party for performance in the QI’s application for a QI Agreement (“Responsible Party”) that:
  - (1) States
    - (i) the number of the QI’s direct account holders during the audit year;
    - (ii) the number of the QI’s indirect account holders during the audit year; and
    - (iii) within each category, the number of account holders that were U.S. exempt recipients, U.S. non-exempt recipients, intermediaries, flow-through entities, and undocumented account holders;
  - (2) States the total amount of any underwithholding or collective refunds for the three years (or, if the QI Agreement has not been in effect for three years, for all preceding years during which the QI Agreement has been in effect) preceding the audit year;
  - (3) States that no event of default under section 11 of the QI Agreement has occurred during the audit year;
  - (4) States that the QI did not refer account holders to an affiliated entity with the effect of circumventing the \$1,000,000 threshold; and
  - (5) Certifies that the QI was in compliance with the QI Agreement during the audit year.

The IRS may contact the QI to request additional information. At its sole discretion, the IRS may agree to waive or refuse to waive performance of the external audit. In determining whether to waive performance of the external audit, the IRS may take into account the information provided, all other information available to the IRS, and also other compliance objectives. For example, to monitor compliance, the IRS may require an external audit for some QIs (chosen on a random basis) that would otherwise qualify for a waiver. The IRS will send the QI a written response to the waiver request indicating whether the IRS agrees to waive the performance of the audit for the audit year. The IRS will not agree to waive the performance of an audit for a PAI, for a group of QIs for which the IRS permits a consolidated audit under AG10.01.3, or for any QI that is included in such a group.

10.01.5. External Audit Waiver (\$1,000,000 to \$4,000,000 Threshold). A QI may request that the IRS waive the performance of the audit by an external auditor for an audit year if, during the audit year, the QI has received reportable amounts exceeding \$1,000,000 but not exceeding \$4,000,000, and the QI has been audited by an external auditor under the QI Agreement for the immediately preceding audit year. To calculate the \$1,000,000 to \$4,000,000 threshold, the QI must aggregate all reportable amounts (including (i) payments of reportable amounts beneficially owned by the QI and (ii) payments of reportable amounts received by all branches of the QI that use the same QI-EIN) received in its accounts with withholding agents that the QI has designated as QI accounts. A QI succeeding to the responsibilities of another QI must aggregate all reportable amounts received by its predecessor for the audit year. The QI must submit its request for a waiver to the IRS before June 30 of the year following the audit year at the address in AG10.01.2.

The QI should include in its request:

- (a) A reconciliation for the audit year of the Forms 1042-S and 1099 issued to the QI and the Forms 1042-S and 1099 issued by the QI, which identifies the reasons for any variances and shows the amount of any unreconciled variances (unreconciled variances are permitted within reasonable limits based on the facts and circumstances); and
- (b) A statement made under penalties of perjury by the Responsible Party, as defined in AG10.01.4(b), that:
  - (1) States
    - (i) The number of the QI's direct account holders during the audit year;
    - (ii) The number of the QI's indirect account holders during the audit year; and
    - (iii) Within each category, the number of account holders that were U.S. exempt recipients, U.S. non-exempt recipients, intermediaries, flow-through entities, and undocumented account holders;
  - (2) States the total amount of any underwithholding or collective refunds for the three years (or, if the QI Agreement has not been in

- effect for three years, for all preceding years during which the QI Agreement has been in effect) preceding the audit year;
- (3) States that no event of default under section 11 of the QI Agreement has occurred during the audit year;
  - (4) States that the QI did not refer account holders to an affiliated entity with the effect of circumventing the \$1,000,000 to \$4,000,000 threshold; and
  - (5) Certifies that the QI was in compliance with the QI Agreement during the audit year.

The IRS may contact the QI to request additional information. At its sole discretion, the IRS may agree to waive or refuse to waive performance of the external audit. In determining whether to waive performance of the external audit, the IRS may take into account the information provided, all other information available to the IRS, and also other compliance objectives. For example, to monitor compliance, the IRS may require an external audit for some QIs (chosen on a random basis) that would otherwise qualify for a waiver. The IRS will send the QI a written response to the waiver request indicating whether the IRS agrees to waive the performance of the audit for the audit year. The IRS will not agree to waive the performance of an audit for a PAI, for a group of QIs for which the IRS permits a consolidated audit under AG10.01.3, or for any QI that is included in such a group.

10.01.6. External Audit Waiver (Annual Internal Review Program). A QI may request that the IRS waive the performance of the audit by an external auditor for an audit year if the QI maintains a substantial and independent internal audit staff, and the QI's internal auditors have conducted a review of the QI's compliance with the QI Agreement each year for the three years preceding the audit year. If this waiver is granted, instead of the required audit by an external auditor, the QI's internal audit department must perform the audit and report to the IRS in accordance with the attached Audit Guidance.

The internal auditors need not have conducted the three preceding annual reviews in accordance with this Audit Guidance. Instead, the internal auditors may perform any tests, checks or other procedures that the internal auditors may determine are appropriate. The internal auditors may request IRS clearance of any proposed program of tests, checks or other procedures by submitting a written description of the proposed program to the address provided in AG10.01.2. The IRS will send a written response to this request.

The QI must submit its request for a waiver to the IRS before June 30 of the year following the audit year at the address in AG10.01.2. The QI must include in its request a statement, made under penalties of perjury by the Responsible Party, as defined in AG10.01.4(b), that states:

- (a) The number of direct account holders and the number of indirect account holders to which the QI has made payments of reportable amounts;
- (b) The aggregate amount of payments of reportable amounts (including payments of

- reportable amounts beneficially owned by the QI) made to its accounts with withholding agents that the QI has designated as QI accounts;
- (c) The audit charter or similar document explaining the internal audit department's position within the organization, its powers and responsibilities, how the internal audit staff is organized, including position descriptions, the number of individuals in each position, the names of the individual or individuals with overall responsibility for internal audit, the routine functions of the internal auditors, and the persons to whom the internal auditors report;
  - (d) Brief summaries (which, like all other documents submitted to the IRS, must be translated into English, if necessary), of the procedures performed, the findings, and the conclusions or recommendations of each annual review of the QI's compliance with the QI Agreement conducted by the QI's internal auditors in each of the three years preceding the audit year; and
  - (e) That, in lieu of the external audit, the QI itself will apply the procedures set forth in section 10 of the QI Agreement to those accounts.

The IRS may contact the QI to request additional information. The QI must agree that its performance of the audit will be governed in all respects by section 10 of the QI Agreement as if the persons conducting the audit were the external auditor referred to in that section. At its sole discretion, the IRS may agree to waive or refuse to waive performance of the external audit. In determining whether to waive performance of the external audit, the IRS may take into account the information provided, all other information available to the IRS, and also other compliance objectives. For example, to monitor compliance, the IRS may require an external audit for some QIs (chosen on a random basis) that would otherwise qualify for a waiver. The IRS will send the QI a written response to the waiver request indicating whether the IRS agrees to waive the performance of the audit for the audit year. The IRS will not agree to waive the external audit for the first audit year of the first term of the QI Agreement. The IRS will not agree to waive the performance of an audit for a PAI, for a group of QIs for which the IRS permits a consolidated audit under AG10.01.3, or for any QI that is included in such a group.

**QI Agreement Sec. 10.02. Designation of External Auditor.** QI's external auditor must be one of the auditors listed in Appendix B of this Agreement, unless QI and the IRS agree, prior to the audit, to substitute another auditor. QI shall not propose an external auditor unless it has a reasonable belief that the auditor is subject to laws, regulations, or rules that impose sanctions for failure to exercise its independence and to perform the audit competently. The IRS has the right to reject a proposed external auditor, or to revoke its acceptance of an external auditor, if the IRS, in its sole discretion, reasonably believes that the auditor is not independent or cannot perform an effective audit under this Agreement.

Audit Guidance Sec. 10.02:

10.02.1. Auditor Approval. To obtain assurance that an external auditor will be acceptable to the IRS, the QI or the external auditor may submit a written request

explaining the qualifications of the external auditor to the IRS at any time. The QI or the external auditor should send the request to the address provided in AG10.01.2. The IRS will send the QI or the external auditor a written response to the request.

10.02.2. Auditor Independence. A QI and its external auditor must disclose to the IRS any circumstances that compromise or reasonably appear to compromise the external auditor's independence or ability to perform an effective audit. To make a disclosure, the QI or the external auditor must submit a written statement explaining the circumstances and any steps taken to address them as soon as such circumstances are discovered. The disclosure must be sent to the address provided in AG10.01.2. If the IRS determines that the external auditor is not acceptable, it will send the QI and the external auditor a written notice to that effect.

**QI Agreement Sec. 10.03. Timing and Scope of External Audits.** QI shall have the external auditor conduct an audit of the second full calendar year and the fifth full calendar year that this Agreement is in effect, subject to section 10.06 of this Agreement. The external auditor shall verify whether QI is in compliance with this Agreement by conducting an audit that meets the requirements of this section 10.03. The external auditor shall verify whether QI is in compliance with its QI agreement by providing a report to the IRS. The report must be received by the IRS, at the address set forth in section 12.06 of this Agreement, no later than June 30 of the year following the year being audited. The IRS may, however, upon request by the external auditor, extend the due date of the audit report upon good cause. The report must disclose that the external auditor has, at a minimum, performed the following checks listed in this paragraph 10.03, and set forth how each of those checks was performed and the results of the checks. QI's (or a PAI's) external auditor is encouraged to contact the IRS at the address set forth in section 12.06 of this Agreement and submit an audit plan (which includes, if relevant, the extent to which the external auditor proposes to rely on QI's internal audit procedures) prior to performing the audit so that the audit may be conducted in the most efficient and least costly manner possible.

Audit Guidance Sec. 10.03:

10.03.1. Scope-In General. AG10.03(A), (B), (C), (D) and (E) corresponds to section 10.03(A), (B), (C), (D) and (E) of the QI Agreement. Each section and subsection of AG10.03(A), (B), (C), (D) and (E) describe procedures that an external auditor should follow and the information to be included in the external auditor's report to the IRS under each corresponding section and subsection of the QI Agreement. For Phase 1 of the audit, the IRS requires the external auditor to complete only certain procedures and to report only certain information generated by those procedures. The IRS may require the external auditor to complete and report on the remaining procedures as part of the follow up fact finding in Phase 2 of the audit process. For convenience, a chart is included at the end of this Audit Guidance that provides an overview of the procedures to be completed in Phase 1.

10.03.2. Phase 1 of the Audit.

- (a) Scope of Phase 1 of the Audit. Those provisions of AG10.03(A) through (E) that must be completed in Phase 1 of the audit are labeled as either **"Phase1-All Accounts (or Sample)," "Phase1-Spot Check,"** or **"Phase 1"** in bold preceding the text of the subparagraph. The remaining provisions are deferred to Phase 2 and are labeled **"Phase 2 only"**
- (1) Phase1- All Accounts (or Sample). The provisions labeled **"Phase1-All Accounts (or Sample)"** relate to procedures that must be performed for all applicable accounts covered by the QI Agreement (e.g., accounts held by either direct foreign account holders, U.S. non-exempt recipients, or indirect account holders, as indicated under the subsection), or all such accounts contained in a valid sample selected under AG10.04.
- (2) Phase 1- Spot Check. The provisions labeled **"Phase 1- Spot Check"** relate to procedures that the external auditor may perform on a "spot check" basis by selecting accounts for testing in accordance with AG10.04.7 instead of examining all applicable accounts covered by the QI Agreement or all such accounts contained in the sample.
- (3) Phase 1. The provisions labeled **"Phase 1"** relate to procedures that either do not require the external auditor to examine accounts or do not require a documentation review. Accordingly, these procedures are performed in accordance with the instructions in these subsections.
- (b) Additional Procedures. As a part of Phase 1 of the audit, the external auditor may perform any additional procedures or other additional fact finding that it deems appropriate.
- (c) Use of explanatory footnotes or addenda. The external auditor may include in its audit report for Phase 1 explanations of information reported, additional information produced by any additional procedures or fact finding, or any proposals to perform additional procedures or fact finding, in the form of footnotes to information required to be included in its audit report or in the form of addenda to its audit report.

10.03.3. Phase 2 of the Audit. After reviewing the external auditor's report for Phase 1, the IRS may determine that additional fact finding is necessary. In that case, the IRS may direct the external auditor to perform and report on certain specific procedures. These procedures may include directing the external auditor to complete a review of all applicable accounts covered by the QI Agreement, or all such accounts contained in the sample, for some or all of the provisions of AG10.03(B), (C), and (D). See AG10.06.2.

10.03.4. Specifications of Audit Report. For guidance on the form and content of the external auditor's report, submitting the report to the IRS, the due date of the report and extensions of the due date, see AG10.05.

10.03.5. Submission of Audit Plan. Submission of an audit plan to the IRS prior to performing the audit is not necessary unless the external auditor plans to modify or deviate from the procedures described in AG10.03 and 10.04. In such circumstances, the external auditor should submit a written plan, identifying and explaining the reasons for any planned modifications or deviations from those procedures, prior to performing the audit. The external auditor should submit the audit plan to the address provided in AG10.01.2. The IRS will send the external auditor a written response to the submission.

10.03.6. Use of Internal Audit. The external auditor may use the QI's internal audit personnel and internal audit reports to any extent the external auditor chooses to do so. In that case, the external auditor remains responsible for the conduct of the audit as if the external auditor had performed the audit. In its report to the IRS, the external auditor must disclose specifically when and how it has used the QI's internal audit personnel and reports in conducting the audit.

10.03.7. Use of Copies. In conducting the audit, the external auditor may use copies of any account records or written materials provided by the QI. Nevertheless, the QI must permit the external auditor to have access to the complete and unaltered account holder records in the original, if the external auditor deems it necessary to examine originals.

**QI Agreement 10.03(A). Documentation. The external auditor must—**

**(1) Verify that QI has training materials, manuals, and directives that instruct the appropriate QI employees how to request, collect, review, and maintain documentation in accordance with this Agreement;**

**Audit Guidance 10.03(A)(1) [Phase 2 only]:**

10.03(A)(1).1. Review of Documentation Training. In Phase 2 of the audit, if the IRS directs, the external auditor must:

- Step 1: Identify the QI's employees that are responsible for opening and maintaining customer accounts.
- Step 2: Collect any written training materials, manuals, and directives used by those employees.
- Step 3: Inspect the written training materials, manuals, and directives to determine whether they contain instructions specific to accounts covered by the QI Agreement on how to request, collect, review, and maintain documentation.

10.03(A)(1).2. Documentation Training Report. The external auditor must specifically report:

Report 1: Whether the QI has written training materials, manuals, and directives that contain instructions specific to accounts covered by the QI Agreement on how to request, collect, review, and maintain customer documentation.

**QI Agreement Sec. 10.03(A)(2). Review QI's account opening procedures and interview QI's employees, to determine if appropriate documentation is requested from account holders and, if obtained, that it is reviewed and maintained in accordance with this Agreement;**

Audit Guidance 10.03(A)(2) [Phase 2 only]:

10.03(A)(2).1. Review of Account Opening Procedures. In Phase 2 of the audit, if the IRS directs, the external auditor must:

Step 1: Identify the QI employees responsible for opening and maintaining customer accounts and select representative employees for interview.

Step 2: Ask the selected employees how accounts covered by the QI Agreement are opened, what documentation is requested, how the documentation is obtained, and how the documentation is reviewed and maintained.

10.03(A)(2).2. Account Opening Procedures Report. The external auditor must specifically report:

Report 1: The number of employees interviewed.

Report 2: The number of employee responses that indicate that Forms W-8 and documents listed in the Attachment to the QI Agreement are not routinely requested, reviewed, cross checked against other account information, or maintained in accordance with section 5.12 of the QI Agreement.

**QI Agreement Sec. 10.03(A)(3). Verify that QI follows procedures designed to inform account holders that claim a reduced rate of withholding under an income tax treaty about any applicable limitation on benefits procedures;**

Audit Guidance 10.03(A)(3) [Phase 2 only]:

10.03(A)(3).1. Review of Limitation on Benefits (LOB) Procedure. In Phase 2 of the audit, if the IRS directs, the external auditor must:

Step 1: Ask the QI employees selected for interview under AG10.03(A)(2) Step 1 how account holders that are not individuals claim a reduced rate of



withholding under an income tax treaty.

10.03(A)(3).2. LOB Procedure Report. The external auditor must specifically report:

Report 1: The number of employee responses that indicate that such customers are not informed about any applicable limitation on benefits provisions.

**QI Agreement 10.03(A)(4). Review QI's accounts, using a valid sample of accounts for which treaty benefits are claimed, to ensure that QI is obtaining the treaty statements required by section 5.03(B);**

Audit Guidance 10.03(A)(4) [Phase 1- All Accounts (or Sample)]:

10.03(A)(4).1. Review of Treaty Statements. In Phase 1 of the audit, the external auditor must:

- Step 1: Identify all accounts covered by the QI Agreement that are held by direct account holders that are not U.S. recipients, or all such accounts contained in a valid sample selected in accordance with AG10.04.
- Step 2: From the accounts identified in Step 1, segregate the accounts for which treaty benefits are claimed.
- Step 3: From the accounts for which treaty benefits are claimed, segregate the accounts for which documentary evidence has been obtained.
- Step 4: From the accounts for which documentary evidence has been obtained, segregate those accounts held by account holders that are not individuals or governments.
- Step 5: For each account segregated in Step 4, determine whether there is a valid treaty statement described in section 5.03(B) of the QI Agreement. A valid treaty statement must be signed and dated by the beneficial owner. A treaty statement may be incorporated into another document that is signed by the beneficial owner.
- Step 6: For the accounts segregated in Step 4, identify:
  - (a) All accounts covered by the QI Agreement held by intermediaries or flow through entities for whose account holders recipient specific reporting is required under section 8.02(B) and (C) or section 8.04 of the QI Agreement.
  - (b) The number in Step 6(a) that are intermediaries.
  - (c) The number in Step 6(a) that are flow through entities
  - (d) The number of indirect account holders holding through each intermediary that is a direct account holder; and
  - (e) The number of indirect account holders holding through each flow

through entity that is a direct account holder.

- Step 7:
- (a) Identify all indirect account holders covered by the QI Agreement or all such account holders contained in the sample selected in accordance with AG10.04. From the indirect account holders identified, segregate the indirect account holders for which treaty benefits are claimed.
  - (b) From the indirect account holders segregated in (a), segregate the indirect account holders for which documentary evidence has been obtained.
  - (c) From the indirect account holders segregated in (b), segregate indirect account holders that are not individuals or governments.
  - (d) For each indirect account holder segregated in (c), determine whether there is a valid treaty statement described in section 5.03(B) of the QI Agreement.

10.03(A)(4).2. Treaty Statements Report. The external auditor must specifically report:

- Report 1: The number of accounts determined under each of Steps 1, 2, 3, and 4.
- Report 2: The number of accounts segregated in Step 4 that do not contain a valid treaty statement described in section 5.03(B) of the QI Agreement.
- Report 3: The number of account holders determined under Step 6(a) through (e).
- Report 4: The number of indirect account holders identified and segregated under Step 7 (a) through (c).
- Report 5: The number of indirect account holders segregated in Step 7(c) whose documentation does not contain a valid treaty statement described in section 5.03(B) of the QI Agreement.

**QI Agreement Sec. 10.03(A)(5).** Review information, using a valid sample, contained in account holder files to determine if the documentation validity standards of section 5.10 of this Agreement are being met. For example, the external auditor must verify that changes in account holder information (e.g., a change of address to a U.S. address or change of account holder status from foreign to U.S.) are being conveyed to QI's withholding agent, or, if QI assumes primary NRA withholding responsibility or primary Form 1099 reporting and backup withholding responsibility, that QI is applying the appropriate withholding rate;

**Audit Guidance 10.03(A)(5) [Phase 1- All Accounts (or Sample)]:**

10.03(A)(5).1. Review of Documentation Validity (Foreign Persons and U.S. Exempt Recipients). In Phase 1 of the audit, the external auditor must:

- Step 1: Identify all accounts covered by the QI Agreement that are held by direct account holders that are not U.S. non-exempt recipients, or all such accounts contained in the sample selected under AG10.04.
- Step 2: Sort those accounts according to whether they contain the following types of documentation:
- (a) Form W-8BEN;
  - (b) Form W-8EXP;
  - (c) Form W-8ECI;
  - (d) Form W-8IMY;
  - (e) Form W-9;
  - (f) Documentary Evidence; and
  - (g) No documentation.
- Step 3: FORM W-8BEN:
- (a) For accounts documented with a Form W-8BEN, inspect Part I of the Form W-8BEN. Determine that the following lines are completed and consistent with each other:
    - (1) Line 1 (name of individual or organization that is the beneficial owner);
    - (2) Line 2 (country of incorporation or organization), for non-individuals;
    - (3) Line 3 (type of beneficial owner);
    - (4) Line 4 (permanent residence address, including country) A permanent residence address cannot be a P.O. Box, in-care-of address or an address at a financial institution, including a hold mail instruction (except when the beneficial owner is a financial institution); and
    - (5) Signature and date.
      - (i) Determine that December 31 of the audit year was within three full calendar years following the year of signature; and
      - (ii) Determine that the certifications attested under penalties of perjury have not been modified.
  - (b) For a Form W-8BEN for which the beneficial owner has claimed treaty benefits, inspect Part II of the Form W-8BEN. Determine that the following lines are completed and consistent with each other and with Part I of the Form:
    - (1) Line 9a (residence certification, including name of country); and
    - (2) Line 9c (section 894 and LOB certification), but only for non-individuals.
- Step 4: FORM W-8EXP. For accounts documented with Form W-8EXP, inspect

Form W-8EXP. Determine that the following lines are completed and consistent with each other:

- (a) Line 1 (name of organization);
- (b) Line 2 (country of incorporation or organization);
- (c) Line 3 (type of entity);
- (d) Line 4 (permanent residence address, including country), A permanent residence address cannot be a P.O. Box, in-care-of address or an address at a financial institution, including a hold mail instruction (except when the beneficial owner is a financial institution);
- (e) Either:
  - (1) Line 9a, and 9b or 9c; or
  - (2) Line 10 (and organization is designated by executive order under 22 U.S.C. 288 through 288(f)); or
  - (3) Line 11; or
  - (4) Line 12a (including date) or 12b (including attached opinion from U.S. counsel), and, for section 501(c)(3) organizations, Line 12c (including affidavit) or 12d, and Line 6; or
  - (5) Line 13;
- (f) Signature and date:
  - (1) Determine that the certifications attested under penalties of perjury have not been modified.

#### Step 5

FORM W-8ECI. For accounts documented with Form W-8ECI, inspect the Form W-8ECI. Determine that the following lines are completed and consistent with each other:

- (a) Line 1 (name of organization);
- (b) Line 2 (country of incorporation or organization);
- (c) Line 3 (type of entity);
- (d) Line 4 (permanent residence address, including country), A permanent residence address cannot be a P.O. Box, in-care-of address or an address at a financial institution, including a hold mail instruction (except when the beneficial owner is a financial institution);
- (e) Line 5 (business address in the United States);
- (f) Line 6 (U.S. taxpayer identification number);
- (g) Line 9 (list of items of income that are effectively connected with the conduct of a trade or business in the United States);
- (h) Signature and date:
  - (1) Determine that December 31 of the audit year was within three full calendar years following the year of signature; and
  - (2) Determine that the certifications attested under penalties of perjury have not been modified.

#### Step 6

FORM W-8IMY. For accounts documented with Form W-8IMY, inspect the Form W-8IMY. Determine that the following lines are completed and

consistent with each other:

- (a) Line 1 (name of individual or organization);
- (b) Line 2 (country of incorporation or organization), for non-individuals;
- (c) Line 3 (type of entity);
- (d) Line 4 (permanent residence address, including country). A permanent residence address cannot be a P.O. Box, in-care-of address or an address at a financial institution, including a hold mail instruction (except when the beneficial owner is a financial institution).
- (e) Either:
  - (1) Line 9a and Line 6 (QI-EIN); or
  - (2) Line 10a and , if applicable, Line 10b; or
  - (3) Line 11 and Line 6 (EIN), and Line 12 or Line 13; or
  - (4) Line 14 and Line 6; or
  - (5) Line 15 (and Line 6 (EIN) if Line 3 is checked as a nonwithholding foreign grantor trust and there are 5 or fewer grantors).
- (f) Signature and date:
  - (1) Determine that the certifications attested under penalties of perjury have not been modified.

**Step 7** FORM W-9. For accounts documented with Form W-9, inspect the Form W-9. Determine that the following lines are completed and consistent with each other:

- (a) Name;
- (b) U.S. taxpayer identification number;
- (c) Part II (For U.S. payees exempt from backup withholding);
- (d) Signature and date.
  - (1) Determine that the certifications attested under penalties of perjury have not been modified.

**Step 8** DOCUMENTARY EVIDENCE. For accounts documented only with documentary evidence, inspect the documentary evidence. Determine whether:

- (a) The documentary evidence is one of the types listed in the applicable Attachment to the QI Agreement,
- (b) The documentary evidence appears to be in proper form when compared to documents of the same type listed in the Attachment,
- (c) The documentary evidence:
  - (1) Supports the account holder's foreign status and, for an account holder that claims treaty benefits, the country of issuance is the same country for which the treaty benefits are claimed and the documentation supports the account holder's residence in the treaty country, or
  - (2) Supports the account holder's status as a U.S. exempt recipient.

- (d) In the case of an international organization, the organization is designated by executive order under 22 U.S.C. 288 through 288(f). In the case of a foreign government or foreign central bank of issue, the documentary evidence supports the account holder's status as such.
- (e) In the case of a foreign government or foreign central bank of issue, the documentary evidence supports the account holder's status as such.
- (f) In the case of a person that has provided documentary evidence indicating it is a bank, broker, custodian, intermediary, or other agent, included with the documentary evidence is a written representation that the person is acting on its own behalf.

#### Step 9

For each account determined to be documented under Steps 3 through 8, examine the most recently updated information for the audit year drawn from the account opening statement, any other account documents or memoranda and any correspondence associated with the account (for purposes of this section, "the account holder's file"). Determine whether:

- (a) The identifying information in the documentation matches the most current identifying information in the account holder's file (taking into account any information that links the identifying information in the documentation to the identifying information in the account holder's file),
- (b) In the case of an account documented with documentary evidence, the documentary evidence and the account holder's file contains only an address at a financial institution, including a hold mail instruction (except when the financial institution is the beneficial owner), an in-care-of address, or a P.O. Box, and if so, whether the QI has satisfied the additional requirements of section 5.10(B)(2)(i) of the QI Agreement.
- (c) The documentation or the account holder's file shows a U.S. mailing or residence address for the account holder or standing instructions to pay from the account to a U.S. address or to an account maintained in the United States, and if so, whether:
  - (1) The account holder is a U.S. person, or
  - (2) In the case of documentary evidence, the QI has satisfied the additional requirements of section 5.10(B)(2)(i), (ii) and (iii) of the QI Agreement or, in the case of Forms W-8, the QI has satisfied the additional requirements of section 1.1441-7(b)(5) of the regulations.
- (d) For accounts where the beneficial owner has claimed treaty benefits, the documentation or the account holder's file shows a residence address or mailing address, or a P.O. Box, in-care-of address or an address at a financial institution, including a hold mail instruction (except when the financial institution is the beneficial owner), that is not in the applicable treaty country, or standing

instructions to pay from the account to an address outside the treaty country or to an account maintained outside the treaty country, and if so, whether:

- (1) In the case of documentary evidence, the QI has satisfied the additional requirements of section 5.10(B)(3) of the QI Agreement; or
- (2) In the case of Forms W-8, the QI has satisfied the additional requirements of section 1.1441-7(b)(6) of the regulations.

Step 10: Include in the category of accounts with no documentation (AG10.03(A)(5).1 Step 2(g)) all accounts:

- (a) That are not documented with Forms W-8BEN, W-8EXP, W-8IMY, W-8ECI, W-9 or documentary evidence that is listed in the applicable Attachment to the QI Agreement, and
- (b) That are documented with Forms W-8 or documentary evidence that is inadequate after applying the additional requirements of AG10.03(A)(5).1 Step 9(a)-(d).

Step 11: (a) Identify all indirect account holders covered by the QI Agreement, or all such account holders contained in the sample selected under AG10.04.

- (b) From those indirect account holders, segregate the indirect account holders that are not U.S. non-exempt recipients.
- (c) Inspect the documentation for each indirect account holder segregated in Step 11(b) to determine whether the documentation validity standards of section 5.10(C) of the QI Agreement are satisfied by performing the procedures under AG10.03(A)(5).1 Steps 1 through 9 with the following modifications:
  - (1) Part II of the Form W-8BEN is not complete unless line 9b and line 6 are completed, except in the case of a claim of treaty benefits for income from a marketable security.
  - (2) Documentary evidence establishing entitlement to treaty benefits must be documentary evidence described in section 5.03(A)(3) of the QI Agreement. Also, except in the case of income from a marketable security, a TIN is required.
  - (3) Documentary evidence for purposes other than establishing entitlement to treaty benefits must be documentary evidence described in Treas. Reg. § 1.6049-5(c)(1).

10.03(A)(5).2. Documentation Validity (Foreign Persons and U.S. Exempt Recipients) Report. The external auditor must specifically report:

Report 1: The number of accounts identified or selected under Step 1.

Report 2: The number of accounts in each of the categories in Step 2(a) through (g).

- Report 3: The number of Forms W-8BEN inspected under Step 3(a) and the number of Forms W-8BEN that did not satisfy the criteria under that section.
- Report 4: The number of Forms W-8BEN inspected under Step 3(b) and the number of Forms W-8BEN that did not satisfy the criteria under that section.
- Report 5: The number of Forms W-8EXP inspected under Step 4 and the number of Forms W-8EXP that did not satisfy the criteria under that section.
- Report 6: The number of Forms W-8ECI inspected under Step 5 and the number of Forms W-8ECI that did not satisfy the criteria under that section.
- Report 7: The number of Forms W-8IMY inspected under Step 6 and the number of Forms W-8IMY that did not satisfy the criteria under that section.
- Report 8: The number of Forms W-9 inspected under Step 7 and the number of Forms W-9 that did not satisfy the criteria under that section.
- Report 9: The number of accounts:
- (a) Documented with documentary evidence inspected under Step 8;
  - (b) Reviewed under Step 8 that did not satisfy criteria (a) or (b) of that section;
  - (c) Reviewed under Step 8 that satisfy the criteria of either section (c)(1) or (2);
  - (d) Reviewed under Step 8 that did not satisfy the criteria of either (c)(1) or (2); and
  - (e) Described in each of (d), (e), and (f) of Step 8 and the number of accounts that did not satisfy the criteria of (d), (e), and (f) of Step 8.
- Report 10: The number of accounts:
- (a) That did not satisfy the criteria of Step 9(a);
  - (b) Described in Step 9(b) and the number of accounts that did not satisfy the additional criteria of that step;
  - (c) Described in Step 9(c), the number of accounts described in (c)(1) of that step, and the number of accounts that did not satisfy (c)(2) of that step; and
  - (d) Described in Step 9(d) and the number of accounts that did not satisfy the criteria of (d)(1) or (2) of that step.
- Report 11: The number of accounts described in each of (a) and (b) of Step 10.
- Report 12: For indirect account holders, the external auditor must separately complete Report 1 through 11.

**QI Agreement Sec. 10.03(A)(6). Review accounts, using a valid sample of U.S.**



**non-exempt recipient account holders, to determine if QI is obtaining Forms W-9 from those customers whose identity is not prohibited by law from disclosure, and that QI is transmitting those forms to a withholding agent to the extent QI does not assume primary Form 1099 reporting and backup withholding responsibility with respect to reportable amounts and, if applicable, designated broker proceeds;**

**Audit Guidance 10.03(A)(6) [Phase 1- All Accounts (or Sample)]:**

**10.03(A)(6).1. Review of Documentation Validity (Disclosed U.S. Non-exempt Recipients).** In Phase 1 of the audit, the external auditor must:

- Step 1: Identify all accounts covered by the QI Agreement that are held by direct account holders that are U.S. non-exempt recipients, or all such accounts contained in the sample selected in accordance with AG10.04.
- Step 2: From those accounts, segregate the accounts of those U.S. non-exempt recipients whose identity is not prohibited by law from disclosure, including the accounts of U.S. non-exempt recipients that have waived the prohibitions against disclosure.
- Step 3: Obtain copies of the QI's Forms W-8IMY and inspect them to determine whether the QI has assumed primary Form 1099 and backup withholding responsibility. From the accounts segregated in Step 2, segregate the accounts of U.S. non-exempt recipients for which the QI has not assumed primary Form 1099 reporting and backup withholding responsibility.
- Step 4: From the accounts segregated in Step 3, segregate the accounts documented with Form W-9 and determine that each Form W-9 satisfies the criteria of AG10.03(A)(5).1 Step 7.
- Step 5: From the accounts segregated in Step 3, segregate the accounts that (i) are not documented with Form W-9 and (ii) the accounts for which the Forms W-9 did not satisfy the criteria of AG10.03(A)(5).1 Step 7.
- Step 6: Obtain the withholding statements associated with QI's Forms W-8IMY.
- Step 7: For each Form W-9 that satisfies the criteria of AG10.03(A)(5).1 Step 7, match the name and TIN on the Form W-9 to the name and TIN on the withholding statement associated with the last payment made to each corresponding account for the audit year.
- Step 8: For each account segregated in Step 5, match the name, and (if provided) address and TIN of the U.S. non-exempt recipient to the name, address and TIN on the withholding statement associated with the last payment made to the account for the audit year.

10.03(A)(6).2. Documentation Validity (U.S. Non-exempt Recipients) Report. The external auditor must specifically report:

Report 1: The number of accounts segregated under each of Steps 1, 2, 3, 4, and 5(i) and (ii).

Report 2: The number of accounts that did not satisfy the criteria of Steps 7 and 8.

**QI Agreement Sec. 10.03(A)(7). Review accounts, using a valid sample of U.S. non-exempt recipient account holders whose identity and account information is prohibited by law, including by contract, from disclosure, to verify that–**

**(i) Such accounts exist in only rare and unusual circumstances (and detailing in the audit report the nature of such circumstances); and**

**(ii) The procedures of section 6.04 have been, and are being, followed.**

Audit Guidance 10.03(A)(7) [Phase 1- All Accounts (or Sample)]:

10.03(A)(7).1. Account Review of U.S. Non-exempt Recipients (Disclosure Prohibited). In Phase 1 of the audit, the external auditor must:

Step 1: Identify all accounts covered by the QI Agreement that are held by direct account holders that are U.S. non-exempt recipients, or all such accounts contained in the sample selected under AG10.04.

Step 2: From those accounts, segregate the accounts of those U.S. non-exempt recipients whose identity is prohibited by law from disclosure, and that have not waived the prohibitions against disclosure.

Step 3: Divide the accounts segregated in Step 2, into those accounts opened prior to January 1, 2001 and those accounts opened on or after January 1, 2001.

Step 4: Obtain a letter from the Responsible Party, as defined in AG10.01.4(b), explaining why the accounts in Step 2 exist and how the procedures of both section 6.04(A) (for those accounts opened prior to January 1, 2001) and section 6.04(B) (for those accounts opened on or after January 1, 2001) of the QI Agreement have been and are being applied.

10.03(A)(7).2. Account Review of U.S. Non-exempt Recipients (Disclosure Prohibited) Report. The external auditor must specifically:

Report 1: Report the number of accounts segregated under Steps 1, 2, and 3; and

Report 2: Include a copy of the letter obtained under Step 4.

**QI Agreement Sec. 10.03(A)(8). Review QI's agreements with its PAIs to ensure that the obligations imposed on the PAIs are identical to the obligations imposed on QI under this Agreement, except as otherwise provided in section 4.02.**

Audit Guidance 10.03(A)(8) [Phase 1]:

10.03(A)(8).1. Review of PAI Obligations. In Phase 1 of the audit, the external auditor must:

Step 1: Obtain copies of the QI Agreement and all PAI agreements.

Step 2: Inspect each PAI agreement to determine whether:

- (a) The PAI agreement covers all offices of the PAI located in a country listed in Appendix A of the QI Agreement;
- (b) The PAI agreement provides that the QI include all reportable payments made by the PAI in the QI's Forms 945, 1099, 1042 and 1042-S;
- (c) The PAI agreement requires the PAI to provide the QI with all information necessary for the QI to meet its obligations under the QI Agreement;
- (d) There are any provisions limiting the PAI's liability for underwithholding or reporting due to the PAI's failure to perform its obligations under the PAI agreement;
- (e) The PAI agreement requires the PAI to disclose U.S. non-exempt recipients and indirect account holders to the same extent as the QI Agreement;
- (f) The PAI agreement prohibits the PAI from assuming primary withholding responsibility or primary Form 1099 reporting and backup withholding responsibility;
- (g) The PAI is subject to audit procedures that are identical to those applicable to the QI under the QI Agreement and the PAI's designated auditor is listed in Appendix B of the QI Agreement or has been approved by the IRS for that PAI; and
- (h) The PAI is subject to all other obligations of the QI under the QI Agreement.

Step 3: Obtain a copy of the notice (described in section 4.01(B) of the QI Agreement) identifying each PAI filed by the QI with the IRS and determine that the date of filing for each notice precedes the date of the first payment received by the PAI from the QI pursuant to the PAI agreement.

Step 4: Obtain a copy of each PAI's W-8IMY provided to the QI and determine

that it satisfies the criteria of AG10.03(A)(5).1 Step 6.

10.03(A)(8).2. PAI Obligations Report. The external auditor must specifically report:

- Report 1: The number of PAI agreements and the name of each PAI;
- Report 2: The number of PAI agreements that did not satisfy the criteria of each of Step 2(a) through (h); and
- Report 3: The number of PAI agreements that did not satisfy the criteria of Step 3.
- Report 4: The number of Forms W-IMY obtained in Step 4 and the number of Forms W-8IMY that did not satisfy the criteria of AG10.03(A)(5).1 Step 6.

**QI Agreement Sec. 10.03(A)(9). State in its external audit report if the auditor is aware that QI is in material violation or is under investigation for violation of any of the know-your-customer rules, practices, or procedures applicable to the offices audited.**

Audit Guidance 10.03(A)(9) [Phase 1]:

10.03(A)(9).1. Knowledge of KYC Investigations. In Phase 1 of the audit, the external auditor must:

- Step 1: Obtain a letter signed by the Responsible Party, as defined in AG10.01.4(b), and by the QI's legal counsel stating whether either is aware that the QI is in material violation or is under investigation for violation of any of the know-your-customer rules, practices, or procedures applicable to any branches of the QI located in countries named in the Attachments to the QI Agreement.

10.03(A)(9).2. KYC Investigations Report. The external auditor must specifically:

- Report 1: Report whether, based on the information in the letter described in Step 1 and on its own information, the external auditor is aware of any such material violations or investigations and, if so, identify them.
- Report 2: Include in its report a summary of the letter described in Step 1.

**QI Agreement Sec. 10.03(A)(10). State in its external audit report if the auditor is aware that QI removes U.S. non-exempt recipients from accounts covered by this Agreement for the purpose of circumventing the Form 1099 reporting and backup withholding provisions of this Agreement.**

Audit Guidance 10.03(A)(10) [Phase 1- All Accounts (or Sample)]:

10.03(A)(10).1. Review of Removal of U.S. Non-exempt Recipients. In Phase 1 of the

audit, the external auditor must:

- Step 1: Identify all accounts covered by the QI Agreement that are held by direct account holders that are U.S. non-exempt recipients, or all such accounts contained in the sample selected under AG10.04.
- Step 2: Inspect account closing records to determine whether the account was closed during the audit year.
- Step 3: If the account was closed during the audit year, inspect account transfer records to determine whether any assets have been transferred to another account held by the same account holder during the audit year.

10.03(A)(10).2. Removal of U.S. Non-exempt Recipients Report. The external auditor must specifically report:

- Report 1: The number of accounts covered by the QI Agreement held by U.S. non-exempt recipients that were closed during the audit year.
- Report 2: Whether the external auditor is aware of any accounts with the QI not covered by the QI Agreement held by the same U.S. non-exempt recipients that were opened during the audit year, and if so, the number of such accounts.
- Report 3: Whether the external auditor is aware of any transfers of assets from an account covered by the QI Agreement held by a U.S. non-exempt recipient to another account with the QI not covered by the QI Agreement held by the same U.S. non-exempt recipient, and if so, the number of accounts to which such transfers were made.
- Report 4: Whether the external auditor is aware that the QI removes U.S. non-exempt recipients from accounts covered by the QI Agreement for the purpose of circumventing the Form 1099 reporting and backup withholding provisions of the QI Agreement.

**QI Agreement Sec. 10.03(B)(1). Withholding Rate Pools. The external auditor must—**

**(1) Verify that QI has training materials, manuals, and directives that instruct the appropriate QI employees how to determine withholding rate pools based on documentation and the presumption rules;**

Audit Guidance 10.03.(B)(1) [Phase 2 Only]:

10.03(B)(1).1. Review of Withholding Rate Pool Training Materials. In Phase 2 of the audit, if the IRS directs, the external auditor must:

- Step 1: Identify the QI's employees that are responsible for determining withholding rate pools.
- Step 2: Collect any written training materials, manuals, and directives used by those employees.
- Step 3: Inspect the written training materials, manuals, and directives to determine whether they contain specific instructions on how to determine withholding rate pools based on documentation and the presumption rules.

10.03(B)(1).2. Withholding Rate Pool Training Materials Report. The external auditor must specifically report:

- Report 1: Whether the QI has written training materials, manuals, and directives that contain specific instructions on how to determine withholding rate pools based on documentation and the presumption rules.

**QI Agreement Sec. 10.03(B)(2). Interview employees responsible for determining withholding rate pools to ascertain if they are adequately trained to determine those pools and that they follow adequate procedures for determining those pools;**

Audit Guidance 10.03(B)(2) [Phase 2 Only]:

10.03(B)(2).1. Review of Personnel Training (Withholding Rate Pool). In Phase 2 of the audit, if the IRS directs, the external auditor must:

- Step 1: Identify the QI's employees that are responsible for determining withholding rate pools and select representative employees for interview.
- Step 2: Ask the selected employees whether they have received any formal or informal training on determining withholding rate pools and if so, ask the selected employees to describe the training, when it occurred, and how much time was devoted to it.
- Step 3: Ask the selected employees how an account is assigned to withholding rate pools.

10.03(B)(2).2. Personnel Training (Withholding Rate Pool) Report. The external auditor must report:

- Report 1: The number of employees interviewed.
- Report 2: The number of employee responses that indicate that the employee has not received training on how to determine withholding rate pools.

Report 3: The number of employee responses that indicate that accounts are assigned to withholding rate pools without routinely referring to documentation, presumptions, the type of income earned, and the withholding rate applied.

**QI Agreement Sec. 10.03(B)(3). Review QI's procedures for preparing the withholding statements associated with QI's Forms W-8IMY and verify that the withholding statements provided to withholding agents convey complete and correct information on a timely basis;**

Audit Guidance 10.03(B)(3) [Phase 2 Only]:

10.03(B)(3).1. Review of Withholding Statements. In Phase 2 of the audit, if the IRS directs, the external auditor must:

- Step 1: Identify the QI's employees that are responsible for preparing withholding statements and providing them to withholding agents, and select representative employees for interview.
- Step 2: Ask the selected employees how withholding statements are prepared and provided to withholding agents.
- Step 3: Determine the last day of the audit year on which the QI received reportable amounts.
- Step 4: For that day, identify the withholding agent from which the QI received the highest reportable amounts in the aggregate.
- Step 5: Obtain copies of the QI's withholding statement(s) associated with all reportable amounts received from the withholding agent identified in step 4 for the day identified in step 3.
- Step 6: Obtain the QI's records of payments for the reportable amounts received from the withholding agent identified in step 4 for the day identified in step 3.
- Step 7: Reconcile the withholding statements with the corresponding records of payment.
- Step 8: Inspect the withholding statements and records of payment to determine whether the withholding statement information was provided to the withholding agent before the withholding agent made payments.

10.03(B)(3).2. Withholding Statement Report. The external auditor must report:

- Report 1: The number of employees interviewed.
- Report 2: The number of employee responses that indicate that withholding statement information was not routinely reviewed, updated and provided to the withholding agent before the withholding agent made payments.
- Report 3: Whether records of payment and the withholding statements were inconsistent.
- Report 4: Whether the withholding statement information was provided to the withholding agent before payment.

**QI Agreement Sec. 10.03(B)(4). Perform test checks, using a valid sample of account holders assigned to each withholding rate pool, and cross check that assignment against the documentation provided by, or presumption rules that apply to, the account holder, the type of income earned, and the withholding rate applied;**

Audit Guidance 10.03(B)(4) [Phase 1- Spot check]:

10.03(B)(4).1. Review of Withholding Rate Pool Classification. In Phase 1 of the audit and, if the IRS directs, in Phase 2 of the audit, the external auditor must:

- Step 1: Identify all accounts covered by the QI Agreement that are held by direct account holders that are not U.S. non-exempt recipients, or all such accounts contained in the sample selected under AG10.04, or, for purposes of the spot check in Phase 1 of the audit, all such accounts selected under AG10.04.7.
- Step 2: Identify the last payment of each income type required to be reported on Form 1042-S that was made to each account.
- Step 3: Obtain copies of the QI's Forms W-8IMY associated with each of the payments identified in Step 2 and inspect them to determine whether the QI has assumed primary NRA withholding responsibility. For accounts covered by the QI Agreement for which the QI has not assumed such responsibility, the external auditor must perform the procedures described in Steps 4 through 6 below.
- Step 4: For the payments identified in Step 2, obtain:
- (a) The account statements and records that show the investment and the type of income earned and the amounts of withholding; and
  - (b) The account records that show how the QI has classified the type of income and withholding rate for purposes of its withholding rate pools.



- Step 5: Based on the documentation for the account (after the determinations under AG10.03(A)(4) and (5) and applicable presumptions under section 5.13 of the QI Agreement have been made), determine the withholding rate and further classify the accounts within a Form 1042-S income classification according to withholding rate. An account within an income classification to which more than one withholding rate has been applied must be placed into multiple withholding rate classifications. The applicable presumption rules under section 5.13 of the QI Agreement may be made on the basis of the most current account information.
- Step 6: Determine whether the classifications under Step 5 match the QI's classifications described in Step 4(b).
- Step 7:
- (a) Identify all indirect account holders covered by the QI Agreement, or use the same sample selected under AG10.04, or, for purposes of the spot check in Phase 1 of the audit, use the account holders selected under AG10.04.7.
  - (b) Segregate the indirect account holders that are not U.S. non-exempt recipients.
  - (c) Apply Steps 2 through 6 to those indirect account holders.

10.03(B)(4).2. Withholding Rate Pool Classification Report. The external auditor must specifically report:

Report 1: The number of accounts identified in Step 1.

Report 2: The number of accounts in Report 1 classified under Step 5.

Report 3: The number of accounts in Report 1 for which the QI's classifications do not match the account records under Step 6.

Report 4: For indirect account holders,

- (a) The number of indirect account holders under Step 7(a) and (b);
- (b) The number of indirect account holders classified under Step 5; and
- (c) The number of indirect account holders for which the QI's classifications do not match the account records under Step 6.

**QI Agreement Sec. 10.03(B)(5). Perform test checks, using a valid sample of accounts of U.S. non-exempt recipients, to verify that appropriate withholding rate pools are established for U.S. non-exempt recipients; and**

Audit Guidance 10.03(B)(5) [Phase 1- Spot check]:

10.03(B)(5).1. Review of Withholding Rate Pool Classification (U.S. Non-exempt Recipients). In Phase 1 of the audit and, if the IRS directs, in Phase 2 of the audit, the external auditor must:

- Step 1: Identify all accounts covered by the QI Agreement that are held by direct account holders that are U.S. non-exempt recipients, or all such accounts contained in the same sample selected under AG10.04, or, for purposes of the spot check in Phase 1 of the audit, all such accounts selected under AG10.04.7.
- Step 2: From those accounts, segregate the accounts of those U.S. non-exempt recipients whose identity is not prohibited by law from disclosure, including the accounts of U.S. non-exempt recipients that have waived the prohibitions against disclosure.
- Step 3: Identify the last payment of each income type required to be reported on Form 1099 that was made to each account identified in Step 2. Obtain copies of the QI's Forms W-8IMY associated with each of the payments and inspect them to determine whether the QI has assumed primary Form 1099 and backup withholding responsibility. For accounts covered by the QI Agreement for which the QI has not assumed such responsibility, the external auditor must perform the procedures described in Steps 4 through 7 below.
- Step 4: For the payments identified in Step 3, obtain:
- (a) The account statements and records that show the investment and the type of income earned and the amounts backup withheld (if any); and
  - (b) The withholding statements associated with the Forms W-8IMY.
- Step 5: Based on the records described in Step 4(a), classify the pools within each account according to the type of reportable amount paid to each account. The external auditor must apply this Step 5 and Step 7 whether or not the QI is using the alternative procedure contained in section 6.03(B) of the QI Agreement.
- Step 6: Based on the records described in Step 4(a), for each account, determine whether reportable payments (other than reportable amounts) were made to the account. If so, classify the pools within each account according to the type of reportable payment made to each account. For example, for non-U.S. payors, such reportable payments would include foreign source income paid within the United States and broker proceeds from the sale of assets if the sale is effected within the United States. See section 2.44 of the QI Agreement. For purposes of this Step 6, the external auditor shall treat foreign source income as paid within the United States only if the account statements and records include a written instruction from the account holder concerning the foreign source income that, on its face, indicates that the written statement was sent from within the United States. For purposes of this Step 6, the external auditor shall treat broker

proceeds as broker proceeds from the sale of an asset effected within the United States only if the account statements and records include (i) a written instruction from the account holder to sell the asset that on its face indicates that the written statement was sent from within the United States, or (ii) confirmation or payment transmitted to the account holder in the United States. The external auditor must apply this Step 6 and Step 7 whether or not the QI is using the alternative procedure contained in section 6.03(B) of the QI Agreement.

- Step 7: Determine whether the classifications and amounts of income and amounts backup withheld (if any) under Steps 5 and 6 match classifications and amounts in the withholding statements described in Step 4(b).
- Step 8:
- (a) Identify all indirect account holders covered by the QI Agreement, or all such account holders contained in the same sample selected under AG10.04, or for purposes of the spot check in Phase 1 of the audit, all such account holders selected under AG10.04.7.
  - (b) From the indirect account holders identified in (a), segregate the indirect account holders that are U.S. non-exempt recipients.
  - (c) Apply Steps 2 through 7 to the indirect account holders segregated in (b).

10.03(B)(5).2. Withholding Rate Pool Classification (U.S. Non-exempt Recipient) Report. The external auditor must specifically report:

Report 1: The number of accounts segregated under Steps 1 and 2.

Report 2: The number of accounts for which the classifications and amounts do not match the classifications and amounts in the QI's withholding statements.

Report 3: For indirect account holders,

- (a) The number of indirect account holders under Step 8(a) through (c);
- (b) The number of indirect account holders under Step 2; and
- (c) The number of indirect account holders for which the classifications and amounts do not match the classifications and amounts in the QI's withholding statements.

**QI Agreement Sec. 10.03(B)(6). Verify, if QI is using the alternative procedure for U.S. non-exempt recipients contained in section 6.03(B) of this Agreement, that QI is providing sufficient and timely information to withholding agents that allocates reportable payments to U.S. non-exempt recipients.**

Audit Guidance 10.03(B)(6) [Phase 1- Spot Check]:

10.03(B)(6).1. Review of Alternative Procedure. In Phase 1 of the audit and, if the IRS

directs, in Phase 2 of the audit, the external auditor must:

- Step 1: Identify all accounts covered by the QI Agreement that are held by direct account holders that are U.S. non-exempt recipients, or all such accounts contained in the same sample selected under AG10.04, or, for purposes of the spot check in Phase 1 of the audit, all such accounts selected under AG10.04.7.
- Step 2: From those accounts, segregate the accounts of those U.S. non-exempt recipients whose identity is not prohibited by law from disclosure, including the accounts of U.S. non-exempt recipients that have waived the prohibitions against disclosure.
- Step 3: Inspect the withholding statements associated with the Forms W-8IMY to determine whether the allocation information for each such account was provided to the withholding agent no later than January 15 of the year following the year of payment.

10.03(B)(6).2. Alternative Procedure Report. The external auditor must specifically report:

- Report 1: The number of accounts for which allocation information was not provided to the withholding agent by January 15 of the year following the year of payment.

**QI Agreement Sec. 10.03(C)(1). Withholding Responsibilities. The external auditor must—**

**(1) To the extent QI has assumed primary NRA withholding responsibility, perform test checks, using a valid sample of foreign account holders, to verify that QI is withholding the proper amounts;**

Audit Guidance 10.03(C)(1) [Phase 1- Spot check]:

10.03(C)(1).1. Review of Withholding (NRA Withholding Assumed). In Phase 1 of the audit, and, if the IRS directs, in Phase 2 of the audit, the external auditor must:

- Step 1: Identify all accounts covered by the QI Agreement that are held by direct account holders that are not U.S. non-exempt recipients, or all such accounts contained in the sample selected under AG10.04, or, for purposes of the spot check in Phase 1 of the audit, all such accounts selected under AG10.04.7.
- Step 2: Obtain copies of the QI's Forms W-8IMY and inspect them to determine whether the QI has assumed primary NRA withholding responsibility. For accounts covered by the QI Agreement for which the QI has assumed

such responsibility, the external auditor must perform the procedures described in Steps 3 through 6 below.

- Step 3: Obtain the account statements and records that show the investment and the type of income earned and the amounts of withholding.
- Step 4:
- (a) Based on the records described in Step 3, classify the accounts according to the type of income paid to each account. An account to which more than one type of income has been paid must be placed into multiple income classifications.
  - (b) Based on the documentation for the account (after the determinations under AG10.03(A)(4) and (5) have been made), determine the withholding rate and further classify the accounts within an income classification according to withholding rate. An account within an income classification to which more than one withholding rate has been applied must be placed into multiple withholding rate classifications.
- Step 5: For each account, determine the amount (if any) by which the amount of withholding based on the classifications under Step 4(a) and Step 4(b) exceeds the amount withheld by the QI as of December 31 of the audit year.
- Step 6: For each account, make adjustments to the underwithholding (if any) determined under Step 5 to the extent necessary to reflect the correct amount of underwithholding (e.g., an adjustment to reflect documentation received after December 31 of the audit year or amounts of tax reported and paid on the QI's Form 1042 or amended 1042 for the audit year).
- Step 7:
- (a) Identify all indirect account holders covered by the QI Agreement, or all such account holders contained in the sample selected under AG10.04, or, for purposes of the spot check in Phase 1 of the audit, all such accounts selected under AG10.04.7.
  - (b) From the indirect account holders identified in (a), segregate the indirect account holders that are not U.S. non-exempt recipients.
  - (c) Obtain copies of the QI's Forms W-8IMY and inspect them to determine whether the QI has assumed primary NRA withholding.
  - (d) For indirect account holders covered by the QI Agreement for which the QI has assumed such responsibility, obtain the withholding statements associated with the payments to the indirect account holders.
  - (e) Classify the accounts according to the type of income paid to each account. An account to which more than one type of income has been paid must be placed into multiple income classifications.
  - (f) Based on the documentation for the account (after the

determinations under AG10.03(A)(4) and (5) have been made), determine the withholding rate and further classify the accounts within an income classification according to withholding rate. An account within an income classification to which more than one withholding rate has been applied must be placed into multiple withholding rate classifications.

- (g) For each account, determine the amount (if any) by which the amount of withholding based on the classifications under (e) and (f) exceeds the amount withheld by the QI as of December 31 of the audit year.
- (h) For each account, make adjustments to the underwithholding (if any) determined under (g) to the extent necessary to reflect the correct amount of underwithholding (e.g., an adjustment to reflect documentation received after December 31 of the audit year or amounts of tax reported and paid on the QI's Form 1042 or amended 1042 for the audit year).

10.03(C)(1).2. Withholding (NRA Withholding Assumed) Report. The external auditor must report:

- Report 1: The amount of underwithholding for each account examined within each withholding rate classification in Step 4(a).
- Report 2: Each adjustment made under Step 6 to the amount of underwithholding for each account, with an explanation of such adjustment.
- Report 3: The amount of underwithholding for each indirect account holder examined within each withholding rate classification in Step 7(e).
- Report 4: Each adjustment made under Step 7(h) to the amount of underwithholding for each account, with an explanation of such adjustment.

**QI Agreement 10.03(C)(2). To the extent QI has not assumed primary NRA withholding responsibility, verify that QI has fulfilled its responsibilities under section 3.02 of this Agreement;**

Audit Guidance 10.03(C)(2) [Phase 1]:

10.03(C)(2).1. Review of Withholding (NRA Withholding Not Assumed). In Phase 1 of the audit and, if the IRS directs, in Phase 2 of the audit, the external auditor must:

- Step 1: For each account required to be reported under AG10.03(B)(4).2 Report 3 and each indirect account holder required to be reported under AG10.03(B)(4).2 Report 4(c), determine the amount (if any) by which the

amount of withholding based on the classifications under AG10.03(B)(4).1 Step 5 exceeds the amount withheld as of December 31 of the audit year.

Step 2: For each account identified in Step 1, make adjustments to the underwithholding (if any) determined under Step 1 to the extent necessary to reflect the correct amount of underwithholding (e.g., an adjustment to reflect documentation received after December 31 of the audit year or amounts of tax reported and paid on the QI's Form 1042 or amended 1042 for the audit year).

10.03(C)(2).2. Withholding (NRA Withholding Not Assumed) Report. The external must report:

Report 1: The amount of under withholding for each account and each indirect account holder within each withholding classification.

Report 2: Each adjustment made under Step 2 to the amount of underwithholding for each account, with an explanation of such adjustment.

**QI Agreement 10.03(C)(3). To the extent QI has assumed primary Form 1099 reporting and backup withholding responsibility, perform test checks using a valid sample of U.S. non-exempt recipient account holders to verify that QI backup withheld when required;**

Audit Guidance 10.03(C)(3) [Phase 1- Spot check]:

10.03(C)(3).1. Review of Backup Withholding (Responsibilities Assumed). In Phase 1 of the audit and, if the IRS directs, in Phase 2 of the audit, the external auditor must:

Step 1: Identify all accounts covered by the QI Agreement that are held by direct account holders that are U.S. non-exempt recipients, or all such accounts contained in the sample under AG10.04, or, for purposes of the spot check in Phase 1 of the audit, all such accounts selected under AG10.04.7.

Step 2: From the accounts identified in Step 1, segregate the accounts of those U.S. non-exempt recipients whose identity is not prohibited by law from disclosure, including the accounts of U.S. non-exempt recipients that have waived the prohibitions against disclosure.

Step 3: Obtain copies of the QI's Forms W-8IMY and inspect them to determine whether the QI has assumed primary Form 1099 and backup withholding responsibility. From the accounts segregated in Step 2, segregate the accounts of U.S. non-exempt recipients for which the QI has assumed

primary Form 1099 reporting and backup withholding responsibility. For these accounts, perform the procedures described in Steps 4 through 6 below.

- Step 4: Obtain the account statements and records that show the investment and the type of income earned and the amounts backup withheld (if any).
- Step 5: Based on the records described in AG10.03(A)(6).1, determine whether account holder's file contains the account holder's TIN.
- Step 6: If the account holder's file does not contain the account holder's TIN, determine whether the QI imposed backup withholding on reportable payments at the correct rate.
- Step 7:
- (a) Identify all indirect account holders covered by the QI Agreement or all such account holders contained in the sample selected under AG10.04, or, for purposes of the spot check in Phase 1 of the audit, all such account holders selected under AG10.04.7.
  - (b) From the indirect account holders in (a), segregate the indirect account holders that are U.S. non-exempt recipients.
  - (c) Apply Steps 2 through 6 to those indirect account holders.

10.03(C)(3).2. Backup Withholding (Responsibilities Assumed) Report. The external auditor must specifically report:

Report 1: The amount of underwithholding for each account and each indirect account holder for which there is no TIN.

**QI Agreement Sec. 10.03(C)(4). To the extent QI has not assumed primary Form 1099 reporting and backup withholding responsibility, perform test checks using a valid sample of U.S. non-exempt account holders to verify that QI has fulfilled its backup withholding responsibilities under sections 3.04, 3.05 and 3.06 of this Agreement;**

Audit Guidance 10.03(C)(4) [Phase 1]:

10.03(C)(4).1 Backup Withholding Review (Responsibilities Not Assumed). In Phase 1 of the audit and, if the IRS directs, in Phase 2 of the audit, the external auditor must:

Step 1: For each account required to be reported under AG10.03(B)(5).2 Report 2 determine whether backup withholding was imposed at the correct amount.

10.03(C)(4).2. Backup Withholding (Responsibilities Not Assumed) Report. The external must report:



Report 1: The amount of underwithholding for each account and each indirect account holder for which backup withholding is required.

**QI Agreement Sec. 10.03(C)(5).** Review the accounts of U.S. non-exempt recipient account holders whose identity is prohibited by law, including by contract, from disclosure and verify that QI or another payor is backup withholding on reportable payments made to such account holders;

Audit Guidance 10.03(C)(5) [Phase 1]:

10.03(C)(5).1. Review of Backup Withholding on Reportable Payments (Disclosure Prohibited). In Phase 1 of the audit and, if the IRS directs, in Phase 2 of the audit, the external auditor must:

Step 1: For each account identified in AG10.03(A)(7) Step 2, and required to be reported under AG10.03(A)(7).2 Report 1, determine whether backup withholding was imposed at the correct amount.

10.03(C)(5).2. Backup Withholding on Reportable Payments (Disclosure Prohibited) Report. The external must report:

Report 1: The amount of under withholding for each account for which backup withholding is required.

**QI Agreement Sec. 10.03(C)(6).** Review a valid sample of accounts of U.S. non-exempt recipient account holders and determine if assets that generate or could generate reportable payments are held in an account of any U.S. non-exempt recipient account holders whose identity is prohibited by law, including by contract, from disclosure, and ascertain the reason why such assets have not been disposed of or the account holder disclosed;

Audit Guidance 10.03(C)(6) [Phase 1]:

10.03(C)(6).1. Review of Assets Held by U.S. Non-exempt Recipients (Disclosure Prohibited). In Phase 1 of the audit and, if the IRS directs, in Phase 2 of the audit, the external auditor must:

Step 1: For each account identified in AG10.03(A)(7) Step 2, and required to be reported under AG10.03(A)(7).2 Report 1, where the assets that generate or could generate reportable payments have not been disposed of or the account holder disclosed, obtain a letter from the Responsible Party, as defined in AG10.01.4(b), explaining the reason why assets that generate or could generate reportable payments have not been disposed of or the account holder disclosed.

10.03(C)(6).2. Assets Held by U.S. Non-exempt Recipients (Disclosure Prohibited) Report. The external auditor must:

Report 1: Include a copy of the letter obtained in Step 1 with its report.

**QI Agreement Sec. 10.03(C)(7). Verify that amounts withheld were timely deposited in accordance with section 3.08 of this Agreement.**

Audit Guidance 10.03(C)(7) [Phase 1]:

10.03(C)(7).1. Review of Timely Deposits. In Phase 1 of the audit the external auditor must:

Step 1: Obtain the QI's records of payments covered by the QI Agreement, the QI's Form 1042 and the QI's records of tax deposits.

Step 2: Determine that the payment dates timely correspond with the deposit dates for any required deposits.

10.03(C)(7).2. Timely Deposits Report. The external auditor must report:

Report 1: Any payment dates that do not timely correspond with deposit dates.

**QI Agreement Sec. 10.03(D)(1). Return Filing and Information Reporting. The external auditor must–**

**(1) Obtain copies of original and amended Forms 1042 and Forms 945, and any schedules, statements, or attachments required to be filed with those forms, and determine whether the amounts of income, taxes, and other information reported on those forms are accurate by–**

**(i) Reviewing work papers;**

**(ii) Reviewing Forms W-8IMY, together with the associated withholding statements, that QI has provided to withholding agents;**

**(iii) Reviewing copies of Forms 1042-S that withholding agents have provided QI;**

**(iv) Reviewing account statements from withholding agents;**

**(v) Reviewing correspondence between QI and withholding agents; and**

**(vi) Interviewing personnel responsible for preparing the Forms 1042 and 945 and the work papers used to prepare those forms.**

Audit Guidance 10.03(D)(1) [Phase 1]:

10.03(D)(1).1. Review of Forms 1042 and 945. In Phase 1 of the audit, the external auditor must:

Step 1: Obtain copies of:

- (a) The QI's Forms 1042 and 945, and the Forms 1042-S and 1099 issued to the QI (the Forms 1099 will be in the name of an unknown recipient) and the Forms 1042-S and 1099 filed by the QI (for PAI's, obtain the reporting pool information provided to its QI); and
- (b) The QI's records of payments from withholding agents and of payments to the QI's reporting pools, other QI's and withholding foreign partnerships and trusts, other recipients for which recipient specific reporting is required under section 8.02 of the QI Agreement, U.S. non-exempt recipients, and U.S. exempt recipients as a class.

Step 2: Reconcile (i) the amounts reported paid to and withheld from the QI on the Forms 1042-S and 1099 issued to the QI, (ii) the amounts reported paid by and withheld by the QI on the Forms 1042-S and 1099 filed by the QI, the amounts shown paid by and withheld by the QI to U.S. non-exempt recipients on its withholding statements and in the QI's records of payments, and the amounts shown paid by and withheld by the QI to U.S. exempt recipients as a class in the QI's records of payments, and (iii) the amounts reported and withheld on the QI's Forms 1042 and 945. For this reconciliation, unreconciled variances are permitted within reasonable limits based on the facts and circumstances. The reconciliation should show the amount of any unreconciled variances.

10.03(D)(1).2. Forms 1042 and 945 Report. The external auditor must report:

- Report 1:
- (a) The aggregate amount reported paid to the QI on the Forms 1042-S issued to the QI;
  - (b) The aggregate amount reported paid to QI on the Forms 1099 issued to QI (unknown recipient);
  - (c) The aggregate amount reported paid by the QI on Forms 1042-S to each reporting pool;
  - (d) The aggregate amount reported paid by the QI on Forms 1042-S to other QI's as a class;
  - (e) The aggregate amount reported paid by the QI on Forms 1042-S to indirect account holders;
  - (f) The aggregate amount shown paid by the QI to U.S. non-exempt recipients as a class;
  - (g) The aggregate amount shown paid by the QI to U.S. exempt recipients as a class;
  - (h) The total amounts withheld by the QI; and
  - (i) The total amounts withheld by others.

Report 2: The aggregate amount of any adjustments under section 9 of the QI Agreement incorporated in each amount in Report 1.

Report 3: The amount of any unreconciled variances.

**QI Agreement Sec. 10.03(D)(2). Obtain copies of original and corrected Forms 1042-S and Forms 1099 together with the work papers used to prepare those forms and determine whether the amounts reported on those forms are accurate by–**

**(i) Reviewing the Forms 1042-S received from withholding agents;**

**(ii) Reviewing the Forms W-8IMY, and the associated withholding statements, that QI has provided withholding agents;**

**(iii) Reviewing a valid sample of account statements issued by QI to account holders; and**

**(iv) Interviewing QI's personnel responsible for preparing the Forms 1042-S and, if applicable, Forms 1099, and the work papers used to prepare those forms.**

**Audit Guidance 10.03(D)(2) [Phase 1- Spot check]:**

**10.03(D)(2).1. Review of Forms 1042-S and 1099.** In Phase 1 of the audit and, if the IRS directs, in Phase 2 of the audit, the external auditor must:

**Step 1:** Identify all indirect account holders covered by the QI Agreement or all such account holders contained in the sample selected under AG10.04, or, for purposes of the spot check in Phase 1 of the audit, all such account holders selected under AG10.04.7.

**Step 2:** Obtain copies of:

- (a) The Forms 1042-S and Forms 1099 filed by the QI for each account holder identified in Step 1 above;
- (b) The Forms W-8IMY and summary of associated withholding statements applicable to each such account provided to the QI;
- (c) The QI's records of payments to each such account.

**Step 3:** Reconcile the QI's records of payments and the withholding statements provided to the QI with the amounts reported for each such account holder on the QI's Forms 1042-S and 1099. For this reconciliation, unreconciled variances are permitted within reasonable limits based on the facts and circumstances. The reconciliation should show the amount of any unreconciled variances.

10.03(D)(2).2. Forms 1042-S and 1099 Report. The external auditor must report:

Report 1: The number of accounts identified or selected in Step 1 above.

Report 2: The number of accounts for which the payments cannot be reconciled with the payments reported on Forms 1042-S and on Forms 1099 and, for those accounts, the amounts reported on each form and the amounts of any unreconciled variances.

**QI Agreement Sec. 10.03(D)(3)**. Thoroughly review the statements attached to amended Forms 1042 filed to claim a refund, ascertain their veracity, and determine the causes of any overwithholding reported and ensure QI did not issue Forms 1042-S to persons whom it included as part of its collective credit or refund.

Audit Guidance 10.03(D)(3) [Phase 2]:

10.03(D)(3).1. Review of Refunds. If the IRS directs in Phase 2 of the audit, the external auditor must:

Step 1: Obtain:

- (a) The QI's amended Form 1042 (including the attached statements), the Forms 1042-S filed by the QI, and the Forms 1042-S issued to the QI;
- (b) The QI's records of payments from withholding agents and the QI's records of payments to the QI's reporting pools; and
- (c) The QI's records of payments to the account holders who received a refund of overwithholding from the QI.

Step 2: Inspect the QI's records of payments to determine whether overwithholding occurred and the amount of the overwithholding.

Step 3: Reconcile the amount of income, withholding, and overwithholding with the QI's Form 1042.

Step 4: Identify the reporting pool or pools to which the overwithholding is attributable and the amount of overwithholding attributable to each pool.

Step 5: Identify the account holders who received a refund of the overwithholding from the QI.

Step 6: Identify all Forms 1042-S filed by the QI on a recipient specific basis.

Step 7: Match the account holders identified under Step 5 with the Forms 1042-S identified under Step 6.

10.03(D)(3).2. Refund Report. The external auditor must report:

Report 1: The total amount of overwithholding under Step 2.

Report 2: The amounts of overwithholding by each pool under Step 4.

Report 3: The number of account holders identified under Step 5.

Report 4: The number of account holders that do not match with Forms 1042-S under Step 7.

**QI Agreement Sec. 10.03(D)(4).** Determine, in the case of collective credits or refunds, that QI repaid the appropriate account holders prior to requesting a collective refund or credit.

Audit Guidance 10.03(D)(4) [Phase 2]:

10.03(D)(4).1. Review of Account Holder Repayment Prior to Refund. If the IRS directs in Phase 2 of the audit, the external auditor must:

Step 1: Obtain:

- (a) The QI's amended Form 1042 (including attached statements); and
- (b) The QI's records of payments to the account holders who received a refund of overwithholding from the QI.

Step 2: Inspect the QI's Form 1042 and records of payments to determine that the dates of payments of overwithholding made to each account holder were prior to the date of filing the refund claim.

10.03(D)(4).2. Account Holder Repayment Prior to Refund Report: The external auditor must report:

Report 1: The amount of overwithholding paid to each account holder that occurred after the date of filing the refund claim.

**QI Agreement Sec. 10.03(E).** Change in Circumstances. The external auditor must verify that in the course of the audit it has not discovered any significant change in circumstances, as described in section 11.03(A), (D), or (E) of this Agreement.

Audit Guidance 10.03(E) [Phase 1]:

10.03(E).1. Review of Change in Circumstance. In Phase 1 of the audit, the external auditor must:

Step 1: Obtain a letter signed by the Responsible Party, as defined in AG

10.01.4(b) and by the QI's legal counsel stating:

- (a) Whether there has been an acquisition of all, or substantially all, of the QI's assets in any transaction in which the QI is not the surviving legal entity;
- (b) Any material changes in the know-your-customer rules and procedures set forth in the Attachments to the QI Agreement; and
- (c) Any significant changes in the QI's business practices that affect the QI's ability to meet its obligations under the QI Agreement.

10.03(E).2. Change in Circumstance Report. The external auditor must report a change in circumstances by:

Report 1: Including a summary of the letter under Step 1.

**QI Agreement Sec. 10.04. Use of Statistical Sampling** . If the external auditor is required to make a determination based on a valid sample of accounts, it shall use a statistical sampling whenever an examination of all of accounts within a particular class of accounts would be prohibitive in terms of time and expense. If it is reasonable to examine all accounts in connection with a particular issue, statistical sampling techniques shall not be used. If statistical sampling techniques are required, the external auditor must determine a sample size that provides a 95 percent confidence level. If statistical sampling has been used and the auditor determines that underwithholding has occurred with respect to the sampled accounts, the IRS will determine the total amount of underwithheld tax by projecting the underwithholding over the entire population of similar accounts. For this purpose, QI agrees to provide the IRS with the information (e.g., number of accounts and amounts) required to project the underwithholding. QI shall either report and pay, in accordance with section 9.06 of this Agreement, the underwithheld tax determined under the IRS projection or propose another amount of underwithholding based on a more accurate population, a more accurate projection technique, or an examination of all similar accounts. If the IRS does not agree with the amount proposed by QI, the IRS shall assess a tax by making a return under section 6020 of the Code.

Audit Guidance 10.04:

10.04.1. Use of Statistical Sampling. Except as provided in AG10.04.2, the external auditor is permitted to use statistical sampling to perform the procedures in AG10.03. The external auditor may select one statistical sample consisting of accounts from each of the three strata described in AG10.04.4, in the proportions determined under AG10.04.5. The external auditor may conduct a 100 percent review instead of selecting a statistical sample. The statistical sampling methodology used in this Audit Guidance cannot be used for any other tax purpose.

10.04.2. Sample Size. The external auditor is permitted to select a sample only if there are more than 50 accounts covered by the QI Agreement. The sample size is the lesser

of (i) the number of accounts determined using the sample formula (see AG10.04.3), or (ii) 25 percent of the total number of accounts covered by the QI Agreement. Under the sample formula, the maximum sample size will not exceed 321. The minimum sample size shall not be less than 50.

10.04.3. Sample Formula. The number of accounts determined using the sample formula is as follows:

$$\text{Sample Size} = \frac{\frac{t^2 PQ}{d^2}}{1 + \frac{1}{N} \left( \frac{t^2 PQ}{d^2} - 1 \right)}$$

where t= 1.645 (confidence coefficient at 95 percent one-sided)

P= 5 percent (error rate)

Q= 1-P

d = 2 percent (precision level)

N= total population

10.04.4 Division of Accounts into Strata. The external auditor must divide all of the accounts covered by the QI Agreement into the following strata:

- (a) A stratum of all accounts covered by the QI Agreement that are held by direct account holders that are not U.S. non-exempt recipients;
- (b) A stratum of all accounts covered by the QI Agreement that are held by direct account holders that are U.S. non-exempt recipients; and
- (c) A stratum of all indirect account holders covered by the QI Agreement.

10.04.5. Allocation of Sample Size to Each Stratum. The external auditor must allocate the number of accounts in the sample determined under AG10.04.2 to each stratum described in AG10.04.4 by multiplying the number of accounts in the sample, as determined under AG10.04.2, by a fraction, the numerator of which is the total number of accounts in the stratum and the denominator of which is the total number of accounts covered by the QI Agreement. The minimum allocation to each stratum is the lesser of (1) 50 accounts or (2) the total number of accounts in the stratum. If there are fewer than 50 accounts in any stratum, all accounts in that stratum must be examined, and the difference between 50 and the number of accounts in the stratum must be reallocated to the remaining strata on a pro rata basis. If there are 50 or more accounts in the stratum, but the allocation, as determined under the fraction above, is less than 50 accounts, the number of accounts in the sample from that stratum is 50 accounts. In that case, the difference between 50 and the number of accounts allocated to that stratum, as originally determined, must reduce the number of accounts allocated to all other strata that exceed 50 accounts, on a pro rata basis.



10.04.6. Number Generator. The external auditor must select the accounts from each stratum by using a random number generator. Information regarding the random number generator used must be included in the records required in AG10.04.8 below. This information must be sufficient to allow the IRS to replicate the random numbers. This information must include the name and version of the random number generator, the seed numbers used or generated, specification of any options selected and the computer equipment on which it was run.

10.04.7. Selection of Accounts for Phase 1 Spot Checks. Under AG10.03.2(a)(2), in Phase 1 of the audit process, the external auditor is required to conduct spot checks. The external auditor must select for spot check (from each strata in the sample, taking into account any reclassification after applying the presumption rules where documentation is missing or invalid) all accounts listed below:

- (a) All accounts reported as not satisfying applicable criteria under AG10.03(A)(4).2 Reports 2 and 5;
- (b) All accounts reported as not satisfying applicable criteria under AG10.03(A)(5).2 Reports 3 through 8, Reports 9(b) through (e), Reports 10(a) through (d) and, for indirect account holders, Reports 11 and Reports 3 through 8, Reports 9(b) through (e), Reports 10(a) through (d), as required in Report 12;
- (c) All accounts reported as not satisfying applicable criteria under AG10.03(A)(6).2 Report 2; and
- (d) All accounts reported under AG10.03(A)(7).2 Report 1 as segregated under Steps 2 and 3 of AG10.03(A)(7).1.

To the extent the number of accounts listed above from the sample (or in the population, if the external auditor has not used statistical sampling) in any stratum is less than 20, the external auditor must also select for spot check (in the order selected by the random number generator under 10.04.6 or, if the external auditor has not used statistical sampling, in the order used by the QI for its record keeping) an additional number of accounts drawn from that stratum that equal the difference between 20 and the number of accounts listed above from the sample in that stratum.

10.04.8. Records of Sampling Methodology. The external auditor is required to record its statistical sampling procedures and to maintain the ability to reconstruct the sample.

10.04.9. Alternative Sampling Methods. The external auditor may select more than one sample, or may use multistage, cluster, or other sampling methodology including additional stratifications with the approval of the IRS. To obtain IRS approval, submit an audit plan in accordance with AG10.03.5.

10.04.10. Optional Substratification by Dollar Amounts. The external auditor may substratify by reportable amounts without submitting an audit plan under AG10.03.5 when the external auditor is otherwise selecting the sample in accordance with AG10.04.1 through AG10.04.6. If the external auditor chooses to substratify under this

AG10.04.10, the external auditor must comply with the following rules:

- (a) The substrata consisting of accounts that have received payments of the highest reportable amounts during the audit year shall not consist of more than 25 accounts.
- (b) The remaining substrata shall be randomly selected to contain approximately equal amounts in each substrata.
- (c) The minimum substrata size shall not be less than 25 accounts.

10.04.11. Phase 1: Determination of Underwithholding. The IRS will not make a determination of underwithheld tax by projection based solely on the external auditor's report in Phase 1 of the audit process. If, after review of the report, the IRS determines that no further action is necessary pursuant to AG10.06.1, the IRS will determine the amount of underwithholding for the accounts that were examined by the external auditor.

10.04.12. Phase 2: Projection. If, after review of the external auditor's report in Phase 1 of the audit process, the IRS determines that further action is necessary with respect to underwithholding, the IRS may direct the auditor to conduct a full review of the entire sample. If, after completion of the full review, the external auditor has determined that underwithholding under AG10.03(C)(1), (2), (3), (4) or (5) has occurred with respect to the sample, then the IRS will determine the total amount of underwithheld tax by projecting the underwithholding over the entire stratum of similar accounts using a projection method that is consistent with the sampling method used. For example, if a stratified random sampling method as provided in this Audit Guidance has been used, the IRS may determine the total amount of underwithheld tax by projecting the underwithholding over the entire stratum as follows:

- (a) Divide the amount of underwithholding for the stratum by the number of accounts in the sample; and
- (b) Multiply the result in (a) by the total number of accounts in the stratum.
- (c) If the external auditor has determined that overwithholding has occurred for a stratum, the QI may not project the amount of overwithholding in order to claim a refund. The IRS will offset any underwithholding in a stratum against any overwithholding in that stratum, provided that the QI enters into a closing agreement (Form 906) that QI will not file a claim for refund for any overwithholding that the external auditor has discovered.
- (d) The IRS will determine whether it is appropriate to project an amount of underwithholding when the facts show that:
  - (1) The amount is the consequence of an identified error; and
  - (2) The error was not repeated throughout the population over which it would be projected.
- (e) The QI may propose that it is not appropriate to project an amount of underwithholding when the QI shows that:
  - (1) The underwithholding was the consequence of an identified error,
  - (2) The QI has corrected the error in the stratum in which it was

- discovered,
- (3) The QI has corrected the error throughout the population,
- (4) The QI has established safeguards to prevent repetition of the error in the future, and
- (5) As a consequence of the correction, the facts as corrected show that there was actually no underwithholding during the audit year. (Penalties and interest may nevertheless be imposed.)

The QI may also propose an alternative projected underwithholding tax adjustment based on facts and circumstances. See Audit meeting in AG10.06.3 for procedures for making such proposals.

**Sec. 10.05. External Auditor's Report.** Upon completion of the audit of QI and any PAI, the external auditor shall issue a report, or reports, of audit findings directly to the IRS by sending the original report to the IRS at the address set forth in section 12.06 of this Agreement by June 30 following the calendar year being audited, or if that date falls on a Saturday or Sunday, the next U.S. business day. The report must be in writing, in English, and currency amounts must be stated in U.S. dollars. The report must fully describe the scope of the audit, the methodologies (including sampling techniques) used to determine whether QI is in compliance with the provisions of this Agreement, and the result of each such determination. The report must also specifically address each of the items in section 10.03 of this Agreement.

Audit Guidance 10.05:

10.05.1. Auditor's Report Requirements. The external auditor's report must:

- (a) List the external auditor's name, address, contact person and contact person's telephone number.
- (b) List the QI's name, address, QI-EIN, Responsible Party and Responsible Party's telephone number.
- (c) List each procedure required under this Audit Guidance in the order listed in the Audit Guidance with a notation that the procedure was performed.
- (d) Identify the audit year.
- (e) List, under each procedure, the items required to be reported under this Audit Guidance in the order listed in the Audit Guidance.
- (f) Include any items required to be attached to the report as Appendix 1. These items should be cross-referenced in the report with footnotes.
- (g) Include any information that requires a narrative response and any other information that the external auditor wishes to include as Appendix 2. These items should be cross-referenced in the report with footnotes.
- (h) Contain a certification signed by the external auditor that the required procedures have been competently performed and that the information reported is accurate and complete.

10.05.2. Standard Report Form. The IRS intends to develop a standard report form,

initially in paper and later in electronic form. For audit reports due after the publication date of the standard form, the external auditor must complete that form and send it to the IRS in the manner required by the form. When the standard report form has been developed, it will be posted on the QI website at [www.irs.gov](http://www.irs.gov) (search IRS site for "QI").

**10.05.3. Report Due Dates.** The external auditor must send the hard copy audit report to the IRS at the address set forth in section 12.06 of the QI Agreement by June 30 of the year following the audit year. The IRS will grant an automatic extension of the due date of the report until December 31 of the year following the audit year if the external auditor submits a request for extension in writing that identifies the QI to be audited to the IRS at the address in AG10.01.2 by June 30 of the year following the audit year. A QI that timely submits a request for waiver of the external audit under AG10.01.4, 10.01.5, or 10.01.6 that is denied by the IRS will be considered to have been granted an automatic extension of the due date of the external auditor's report until December 31 of the year following the audit year. The external auditor may request further extensions of the due date of the report by submitting a request for extension in writing signed by the external auditor or by the QI's Responsible Party, as defined in AG10.01.4(b), to the IRS at the address in AG10.01.2 before the due date under any previous extension. The request should state the date to which the extension is requested, explain the reason for the extension and include telephone numbers for the external auditor's contact person and the QI's Responsible Party. The IRS will send the external auditor or the QI a written response after receiving the request.

**Sec. 10.06. Expanding Scope and Timing of External Audit . Upon review of the external auditor's report, the IRS may request, and QI must permit, the external auditor to perform additional audit procedures, or to expand the external audit to cover some or all of the calendar years for which the period of limitations for assessment of taxes has not expired. In addition, the IRS may request, and QI agrees to permit, the external auditor to perform an audit for one or more calendar years not scheduled for audit under section 10.03 of this Agreement.**

**Audit Guidance 10.06:**

**10.06.1. IRS Review of Audit Report.** After the IRS receives the external auditor's report, the IRS will review the report and, if the IRS determines that no further action is necessary, the IRS will send a written notice to the QI and the external auditor informing them of this determination.

**10.06.2. Audit Phase 2: IRS Directed Procedures.** After the IRS reviews the external auditor's report, the IRS may determine that additional fact finding is necessary. In such cases, the IRS will contact the external auditor and the QI by telephone or in writing. The IRS will direct the external auditor to perform specific audit procedures and to report in writing the results of those procedures. The IRS directed procedures may include instructing the external auditor to forward to the IRS certain of the external auditor's work papers and reports or instructing the external auditor to perform specific procedures (or perform an audit in accordance with this Audit Guidance) for the audit

year or for years other than the audit year. The IRS will stipulate a due date not more than 120 days from the date of its instructions to the external auditor for the external auditor's report on the results of any IRS directed procedures. The external auditor may request an extension of the due date in accordance with AG10.05 at any time before the due date. After receiving the external auditor's report on the results of the initial IRS directed procedures, the IRS will contact the external auditor and the QI. If the IRS determines that additional fact finding is necessary, the IRS may direct the external auditor to perform further additional procedures under this section until the IRS determines that the facts have been sufficiently developed. If the IRS determines that the audit is complete, the IRS will notify the external auditor and the QI in writing of the completion of the audit and of any actions that it will take as a result of the audit.

10.06.3. Audit Phase 3: Audit Meeting. At any time after the external auditor has submitted its report on the initial IRS directed procedures and before the IRS notifies the QI and the external auditor of the completion of the audit, either the IRS or the QI may request an audit meeting between the IRS and the QI to accelerate fact finding, and to clarify and resolve concerns. To request and schedule a meeting, the IRS will contact the QI's Responsible Party, as defined in AG10.01.4(b), by telephone or in writing, and the QI may contact the IRS by telephone or in writing at the address in AG10.01.2. After the IRS receives the request, the IRS will meet with the QI at such time as the IRS and the QI may agree. If the IRS and the QI agree, the employees of the external auditor who are acting in the capacity of external auditors under the QI Agreement may attend the audit meeting in that capacity, and other employees of the same firm may attend in other capacities. The IRS may continue to direct the external auditor to perform specific audit procedures under AG10.06.2 without regard to whether an audit meeting has been scheduled or held. After the first audit meeting, either the IRS or the QI may request further audit meetings at any time before the IRS notifies the external auditor and the QI of the completion of the audit.

## SUMMARY OF PROCEDURES

As described in more detail in section 10.03 above, only certain procedures in section 10.03(A), (B), (C) and (D) must be completed in Phase 1 of the Audit. Those provisions of AG10.03 that require a review of accounts in Phase 1 are labeled either "**Phase 1-All Accounts (or Sample)**" or "**Phase 1- Spot Check.**" The procedures labeled "**Phase 1-All Accounts (or Sample)**" require the external auditor to examine all accounts identified in AG10.04.4(a) through (c) or selected as a sample from those identified accounts. The procedures labeled "**Phase 1- Spot Check**" require the external auditor to examine only those accounts selected for testing in accordance with AG10.04.7. Those procedures that must be completed in Phase 1 but do not require a review of accounts are labeled "**Phase 1.**" Those procedures that are not required to be performed in Phase 1 are labeled "**Phase 2 only.**"

<b>Audit Guidance 10.03(A)(1)</b> 10.03(A)(1).1. Review of Documentation Training 10.03(A)(1).2. Documentation Training Report.	<b>Phase 2 Only</b>
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<b>Audit Guidance 10.03(A)(2)</b> 10.03(A)(2).1. Review of Account Opening Procedures. 10.03(A)(2).2. Account Opening Procedures Report.	Phase 2 Only
<b>Audit Guidance 10.03(A)(3)</b> 10.03(A)(3).1. Review Limitation on Benefits (LOB) Procedure. 10.03(A)(3).2. LOB Procedure Report.	Phase 2 Only
<b>Audit Guidance 10.03(A)(4)</b> 10.03(A)(4).1. Review of Treaty Statements. 10.03(A)(4).2. Treaty Statements Report.	Phase 1-All Accounts (or Sample)
<b>Audit Guidance 10.03(A)(5)</b> 10.03(A)(5).1. Review of Documentation Validity (Foreign Persons and U.S. Exempt Recipients). 10.03(A)(5).2. Documentation Validity Report (Foreign Persons and U.S. Exempt Recipients).	Phase 1-All Accounts (or Sample)
<b>Audit Guidance 10.03(A)(6)</b> 10.03(A)(6).1. Review of Documentation Validity (Disclosed U.S. Non-exempt Recipients) 10.03(A)(6).2. Documentation Validity (U.S. Non-exempt Recipients) Report.	Phase 1-All Accounts (or Sample)
<b>Audit Guidance 10.03(A)(7)</b> 10.03(A)(7).1. Account Review of U.S. Non-exempt Recipients (Disclosure Prohibited). 10.03(A)(7).2. Account Review of U.S. Non-exempt Recipients (Disclosure Prohibited) Report.	Phase 1-All Accounts (or Sample)
<b>Audit Guidance 10.03(A)(8)</b> 10.03(A)(8).1. Review PAI Obligations. 10.03(A)(8).2. PAI Obligations Report.	Phase 1
<b>Audit Guidance 10.03(A)(9)</b> 10.03(A)(9).1. Knowledge of KYC Investigations. 10.03(A)(9).2. KYC Investigations Report.	Phase 1
<b>Audit Guidance 10.03(A)(10)</b> 10.03(A)(10).1. Review for Removal of U.S. Non-exempt Recipients. 10.03(A)(10).2. Removal of U.S. Non-exempt Recipients Report	Phase 1-All Accounts (or Sample)
<b>Audit Guidance 10.03.(B)(1)</b> 10.03(B)(1).1. Review of Withholding Rate Pool Training Materials.. 10.03(B)(1).2. Withholding Rate Pool Training Materials Report.	Phase 2 Only
<b>Audit Guidance 10.03(B)(2)</b> 10.03(B)(2).1. Review of Personnel Training (Withholding Rate Pool). 10.03(B)(2).2. Personnel Training (Withholding Rate Pool) Report.	Phase 2 Only
<b>Audit Guidance 10.03(B)(3)</b> 10.03(B)(3).1. Review of Withholding Statements. 10.03(B)(3).2. Withholding Statement Report.	Phase 2 Only

<b>Audit Guidance 10.03(B)(4)</b> 10.03(B)(4).1. Review Withholding Rate Pool Classification. 10.03(B)(4).2. Withholding Rate Pool Classification Report.	<b>Phase 1- Spot Check</b>
<b>Audit Guidance 10.03(B)(5)</b> 10.03(B)(5).1. Review of Withholding Rate Pool Classification (U.S. Non-exempt Recipients). 10.03(B)(5).2. Withholding Rate Pool Classification (U.S. Non-exempt Recipient) Report.	<b>Phase 1- Spot Check</b>
<b>Audit Guidance 10.03(B)(6)</b> 10.03(B)(6).1. Review of Alternative Procedure. 10.03(B)(6).2. Alternative Procedure Report.	<b>Phase 1- Spot Check</b>
<b>Audit Guidance 10.03(C)(1)</b> 10.03(C)(1).1. Review of Withholding (NRA Withholding Assumed). 10.03(C)(1).2. Withholding (NRA Withholding Assumed) Report.	<b>Phase 1- Spot Check</b>
<b>Audit Guidance 10.03(C)(2)</b> 10.03(C)(2).1. Review of Withholding (NRA Withholding Not Assumed). 10.03(C)(2).2. Withholding (NRA Withholding Not Assumed) Report.	<b>Phase 1</b>
<b>Audit Guidance 10.03(C)(3)</b> 10.03(C)(3).1. Review of Backup Withholding (Responsibilities Assumed). 10.03(C)(3).2. Backup Withholding Report (Responsibilities Assumed).	<b>Phase 1- Spot Check</b>
<b>Audit Guidance 10.03(C)(4)</b> 10.03(C)(4).1 Backup Withholding Review (Responsibilities Not Assumed). 10.03(C)(4).2. Backup Withholding Report (Responsibilities Not Assumed)	<b>Phase 1</b>
<b>Audit Guidance 10.03(C)(5)</b> 10.03(C)(5).1. Review of Backup Withholding on Reportable Payments (Disclosure Prohibited). 10.03(C)(5).2. Backup Withholding on Reportable Payments (Disclosure Prohibited) Report.	<b>Phase 1</b>
<b>Audit Guidance 10.03(C)(6)</b> 10.03(C)(6).1. Review of Assets Held by U.S. Non-exempt Recipients (Disclosure Prohibited). 10.03(C)(6).2. Assets Held by U.S. Non-exempt Recipients (Disclosure Prohibited) Report.	<b>Phase 1</b>
<b>Audit Guidance 10.03(C)(7)</b> 10.03(C)(7).1. Review of Timely Deposits. 10.03(C)(7).2. Timely Deposits Report.	<b>Phase 1</b>
<b>Audit Guidance 10.03(D)(1)</b> 10.03(D)(1).1. Review of Forms 1042 and 945. 10.03(D)(1).2. Forms 1042 and 945 Report.	<b>Phase 1</b>

<b>Audit Guidance 10.03(D)(2)</b> 10.03(D)(2).1. Review of Forms 1042-S and 1099. 10.03(D)(2).2. Forms 1042-S and 1099 Report.	<b>Phase 1- Spot Check</b>
<b>Audit Guidance 10.03(D)(3)</b> 10.03(D)(3).1. Review of Refunds. 10.03(D)(3).2. Refund Report.	<b>Phase 2 Only</b>
<b>Audit Guidance 10.03(D)(4)</b> 10.03(D)(4).1. Review of Account Holder Repayment Prior to Refund. 10.03(D)(4).2. Account Holder Repayment Prior to Refund Report.	<b>Phase 2 Only</b>
<b>Audit Guidance 10.03(E)</b> 10.03(E).1. Review of Change in Circumstance. 10.03(E).2. Change in Circumstance Report.	<b>Phase 1</b>