

Office of Chief Counsel  
Internal Revenue Service  
**Memorandum**

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date: June 14, 2006

to: Area Counsel  
(Large & Mid-Size Business)

from: Chief, Branch 2  
Disclosure & Privacy Law  
(Procedure & Administration)

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subject: Disclosure of Return Information of Certain Qualified Intermediaries for Examination or Investigation Purposes

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUES

This is in response to a request for advice regarding whether return information of certain qualified intermediaries may be disclosed to the intermediary's withholding agents or external auditors in the course of an IRS investigation into the intermediary's compliance with the Internal Revenue Code (Code) and rules and regulations applicable to qualified intermediaries.

1. Whether the IRS may contact the withholding agents (WAs) of a disqualified qualified intermediary (DQI) to ask whether the DQI has informed the WAs of the disqualification.
2. Whether the IRS may contact the external auditor of a qualified intermediary (QI) to review the audit procedures followed by the external auditor and to confirm the external auditor's determination regarding the QI's compliance with its reporting and withholding obligations.

## CONCLUSIONS

1. A strong argument can be made that the mere fact that a QI is no longer qualified, and the effective date of the end of qualification, is not return information of the QI. As such, this limited information may be disclosed to any person without concern for the restrictions imposed by IRC § 6103. Information pertaining to the reason that the QI is no longer qualified cannot be disclosed.

Alternatively, if the mere fact that a QI is no longer qualified (and the effective date) is deemed to be return information, then, pursuant to IRC § 6103(k)(6), in connection with an audit of the DQI's compliance with its obligations under the Internal Revenue Code following the disqualification, the IRS may contact the WAs to which a DQI has (or may have) furnished reports or payments in order to obtain information not otherwise reasonably available pertaining to such compliance.

2. Pursuant to IRC § 6103(k)(6), the IRS may disclose to the external auditor of a QI such return information of the QI as is necessary in order to obtain information not otherwise reasonably available with respect to determining the QI's compliance with its obligations under the Internal Revenue Code.

## FACTS

Under Treasury Regulation § 1.1441-1(b)(2)(vii)(B) and (C), for IRC § 1441 withholding and reporting purposes a WA may treat a payment as made to a Qualified Intermediary (QI) if the QI provides a valid intermediary withholding certificate to associate with the payment. The withholding certificate must include certain required information, including the QI's name, address and QI-EIN. Treas. Reg. § 1.1441-1(e)(3)(ii). A QI-EIN can be obtained by certain foreign financial institutions that execute a Qualified Intermediary agreement with the IRS, the model agreement for which was published in Rev. Proc. 2000-12, 2000-1 C.B. 387. These agreements are executed for a limited number of years, and are subject to termination at or before their scheduled expiration based on various conditions.

These agreements provide various benefits to these institutions in exchange for their assumption of withholding and reporting responsibilities. Among other things, the QI need not generally provide to its WAs or to the IRS the identities of foreign persons on whose behalf the QI receives payments of income. Instead, the QI itself obtains documentation for its accountholders to establish whether a reduced rate of withholding might apply, one lower than the 30% statutory rate under section 1441. In contrast, non-qualified intermediaries are required to furnish to their WAs accountholder documentation to justify any claim of reduced withholding.

It is important for a WA to know whether an intermediary remains qualified, because the WA's own withholding-related obligations differ depending on whether or not the intermediary is qualified. So long as the WA acts in accordance with the due

diligence requirements prescribed in the regulations for establishing the qualified status of intermediaries, it will not be held liable for underwithholding with respect to the withholding obligations of those intermediaries and their accountholders. Treas. Reg. § 1.1441-7(b)(1). At present, there is no standard procedure for the WA to timely confirm with the IRS the continuing qualified status of an intermediary, nor for the IRS to inform a WA of the disqualification of any QI or that a purported QI was never qualified. Until such IRS notice or confirmation is provided, a WA can, consistent with its due diligence requirements, continue to rely on the QI-EIN previously provided, until it otherwise knows, or reasonably should know, of the termination.

Section 10 of the QI agreement provides that unless the QI requests an IRS audit, an external auditor agreed to between the IRS and the QI will review the QI's compliance with its withholding and reporting obligations. The IRS will contact these external auditors to review the audit procedures and to examine the auditor's work papers and reports, for purposes of reviewing and confirming the QI's compliance with its reporting and withholding obligations under the Code.

#### LAW AND ANALYSIS

A strong argument can be made that the mere fact that an entity that was a QI is not qualified as of a certain date, without more, is not return information. Return information, as defined in IRC § 6103(b)(2), includes essentially all records or information received, obtained, or created by the IRS "with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title [26] for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense." Qualification is a matter of licensing by the IRS, through the agreement set forth in Rev. Proc, 2000-12. Qualification creates certain obligations and liabilities under the Internal Revenue Code. A QI can, however, lose its qualified status for several reasons, including choosing not to renew the agreement with the IRS, withdrawing from the agreement with the IRS, and failure to meet the obligations under the agreement. The status of qualified or disqualified is not initially collected by the IRS with respect to determining the QI's liability under the Code; rather, it results from one of several possible actions by the QI, and creates certain responsibilities under the Code. An entity's status as a QI or not reflects only whether the entity has a current, in good standing, agreement with the IRS; it does not reflect whether the QI has met all of its obligations under the Code, the regulations or the revenue procedure. Thus, we would contend that the fact that a QI is no longer a QI, and the date that the status changed, are not items of return information and may be disclosed without regard to IRC § 6103. However, no information may be disclosed regarding why the former QI is no longer qualified. Some reasons for losing qualified status are return information which cannot be disclosed. In order to ensure that this return information is not disclosed, the IRS cannot disclose the reason for any entity's loss of qualified status.

Our argument here regarding the fact of a former QI's non-qualified status is analogous to our determination that the mere fact that a specific enrolled agent may not represent taxpayers before the IRS is not, by itself, return information. Enrolled agent status is a matter of licensing by the IRS. An enrolled agent can lose that status for several reasons, including voluntary retirement, failure to renew the enrolled agent license, conviction of any criminal offense involving dishonesty, willfully violating the regulations applicable to enrolled agents, misappropriation of client funds, willfully participating in any attempt to evade assessment or payment of taxes, failure to file his/her own tax returns, or filing erroneous returns of his/her own. As with the QI status, some of the reasons for losing enrolled agent status are return information of the enrolled agent, and cannot be disclosed to any client of that enrolled agent. However, the mere fact of the status of the license is not collected by the IRS with respect to determining any liability under the Code.

Our determination that the mere status of an enrolled agent as eligible or ineligible to represent taxpayers is not return information, however, has never been challenged in litigation. There is a chance that a court would disagree with our position with respect to the enrolled agents, or with respect to the QIs. Therefore, we also present the alternative position that IRC § 6103(k)(6) authorizes the disclosure of the QI's status (and the effective date) as no longer qualified to WAs to which the QI furnished (or may have furnished) reports or payments.

Section (k)(6) authorizes IRS employees to disclose return information "in connection with [their] official duties relating to any audit, ... to the extent that such disclosure is necessary in obtaining information, which is not otherwise reasonably available, with respect to the correct determination of tax, or the amount to be collected or with respect to the enforcement of any other provision of this title." Disclosures made under this provision are often referred to as "investigative disclosures". Here, the IRS employees would be investigating whether the DQI complied with its obligations under the QI agreement.

Pursuant to section 6.02 of the QI agreement, a QI is required to update its withholding statement furnished to the WA as often necessary for the WA to meet its reporting and withholding obligations. Pursuant to this provision, a DQI is required to provide notice of the disqualification to all WAs to which it has previously furnished reports or payments. An investigation or examination into a DQI's compliance with its obligations under the QI agreement, which operates under IRC § 1441, is an audit for purposes of IRC § 6103(k)(6). Therefore, an IRS employee whose official duties include the audit of a DQI is authorized to disclose to any WA to which the DQI furnished (or may have furnished) reports or payments such return information of the DQI as is necessary to obtain from the WA information pertaining to the DQI's compliance with its obligations under the QI agreement (including confirmation of the DQI's assertions of compliance). Information sought may include whether, when, and how the WA learned of the QI's disqualification.

Information disclosed pursuant to IRC § 6103(k)(6) must be limited to the information necessary to be disclosed in order to obtain accurate and complete information from the WA. Section (k)(6) does not authorize disclosures merely to assist the WA in meeting its own obligations under the Code nor to assist the WA in meeting any other business obligation.

Pursuant to section 10 of the QI agreement, an external auditor agreed to between the IRS and the QI will review the QI's compliance with its withholding and reporting obligations. The IRS will contact these external auditors to review the audit procedures and to examine the auditor's work papers and reports, for purposes of reviewing and confirming the QI's compliance with its reporting and withholding obligations under the Code. In these situations, the underlying reality is that the IRS is auditing the QI. Section (k)(6) authorizes IRS employees to disclose return information in connection with their official duties relating to an audit, to the extent necessary to obtain information not otherwise reasonably available. Thus, to the extent that it is necessary for the IRS to disclose the QI's return information to the external auditor in order to conduct the audit of the QI, such disclosure is authorized. As noted above, disclosures made pursuant to section (k)(6) must be limited to that information which needs to be disclosed in order for the IRS employee to obtain accurate and complete information from the external auditor.

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Please call \_\_\_\_\_ if you have any further questions.