Qualified Intermediary (“QI”) regime - Impact on Middle East financial institutions

September 2024

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In brief

Countries in the Middle-East region including the United Arab Emirates (“UAE”) and the Kingdom of Saudi Arabia (“KSA”) have recently been certified by the United States (“US”) Internal Revenue Service (“IRS”) as Qualified Intermediary (“QI”) jurisdictions.

The purpose of the QI regime is to allow foreign financial institutions (“FIs”) to assume certain tax withholding and reporting responsibilities for US source income paid to account holders.

By becoming a QI, a Financial Institution can streamline its compliance process, protect the confidentiality of its clients having US source income and reduce risk of errors in withholding and reporting.

In detail

The QI regime has been established by the US IRS to streamline the process of withholding taxes (“**WHT**”) on income earned by non-**US persons*** from investment in the US. It is primarily aimed at FIs that handle the investments on behalf of their clients.

The FIs will assume the responsibility of certain WHT and reporting obligations, thereby reducing the administrative burden on both the IRS, the FIs and their clients. The key considerations for the QI regime are as follows:

QI Agreement

The FI needs to enter into a QI agreement with the IRS. The QI agreement is a formal contract between the FI and the IRS, outlining the responsibilities of the QI in terms of withholding and reporting US tax on US source income which includes dividend, interest, royalties and other types of passive income.

Withholding Tax Rates

The applicable US WHT rate is generally 30%, but this can be reduced under applicable tax treaties (“**DTA**”) that the US has with jurisdictions of the underlying investors and if proper documentation has been provided.

Aggregation

QIs can report income on an aggregate basis to the IRS. They do not need to disclose individual client’s information, provided that they meet the necessary documentation requirements.

Reporting Obligations

QIs are required to report the income and taxes withheld to the IRS using Form 1042-S i.e. Foreign Person’s US Source Income Subject to Withholding, by the deadline specified in the QI agreement.

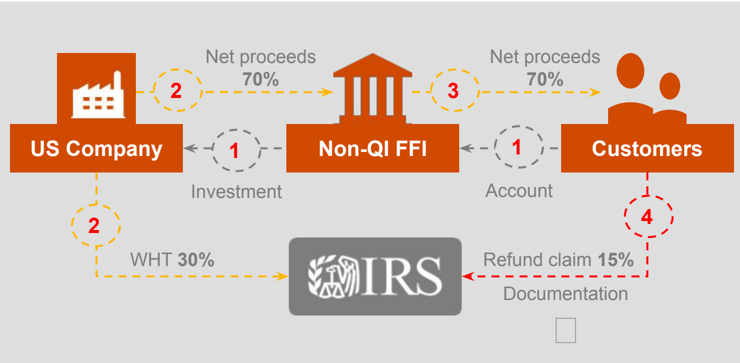
*A US person is defined as (a) US citizen or resident individual;(b) partnership or corporation organized in the US, or under the laws of the US (or any of its States); or (c) trust, if, in general terms, a US court has jurisdiction over it and it is controlled by US persons

> “Becoming a Qualified Intermediary and successfully managing the associated responsibilities requires a comprehensive understanding of QI and also strategic planning and effective client management. By adopting those solutions, businesses will be able to provide valuable services to its clients and enhance client satisfaction and trust.”

The QI regime

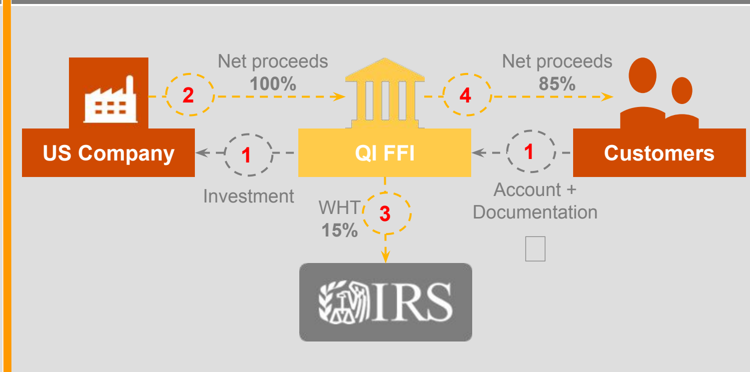
Illustration on the QI regime

Non - Qualified Intermediary



1. Non-US Customers create an account in a **Non-QI FFI** in the UAE or KSA for onward investment in US debts
2. 30% WHT is withheld on the investment proceeds upon payment and remitted to the IRS
3. The Non-QI FFI pays net proceed of 70% to its customers
4. The customers submit their documentations individually with the IRS to claim the extra 15% WHT suffered. (Assuming DTA WHT rate 15%)

Qualified Intermediary



1. Non-US Customers creates an account in a **QI FFI** in the UAE or KSA for onward investment in US debts
2. 100% of the proceed is paid to the QI. The WHT responsibility sits with the QI based on documentation submitted by the customers.
3. The QI remits the 15% WHT to the IRS on an aggregate basis based on the documentation on its customers. (Assuming DTA WHT rate15%)
4. The 85% net proceed is paid to the customers. The customers do not need to identify themselves with the IRS

Key takeaways

If a QI obtains appropriate documentation from the non-US client, the latter can benefit from the direct application of lower withholding rates in accordance with the applicable double tax treaty. The main benefits of entering into a QI agreement with the IRS are:

Client privacy - One of the major advantages of the QI regime is that it allows the QIs to protect the confidentiality of their non-US clients by reporting on aggregate basis. Individual information is not shared to the IRS.

Streamline processes - The QI regime simplifies the process of WHT and reporting.

Reduced Risk of Penalties - By adhering to the QI agreement, institutions minimise the risk of errors in WHT or reporting that could lead to penalties and additional scrutiny from the IRS.

Treaty Benefits - QIs can apply the reduced WHT rates under the applicable tax treaties between the US and the client's country of residence, provided that all the documentation has been submitted by the client.

Next Steps

- Businesses having a client portfolio with investment in the US need to evaluate whether the adoption of the QI regime would enhance their services and be more attractive to clients.
- Systems and processes should be reviewed to assess whether there are any gaps or leakage for any claims of WHT where the client has beneficial rates under any relevant tax treaties.
- Remedial actions or framework should be set where gaps have been identified.

How can we help

Our Middle East financial services tax and legal practice works with local, regional and global financial institutions and has a deep understanding of the global reporting issues typically faced by the sector. We would be delighted to arrange an introductory call to discuss these issues in more detail and how we may be able to support you.

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Let's talk

For a deeper discussion of how this might affect your business, please contact:

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Thank you