Form 1042-S: Withholding on Foreign Persons' U.S. Income Avoiding Filing Errors, Credit Disallowances and Audit Penalties

TUESDAY, JULY 30, 2019, 1:00-2:50 pm Eastern

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Form 1042-S: Withholding on Foreign Persons' U.S. Income Avoiding Filing Errors, Credit Disallowances and Audit Penalties

July 30, 2019

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Forms 1042 and 1042-S: Reporting and Withholding on U.S. Source Income for Foreign Persons

Ed Kennedy
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Forms 1042 and 1042-S: Reporting and Withholding

• Forms 1042 and 1042-S Background and Overview
  • Identification of Payees
  • Amounts Subject to Reporting
  • Determining US Source Income
  • Exceptions to Reporting
• FATCA and Chapter 4 - Overview
• Withholding Requirements
  • Amount to be Withheld
  • Determining When Payments are Required
  • Exceptions to Withholding
  • Closer look at Corporations and Partnerships
• Examples
Form 1042-S and Form 1042 – Background and overview

- Foreign persons are taxed in the US on two distinct types of income:
  - US sourced fixed or determinable annual periodical income ("FDAP")
    - Generally what we think of as passive types of income including interest, dividends, rents, royalties, and annuities.
  - US effectively connected income ("ECI") associated with a trade or business in the US.

- The tax liability on FDAP income is generally required to be withheld at source by US withholding agents at a 30% rate under the code.

- FDAP income is reported on Forms 1042 and 1042-S.
  - DC pays FC a dividend. DC is required to withhold 30% on the dividend and report the amount on Form 1042-S. DC also files a Form 1042 to report all amounts paid and withheld on Forms 1042-S.
Form 1042-S and Form 1042 – Background and overview

• Forms 1042 and 1042-S are filed to report reportable payments made by withholding agents to foreign persons and US income tax withheld on those payments.
Form 1042-S and Form 1042 – Background and overview

• Form 1042-S – Foreign Person’s U.S. Source Income Subject to Withholding
  • Information return prepared by the withholding agent to report payments to each foreign recipient.
  • Required to be filed if an amount subject to reporting is paid to a foreign person during the year.
  • Due date: March 15th. A 30-day extension is available by filing Form 8809 (additional 30 days available due to hardship – fire, casualty disaster area, etc.).
  • Form 1042-T is filed to submit Forms 1042-S by paper.
• Electronic filing required for financial institutions (FIs) and those that submit more than 250 forms are submitted.
  • Definition of an FI is very broad and will include funds and professional investment managers in addition to banks.
Form 1042-S and Form 1042 – Background and overview

• Form 1042 – Annual Withholding Tax Return for U.S. Source Income of Foreign Persons
  • Annual return filed by the withholding agent to report the total amount of income paid and tax withheld for the year.
  • Due March 15th - A six month extension is available.
  • Required to be filed by withholding agents and intermediaries who have custody of or pay a withholdable payment and any person who is required to file Form 1042-S or otherwise filed the form.
Form 1042-S and Form 1042—Withholding agent and payee

• A withholding agent is any person that has control, receipt, or custody of an amount subject to withholding. Generally the US person who transmits the payment to a foreign person but can include foreign persons.
  • Entities that have withholding agreements with the IRS (QI, WP, WT)
  • FFIs where payments are withholdable for Chapter 4.
  • Very broadly defined (ex foreign corporation with branch interest)

• A foreign person is any non-US person or entity for tax purposes including a nonresident alien, a foreign corporation, foreign partnership, foreign trust, foreign estate, or any other person.

• Beneficial owner of the income in most cases is the person who would be required to include the income on their return under US tax principles.
Identification of Payees – determination of status

- A beneficial owner certificate identifies the payee that is the beneficial owner of the income:
  - Form W-9 – US persons
  - Form W-8BEN – Nonresident individual
  - Form W-8BEN-E – Foreign entities that are beneficial owners
  - Form W-8EXP – Foreign governments, tax exempts, international organizations
  - Form W-8IMY – Intermediaries including QIs, NQIs, foreign partnerships, foreign trusts
  - Form W-8ECI – Provided by foreign person claiming income is effectively connected with the conduct of a trade or business in US.

- Withholding agent may rely on representations made by payee unless they have actual knowledge or reason to know otherwise.
Identification of Payees – determination of status

• If no documentation is received then the withholding agent must follow the presumption rules.
  • Presumption rules apply to determine status of person as US or foreign and other relevant characteristics.
  • May not apply rules to apply a reduced rate of withholding (example - portfolio interest requires documentation).
  • Indicators of foreign status: ‘98’ EIN, communications with payee are mailed to a foreign country, name of the payee indicates a per se corporation, payment is made with respect to an offshore obligation, telephone contact number is outside the US.
  • Special rules for certain types of income. (scholarships, pensions and annuities, offshore obligations).
Form 1042-S – Amounts Subject to reporting

• Amounts subject to reporting under Chapter 3 and Chapter 4 include U.S. source:
  • FDAP Income: interest, dividends, rents, royalties, annuities, pension distributions and other deferred income
  • Corporate distributions – entire amount
  • Compensation for independent personal services performed in the United States.
  • Compensation for dependent personal services performed in the United States (but only if the beneficial owner is claiming treaty benefits)
  • Gambling winnings
Form 1042-S – Amounts Subject to reporting

Amounts subject to reporting under Chapter 3 and Chapter 4 include U.S. source:

- Cancellation of indebtedness,
- Scholarship, fellowship, or grant income, dividend equivalents,
- OID paid on the redemption of an obligation,
- Federal procurement payments,
- Payments to covered expatriates.
- Notional principal contract income
- Insurance premiums
- Guarantee of indebtedness income
Form 1042-S – Amounts Subject to reporting

Amounts subject to reporting under Chapter 3 and Chapter 4 include US source:

• REMIC excess inclusions.

• Amounts paid to foreign governments, foreign central banks of issue, and international organizations even if exempt from Chapter 3 withholding

• Interest paid on registered obligations targeted to foreign markets paid by a U.S. person to a foreign person other than a financial institution or a member of a clearing organization

• Certain distributions attributable to dispositions of U.S. real property interests (Section 1445 withholding)
Form 1042-S – Amounts Subject to reporting

Amounts subject to reporting under Chapter 3 and Chapter 4 include US source:

• Payments that are or are presumed to be ECI (excluding ECI reported by foreign partners)

• Publicly traded partnerships payments of ECI (Section 1446 withholding)

• Other U.S.-source dividend equivalent payments

Reporting must occur regardless of whether amounts are subject to withholding
Amounts Subject to reporting - Source of income rules

• General Rules:
  • Interest – residence or place of incorporation of payor
  • Dividends – place of incorporation of payor
  • Personal services – place of performance
  • Rents – where the property is located
  • Royalties – where the property is used
  • Capital gains – residence of the seller
  • Real Estate Capital Gains – disposition of US RPI is US source
Form 1042-S – Exceptions to Reportable Amounts Under Chapter 3

• Notable exceptions to reportable amounts under Chapter 3:
  • Bank deposit interest except amounts paid to certain NRAs
    • NRAs that are resident in a country that the US has an information exchange agreement with (See Rev Proc 2017-46)
  • Interest that is ECI
  • Interest or OID on short term obligations
  • Notional principal contract payments that are not ECI
  • Amounts required to be reported on other information returns including Form W-2, Form 1099, Form 8288 (disposition of real property), Form 8804 and 8805 (partnership ECI withholding).
  • Individual taxpayers who are not required to withhold when the payment is not part of a trade or business. Ex – Individual pays interest that is portfolio interest to a foreign person.

• Note that amounts are still reportable if they are subject to Chapter 4 (FATCA) withholding.
  • Example: bank deposit interest paid to nonparticipating FFI or recalcitrant account holder.
Form 1042-S – determining whether a payment is reportable

• Form 1042-S covers most US sourced payments made to a foreign person. When a payment is made:
  • Is the payment being made to a foreign person?
  • Is the payment US source income?
    • Different sourcing rules for different income types.
  • Do any exceptions to reporting or withholding apply?
FATCA - Overview

• The Foreign Account Tax Compliance Act (“FATCA”) imposes a punitive 30% withholding tax on certain US source passive income paid to foreign entities (Chapter 4 Withholding).

• FATCA classifies foreign entities into two categories:
  • Foreign Financial Institutions (“FFIs”); and
  • Non-financial foreign entities (“NFFEs”)

• To avoid 30% FATCA withholding:
  • FFIs not covered by a Model I Intergovernmental Agreement (“IGA”) must enter into an FFI agreement with the IRS to report US account holder information to the IRS and withhold on noncompliant accounts.
  • FFIs covered by a Model I IGA will report U.S. account holder information directly to their home country.
  • NFFEs must certify that they do not have any U.S. 10% owners or submit information related to US owners to the withholding agent or submit proof of “excepted NFFE” status
  • Certifications made to withholding agent on W-8 form.
FATCA - Overview

• FI is very broadly defined and in addition to what we may naturally think of as an FI (bank) it can also include: investment funds such as PE funds and hedge funds, entities whose primary business is managing money or funds on behalf of others (example – professional trustee), and entities that are managed by those types of entities (example – trust managed by a corporate trustee).

• Chapter 4 withholdable payments include:
  • US source FDAP income (interest, dividends, annuities) except for non-financial payments.
  • Gross proceeds from property that could produce US interest or dividends (capital gains from sale of US C-Corporation stock) starting January 1st 2019.

• Nonfinancial payments: services, rent, royalties, transportation and freight, gambling winnings, awards, prizes, scholarships.

• If an FFI is noncompliant it can be treated as the payee for Chapter 4 even if it would otherwise be transparent (foreign partnership that is NPFFI).
Withholding Requirements – amount to be withheld

• The tax liability on income reported on Form 1042-S is generally required to be withheld at source by US withholding agents at a 30% rate under the code (generally FDAP income).
  • Other withholding rates may apply under the code in special circumstances:
    • Payments to private foundations if not exempt under treaty may be subject to excise tax at 4%.
    • FIRPTA gain distributed from qualified investment entities (REIT capital gain dividends) at 21% withholding.
Withholding Requirements – amount to be withheld

• Exceptions:
  • Bank deposit interest is withheld at a 0% rate.
  • Portfolio interest is withheld at a 0% rate. Interest on most debt instruments held by foreign persons unrelated to the payor may qualify as portfolio interest if structured properly (should be in registered form).
  • Effectively Connected Income (where a W-8ECI is received).
  • Exempt recipients that provided a Form W-8EXP (example foreign sovereign investors).
  • Income tax treaties.
Withholding Requirements – Timing of withholding

• Withholding is due based on when payments are made – follows cash payments as opposed to accruals.

• Timing of deposits:
  • Liability $2,000 or more: Three business days after the end of the quarter monthly period when then payment is made (7\textsuperscript{th}, 15\textsuperscript{th}, 22\textsuperscript{nd}, and last day of each month)
  • Liability $200 - $2,000: Fifteen days after the end of the month.
  • Liability less than $200: By original due date of the Form 1042 or with the form.

• Withholding must be deposited electronically using the Electronic Federal Tax Payment System (EFTPS).
Withholding Requirements – Corporations

• Corporations
  • Scenario: Distribution is made during the year from DC to FC. DC must determine how much to withhold but has not finalized its E&P for the year.
  • General rule is that withholding is required on the entire amount of a corporate distribution.
  • May elect to withhold based on a reasonable estimate of E&P.
  • Reasonable estimate must be based upon:
    • the anticipated amount of accumulated earnings and profits and current earnings and profits for the taxable year in which the distribution is made.
    • the distributions made prior to the distribution for which the estimate is made.
    • all other relevant facts and circumstances.
  • Reasonable estimate should be documented.
Withholding Requirements – Corporations

• Reasonable estimate example (from the Regs):
  • Analysis. Based on the facts in paragraph (i) of this Example, including the fact that earnings and profits estimate was made within a reasonable time before the distribution, Corporation X can rely on the estimate under paragraph (c)(2)(ii)(A) of this section. Therefore, Corporation X may treat $9 million of the $18 million of the October 1, 2002, distribution to foreign shareholders as a non-dividend distribution.
Withholding Requirements – Corporations

• Reasonable estimate example (from the Regs):

  • Corporation X, a publicly traded corporation with both U.S. and foreign shareholders and a calendar year taxpayer, has an accumulated deficit in earnings and profits at the close of 2018.

  • In 2019, Corporation X generates $1 million of current earnings and profits each month and makes an $18 million distribution, resulting in a $12 million dividend.

  • Corporation X plans to make an additional $18 million distribution on October 1, 2020.

  • Approximately one month before that date, Corporation X’s management receives an internal report from its legal and accounting department concerning Corporation X’s estimated current earnings and profits. The report states that Corporation X should generate only $5.1 million of current earnings and profits by the close of the third quarter due to costs relating to substantial organizational and product changes, but these changes will enable Corporation X to generate $1.3 million of earnings and profits monthly for the last quarter of the 2002 fiscal year.

  • Thus, the total amount of current and earnings and profits for 2020 is estimated to be $9 million.
Withholding Requirements – Partnerships

• Partnerships are required to withhold when distributions of withholdable income are made to foreign partners and report FDAP income in the year distributed on Forms 1042-S and 1042.

• If a partnership does not distribute a foreign partner’s distributive share of the income it earns during the year then the income is deemed distributed the following year on the earlier of the:
  • Date the Schedule K-1 is sent to the foreign partner
  • The due date for providing the Schedule K-1 to the partner

• Deemed distribution is treated as a regular distribution for purposes of determining when withholding is required (timing of deposits).
Examples – Example 1

• US Corp ("DC") rents its office space from Foreign Corp ("FC"). During the year DC makes a monthly $10,000 payments of rent to FC on the 10th of each month. FC provides a W-8BEN-E to DC showing that it is corporation and reporting model 1 FI.
  • What are DC’s withholding and 1042/1042-S reporting obligations?
    • DC must pay in 30% withholding tax ($3,000) on the gross rents paid to FC within three business days after the 15th of each month.
    • DC would report the gross payments and amounts withheld on Forms 1042 and 1042-S to FC.
    • DC would provide a copy of Form 1042-S to FC.
  • If in the example above what if FC provided a Form W-8ECI to DC?
    • No withholding applies.
Examples – Example 2

• US Corp ("DC") has borrowed money from a foreign lender ("FL") to expand its operations. The note and the interest on it qualify as a portfolio interest. FL provides DC a Form W-8IMY.

• The Form W-8IMY indicates that FL is a nonwithholding foreign partnership that is FATCA compliant. The withholding statement indicates that FL has five partners. Four of the partners are foreign partners F1, F2, F3, and F4. The fifth partner is a US person US1.

• The four foreign partners are all foreign corporations and three are FATCA compliant. No FATCA status is given for F4. Examining F4’s W-8BEN-E shows no Chapter 4 status was selected on their form.

• What are DC’s withholding and 1042/1042-S reporting obligations?
  • DC needs to report the portion of the payments made to F1, F2, F3, and F4 on Forms 1042 and 1042-s.
  • DC will issue Forms 1042-S to each of the foreign beneficial owners showing them as the recipients and FL as an intermediary.
  • Because the interest is portfolio interest no withholding is required under Chapter 3.
  • Withholding at 30% is required under Chapter 4 on the portion of the payment going to F4.
Examples – Example 3

- US Corp (“DC”) contracts with photographers to license their images in different media used in the US. DC pays a nonresident photographer (F1) $500 to use one of their images in January and has made no other payments that month. In February DC pays another nonresident photographer (F2) $500 to use one of their images in the US.
  - What are DC’s withholding and 1042/1042-S reporting obligations?
    - DC must pay in 30% withholding tax on the income paid to F1 and F2 ($150 each).
    - In January DC’s liability is less than $200 so no payment needs to be made at that time. After making the second payment in February DC’s liability is $300 so DC needs to pay in the amount due by March 15th
    - DC would report the gross payments and amounts withheld on Forms 1042 and 1042-S to F1 and F2.
    - DC would provide a copies of Forms 1042-S to F1 and F2.
  - Is the payment being made to a foreign person?
    - DC would need to know they are foreign through collecting Forms W-8BEN or applying the presumption rules (payment made to foreign address etc).
  - Is the payment US source income?
    - Need to determine income type and source. Payment being made for right to use intangible property so classification = royalty. Royalties are sourced based on where they used (US).
Examples – Example 4

• US Partnership ("USP") has four foreign partners (F1, F2, F3, and F4) that each own a 25% interest. USP has the following income during the year:
  • Ordinary income that is ECI $10,000
  • Interest that is PI $10,000
  • Dividends (US source) $10,000

• During the year USP distributes half of each partner’s allocable share of income.

• F1, F2, and F3 are foreign corporations that have provided a Form W-8BEN-E. F1 and F2 are passive NFFEs. F3 is a noncompliant FFI.

• F4 is a foreign sovereign investor (892) that has provided a Form W-8EXP.

• What is the current year 1042 and 1042-S withholding on F1, F2, F3, and F4
### Example 4

<table>
<thead>
<tr>
<th>Income Type</th>
<th>Amount</th>
<th>F1</th>
<th>F2</th>
<th>F3</th>
<th>F4</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Form 1042-S Income Reporting:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ordinary Income</td>
<td>$5,000</td>
<td>$1,250</td>
<td>$1,250</td>
<td>$1,250</td>
<td>$1,250</td>
</tr>
<tr>
<td>Interest (PI)</td>
<td>$6,000</td>
<td>$1,500</td>
<td>$1,500</td>
<td>$1,500</td>
<td>$1,500</td>
</tr>
<tr>
<td>Dividends</td>
<td>$4,000</td>
<td>$1,000</td>
<td>$1,000</td>
<td>$1,000</td>
<td>$1,000</td>
</tr>
<tr>
<td><strong>Form 1042-S Withholding:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ordinary Income</td>
<td>$5,000</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>Interest (PI)</td>
<td>$6,000</td>
<td>$0</td>
<td>$0</td>
<td>$450</td>
<td>$0</td>
</tr>
<tr>
<td>Dividends</td>
<td>$4,000</td>
<td>$300</td>
<td>$300</td>
<td>$300</td>
<td>$0</td>
</tr>
</tbody>
</table>

July 30, 2019
Form 1042-S: Penalties & Compliance Campaigns

Ed Kennedy
Penalties
Increase in penalties for late or incorrect information returns/recipient statements

On June 29, 2015, the Trade Preferences Extension Act of 2015 (P.L. 114-27) increased the penalty amounts for failures to file information returns and furnish payee statements under IRC sections 6721 and 6722. Rev. Proc. 2016-11 provides inflation-adjusted amounts for the increased penalty amounts. The new amounts apply to returns and statements required to be filed after December 31, 2015.

<table>
<thead>
<tr>
<th>Reduced rates based on date of filing of correction (Note 1)</th>
<th>Returns Due in 2016 (payments made in calendar year 2015)</th>
<th>Returns Due in 2017 (payments made in calendar year 2016)</th>
<th>Returns Due in 2018 (payments made in calendar year 2017)</th>
<th>Returns Due in 2019 (payments made in calendar year 2018)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Correctly file within 30 days</td>
<td>$50</td>
<td>$50</td>
<td>$50</td>
<td>$50</td>
</tr>
<tr>
<td>Annual maximum if failure is corrected within 30 days</td>
<td>$529,500</td>
<td>$532,000</td>
<td>$536,000</td>
<td>$545,500</td>
</tr>
<tr>
<td>Correctly file more than 30 days after due date but by August 1</td>
<td>$100</td>
<td>$100</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Annual maximum if failure is corrected more than 30 days after due date but by August 1</td>
<td>$1,589,000</td>
<td>$1,596,500</td>
<td>$1,609,000</td>
<td>$1,637,500</td>
</tr>
<tr>
<td>File after August 1 or do not file correct form</td>
<td>$260</td>
<td></td>
<td>$260</td>
<td></td>
</tr>
<tr>
<td>Annual maximum if file after August 1 or do not file correct form</td>
<td>$3,178,500</td>
<td>$3,193,000</td>
<td>$3,218,500</td>
<td>$3,275,500</td>
</tr>
</tbody>
</table>

Failure to furnish correct recipient statement*

| Maximum penalty if fail to furnish recipient statement when due (Note 2) | $260                                                     | $260                                                     | $260                                                     | $260                                                     |
| Annual maximum for all failures to furnish correct recipient statements | $3,178,500                                              | $3,193,000                                              | $3,218,500                                              | $3,275,500                                              |
Increase in penalties for late or incorrect information returns/recipient statements

Note 1: If you intentionally disregarded the requirement to report correct information, each $260 penalty is increased to the greater of $530 or 10% of the total amount of items required to be reported, with no maximum penalty.

Note 2: If you provide the correct statement on or before August 1, reduced penalties similar to those for failing to file a correct Form 1042-S with the IRS may be imposed. Sources: www.irs.gov & 2015-2018 versions of the Form 1042-S Instructions.
IRS Compliance Campaigns
IRS LB&I Compliance Campaigns

• The IRS Large Business and International division (LB&I) is moving toward issue-based examinations and a compliance campaign process in which the organization decides which compliance issues that present risk require a response in the form of one or multiple treatment streams to achieve compliance objectives. This approach makes use of IRS knowledge and deploys the right resources to address those issues.

• The campaigns are the culmination of an extensive effort to redefine large business compliance work and build a supportive infrastructure inside LB&I. Campaign development requires strategic planning and deployment of resources, training and tools, metrics and feedback. LB&I is investing the time and resources necessary to build well-run and well-planned compliance campaigns.
IRS Compliance Campaigns

• On November 3, 2017, the IRS LB&I group announced the identification and selection of 11 new campaigns, on top of the 13 identified in a previous campaign initiative in February of 2017. Two of the campaigns focused on verifying withholding at source:

• **Form 1120-F Chapter 3 and Chapter 4 Withholding Campaign**
  • Campaign is designed to verify withholding at source for 1120-Fs claiming refunds. Before a claim for credit (refund or credit elect) is paid, the IRS must verify that withholding agents have filed the required forms (1041, 1042-S, 8804, 8805, 8288 and 8288-A). Focus will be on verification of withholding credits before the claim for refund or credit is allowed.

• **Verification of Form 1042-S Credit Claimed on Form 1040NR Campaign**
  • This campaign is intended to ensure the amount of withholding credits or refunds/credit elect claimed on Form 1040NR, *U.S. Nonresident Alien Tax Return*, is verified and whether the taxpayer has properly reported the income reflected on Form 1042-S, *Foreign Person’s U.S. Source Income Subject to Withholding*. Before a refund is issued or credit allowed, the Internal Revenue Service verifies the withholding credits reported on the 1042-S.
IRS Compliance Campaigns

- On October 30, 2018, the IRS LB&I group announced the identification and selection of the following campaign which was also focused on verifying withholding at source:

- **FATCA Filing Accuracy**
  - The Foreign Account Tax Compliance Act (FATCA) was enacted in 2010 as part of the HIRE Act. The overall purpose is to detect, deter and discourage offshore tax abuses through increased transparency, enhanced reporting and strong sanctions. Foreign Financial Institutions and certain Non-Financial Foreign Entities are generally required to report the foreign assets held by their U.S. account holders and substantial U.S. owners under the FATCA. This campaign addresses those entities that have FATCA reporting obligations but do not meet all their compliance responsibilities. The Service will address noncompliance through a variety of treatment streams, including termination of the FATCA status.
IRS Compliance Campaigns

• A full list of the compliance campaigns can be found here:
C Edward Kennedy Jr
Managing Director
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Ed has over 37 years of experience dealing with a variety of international tax matters. He specializes in tax consulting services to a wide variety of clients ranging from closely held companies to multi-national businesses. His expertise includes domestic and foreign income and social security tax planning, tax compliance for individuals and corporations, tax treatment of incentive compensation plans, international assignment program administration and policy design. Ed has also served as the practice lead for a Big 4 CPA Firm’s international social security practice.

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Discussion Topics

1. Form 1042-S Reporting Obligations
2. What is Form 1042-S?
3. Completing Form 1042-S
4. Recent Form and instructional changes impacting Form 1042-S
5. Recent regulatory changes impacting Form 1042-S
6. Avoiding Common Errors
7. Associated Information Returns & Tax Returns
Form 1042-S Reporting Obligations
When do USWAs have Form 1042-S Reporting Obligations?

A withholding agent must report on Form 1042-S any chapter 3 reportable amount or chapter 4 reportable amount

- Exception applies for individuals that are not acting in the course of a trade or business with respect to the payment

Chapter 3 Reportable Amounts

- All payments that *have* been withheld upon (whether necessary or not)
- All payments that *should have* been withheld upon (even if they weren’t) and
- Amounts subject to withholding under chapter 3 (which includes most U.S. source FDAP payments) unless specifically excepted

Notable Exceptions Include:

- Bank deposit interest paid to an entity
- Bank deposit interest paid to an individual resident in a country not identified in Rev. Proc. 2018-36
- Short term interest or OID
- Insurance premiums subject to the excise tax under section 4371
When do USWAs have Form 1042-S Reporting Obligations? (continued)

Chapter 4 Reportable Amounts

Any of the following:
- All payments that *have* been withheld upon (whether necessary or not)
- All payments that *should have* been withheld upon (even if they weren’t) and
- Any withholdable payment that must be reported for chapter 3 purposes

In addition, for payments that are not withholdable payments but that must be reported for chapter 3 purposes, the withholding agent will need to provide a FATCA exemption code on the Form 1042-S. However, a withholding agent is only required to identify the FATCA status of the payee if the payment is a withholdable payment.

Thus, the withholding agent will need to have a system that characterizes, tracks, and reports FATCA payments regardless of whether they are actually subject to FATCA withholding.

**Examples where reporting not required:**
- Bank deposit interest payments to an entity if FATCA withholding is not required (e.g., grandfathered obligation or payee is not subject to withholding)
- Insurance premiums subject to excise tax under IRC 4371 and reported on a Form 720 for which FATCA withholding is not required (e.g., grandfathered obligation or payee not subject to withholding)
When do FFIs have Form 1042-S Reporting Obligations?

As a general rule, FFIs are withholding agents and have a Form 1042-S reporting obligation when the FFI makes payments subject to withholding or reporting.

Practically, however, FFIs that are not QIs, WPs, or WTs will have a limited Form 1042-S reporting responsibilities due to the following:

- Model 1 IGA FFIs have no withholding obligation and, accordingly, have no Form 1042-S reporting obligation unless the FFI is a QI, WP, or WT
- FFIs that are passing up withholding responsibility to an upstream withholding agent have only residual reporting obligations (meaning that such FFIs only have a Form 1042-S obligation when they have reason to know that the upstream withholding agent did not withhold or report properly)
What is Form 1042-S?
What is a Form 1042-S?

<table>
<thead>
<tr>
<th>Code</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Income code</td>
</tr>
<tr>
<td>2</td>
<td>Gross income code</td>
</tr>
<tr>
<td>3</td>
<td>Chapter indicator, Enter &quot;3&quot; or &quot;4&quot;</td>
</tr>
<tr>
<td>3a</td>
<td>Exemption code</td>
</tr>
<tr>
<td>3b</td>
<td>Tax rate</td>
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<tr>
<td>3c</td>
<td>Tax rate</td>
</tr>
<tr>
<td>3d</td>
<td>Tax rate</td>
</tr>
<tr>
<td>3e</td>
<td>Recipient's U.S. TIN, if any</td>
</tr>
<tr>
<td>3f</td>
<td>Ch. 3 status code</td>
</tr>
<tr>
<td>3g</td>
<td>Ch. 4 status code</td>
</tr>
<tr>
<td>3h</td>
<td>Recipient's GIN</td>
</tr>
<tr>
<td>3i</td>
<td>Recipient's foreign tax identification number, if any</td>
</tr>
<tr>
<td>3j</td>
<td>LOR code</td>
</tr>
<tr>
<td>4</td>
<td>Withholding allowance</td>
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<tr>
<td>5</td>
<td>Net income</td>
</tr>
<tr>
<td>5a</td>
<td>Federal tax withheld</td>
</tr>
<tr>
<td>5b</td>
<td>Check if federal tax withheld was not deposited with the IRS because escrow procedures were applied (see instructions)</td>
</tr>
<tr>
<td>5c</td>
<td>Tax withheld by other agents</td>
</tr>
<tr>
<td>5d</td>
<td>Overwithheld tax paid to recipient pursuant to adjustment procedures (see instructions)</td>
</tr>
<tr>
<td>5e</td>
<td>Total withholding credit (combine boxes 7a, 8, and 9)</td>
</tr>
<tr>
<td>6</td>
<td>Tax paid by withholding agent (amounts not withheld) (see instructions)</td>
</tr>
<tr>
<td>6a</td>
<td>Withholding agent's EIN</td>
</tr>
<tr>
<td>6b</td>
<td>Ch. 3 status code</td>
</tr>
<tr>
<td>6c</td>
<td>Ch. 4 status code</td>
</tr>
<tr>
<td>6d</td>
<td>Name of withholding agent</td>
</tr>
<tr>
<td>6e</td>
<td>Intermediary or flow-through entity's EIN, if any</td>
</tr>
<tr>
<td>6f</td>
<td>Ch. 3 status code</td>
</tr>
<tr>
<td>6g</td>
<td>Ch. 4 status code</td>
</tr>
<tr>
<td>6h</td>
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<td>Country code</td>
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<tr>
<td>6k</td>
<td>Foreign tax identification number, if any</td>
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<td>6l</td>
<td>Address (number and street)</td>
</tr>
<tr>
<td>6m</td>
<td>City or town, state or province, country, ZIP or foreign postal code</td>
</tr>
<tr>
<td>7</td>
<td>Payer's name</td>
</tr>
<tr>
<td>7a</td>
<td>Payer's TIN</td>
</tr>
<tr>
<td>7b</td>
<td>Recipient's GIN</td>
</tr>
<tr>
<td>7c</td>
<td>Name of state</td>
</tr>
<tr>
<td>7d</td>
<td>Address (number and street)</td>
</tr>
</tbody>
</table>

For Privacy Act and Paperwork Reduction Act Notice, see instructions.
What is Form 1042-S?, (continued)

- Generally used to report U.S. source FDAP income paid to non-U.S. persons in the course of a trade or business
  - Covers reporting required under both chapter 3 (NRA) and chapter 4 (FATCA)
  - In order to avoid reporting or withholding, must be exempt under both chapters 3 and 4
- Also used to report withholding imposed or required
- Financial institutions required to file electronically through the IRS FIRE System
- No minimum reporting thresholds
  - Form 1042-S is used to report U.S. source FDAP income to non-U.S. recipients.
  - There is no minimum threshold for reportable amounts
  - The form must be furnished to the recipient and filed with the IRS.
- Information required for reporting largely gleaned from Forms W-8
Substitute Forms 1042-S

— Not allowed.
— Forms sent to recipients must look exactly like the official IRS version.
— Only adjustment allowed is presenting the Form on a landscape sheet of paper, rather than portrait, if the information cannot fit in the smaller space.
— Only one Form 1042-S may be provided per page.
— No substitute statements listing multiple income types on one sheet.
Form 1042-S & 1042 Filing Requirements

Due Date for Forms 1042-S and 1042
• March 15th following the year of the payment

Extensions
• Automatic 30 day extension available for Forms 1042-S (IRS Copies) by filing Form 8809 prior to due date
• Additional 30 day extension may be available for Forms 1042-S (IRS Copies) by filing Form 8809 again prior to end of extension period
• Max. 30 day extensions for Forms 1042-S (Recipient copies) by writing letter to IRS including a reason for delay and postmarked by the due date
  - Requests must be sent to: IRS Enterprise Computer Center – Martinsburg, Information Reporting Program, Attn: Extension of Time Coordinator, 240 Murall Drive, Kearneysville, WV 25430.
  - Must include: a) the requestor’s name, b) address, c) TIN, d) type of return to extend e) statement that extension request is for providing statements to recipients f) reason for delay, and g) the signature of the taxpayer or authorized agent.
  - Separate submissions must be made for each withholding agent requesting an extension.
• Automatic 6-month extension available for Form 1042 (Form 7004 prior to due date)
Form 1042-S & 1042 Filing Requirements, (continued)

Electronic Filing Requirement

• Financial institutions must now file electronically through the IRS FIRE System
• Generally, all other withholding agents must file electronically through the IRS FIRE System if they file 250 or more Forms 1042-S per year for calendar year 2019
Completing Form 1042-S
Completing the Form 1042-S

Unique Identifier:

• Completion is mandatory.
• Withholding agents are required to assign a unique identifying number to each Form 1042-S that they file.
  • Must be numeric;
  • Must be 10 digits;
  • Cannot be the account number (not unique);
  • Cannot be the payees U.S. or Foreign TIN.
• The unique identifier can be reused in a subsequent year.

Amendment Number:

• Completion is mandatory.
• Sequential number indicating how many times the particular form (unique identifier) is amended.
• The IRS has informally indicated that withholding agents will still be able to aggregate amendments and transmit these collectively instead of sending each amended as it is completed.
Completing the Form 1042-S, (continued)

Box 1: Income Code

- Completion is mandatory.
- All filers must enter only one 2-digit income code from the list in Appendix A of the Form 1042-S instructions.
  - **Helpful Reminders:**
    - *As with prior years, income codes have again changed!* If you have hard coded your ERP systems for income codes, you must review and update. Other income code has again changed! It was 50, then 51, then 54. The new code is 23.
    - *Financial institutions completing Form 1042-S reporting for bank deposit interest income should use code 29 (deposit interest), not code 01 (interest paid by U.S. obligors general).*
    - **NEW for 2019:** A new income code, income code 55, was added for taxable death benefits paid on a life insurance contract

Box 2: Gross Income

- Completion is mandatory.
- For each income type, enter the gross amount paid (in whole dollars) to or on behalf of the recipient during the calendar year, including withheld tax
  - **Helpful Reminders:**
    - *Reporting is done on a cash basis – total amount that was paid to recipient during the calendar year.*
    - *The gross income amount reported cannot be equal to zero.*
    - *The gross income amount reported cannot be a negative number.*
Completing the Form 1042-S, (continued)

Box 3: Chap. 3/4 Checkbox

• Completion is mandatory.

• This indicator denotes whether amounts were withheld (or paid by withholding agent) pursuant to chapter 3 or 4

• Enter "4" if FATCA withholding applies

• Enter "3" if payment is made to a U.S. payee pool

• Enter "3" if either chapter 3 withholding applies or no withholding applies on payment to foreign person

• One box must always be checked but never both

  • Helpful Reminders:
    • Only indicate chapter 4 if you have actually completed FATCA withholding on the payment. In all other cases, you must indicate chapter 3.
    • This means separate Forms 1042-S are required if there was both FATCA withholding and chapter 3 withholding during a given calendar year.
Completing the Form 1042-S, (continued)

Boxes 3a & 3b: Ch. 3 Exemption Code, and Ch. 3 Tax Rate

- Completion is mandatory
- Should have 2 digit code for appropriate exemption (from Appendix B of Form 1042-S instructions) if the tax rate in Box 3b is 00.00
- Should have tax rate that represents the correct rate of withholding that applies to the income in Box 2 or Box 6. The number must be entered as a two-digit whole number and two digit decimal (For example 20.00 for 20%).

  **Helpful Reminders:**
  - If 30% chapter 3 withholding applies ⇒ Enter “00” in Line 3a and “30.00” in Line 3b
  - If chapter 3 withholding applies at reduced rate (greater than 0) ⇒ Enter "00" in Line 3a and enter appropriate tax rate in Line 3b (e.g., "15.00")
  - If no withholding applies (under either chapter 3 or FATCA) ⇒ Enter appropriate exemption code in Line 3a and “00.00” in Line 3b
  - If no chapter 3 withholding applies because FATCA withholding is imposed ⇒
    - You may enter exemption code 12 in Line 3a and tax rate “00.00” in Line 3b.
    - Alternately you may enter an appropriate chapter 3 exemption code and the tax rate that would have applied if chapter 4 withholding was not imposed
  - For payments made to a U.S. Payee pool ⇒ Leave Lines 3a and 3b blank
  - For payments to which back up withholding was applied ⇒ Leave Line 3a blank and enter “24.00” in Line 3b
Completing the Form 1042-S, (continued)

Boxes 4a & 4b: Ch. 4 Exemption Code, and Ch. 4 Tax Rate

• Completion is mandatory
• Should have 2 digit code for appropriate exemption (from Appendix B of Form 1042-S instructions) if the tax rate in Box 4b is 00.00
• Should have tax rate that represents the correct rate of withholding that applies to the income in Box 2 or Box 6. The number must be entered as a two-digit whole number and two digit decimal (For example 30.00 for 30%).

• helpful reminders:
  • if 30% FATCA withholding applies ⇒ enter “00” in line 4a and “30.00” in line 4b
  • if no FATCA withholding applies ⇒ enter the appropriate exemption code in line 4a and “00.00” in line 4b
Completing the Form 1042-S, (continued)

Boxes 5-6: Withholding Allowance, and Net Income

- Completion should be conditional.
- Only complete for the following income codes: 16, 17, 18, 19, 20, or 42
- For each applicable income type, enter the gross amount exempt from withholding and the net amount of income reported after taking into consideration the withholding allowance amount reported in Box 5.

Box 7a: Federal Tax Withheld

- Completion is mandatory.
- Enter the total amount (in whole dollars) of U.S. federal tax actually withheld under chapter 3 or 4. Enter “-0-” in Line 7 if no tax was withheld. Do not leave Line 7 blank.

Box 7b: Escrow Procedure

- Completion should be conditional.
- Check this box only if an amount withheld was not deposited because the WA is using the escrow procedures when the character or source of the payment is unknown.

Box 7c: Subsequent Partnership Interest Withholding

- Completion is not mandatory.
- **NEW for 2019**: Checkbox 7c. A new box was added for partnerships to indicate if withholding with respect to a partnership interest occurred in the subsequent year.
Completing the Form 1042-S, (continued)

Box 8: Tax withheld by other agents
• Completion should be conditional.
• Complete Line 8 only if you are reporting income already withheld upon by another withholding agent. Include any credit forward of prior withholding on substitute dividends in this amount.

Box 9: Overwithheld tax repaid to recipient
• Completion should be conditional.
• Significant 2018 Update: Boxes 9 and 11 have been switched. Box 9 is now used to report tax repaid to recipients, and box 11 is used to report tax paid by the withholding agent.

Box 10: Total withholding credit
• Completion is mandatory
• Enter the total amount of tax withheld by you (box 7a) and any other withholding agent (box 8) and overwithheld tax repaid to recipient pursuant to adjustment procedures (box 9).
• Line 10 should be the total of Lines 7 and 8 less box 9
Completing the Form 1042-S, (continued)

**Box 11: Tax paid by withholding agent**

- Completion should be conditional.
- Enter the total amount of tax paid by the payor to the IRS and not withheld from the payment to the recipient.
- The amounts reported in Box 11 should be the amounts paid by the withholding agent from its own funds rather than through withholding from the payment to the recipient.
Completing the Form 1042-S, (continued)

Boxes12a to 12i (Withholding Agent Information)

- Generally, completion is mandatory
- If a paying agent is completing this form pursuant to an agreement whereby the paying agent agrees to withhold and report, enter the paying agent’s information here
- USWAs are not required to enter a GIIN
- For forms reporting bank deposit interest paid to an individual, a telephone number for the withholding agent should be entered along with the address

**Helpful Reminders:**

- You must enter both a chapter 3 and a chapter 4 withholding agent status code regardless of the type of payment being made.
- **UPDATE:** You should not use code 01 (U.S. Withholding Agent - FI) or code 02 (U.S. Withholding Agent - Other) as your withholding agent’s chapter 3 status code. For example, if you are a U.S. partnership, use chapter 3 status code 08 (Partnership other than Withholding Foreign Partnership)
Completing the Form 1042-S, (continued)

**Lines 13a to 13l (Recipient Information)**

- Generally, completion is Mandatory for Boxes 13a-13d
- For Box 13e (US TIN), Box 13g (Chp. 4 Status), Box 13h (GIIN), Box 13i (FTIN), Box 13j (LOB code), Box 13k (Account number), and Box 13l (DOB), completion is conditional
- A US TIN must be reported for those instances in which it is required based on the chapter 3 or chapter 4 exemption code reported. (e.g., ECI income earned, or payee is a QI, WFP, or WFT)
- Recipient’s account number is required to be reported when a financial institution is reporting a payment made to a financial account maintained at its U.S. branch unless the payment is made through an intermediary or flow-through entity
- Starting in 2017, the WA will be required to report either an individual recipient’s foreign TIN or date of birth (However, only US branches of financial institutions are required to collect this information)
- QIs, WPs, and WTs are treated as recipients
- If payment is made to a QI or FFI that attributes the payment to a FATCA pool, the FATCA status should be the code associated with the FATCA pool rather than the QI’s or FFI’s own FATCA status
Completing the Form 1042-S, (continued)

Boxes 14a & 14b (Primary Withholding Agent)
• Completion should be conditional.
• Should only be completed when the withholding agent filing the return is reporting an amount that was withheld by another withholding agent
• Enter name and EIN of withholding agent that withheld the tax

Box 15 (Pro-Rata Reporting)
• Completion should be conditional.
• Complete if an NQI that used the alternative procedures permitted in the regulations failed to comply with those procedures

Boxes15a to 15i (Intermediary or Flow-Through Entity Information)
• Completion should be conditional.
• Complete only if payment is made to an intermediary or flow-through entity
• However, generally do not complete if payment is made to QI, WP, or WT (these entities are generally treated as recipients)
• FATCA status required only if payment is a withholdable payment
• If Intermediary or flow-through entity completed Part II of the form, enter the GIIN from Part II in this section
Completing the Form 1042-S, (continued)

Boxes 16a-16e (Payer’s Information)

• Completion should be conditional.
• Complete only if the WA filing the Form 1042-S is a paying agent acting pursuant to an agreement whereby it agrees to withhold and report the payment
• In such case, enter the information of the person on whose behalf the paying agent is acting in Lines 16a-16e

Boxes 17a-17c (State Taxes)

• Completion should be conditional.
• Enter any information regarding state income taxes withheld, if any, here
Recent Form and instructional changes impacting Form 1042-S
## Evolution of the Form 1042-S

<table>
<thead>
<tr>
<th>2016 Form 1042-S</th>
<th>2017 Form 1042-S</th>
<th>2018 Form 1042-S</th>
<th>2019 Draft Form 1042-S</th>
</tr>
</thead>
</table>
| **Box 13j**  
Limitation on Benefits (LOB codes) | Unique form identifier  
— Withholding agents must assign a 10 digit numeric identifier to each original Form 1042-S | **Removal of Chapter 3 Status Codes**  
— Removed chapter 3 Status Codes: 13 (Qualified Securities Lender – Qualified Intermediary) and 14 (Qualified Securities Lender). | **Box 7c**  
— Asks if withholding occurred in a subsequent year with respect to a partnership interest |
| **Boxes 16d and 16e**  
(Payer’s chapter 3 and 4 status code) | Amendment No. Box  
— Amended Forms 1042-S must indicate the amendment number (beginning with 1) along with the same unique identifier number | **Removed Chapter 3 Pooled Reporting Codes**  
— Code 33: Joint account withholding rate pool  
— Code 36: Qualifying dividend equivalent payments to U.S. persons – Undisclosed  
— Code 37: Nonqualifying dividend equivalent payments to U.S. persons – Undisclosed  
— Code 38: Other qualifying dividend equivalent offsetting payments (ECI) | **Qualified Securities Lender regime extended**  
— QSL regime has been extended through 2020. |
| **Renamed Chapter 4 Status Code**  
— Code 14 renamed from “Certified Deemed-Compliant FFI – Investment Advisor or Investment Manager,” to “Certified Deemed-Compliant FFI- Investment Entity that does not maintain financial accounts.” | **New and Updated Chapter 3 Exemption Code**  
— The IRS added chapter 3 exemption code 23, Exempt under section 897(l).  
— Code 54 changed from “Other Income” to “Substitute Payments – Interest from certain actively traded or publicly offered securities” | **Removed Chapter 3 Pooled Reporting Codes**  
— Code 33: Joint account withholding rate pool  
— Code 36: Qualifying dividend equivalent payments to U.S. persons – Undisclosed  
— Code 37: Nonqualifying dividend equivalent payments to U.S. persons – Undisclosed  
— Code 38: Other qualifying dividend equivalent offsetting payments (ECI) | **Qualified Securities Lender regime extended**  
— QSL regime has been extended through 2020. |
## Evolution of the Form 1042-S (continued)

<table>
<thead>
<tr>
<th>2016 Form 1042-S</th>
<th>2017 Form 1042-S</th>
<th>2018 Form 1042-S</th>
<th>2019 Draft Form 1042-S</th>
</tr>
</thead>
</table>
| **New Chapter 3 and Chapter 4 Withholding Agent status codes** | Formerly located at the top of the 2016 Form 1042-S, the pro-rata checkbox is now Box 15. | **New Chapter 4 Status Codes** | - 17 (U.S. Branch – treated as U.S. person)  
- 18 (U.S. Branch – not treated as U.S. person (reporting under section 1471)) |
| - New Chapter 3 status code (code 34) and  
- New Chapter 4 status code (code 50) for payments made by a foreign branch of a U.S. financial institution. | **LOB Code updates:** | - Removed LOB code 01, Individual.  
- Code 54 changed from “Other Income” to “Substitute Payments – Interest from certain actively traded or publicly offered securities” |
Recent regulatory changes impacting Form 1042-S
Proposed regulations affecting Form 1042-S requirements

— Proposed Regulations released on December 13, 2018
  - incorporate industry comments/feedback
  - intended to reduce burdens under IRC chapters 3 and 4
  - taxpayers generally allowed to rely on the proposed regulations until final regulations released
— Key changes include
  - narrowing scope of payments subject to FATCA
  - revised documentation requirements
  - revised timing for reimbursement and set-off procedures
Proposed regulations affecting Form 1042-S requirements

- On December 13, 2018, the Department of Treasury (Treasury) and the Internal Revenue Service (IRS) released proposed regulations (Proposed Regulations) under chapters 3 and 4 of the Internal Revenue Code (IRC).
  - Taxpayers may generally rely on the Proposed Regulations until final regulations are issued.

- Elimination of FATCA Withholding on Gross Proceeds
  - The definition of a “withholdable payment” under the FATCA regulations has historically included i) payments of U.S. source FDAP income, and ii) gross proceeds from the sale or other disposition of any property of a type that can produce interest or dividends that are U.S. source FDAP income.
  - However, Treasury and the IRS have repeatedly issued guidance deferring the date on which gross proceeds would be treated as withholdable payments subject to FATCA withholding.
  - Rather than including another deferral, the Proposed Regulations remove gross proceeds from the definition of withholdable payment entirely.
Proposed regulations affecting Form 1042-S requirements (continued)

Deferral of FATCA Withholding on Foreign Passthru Payments

The FATCA regulations generally require a Participating Foreign Financial Institutions (PFFI) to withhold on any “foreign passthru payment” it makes to a recalcitrant account holder or a foreign financial institution that fails to comply with FATCA (i.e., a nonparticipating FFI, or NPFFI).

- A foreign passthru payment generally refers to any payment to the extent such payment is attributable to a withholdable payment, See IRC § 1471(d)(7).

The Proposed Regulations delay a PFFI’s requirement to withhold on foreign passthru payments made to recalcitrant account holders and NPFFIs until the date that is two (2) years after final regulations defining the term “foreign passthru payment” are published in the Federal Register.

- While the Proposed Regulations further delay withholding requirements with respect to foreign passthru payments, the preamble makes it clear that Treasury and the IRS still believe that, unlike gross proceeds, withholding on foreign passthru payments remains an important tool for achieving FATCA’s goal of preventing tax evasion.

- The preamble elaborates that foreign passthru payment withholding may be necessary to ensure that non-compliant financial institutions do not attempt to evade FATCA withholding by investing through blockers that produce only non-U.S. source income.
Proposed regulations affecting Form 1042-S requirements (continued)

Elimination of FATCA Withholding on Non-Cash Value Insurance Premiums

- The potential for FATCA withholding on non-cash value insurance premiums has historically strengthened the IRS’s enforcement efforts in the passive foreign investment company (PFIC) context by encouraging reporting of U.S. owners in order to avoid FATCA withholding on premiums received by the entity.

  - The Tax Cuts and Jobs Act narrowed the availability of certain PFIC reporting exceptions, however, therefore diminishing the enforcement value of FATCA withholding as the U.S. owners may now be reported for PFIC purposes.

  - In response, Treasury and the IRS have eliminated FATCA withholding on non-cash value insurance premiums by including such premiums in the definition of an “excluded nonfinancial payment,” meaning that such payments are no longer considered withholdable payments subject to FATCA withholding.

- The elimination of FATCA withholding on non-cash value insurance premiums will provide substantial relief for members of the insurance industry.

  - This rule change now scales back the collection of documentation for insurance premiums and limits the focus to insurance premiums that are likely to be made to FFIs, or intermediaries acting on behalf of FFIs.
Proposed regulations affecting Form 1042-S requirements (continued)

Elimination of “lag method” for partnership Form 1042-S reporting

— Under prior guidance, a partnership that did not distribute U.S. source income to a partner in the same year the partnership earned the income was generally required to report the income on a Form 1042-S for the year of the distribution (actual or deemed) rather than the year in which the income was earned by the partnership.

— Under the proposed regulations, partnerships must instead report payments for which withholding is applied on Forms 1042 and Forms 1042-S for the year in which the income was earned by the partnership. Relatedly, deposits of amounts withheld from such distributions should be attributed to the year in which the income was earned by the partnership.

- exception: non-calendar year partnerships (i.e., fiscal year partnerships) may, but are not required to, report distributions to partners on Forms 1042 and Forms 1042-S, and designate deposits, for the year in which the distribution occurs (i.e., in line with the lag method required under prior guidance).

— Where a partnership withholds on a distribution after March 15th of the year following the year the underlying income was earned by the partnership but the partnership attributes the deposit to the prior year in which the partnership earned the income (i.e., in line with the new rule), the due date for the associated Form 1042-S is postponed until September 15th. The IRS intends to add a check box to Form 1042-S so that the withholding agent can indicate when it qualifies for the September 15th due date.
Proposed regulations affecting Form 1042-S requirements (continued)

— Similar rules apply in all cases in which a withholding agent (including a non-partnership) is permitted to withhold in the year following the year of payment.
  - E.g., spillover dividends, withholding under section 305(c).

Revised Form 1042-S reporting procedures for nonqualified intermediaries (NQIs) who have been withheld upon under FATCA because they did not provide necessary information regarding beneficial owners.

— Where an upstream withholding agent imposes FATCA withholding on a payment reported to an unknown recipient with the NQI as the intermediary, the NQI may then report the payment to its payee as subject to chapter 3 withholding, instead of FATCA withholding, provided that

i) The NQI is a participating FFI or registered deemed-compliant FFI, and

ii) The NQI can confirm that, based on the payee's chapter 4 status, the payment should not be subject to FATCA withholding.

— Change helps the underlying account holders of NQIs claim tax credits in their respective jurisdictions of residence

  - Reporting the withheld amounts as FATCA withholding was previously causing issues when these underlying owners tried to claim tax credits, as some jurisdictions do not regard FATCA withholding as a creditable income tax.
Proposed regulations affecting Form 1042-S requirements (continued)

Updates to Reimbursement and Set-off Procedures

— Under prior guidance, adjustments made under the reimbursement and set-off procedures were generally required to be made prior to March 15th (i.e., the original due date of Forms 1042 and 1042-S)

— The Proposed Regulations extend the deadline for a withholding agent to refund a beneficial owner or payee under the reimbursement and set-off procedures from the original due date of Form 1042-S (i.e., March 15th) to the extended due date
  - Generally 30 days, or 60 days with 2nd extension
  - For partnerships eligible for the September 15th Form 1042-S filing deadline (for amounts not distributed in the year earned by the partnership and withheld on or after March 15th) should now have until September 15th

— Refunds to beneficial owners or payees under these procedures be made prior to the date the Form 1042-S is furnished to such beneficial owner or payee
  - Previously, refunds had to be made prior to the time the forms were filed with the IRS
  - Change helps ensure that the Form 1042-S furnished to a beneficial owner or payee properly reflects any repayments made under these procedures and is consistent with the Forms 1042-S filed with the IRS
New filing requirements for Form 1042-S

— Internal Revenue Bulletin (IRB) No. 2018-25 was issued on June 18, 2018 and issued proposed regulations which are now in effect.

— Prior rule:
  - Persons were not required to electronically file information returns covered by Section 301.6011-2 (e.g., Forms 1042-S and 1099) unless the person was required to file 250 or more such returns during the calendar year.
  - The threshold applied separately to each type of information return (and each type of corrected information return) filed. Essentially, forms were not aggregated for purposes of determining whether the 250-return threshold was met.

— The proposed guidance may do the following in the future:
  - A person is required to file electronically if they are filing, in the aggregate, 250 or more information returns. Corrected information returns are not taken into account in determining whether the 250-return threshold is met.
  - Corrected information returns must be filed electronically if the information returns originally filed for the calendar year are required to be filed electronically.
New filing requirements for Form 1042-S (continued)

— If fewer than 250 returns covered by Section 301.6011–2(b) are required to be filed for the calendar year, the original returns for the calendar year, as well as the corrected returns for the calendar year, are not required to be filed electronically

- All financial institutions must electronically file regardless of the number of forms being filed

— Additionally, the 2019 version of Publication 515 noted certain changes to the filing requirements, as well as potential future developments

- partnerships with a Form 1042-S filing requirement that have more than 100 partners or are required to file at least 150 Forms 1042-S for the year must file Forms 1042-S electronically.

- The 2019 version of Publication 515 (consistent with recently signed law) also notes that the threshold for mandatory electronic filing will continue to drop in future years (i.e., the 2019 threshold of 150 Forms 1042-S is expected to be reduced to 100 in 2020, 50 in 2021, and 20 in subsequent tax years).

— The IRS also continues to encourage taxpayers to file electronically even if not specifically required.
Avoiding Common Errors
Avoid Common Errors

To ensure that your Forms 1042-S can be correctly processed, be sure that you do the following.

- Carefully read the information provided in Pub. 515 and the Form 1042-S instructions.
- Comply with the requirements in Pub. 1187 if you are an electronic filer.
- Complete all required fields.
- If the amount reported in Box 2 is a withholdable payment, you must also enter information in Boxes 4a, 4b, and 13g. If the amount reported in Box 2 is an amount subject to chapter 3 withholding, you must enter information in Boxes 12b, 12c, and 13f.
- If the amount reported in Box 2 is not subject to chapter 4 withholding or is not a withholdable payment, you must enter “00.00” in Box 4b and provide the applicable exemption code in Box 4a.
- If the amount reported in Box 2 is a withholdable payment and an amount subject to chapter 3 withholding and the tax rate in Box 4b is 00.00, you must enter information in Boxes 3a and 3b.
- If you are a QI, WP, or WT that is pool reporting for its direct account holders only, either a chapter 3 status code (Box 13f) or chapter 4 status code (Box 13g) is required.
- If the recipient in Box 13 or entity in Box 15 is a participating FFI, registered deemed-compliant FFI, sponsored FFI, direct reporting NFFE, or sponsored direct reporting NFFE, you must enter the entity's GIIN or the GIIN of the sponsoring entity in Box 13h or 15e (to the extent that you may rely on a sponsored entity's GIIN under the chapter 4 regulations or an applicable IGA for withholding purposes).
Avoid Common Errors, (continued)

- Use only income, status, and exemption codes specifically listed in the instructions.
- Use only tax rates that are allowed by statute, regulations, or treaty. Do not attempt to “blend” rates. Instead, if necessary, submit multiple Forms 1042-S to show changes in tax rate.
- In the case of joint owners, Form 1042-S can only list one of the owners as the recipient in Box 13a. Form 1042-S must not be completed with more than one of the joint owners as the recipient.
- The country code that you report in Boxes 13b and 15f must be present and correctly coded and cannot be “US” (unless the intermediary identified in line 15 is a U.S. branch that is not treated as a U.S. person).
- If you are reporting a reduced rate of withholding pursuant to a treaty a US or foreign TIN must be included, if the income is not attributable to a marketable security.
- Confirm the accuracy of the tax rate reported (Gross Income X Tax Rate= Tax Withheld)

**RECONCILE PRIOR TO FILING:**
- # of forms filed via paper;
- # of forms filed electronically; and
- # gross income and withholding.
Associated Information
Returns & Tax Returns
Form 8966: Reporting of foreign persons

Form 8966

— Form 8966 is a form introduced by FATCA.

— The form is used by U.S. persons to report certain information regarding substantial U.S. owners of passive NFFEs and U.S. owners of owner documented FFIs to the IRS.

— The form is not required to be furnished to the account holder.

— Information to be reported:
  
— Name of the passive NFFE or ODFFI

— Name, address, and TIN of each specified U.S. person that has a (direct or indirect) interest in the ODFFI

— Total of all payments made to the passive NFFE or ODFFI during the year

— Account balance or value of the account (for ODFFIs)

— Any other information required by the form instructions
Form 1042: Annual Withholding Tax Return for U.S. Source Income of Foreign Persons

Used to report the aggregate amounts paid and withheld under FATCA and chapter 3 (i.e., all amounts that are, or should have been, reported on Forms 1042-S).

Type of information required (non-exhaustive list):

- Total gross amount paid to payees
- Total amount withheld from such payments
- Total amount deposited with the IRS
- Total withholding tax liability
- Net under- or overwithholding for the year
- Separately identify the amounts specifically withheld under FATCA, as well as provide an allocation of withholdable payments not withheld on among the various FATCA exemption and compliance categories (e.g., nonfinancial payments, properly documented, effectively connected income, etc.).

Must file Form 1042 regardless of whether any withholding was required or was withheld under chapter 3 or FATCA.
What questions do you have?
With you today

Background

Elis is a senior manager within KPMG’s Information Reporting and Withholding practice. He has considerable experience advising financial institutions on information reporting and withholding related issues arising out of Internal Revenue Code chapters 3, 4, and 61 and the regulations thereunder. In addition, Elis also advises on issues related to Tax Information Exchange Agreements entered into by the United States, the Organization for Economic Co-operation and Development’s (OECD) Standard for Automatic Exchange of Financial Account Information in Tax Matters (commonly referred to as the Common Reporting Standard, or CRS).

Professional and Industry Experience

In his role, Elis’ primary focus concerns product analysis, the interpretation of formal tax guidance, the identification of compliance requirements, and the development of, or modification of processes that need to be implemented in order to achieve or maintain compliance.

Prior to joining KPMG, Elis was at a global custodian, The Bank of New York Mellon, where he assisted in the development and implementation of operational tax solutions and the creation of preventative measures for mitigating withholding related business risk.

Elis received his Juris Doctorate from Seton Hall School of Law, and his Bachelor of Science from the City University of New York at Brooklyn College.