NOT YOUR SAME OLD 1042-S

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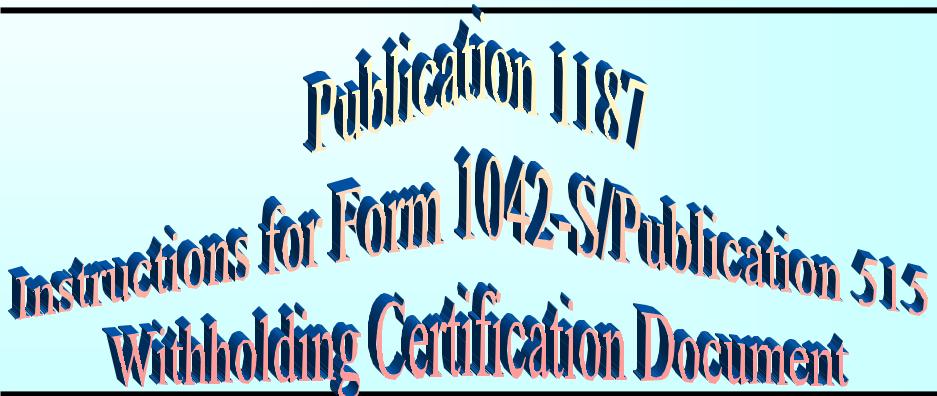
TOPICS FOR DISCUSSION

- **Radically different processing system**
- **Integrated approach to documentation and reporting**
- **What you need to Know**
- **Common Errors**
- **Resources**

Learn Them, Know Them, Live Them

Publication 1187

Instructions for Form 1042-S/Publication 515 Withholding Certification Document

2003 IRS Nationwide Tax Forum

Tax Law Basics

- Foreign persons are subject to tax on U.S. source income
- Statutory rate of tax is 30%
- Exceptions are through statute or tax treaty. ONLY.
- Claim for exception must be based on reliable documentation that enables a withholding agent to establish status of recipient beneficial owner as U.S. or foreign

Reliable Documentation

- Correct, complete documentation = properly completed Form 1042-S
- What is reliable documentation?
  - Complete and signed
  - Internally consistent information
  - Permanent residence address outside U.S.
  - No other contradictory information

Taxpayer Identification Number (TIN)

- **A recipient TIN is <u>required</u> for**
  - **Claims for most treaty benefits**
  - **Exemption from withholding on effectively connected income**
  - **A Qualified Intermediary and similar recipients**
  - **<u>All</u> U.S. persons**
- **Inform your customer if a TIN is needed!**

  <u>NO TIN = NO REDUCTION OR EXEMPTION FROM WITHHOLDING AT 30%</u>

New Reporting Requirements

- New and expanded income, recipient, exemption codes
- New tables incorporate all current statutory and treaty tax rates
- Newly structured country code table
  - Use of "OC" (Other Country) and "UC" (Unknown Country) severely restricted

  <u>USE ONLY THESE NEW CODES AND TABLES</u>

New Process

- **New 1042-S processing structure**
- **Publication 1187 contains record layout (format) for magnetic/electronic submissions**
- **Filers submit to MCC**
- **MCC determines if file is <u>properly formatted</u>**
- **<u>Properly formatted</u> file is then passed through other programs to check for internal tax law errors**

New Process (cont'd)

- **Files not meeting format requirements must be resubmitted**

    - MCC requests replacement file and tracks response

- **MCC processing focuses on <u>fatal format errors only</u>**

- **<u>Testing</u> by MCC -- only format testing**

- **<u>Testing and processing</u> by MCC no longer includes "within record" tax law**

New Process (cont'd)

- **Properly formatted records are passed to error correction process**
- **Records "fall out" to 1 of 3 databases**
- **"Good" records post to Master File with no human intervention**
- **"Errored" records are reviewed by tax examiners using complex validity, consistency, and math error checks**

New Process (cont'd)

- **Income, recipient, and exemption codes, tax rate, and country code combinations must accurately reflect tax law with regard to the payment being made**
- **Complex matrix tables have been built**
- **Each record is checked against all possible combinations**
- **Filers resubmit only errored records**

<u>Hint:</u> You can program these checks too.

Common Errors – Publication 1187

- **Specifies format, not tax law**
- **Must provide for all possible reporting situations**
- **This does not mean that "any old information" will do**
- **You must apply the <u>tax law</u> to your record entry**
- **"Required" field must contain data**
- **"Conditional" field -- you must apply the condition associated with that field**

Common Errors – T Record

- **Error correction process requires that T Record be corrected before Q Record can be corrected**

- **Withholding Agent EIN, Name, and Address must be present**

- **Over 95% of all errored T Records simply had a wrong TIN Indicator**

- **A U.S. withholding agent has an "EIN", not a "QI-EIN"**

Common Errors – Q Record

- **There is no Income Code "00"**

- **"Blended rates" are not allowed**

- **If Exemption Code 04 is used, CC must = Treaty Country**

- **Recipient TIN must be generally be present**

- **Country of Residence for Tax Purposes**

  - **<u>MUST</u> be present and <u>CANNOT BE U.S.</u>**

  - **Must be consistent with permanent address provided**

  - **Must be on the Country Code Table**

Common Errors – Q Record (cont'd)

- **Recipient Code 20 (Unknown Recipient)**
- **Use only if your documentation does not have a recipient name and address**
- **If Recipient Code is 20, Recipient Name Line 1 must = "Unknown"**
- **If your documentation shows a recipient name and address, you must show them on your 1042-S**
- **If Recipient Name and Address are present on Form 1042-S then Recipient Code CANNOT = 20**
- **If, after all this, you use Recipient Code 20, your Tax Rate and tax withheld must always = 30%**
- ➔ **Exemption Code 04 (treaty rate) CANNOT BE USED**

You Can't Fool the System

- **Overall error rate for TY2001 = 65%**

- **Ranged from a low of 13% to a high of 97%**

- **Most errors were AVOIDABLE**

YOU, THE WITHHOLDING AGENT, ARE RESPONSIBLE FOR THE TAX IF YOU KNOW, OR SHOULD HAVE KNOWN, THAT UNDERWITHHOLDING HAS OCCURRED

Ask Yourself. . . .

- Does the Income Code I used reflect the type of income I paid?
- Does the Recipient Code I used accurately identify the recipient's status?
- Does the Exemption Code I used identify the proper tax status of the payment?
- If I used Exemption Code 04, does my documentation adequately reflect the recipient's right to a treaty benefit?
- Have I read the treaty correctly? IS THERE A TREATY?
- Is the Country Code I used correct?
- Have I properly entered Withholding Agent Information?
- Have I properly entered Recipient Information?
- Have I entered TIN's whenever necessary?
- Is my format right? Is my math right?

Resources

E-mail Your Tax Law Questions

>> From the IRS Home page (www.irs.gov)

>> Click on Site Map

>> Click on Tax Law Questions

>> Select "Aliens and U.S. Citizens Living Abroad"

> Or, Contact the International Call Site

>> 215-515-2000 (phone)

>> 215-516-2555 (fax)

>> Mailing address: P.O. Box 920, International Section, Bensalem, PA, 19020-8518

Contact MCC for Format Questions

>> Toll-free - 866-455-7438

>> Email: mccirp@irs.gov