

Excerpt from eBook

IRS Tax Audits and Collections

Form W-8 Tax Withholding

IRS Form W-9

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Gary S. Wolfe has over 34 years of experience, specializing in IRS Tax Audits and International Tax Matters including: International Tax Planning/Tax Compliance, and International Asset Protection.

As of July 2016, Gary Wolfe has internationally published 15 books and 28 articles. Gary has received 14 international tax awards from five different Global expert societies in LONDON/UK including being voted one of the 100 leading world's law firms with votes from over 150,000 voters in over 160 countries with the following award: Global 100 (2016) (KMH Media Group) - CA/US International Tax Planning Law Firm of the Year.

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Chapter 14 - Form W-8 Tax Withholding

Under IRC §§1441 and 1442, a Tax Withholding Agent must withhold 30% of any payment of an amount subject to tax withholding made to a Payee that is a Foreign Person unless the Withholding Agent obtains valid documentation that the Payee is either a U.S. Payee or a Beneficial Owner.

A U.S. Payee is any person required to furnish Form W-9.

A Beneficial Owner is any person or entity that is required to furnish:

1. Form W-8 BEN (Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding, [i.e., the Beneficiary is exempt from tax under a treaty]);
2. Form W-8 ECI (Certificate of Foreign Persons Claiming that Income is Effectively Connected with the Conduct of the Trade of Business in the United States, [i.e., the effectively connected income will be declared in the United States by the Beneficiary filing a U.S. Income Tax Return]); or
3. Form W-8 EXP (Certificate of Foreign Government or Other Foreign Organization for United States Tax Withholding, [i.e., any Foreign Government, International Organization, Foreign Central Bank of Issue, Foreign Tax-Exempt Organization, Foreign Private Foundation or Government of a U.S Possession]).

Under Form W-8 EXP, the Payee claims an exemption for withholding under IRC §115(2), IRC §501(C), IRC §892, IRC §895, or claims a reduced rate of withholding under IRC §1443(b).

Tax Withholding Agents

Tax Withholding on Payments to Foreign Taxpayer

Non-Resident Aliens and Foreign Corporations are generally subject to a flat 30% tax on U.S. Source Income that is not effectively connected with the conduct of a U.S. trade or business. To insure collection and payment of the tax, a Tax Withholding Agent must withhold 30% of the gross amount paid to a Foreign Taxpayer which is subject to tax (IRC §§1441 and 1442).

A lower tax-withholding rate may apply to scholarship or fellowship grants, gross investment income, and dispositions of U.S. real property interests. In addition, a tax treaty may also reduce the rate of tax withholding.

Only income of a Foreign Taxpayer is subject to tax withholding rules. A Foreign Taxpayer includes any Non-Resident Alien, (including a bona fide Resident of Puerto Rico) or an Alien Resident of Guam, the Northern Mariana Islands, the U.S. Virgin Islands and American Samoa (Treas. Reg. 1.1441-1(c)).

A Non-Resident Alien who elects resident status for income tax purposes will still be considered a Foreign Taxpayer for withholding purposes. A Foreign Taxpayer includes Foreign Corporations, Partnerships, Estates, Trusts (and the Foreign Branch of U.S. Financial Institutions in certain circumstances).

Income Subject to Tax Withholding

Income is subject to tax withholding requirements if it is from sources within the United States and is:

1. Fixed or determinable annual or periodical income ("FDAP" Income, e.g., interest, dividends, rents, royalties and compensation). FDAP Income does not include most gains from the sale of property.
2. Certain gains for the disposal of timber, coal, or domestic iron ore.
3. Gains relating to the contingent payment received from the sale or exchange of patents, copyrights, and similar intangible property.

Income payable for personal services performed in the United States will be treated as from sources who are within the United States, regardless of where the location of the contract, place of payment or residence of Payor.

Effectively Connected Income ("ECI") with the conduct of a U.S. trade or business is not subject to the withholding requirement (including income received as wages). ECI is subject to the tax and withholding rules, as if the Foreign Taxpayer were a U.S. Citizen Resident, or Domestic Entity.

Under IRC §1446, special rules apply to the effectively connected income of a Partnership (Foreign or Domestic) that is allocable to its Foreign Partners.

Withholding Agent

A Withholding Agent is the Person or Entity required to deduct, withhold and pay any tax on income paid to a Foreign Taxpayer (Treas. Reg. 1.1441-7). This duty is imposed on all persons that have the control, receive, custody, disposal, or payment of any items of income which are subject to withholding.

The Withholding Agent may be an Individual, Corporation, Partnership, Trust, or other entity (including a Foreign Intermediary or Partnership). A Withholding Agent may designate an Authorized Agent on its behalf.

The Tax Withholding Agent is personally liable for any tax required to be withheld, except in the case of certain conduit financing arrangements (IRC §1461). This liability is independent of the tax liability of the Foreign Taxpayer for whom any income is paid. Even if the Foreign Taxpayer pays the tax, the Withholding Agent may still be liable for any interest, penalties, or additions for failure to withhold (IRC §1463).

No Withholding

A Withholding Agent will not be required to withhold any amount if it has received documentation that confirms:

1. The Payee is a U.S. Person.
2. The Payee is a Beneficial Owner (i.e., a Foreign Person entitled to a reduced rate of withholding or a withholding exemption. Treas. Reg. 1.1441-1).

The Withholding Agent must obtain valid documentation from the Payee that it is either a U.S. Payee or Beneficial Owner. A U.S. Payee is any person required to furnish Form W-9. The U.S. Payee who furnishes Form W-9 may be subject to Form 1099 tax reporting and tax withholding requirements.

A Beneficial Owner is any person or entity who is required to furnish Form W-8 BEN, Form W-8 ECI, or Form W-8 EXP.

Payments to an intermediary (whether qualified or not), flow-through entity, or U.S. branch of Foreign Entity, may be treated as a U.S. Payee if valid documentation is provided on the Form W-8 IMY.

Withholding Agent Annual Returns

Every Withholding Agent must file an annual information return on Form 1042-S to report income paid to a Foreign Taxpayer during the tax year that is subject to withholding unless an exception applies (Treas. Reg. 1.1461-1, 1.6302-2).

A separate Form 1042-S must be filed for each recipient, as well as for each type of income that is paid to the same recipient. Form 1042 is used by the Withholding Agent to report and pay the withholding taxes.

Form 1042, Form 1042-S, must be filed regardless of whether or not taxes were required to be withheld. Forms 1042 and 1042-S must be filed by March 15th of the year following the year in which the income was paid.

The amount of tax required to be withheld will determine whether the Withholding Agent must deposit the taxes prior to the due date for filing the returns and how frequently such amounts must be deposited. Penalties may be imposed for failure to file, to provide complete and correct information, as well as for failure to pay any taxes.

Chapter 15 - IRS Form W-9

IRS Form W-9 is used by a person who files information returns with the IRS to report transactions. A U.S. Person (including a resident alien) provides their current Taxpayer Identification Number to the person requesting it ("The Requestor").

Summary

The Requestor uses the U.S. Person's Taxpayer Identification Number ("TIN") to report:

1. Income Paid (to the U.S. Person)
2. Real Estate Transactions
3. Mortgage Paid (by the U.S. Person)
4. Debt Cancellation
5. Acquisition or Abandonment of Secured Property
6. IRA Contributions (by the U.S. Person)

Form W-9 is used by a U.S. Person to certify:

1. Their Taxpayer Identification Number
2. They are not subject to "Back-up withholding"
3. If applicable, their allocable share of U.S. partnership income (U.S. trade or business) not subject to withholding tax, on foreign partners' share of "effectively connected income".

Form W-9 is used to claim exemption from back-up withholding for a U.S. Exempt Payee (who is exempt from tax under a U.S. Tax Treaty).

For Federal Tax purposes, a U.S. Person is defined as:

1. An Individual who is a U.S. Citizen or U.S. Resident Alien;
2. A U.S. Partnership, Corporation, Company or Association;
3. A U.S. Estate;
4. A Domestic Trust (defined under Treas. Reg. Section 301.7701-7).

Back-up Withholding

Payors making payments to U.S. Payees, under certain conditions must withhold and pay 28% of such payments to the IRS, known as "back-up withholding".

Payments that may be subject to back-up withholding include:

1. Interest
2. Tax-exempt Interest
3. Dividends
4. Broker and Barter Exchange Transactions
5. Rents
6. Royalties
7. Non-employee Pay
8. Real Estate transactions are not subject to back-up withholding

A U.S. Person is not subject to back-up withholding on payments received if they:

1. Give the Requestor their correct TIN
2. Make the proper certifications
3. Report all taxable dividends and interest on their tax return

Payments received by a U.S. Payee will be subject to back-up withholding if:

1. They do not give their TIN to the Requestor
2. They do not certify the TIN
3. The IRS tells the Requestor the U.S. Payee furnished an incorrect TIN
4. The IRS tells the Requestor the U.S. Payee is subject to back-up withholding because they did not disclose all reportable interest and dividends on their tax return
5. The U.S. Payee did not certify to the Requestor they are not subject to back-up withholding (for reportable interest and dividends for accounts opened after 1983)

Foreign Person (Non-Resident Alien/Foreign Entities)

A Foreign Person gives the Requestor the appropriate Form W-8 (not Form W-9) to confirm they are not subject to back-up withholding.

Non-Resident Alien who becomes a Resident Alien

Generally, only a Non-Resident Alien may use a tax treaty to reduce or eliminate U.S. Tax on income. Most treaties contain a "savings clause" which may specify exceptions which permit an exemption from tax (for certain types of income), even after the payee has become a U.S. Resident Alien (for tax purposes).

A U.S. Resident Alien who claims an exemption from tax (under a Tax Treaty Savings Clause) must attach a Form W-9 statement which specifies:

1. The Treaty Country (under which the Non-Resident Alien claimed a tax exemption)
2. The Treaty Article addressing the income received
3. The Tax Treaty Article which contains the Savings Clause (and its exceptions)
4. The type and amount of income exempt from tax
5. Sufficient facts to justify the tax exemption under the Treaty

Special Rules for Partnerships

U.S. Partnerships (that conduct a U.S. trade or business) are generally required to pay a withholding tax on any foreign partners' share of U.S. partnership income. If a Form W-9 is not received the Partnership is required to presume that a Partner is a Foreign Person, and pay the withholding tax.

The following U.S. Persons are required to give the Form W-9 to the Partnership to establish their U.S. tax status (and avoid withholding on their allocable shares of partnership net income):

1. The U.S. Owner of a Disregarded Entity (not the Entity);
2. The U.S. Grantor of a Grantor Trust (not the Trust);
3. The U.S. Trust (other than a Grantor Trust) and not the Trust beneficiaries.

Penalties

1. Failure to Furnish Correct TIN to Requestor - \$50 penalty for each such failure (unless the failure is due to reasonable cause and not willful neglect).
2. Civil Penalty for False Information with Respect to Withholding - \$500 penalty (if no reasonable basis for false statement).
3. Criminal Penalty for Falsifying Information - Willful falsifying certifications subject to fines and/or imprisonment.
4. Misuse of TIN's - If the Requestor discloses or uses TIN's in violation of Federal law, the Requestor may be subject to civil and criminal penalties.

