NOT YOUR SAME OLD 1042-S

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2003 IRS Nationwide Tax Forum

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

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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**

USE ONLY THESE NEW CODES AND TABLES

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 properly formatted
- Properly formatted 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 tax law 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
  - MUST be present and CANNOT BE U.S.
  - 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