

**MEMO# 7803**

April 22, 1996

## **PROPOSED REGULATIONS ON NONRESIDENT ALIEN WITHHOLDING**

1 See, e.g., Institute Memorandum to Operations Committee No. 38-94, Tax Committee No. 40-94 and Transfer Agent Advisory Committee No. 52-94, dated December 29, 1994. 2 See Institute Memorandum to Tax Members No. 30-95, Operations Committee No. 21-95 and Transfer Agent Advisory Committee No. 34-95, dated June 12, 1995. April 25, 1996 TO: TAX MEMBERS No. 19-96 OPERATIONS MEMBERS No. 18-96 TRANSFER AGENT ADVISORY COMMITTEE No. 22-96 RE: PROPOSED REGULATIONS ON NONRESIDENT ALIEN WITHHOLDING

For the past several years, the Internal Revenue Service ("IRS") has been considering major changes to regulations under Internal Revenue Code sections 1441 that impose withholding tax on certain payments made to persons who are neither citizens nor residents of the United States ("nonresident aliens" or "NRAs"). In the absence of a treaty provision to the contrary, regulated investment companies ("RICs") are required generally by the regulations under section 1441 to impose 30 percent withholding tax on ordinary income dividends, but not on capital gain dividends or redemptions, paid to an NRA shareholder. In addition, IRS regulations require RICs to impose backup withholding of 31 percent on a RICs payments, including redemption proceeds, to any shareholder who has neither provided a certified U.S. taxpayer identification number ("TIN") nor certified his or her status as an NRA investor. One NRA withholding provision that has received particular IRS attention is the so-called "address rule" pursuant to which dividends may be paid to NRAs at reduced treaty rates if a foreign address is provided. Specifically, there have been strong indications that IRS would eliminate the address rule and require instead that all foreign individuals investing in the United States apply to IRS for an individual taxpayer identification number ("ITIN") that could be used to claim eligibility for treaty benefits and exemption from backup withholding. Because any requirement that foreigners receive from IRS a U.S. taxpayer identification number would create a significant deterrent to foreign investment in the U.S. capital markets, the Institute has repeatedly urged IRS not to impose a mandatory ITIN requirement.<sup>1</sup> IRS guidance resulting from the continuing reexamination of the NRA withholding rules has been released in two parts. As we previously informed you, last June IRS released proposed regulations that would require NRAs filing U.S. tax returns, such as to recover a refund of U.S. withholding tax, to apply for and include on the tax return an ITIN.<sup>2</sup> In the attached regulations, which would be effective for payments after December 31, 1997, IRS has proposed an extensive revision to the withholding rules applicable to NRAs. While the proposed regulations generally would eliminate the address rule for dividends paid after December 31, 1999, they adopt the Institute position that NRAs not be required to receive ITINs in order to receive treaty-provided reduced withholding rates and to be exempt from backup withholding. Instead, NRA investors would be required to make

certain certifications. - 2 - The attached memorandum discusses in detail the proposed regulations. In addition, the memorandum discusses a proposed revenue procedure that IRS also has released which sets forth procedures whereby a foreign person, such as a bank or a broker, could apply to be a "qualified intermediary" -- a new designation created by the proposed regulations -- for purposes of withholding and reporting on certain payments to foreign persons. We will keep you informed of developments. Keith D. Lawson Associate Counsel - Tax Attachments Note: Not all recipients of this memo will receive the attachments. If you wish to obtain a copy of the attachments referred to in this memo, please call the Institute's Information Resource Center at (202)326-8304, and ask for this memo's attachment number: 7803.

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