

**MEMO# 11902**

May 23, 2000

# **IRS RELEASES SIGNIFICANT AMENDMENTS TO NONRESIDENT ALIEN WITHHOLDING TAX REGULATIONS**

1 See Institute Memorandum to Bank and Trust Advisory Committee No. 1-00, Operations Committee No. 1-00, Tax Committee No. 1-00, and Transfer Agent Advisory Committee No. 2-00, dated January 11, 2000. [11902] May 24, 2000 TO: BANK AND TRUST ADVISORY COMMITTEE No. 13-00 BROKER/DEALER ADVISORY COMMITTEE No. 11-00 INTERNATIONAL COMMITTEE No. 16-00 OPERATIONS COMMITTEE No. 12-00 TAX COMMITTEE No. 24-00 TRANSFER AGENT ADVISORY COMMITTEE No. 24-00 RE: IRS RELEASES SIGNIFICANT AMENDMENTS TO NONRESIDENT ALIEN WITHHOLDING TAX REGULATIONS

I.  
INTRODUCTION The Internal Revenue Service ("IRS") has issued the attached final regulations (TD 8881) which make significant changes to the withholding tax rules that will apply to payments of certain US source income to payees that are neither citizens nor residents of the United States ("nonresident aliens" or "nras") after December 31, 2000. The final regulations are effective on January 1, 2001. Of particular interest to US mutual funds and their shareholders, and as discussed below, the attached final regulations (1) provide revised rules to determine when a US withholding agent may rely on a Form W-8 received from a foreign payee, including revised "reason to know" and validity period rules, revisions to the rule for broker-held Forms W-8, and changes to the 90-day "grace period" rule for Forms W-8 received by facsimile; (2) conform the rules applicable to "qualified" foreign intermediaries to those previously announced in Revenue Procedure 2000-12; (3) provide specific rules regarding documentation to be provided to a US withholding agent by a "non-qualified" foreign intermediary; (4) generally conform the withholding tax treatment of flow-through entities, including "non-withholding" foreign partnerships, "non-qualified" foreign intermediaries, foreign simple trusts, and foreign grantor trusts; (5) treat foreign complex trusts and foreign estates as beneficial owners of payments received; (6) generally subject payments to nonresident aliens from individual retirement accounts and annuities to the nonresident alien withholding rules; and (7) clarify and modify the presumptions regarding the validity of "documentary evidence" provided for offshore accounts. The regulations also finalize, effective January 1, 2000, the proposed rules regarding the electronic transmission of Forms W-8. 2 In addition, the IRS has clarified in the attached Announcement 2000-48 the circumstances under which certain foreign entities (or foreign branches) may apply to the IRS to become "qualified intermediaries" or "QIs" where no income tax treaty or exchange of information agreement exists between their country of residence and the United States. The remainder of this memorandum summarizes changes made by the final regulations to the nonresident alien withholding tax rules that are of particular significance to US mutual funds and their shareholders. Given the detailed nature

of the final regulations, however, they should be reviewed carefully and in their entirety. As a basis for comparison, attached to this memorandum are two handouts from the meeting held at the Institute on May 15, 2000 to discuss the nonresident alien withholding tax rules prior to their amendment by the final regulations.

## II. DISCUSSION OF FINAL REGULATIONS

### A. Reliability of Forms W-8 and Other Documentary Evidence

#### 1. "Reason to Know" Standard

Nonresident investors seeking to reduce or eliminate US withholding or backup withholding taxes generally must provide new withholding certificates (e.g., Forms W-8BEN, Form W-8IMY) to their US withholding agent no later than December 31, 2000. Upon receipt of a withholding certificate (or, in some cases, other documentary evidence), a US withholding agent generally is entitled to assume that the certificate (or other documentary evidence) is valid and reliable unless the agent "knows" or has "reason to know" that the certificate is invalid. A withholding agent is generally presumed to have "reason to know" that a certificate or other documentary evidence is invalid if its knowledge of relevant facts or statements contained in such certificate or documentary evidence is such that a reasonably prudent person in the position of the withholding agent would question the claims made. Limits are placed on the "reason to know" standard in the case of a withholding agent that is a regulated investment company ("RIC") or other financial institution making a payment of income from certain publicly-offered securities, including RIC shares. As discussed below, the final regulations significantly complicate and, in some cases, expand the limits on the "reason to know" standard for RICs and other financial institutions.

#### a. Limits on reason to know -- direct account holders or "beneficial owners"

Under the final regulations, where a withholding agent that is a financial institution has a direct account relationship with a beneficial owner (i.e., a direct account holder) the financial institution has reason to know that documentation provided by the account holder is unreliable or incorrect only if one or more of the following circumstances exist:

- 3i. For a beneficial owner withholding certificate (e.g., Form W-8BEN), if: a) the withholding certificate is incomplete with respect to any item on the certificate that is relevant to the claims made by the direct account holder; b) the withholding certificate has any information that is inconsistent with the direct account holder's claim; c) the withholding agent has other account information that is inconsistent with the direct account holder's claim; d) the withholding certificate lacks information necessary to establish entitlement to a reduced rate of withholding; or e) the name of the person on the withholding certificate indicates that the person is a corporation, partnership, trust, estate or an individual and the person's claim of classification (e.g., individual, partnership, corporation) is not consistent with such indication and a difference in classification would result in a different rate of withholding or a difference in the person or persons to whom the payment is reported.
- ii. For a beneficial owner withholding certificate provided to establish foreign status, if: a) the withholding certificate has a permanent residence address in the United States; b) the withholding certificate has a mailing address in the United States; c) the withholding agent has a residence or mailing address as part of its account information that is an address in the United States; or d) the direct account holder notifies the withholding agent of a new residence or mailing address in the United States (whether or not provided on the withholding certificate).

Exceptions: However, a withholding agent may rely on a withholding certificate as establishing the account holder's foreign status if the following conditions exist:

#### 4 For a direct account holder that is an individual:

- aa) the withholding agent has in its possession, or obtains, documentary evidence (that does not contain a US address) -- that is no more than three years old, that supports the claim of foreign status, and the direct account holder provides the withholding agent with a reasonable explanation in writing supporting the account holder's foreign status; or
- bb) the account is maintained at an office of the withholding agent outside the United States and the withholding agent is required to report annually a payment to the direct account holder on a tax information statement that is filed with the tax authority of

the country in which the office is located and that country has an income tax treaty in effect with the United States For a direct account holder that is an entity: cc) the withholding agent does not know or have reason to know that the entity is a flow-through entity; and dd) the withholding agent has in its possession, or obtains, documentation that substantiates that the entity is actually organized or created under the laws of a foreign country or the account is maintained at an office of the withholding agent outside the United States and the withholding agent is required to report annually a payment to the direct account holder on a tax information statement that is filed with the tax authority of the country in which the office is located and that country has an income tax treaty in effect with the United States. For a withholding certificate provided for an offshore account: ee) where the direct account holder has standing instructions directing the withholding agent to pay amounts from its account to an address or an account maintained in the United States, a beneficial owner withholding certificate for such account is generally treated as unreliable or incorrect. However, the withholding agent may treat the direct account holder as a foreign person if the direct account holder provides a reasonable explanation in writing that supports its foreign status. iii. For a beneficial owner withholding certificate provided to claim a reduced rate of withholding under an income tax treaty, if: 5a) the permanent residence address on the withholding certificate is not in the country whose treaty is invoked, or the direct account holder notifies the withholding agent of a new permanent residence address that is not in the treaty country; Exceptions: However, a withholding agent may grant treaty relief if -- aa) the direct account holder provides a reasonable explanation for the permanent residence address outside the treaty country (e.g., the address is the address of a branch of the beneficial owner located outside the treaty country in which the entity is resident); or bb) the withholding agent has in its possession, or obtains, documentary evidence that establishes residency in a treaty country. b) the permanent residence address on the withholding certificate is in the applicable treaty country, but the withholding certificate contains a mailing address outside the treaty country or the withholding agent has a mailing address as part of its account information that is outside the treaty country. c) a mailing address that is a P.O. box, an in-care-of address, or address at a financial institution (if the financial institution is not the beneficial owner) shall not preclude a withholding agent from treating the direct account holder as a resident of a treaty country if such address is in the treaty country. Exceptions: if a withholding agent has a mailing address (whether or not contained in the withholding certificate) outside the applicable treaty country, the withholding agent still may treat a direct account holder as a resident of an applicable treaty country if -- aa) the withholding agent has in its possession, or obtains, additional documentation supporting the direct account holder's claim of residence in the applicable treaty country (and the additional documentation does not contain an address outside the treaty country); bb) the withholding agent has in its possession, or obtains, documentation that establishes that the direct account holder is an entity organized in a treaty country (or an entity managed and controlled in a treaty country, if the applicable treaty so requires); cc) the withholding agent knows that the address outside the applicable treaty country (other than a P.O. box or an in-care-of address) is a branch of a bank or insurance company that is a resident of the applicable treaty country; or 6dd) the withholding agent obtains a written statement from the account holder that reasonably establishes entitlement to treaty benefits. d) the direct account holder has standing instructions for the withholding agent to pay amounts from its account to an address or an account outside of the treaty country, unless the direct account holder provides a reasonable explanation in writing establishing the direct account holder's residence in the applicable treaty country. iv. For documentary evidence generally, if: a) the documentary evidence provided does not reasonably establish the identity of the person presenting the documentary evidence. Example: Documentary evidence is not valid

if it is provided in person by a direct account holder that is a natural person and the photograph or signature on the documentary evidence, if any, does not match the appearance or signature of the person presenting the document. b) a withholding agent shall not rely on documentary evidence to reduce the rate of withholding that would otherwise apply under the “presumption rules” if – aa) the documentary evidence contains information that is inconsistent with the direct account holder’s claim of a reduced rate of withholding; bb) the withholding agent has other account information that is inconsistent with the direct account holder’s claim of a reduced rate of withholding; or cc) the documentary evidence lacks information necessary to establish a reduced rate of withholding. v. For documentary evidence used to establish foreign status, if: a) for documentary evidence provided by an account holder after December 31, 2000, the only mailing or residence address that is available to the withholding agent is an address at a financial institution (unless the financial institution is the beneficial owner of the income), an in-care-of-address, or a P.O. box. In this case, the withholding agent must obtain additional documentation that is sufficient to establish the direct account holder’s status as a foreign person. b) for documentary evidence provided by an account holder before January 1, 2001, the withholding agent has actual knowledge that the direct account holder is a US person or if it has a mailing or residence address for the direct account holder in the United States. However, see paragraph (c) below for an exception to this rule. c) the withholding agent has a mailing or residence address (whether or not part of the documentation) for the direct account holder in the United States or if the direct account holder notifies the withholding agent of a new address in the United States. Exceptions: In this case, a withholding agent may still treat documentary evidence as establishing the account holder’s foreign status if the following conditions exist: For a direct account holder that is an individual, if: aa) the withholding agent has in its possession, or obtains, additional documentary evidence (that does not contain a US address) supporting the claim of foreign status and a reasonable explanation in writing supporting the account holder’s foreign status; bb) the withholding agent has in its possession, or obtains, a valid withholding certificate on Form W-8 and the Form W-8 contains a permanent residence address outside the United States and a mailing address outside the United States (or if a mailing address is inside the United States, the direct account holder provides a reasonable explanation in writing supporting the direct account holder’s foreign status); or cc) the account is maintained at an office of the withholding agent outside the United States and the withholding agent is required to report annually a payment to the direct account holder on a tax information statement that is filed with the tax authority of the country in which the office is located and that country has an income tax treaty in effect with the United States. For a direct account holder that is an entity (other than a flow-through entity): dd) the withholding agent has in its possession, or obtains, documentation that substantiates that the entity is actually organized or created under the laws of a foreign country; ee) the withholding agent obtains a valid withholding certificate on Form W-8 and the Form W-8 contains a permanent residence address outside the United States (or if a mailing address is inside the United States the direct account holder provides additional documentary evidence sufficient to establish the direct account holder’s foreign status); or ff) the account is maintained an office of the withholding agent outside the United States and the withholding agent is required to report annually a payment to the direct account holder on a tax information statement that is filed with the tax authority of the country in which the office is located and that country has an income tax treaty in effect with the United States. d) the direct account holder has standing instructions directing the withholding agent to pay amounts from its account to an address or an account maintained in the United States. The withholding agent may treat the direct account holder as a foreign person, however, if the account holder provides a reasonable explanation in writing that supports its foreign

status. vi. For documentary evidence provided to support a claim of a reduced rate of withholding under an income tax treaty, if: a) the withholding agent has a mailing or residence address for the direct account holder (whether or not on the documentary evidence) that is outside the applicable treaty country, or the only address that the withholding agent has (whether inside or outside the applicable treaty country) is a P.O. box, an in-care-of address, or the address of a financial institution (if the financial institution is not the beneficial owner). Exceptions: A withholding agent may still treat a direct account holder as a resident of an applicable treaty country if the withholding agent – aa) has in its possession, or obtains, additional documentary evidence supporting the direct account holder's claim of residence in the applicable treaty country (and the documentary evidence does not contain an address outside the applicable treaty country, a P.O. box, an in-care-of address, or the address of a financial institution); bb) has in its possession, or obtains, documentary evidence establishing that the direct account holder is an entity organized in a treaty country (or an entity managed and controlled in a treaty country, if the applicable treaty so requires); or cc) obtains a valid withholding certificate on Form W-8 that contains a permanent residence address and a mailing address in the applicable treaty country. b) the direct account holder has standing instructions directing the withholding agent to pay amounts from its account to an address or an account maintained outside the treaty country unless the direct account holder provides a reasonable explanation, in writing, establishing the direct account holder's residence in the applicable treaty country. b. Actions to be taken by withholding agent with respect to unreliable documentation If a direct account holder has provided documentation that is unreliable or incorrect under the above rules, the withholding agent may require new documentation. Alternatively, the withholding agent may rely on the documentation originally provided if the above rules permit such reliance based on additional statements and documentation. c. Limits on reason to know – indirect account holders A RIC or other financial institution that receives documentation from a payee through a “non-qualified” intermediary, a flow-through entity or certain US branches with respect to payments from publicly-traded securities (including RIC shares) has reason to know that such documentation is unreliable or incorrect if a reasonably prudent person in the position of a withholding agent would question the claims made. At a minimum, the withholding agent must comply with the following rules: i. The withholding agent must review the information provided by the intermediary on its “withholding statement” and may not rely on information in the withholding statement to the extent that such information does not support the claims made for any payee. Example: A withholding agent generally may not treat a payee as a foreign person if an address in the United States is provided for such payee and may not treat a person as a resident of a country with which the United States has an income tax treaty if the address for that person is outside the applicable treaty country. But, the withholding agent may treat a payee as a foreign person or as a resident of a treaty country if a reasonable explanation is provided, in writing, by the intermediary supporting the payee's foreign status or residency in the treaty country. ii. The withholding agent must review each withholding certificate under the rules, as described above, for direct account holders claiming foreign and/or treaty status. The withholding agent must also verify that the information on each withholding certificate is consistent with the information on the “withholding statement” to be provided by the intermediary. In the event of a discrepancy, the withholding agent may choose to rely on the withholding certificate, if valid, and instruct the intermediary to correct its withholding statement or to apply the “presumption rules” to the portion of the payment that is allocable to the payee who provided the related withholding certificate. iii. A withholding agent that receives a withholding certificate before December 31, 2001 is not required to review the information on the withholding certificate or to determine if such information is consistent with the intermediary's withholding statement until December 31,

2001. iv. A withholding agent may withhold and report in accordance with the intermediary's withholding statement until December 31, 2001, unless the withholding agent has actually performed verification procedures and determined that the withholding statement is inaccurate with respect to a particular payee. v. The withholding agent must review documentary evidence provided by a non-qualified intermediary, flow-through entity, or certain US branches to determine that there is no obvious indication that the payee is a US "non-exempt" recipient or that the documentary evidence does not establish the identity of the person who provided the documentation (i.e., the documentary evidence does not appear to be an identification document).

2. Validity Period Under the final regulations, documentary evidence now will remain valid until the earlier of the last day of the third calendar year following the year in which the documentary evidence is provided to the withholding agent or the day that a change in circumstances occurs that makes any information on the certificate incorrect. Under the prior rules, the measurement period began from the time the documentary evidence was "created." In addition, a Form W-8 provided by a foreign simple trust or foreign grantor trust for purposes of transmitting withholding certificates or documentary evidence will now have an indefinite validity period, barring any changes that would make the information on the Form W-8 no longer correct.

3. Taxpayer Identification Number ("TIN") Requirements

a. Foreign trusts The final regulations only require foreign grantor trusts with five or fewer owners to provide a TIN on withholding certificates. Other foreign trusts are no longer subject to a TIN requirement.

b. Non-withholding foreign partnerships The final regulations clarify that a non-withholding foreign partnership is not required to provide a TIN on withholding certificates used to transmit documentation and information relating to its partners.

c. Certified TIN procedure eliminated The final regulations no longer require a foreign person to obtain a "certified" TIN from the IRS in order to claim treaty benefits on Form W-8. The IRS reserves the authority, however, to issue further guidance on the requirements that a treaty claimant must follow to establish entitlement to treaty benefits.

11 4. Grace Period Rule Under the "grace period" rule, a withholding agent may choose to treat an account holder as foreign and, based upon a faxed copy of a Form W-8, to apply a reduced rate of withholding under an income tax treaty. The final regulations clarify that a US withholding agent is permitted to apply this rule to payees that are presumed to be either US or foreign. In addition, the final regulations generally change the duration of the rule to the earlier of 90 days or the date on which documentation is provided by the payee. The grace period is no longer required to terminate at the end of any calendar year.

5. Broker-held Forms W-8 or Other Documentation A special rule applies to allow a withholding agent to rely on the certification of a broker acting as the agent of a beneficial owner if the broker holds a valid withholding certificate or other documentation for that beneficial owner.

a. Applies to US brokers and "readily-tradable" instruments only The final regulations limit the above rule for broker-held Forms W-8 or other documentation to US brokers. As redrafted, the rule permits a US broker that is acting as an introducing or corresponding broker to provide a clearing broker with a certification that it holds a valid withholding certificate or other appropriate documentation for a beneficial owner. In addition, the rule has been limited to certifications with respect to "readily-tradable" instruments, as is the case with the mirror rule for broker-held Forms W-9.

b. Unrelated withholding agents may now use a common information system In general, each withholding agent that makes a payment to a beneficial owner must obtain a separate withholding certificate for such owner. In addition, a withholding agent that is a financial institution must obtain withholding certificates or other appropriate documentation on an account-by-account basis from its customers. However, a withholding agent may rely on a withholding certificate held at another branch of the same withholding agent or of a person related to the withholding agent, provided there is a system in place that allows the withholding agent to access data regarding the

withholding certificate and to transmit data affecting the validity of the documentation into the system. The final regulations now allow related or unrelated withholding agents to utilize such a common information system.<sup>6</sup>

### Withholding Certificate Transition Issues

Certain of the changes in the final regulations will require revisions to the instructions to the Forms W-8 and, in some cases, certain minor changes to the Forms W-8 themselves. Under the final regulations, withholding agents may rely on the Forms W-8 currently in effect. However, withholding agents should take into account that Form W-8IMY and its instructions do not reflect the new “withholding statement” requirements for intermediaries contained in the final regulations.

### B. Electronic Transmission of Forms W-8

In October 1997, the IRS issued Prop. Treas. Reg. 1.1441-1 providing for the electronic transmission of Forms W-8 from direct account holders. These regulations relating to the electronic submission of Forms W-8 from direct account holders are now effective, beginning January 1, 2000.

#### 1. Electronic System Design

Under the final regulations, the electronic system must ensure that the information received is the information sent, and must document all occasions of user access that result in the submission, renewal or modification of a Form W-8. In addition, the design and operation of the electronic system, including access procedures, must make it reasonably certain that the person accessing the system and furnishing Form W-8 is the person named in the Form W-8.

#### 2. Content of Electronic Transmission

The electronic transmission must provide the withholding agent or payor with exactly the same information as the paper Form W-8 and must contain an electronic signature by the person whose name is on the Form W-8. All electronic signatures must be provided under penalties of perjury.

#### 3. Perjury Statement

The perjury statement must contain the language that appears on the paper Form W-8. The instructions and language of the perjury statement must immediately follow the person’s certifying statements and immediately precede the person’s electronic signature.

#### 4. Electronic Signature

The act of the electronic signature must be effected by the person whose name is on the electronic Form W-8. The signature must “authenticate” and “verify” the submission in the same manner as a paper Form W-8. An electronic signature can be in any form that satisfies the foregoing requirements. The electronic signature must be the final entry in the person’s Form W-8 submission.

#### 5. Requests for Electronic Form W-8 Data

Upon request by the IRS during an examination, the withholding agent must supply a hard copy of the electronic Form W-8 and a statement that, to the best of the withholding agent’s knowledge, the electronic Form W-8 was filed by the person whose name is on the form. The hard copy of the electronic Form W-8 must provide exactly the same information as, but need not be identical to, the paper Form W-8.

### 2 See Institute Memorandum to Operations Members No. 22-98, Pension Members No. 55-98, Pension Operations Advisory Committee No. 39-98, Tax Members No. 28-98, and Transfer Agent Advisory Committee No. 53-98, dated August 28, 1998.

### 13 6. Comments Solicited on Electronic Transmission of Forms W-8 Through Intermediaries

The preamble to the final regulations notes that while IRS and Treasury recognize the benefits of allowing the electronic transmission of Forms W-8 through one or more intermediaries, they will continue to solicit comments regarding the requirements necessary to ensure the integrity, accuracy, and reliability of electronically transmitted forms through tiers of intermediaries.

### 7. Coordination with 90-day Grace Period Rule

Under the final regulations, a facsimile copy of a Form W-8 may only be relied upon under the “grace period” rule for a maximum of 90 days. It is unclear whether a facsimile copy of a Form W-8 also qualifies as an “electronic transmission” under the final regulations. We note that the “Instructions for the Requestor of Form W-9” states that payers “may establish a system for payees to submit Forms W-9 electronically, including by fax.” The underlying authority for those instructions, Announcement 98-27, provides conditions for the electronic transmission of Forms W-9 that are essentially identical to those provided in the final regulations for the electronic transmission of Forms W-8.

### 2 C. Qualified Intermediaries

In January 2000, the IRS released

Revenue Procedure 2000-12 containing the application procedures for becoming a “qualified intermediary” or a “QI” and the final model QI withholding agreement. The final regulations generally incorporate the withholding and information reporting rules for QIs, as described in Revenue Procedure 2000-12. Changes adopted by the final regulations with respect to QIs include the following:

1. Use of a Single Withholding Rate Pool A QI and a US withholding agent are permitted to mutually agree to use a single withholding rate pool for US non-exempt recipients for whom no backup withholding is required (i.e., the QI has provided the withholding agent with Forms W-9 for such recipients) and a single withholding rate pool for US non-exempt recipients that are subject to back-up withholding. This option is only available to QIs and not to other types of intermediaries; and Note: If such withholding rate pools are used, the QI must provide the withholding agent no later than January 15 information allocating the reportable payments to each US non-exempt recipient account holder. Failure to provide this allocation information on a timely basis may result in penalties imposed on the QI and termination of the QI agreement.
- 14 2. Form 1099 Reporting and Backup Withholding Subject to agreement with the IRS, any QI may now assume Form 1099 reporting and backup withholding responsibility with respect to US recipients.

D. Non-Qualified Intermediary and Flow-through Withholding Certificates The final regulations generally conform the withholding tax treatment of non-qualified intermediaries (“NQIs”), non-withholding foreign partnerships (“NFPs”), foreign simple trusts and foreign grantor trusts. For this purpose, a “flow-through withholding certificate” is defined as a withholding certificate on Form W-8 furnished by a NFP, foreign simple trust or foreign grantor trust presenting claims on behalf of its interest holders for a reduced rate of withholding under an income tax treaty. A comparable withholding certificate provided by a NQI is called a NQI withholding certificate.

1. Withholding Certificates Under the final regulations, payee documentation need only be associated with, rather than attached to, a NQI, flow-through or US branch certificate to eliminate the need for a new withholding certificate each time payee documentation is provided to the withholding agent. The regulations do not provide specific requirements for “associating” documentation. Any reasonable method may be used to associate documentation with its intermediary withholding certificate.
2. Withholding Statement The final regulations provide that a NQI must associate its NQI withholding certificate with a “withholding statement” that includes the information a withholding agent needs to allocate a payment to each payee on whose behalf the NQI acts and to report the payment. The withholding statement must be updated as often as required to keep the information therein correct prior to each subsequent payment. The withholding statement may be provided in any manner in which the withholding agent and NQI agree, including electronically. For each payee, the withholding statement must provide the payee’s name, address, country of residence, TIN (if any), the payee’s recipient type for Form 1042-S reporting, applicable rate of withholding, the type of withholding exception applied (if any) and the name of any other intermediary or flow-through entity from whom the payee directly receives the income. In the case of a claim of treaty benefits, the withholding statement must also state whether the “limitation on benefits” and section 894 statements have been provided.
3. Bank Secrecy Issues Unlike a QI, a NQI must provide information to the withholding agent regarding US non-exempt recipients irrespective of any local laws that prohibit disclosure of an account holder or account information. To the extent payee information is not provided, whether for a US non-exempt recipient or any other payee, the final regulations expressly state that the withholding agent must withhold under the “presumption rules.”
4. Withholding Obligations and Penalties A NQI remains liable for any tax not withheld by the withholding agent. In addition, unless the NQI itself files information returns, the NQI remains liable for penalties imposed for failure to file such returns.
5. Alternative Reporting Procedure 15 Given the practical difficulties of providing payment allocation information for each payee in advance



of each payment, the final regulations provide an alternative reporting procedure that allows a NQI to provide information allocating a payment of a reportable amount to each payee after the payment. Note that this reporting procedure is optional and must be agreed to by both the NQI and the withholding agent. Also note that this reporting procedure may not be used for payments that are allocable to US non-exempt recipients. In place of a payee-by-payee allocation, the NQI under the alternative reporting procedure must provide the withholding agent with withholding information by “withholding rate pools.” The NQI withholding statement must contain all other information, as described above. Each payee listed in the withholding statement must be assigned to a withholding rate pool. A withholding rate pool is a payment of a single type of income, determined in accordance with the categories of income used to file Form 1042-S, that is subject to a single rate of withholding. A withholding rate pool may be established by any reasonable method to which the NQI and the withholding agent agree (e.g., by establishing a separate account for a single withholding rate pool, or by dividing a payment made to a single account into portions allocable to each withholding rate pool). The NQI must provide the withholding agent with sufficient information to allocate the income in each withholding rate pool to each payee (including US exempt recipients) within the pool no later than January 31 of the year following the year of payment. If a NQI fails to provide allocation information by January 31 for any withholding rate pool, a withholding agent essentially cannot apply the alternative procedures with respect to payments to that NQI for any future payments or taxable years. A NQI may cure any failure to provide allocation information by providing the required allocation information to the withholding agent no later than February 14 following the calendar year of payment. If a NQI fails to provide allocation information by February 14 following the year of payment for a withholding rate pool, the withholding agent must file Forms 1042-S for each payee in that pool (other than US exempt recipients) in the prior calendar year by pro rating the payment to each payee (including US exempt recipients) listed in the withholding statement for the withholding rate pool. A NQI that fails to meet the February 14 deadline, rather than the withholding agent, is liable for any tax not withheld by the withholding agent, interest on any underwithheld tax, and any applicable penalties. The IRS also may notify a withholding agent that the alternative reporting procedures are not applicable to a specified NQI.

6. Form 1042-S reporting Under the final regulations, a US withholding agent must prepare a Form 1042-S for each “recipient” of an amount subject to withholding. For this purpose, a recipient generally does not include a NQI, a disregarded entity, a flow-through entity and a US branch not treated as a US person. This means that amounts paid to such entities must be reported as paid to the persons or “recipients” on whose behalf the entity acts or the interest holders in the entity. We understand that the Form 1042-S will be revised to require that the US withholding agent report not only the recipient of the amount subject to withholding, but also the intermediary acting on behalf of that recipient.

7. Undocumented Payees of a NQI In the absence of valid and reliable documentation for a specific payee, as described above, the final regulations provide that a withholding agent must treat payments to such payee as made to an undocumented foreign recipient and subject to 30 percent withholding.

E. Foreign Trusts and Estates

16 1. Foreign Complex Trusts and Foreign Estates The final regulations now treat a foreign complex trust or foreign estate as the beneficial owner of income paid to such entities. This means that a foreign complex trust or foreign estate will file a Form W-8BEN on its own behalf, rather than a Form W-8IMY.

2. Foreign Simple Trusts and Foreign Grantor Trusts The final regulations retain the presumption that the beneficial owners of a payment to a foreign simple trust are the beneficiaries of the trust. Similarly, the owners of a foreign grantor trust are the beneficial owners of income paid to that entity.

3. Presumption of Status for Foreign Trusts Under the final regulations, if a payee is presumed to be a foreign trust, but its status as a complex, simple or grantor trust is

unknown, it will be treated as a complex trust. If the trust is known to be a foreign simple or a foreign grantor trust, its beneficiaries or owners will generally be presumed to be foreign with respect to payments of amounts subject to withholding.

**F. IRAs and Individual Retirement Annuities**

**1. Change to US Status Presumption Rule** The final regulations expand the presumption rule applicable to pensions and annuities to individual retirement accounts (“IRAs”) and individual retirement annuities. Under this rule, as amended, a payment from a trust described in section 401(a), an annuity plan described in section 403(a), a payment with respect to an annuity, custodial account or retirement income described in section 403(b), or a payment from an IRA or individual retirement annuity described in section 408 that a withholding agent cannot reliably associate with documentation is presumed made to a US person only if:

- a. the withholding agent has a record of a social security number for the payee; and
- b. the withholding agent relies on a mailing address used for purposes of information reporting or otherwise communicating with the payee that is:
  - i. an address in the United States; or
  - ii. an address in a foreign country with which the United States has an income tax treaty in effect and the treaty provides that the payee, if an individual resident in that country, would be entitled to an exemption from US tax on amounts in this section.

**2. Nonresident Alien Withholding versus Section 3405 Withholding** The final regulations clarify that payments to a nonresident alien individual from any trust described in section 401(a), any annuity plan described in section 403(a), any annuity, custodial account or retirement income account described in section 403(b), or an IRA or individual retirement annuity described in section 408 are generally subject to withholding under section 1441, and not under section 3405 or section 3406.

**G. Documentary Evidence for an Offshore Account**

**17** If a withholding agent can reliably associate a payment with documentary evidence (i.e., documentation other than a withholding certificate) from which it cannot determine an entity’s classification, the withholding agent generally may treat such entity as a corporation. However, a withholding agent may not treat an entity as a corporation if it knows, or should know, that the entity is a flow-through entity or intermediary. An entity that is presumed to be a foreign corporation under this new rule cannot be treated as the beneficial owner entitled to a reduced rate of withholding to the extent the documentary evidence indicates that it is a bank, broker, custodian, intermediary or other agent unless the entity provides a statement that it is the beneficial owner of the income. Finally, this presumption does not necessarily mean that treaty benefits will be granted to the entity; such benefits will depend upon the terms of the treaty and the requirements of section 894.

**H. New Definitions** The final regulations consolidate and expand the defined terms used in the regulations. New definitions, or cross-references to existing definitions, have been provided for a number of terms, including beneficial owner, payee, intermediary, NQI, QI, withholding certificate and documentary evidence. It is important to note, however, that the definition of the term “beneficial owner” does not apply in cases where a reduced rate of withholding is being claimed under an income tax treaty. Rather, a person who is a beneficial owner of an item of income for purposes of the nonresident alien regulations may not necessarily be the beneficial owner of the income for purposes of an income tax treaty.

**Example:** A collective investment vehicle in a foreign jurisdiction may be a corporation under general US tax law principles and, thus, a “beneficial owner” for 18 purposes of eliminating backup withholding on gross proceeds. However, that same entity may or may not be a “resident” entitled to a reduced rate of withholding under the terms of an applicable income tax treaty and the requirements of section 894.

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should not be considered a substitute for, legal advice.