

Withholding of Tax on Nonresident Aliens and Foreign Entities

The Silver State CPA, May 2010

Generally, a foreign person is subject to U.S. tax on its U.S. source income. Most types of U.S. source income received by a foreign person are subject to U.S. tax of 30%. A reduced rate, including exemption, may apply if there is a tax treaty between the foreign person's country of residence and the United States. Payments to foreign persons, including nonresident alien individuals, foreign entities and governments, may be subject to Nonresident Alien (NRA) withholding. A withholding agent is the person responsible for withholding on payments made to foreign person. A withholding agent may apply a reduced rate of withholding (including an exemption from withholding) if it can reliably associate the payment with documentation from a beneficial owner that is a foreign person entitled to a reduce rate of withholding. You are considered a withholding agent if you are a U.S. or foreign person that has control, receipt, custody, disposal, or payment of any item of income of a foreign person that is subject to withholding. A withholding agent may be an individual, corporation, or partnership.

Withholding Requirements

Withholding is required at the time a payment is made to the foreign person. Withholding must be made on the gross income and cannot be reduced by any deductions. The withholding agent is personally liable for any tax required to be withheld. This liability is independent of the tax liability of the foreign person to whom the payment is made. Both the withholding agent and payee are subject to interest and penalties in addition to the tax liability when fail to comply with withholding requirements.

Deposits required for any period in one calendar year must be made separately from a deposit for another calendar year. A deposit of this tax must also be made separately from a deposit of other types of tax.

Deposit Requirements

The frequency of deposit must be made in accordance with the following rules:

1. If at the end of the calendar year the total amount of undeposited taxes is less than \$200, deposits may be made with Form 1042 or deposit the entire amount by the due date of Form 1042.
2. If at the end of the month the total amount of undeposited taxes is \$200 or more but less than \$2,000, deposit must be made within 15 days after the end of the month. If a deposit of \$2,000 or more is made during the month (except December), carry over any end of the month balance of less than \$2,000 to the next month. If a deposit of \$2,000 or more is made during December, any end of December balance of less than \$2,000 should be remitted with Form 1042 by the due date.
3. If at the end of any quarter monthly period the total amount of undeposited taxes is \$2,000 or more, it is mandatory to deposit the taxes within three banking days after the end of the quarter monthly period. (A quarter monthly period ends on the 7th, 15th and 22nd, and last day of the month.)

Depositing at least 90% of the actual tax liability is considered to meet the depositing requirement under rule (3). If deposit is not made electronically, Form 8109 must be submitted with the payment.

Returns Required by Withholding Agent

Every withholding agent, whether U.S. or foreign, must file Forms 1042 Annual Withholding Tax Return for U.S. Source Income of Foreign Persons and Form 1042 S Foreign Person's U.S. Source income Subject to Withholding to report payments of amounts subject to NRA withholding. Forms 1042 and

1042 S must be filed by March 15 of the year following the calendar year in which the income subject to reporting was paid. If March 15 falls on a Saturday, Sunday, or legal holiday, the due date is the next business day. A separate Form 1042 S is required for each recipient of income to whom the payments are made during the preceding calendar year. A separate Form 1042 S is also required for each type of income paid to the same recipient. If Form 1042 S is filed on paper, it must be filed with Form 1042 T. An automatic 6 month extension of time to file Form 1042 can be obtained by filing Form 7004, Application for Automatic Extension of Time to File Certain Business Income Tax, Information, and Other Returns. An automatic 30 day extension to file Form 1042 S will be granted by filing Form 8809, Application for Extension of Time to File Information Returns. Forms 7004 and 8809 must be filed no later than the original due date of Forms 1042 and 1042 S respectively.

Forms Required from Payee

Form W 8BEN, Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding must be provided to the withholding agent or payer if the foreign person is the beneficial owner of an amount subject to withholding. Form W 8BEN is not required if the foreign person provides Form 8233, Exemption from Withholding on Compensation for Independent Personal Services of Nonresident Alien Individual.

The foreign person must provide Form 8233 to the Withholding Agent to claim a tax treaty withholding exemption for both compensation for personal services and noncompensatory scholarship or fellowship income received from same withholding agent. The Withholding Agent must sign the certification in Part IV of Form 8233 after review and satisfy that the exemption from withholding is warranted. The withholding agent will need three copies of the completed Form 8233. One copy must return back to the nonresident alien individual. Keep a copy for personal record and forward one copy to:

**Internal Revenue Service
International Section
P.O. Box 920**

The withholding agent must generally request that the payee provide its U.S. taxpayer identification number (TIN) on forms, statements, and other tax documents. If the individual does not have, and is not eligible for, an SSN, he or she must apply for an ITIN by using Form W 7. Any payee other than an individual and any individual who is an employer must have an employer identification number (EIN). Use Form SS 4 to get an EIN.