

Global IRW Newsbriefs

Information reporting and withholding (IRW)

April 27, 2012

IRS issues final guidance extending information reporting of U.S. bank deposit interest paid to non-resident aliens

Executive Summary

On April 17, 2012, the Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) released final regulations that expand U.S. tax information reporting requirements to include bank deposit interest paid to nonresident alien (NRA) individuals resident in certain countries. The final regulations adopted the requirement originally established in the 2002 proposed regulations by establishing that information reporting is limited to U.S. bank deposit interest paid to an NRA that is a resident of one of the countries with which the U.S. has a tax information exchange agreement. Currently, reporting of U.S. bank deposit interest is required only to a NRA individual who is resident in Canada. The final regulations apply to U.S. bank deposit interest paid on or after January 1, 2013.

A full copy of TD 9584 which contains the preamble to the final regulations and the amendments to regulations under Internal Revenue Code sections 3406 and 6049 can be found [here](#).

PwC Observation: *The final regulations will affect commercial banks, savings institutions, credit unions, securities brokerages, and insurance companies that maintain deposit accounts for non-resident alien individuals. In addition, U.S. branches of non-U.S. financial institutions*



must also report this interest if the deposit accounts are maintained in the U.S.

Reporting Requirement

Under the final regulations, U.S. tax information reporting is required for interest earned on deposits maintained at an office within the U.S. that in the calendar year aggregates to \$10 or more and is paid to an NRA individual. Payors will be required to report the interest to the IRS and to the NRA on Form 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*. This reporting is only required if the NRA is resident of certain countries with which the U.S. has in force an information exchange agreement (e.g., an agreement to provide, as well as receive, information). A listing of countries with agreements with the U.S. is provided in [Revenue Procedure 2012-24](#) which was issued simultaneously with the final regulations. Payors are permitted to report interest paid to residents of any country, instead of only those resident in the countries specified in the Revenue Procedure.

PwC Observation: *In allowing for the reporting of deposit interest on all NRAs, the IRS is addressing burdens that may be incurred in connection with selecting which accounts to report. Such reporting does not necessarily mean that the information collected will be reported to a foreign jurisdiction.*

The final regulations did eliminate the requirement in the 2011 proposed regulations that required financial institutions to include information in the statement furnished to the NRA informing them that the information may be furnished to the government where the recipient resides. The final regulation also clarified that a payor or middleman may rely on the permanent residence address provided on a valid Form W-8BEN, *Beneficial Owner Certificate of Foreign Status for U.S. Tax Withholding*, for purposes of determining the country of residence of an NRA to whom reportable interest is paid unless the payor or middleman knows or has reason to know that the documentation is unreliable or incorrect. Form 1042-S must be either delivered in person or by first class mail to the NRA account holder.

PwC Observation: *Relying on the permanent residence address furnished on a valid Form W-8BEN could be a useful safe harbor for many payors. However, some payors might have difficulty implementing this safe harbor if they do not currently store a customer's permanent residence address in their computerized account systems.*

Withholding

Backup withholding on U.S. source bank deposit interest is not required if paid to a properly documented account. However, if an account is not properly documented with a Form W-9, *Request for Taxpayer Identification Number and Certification* or a Form W-8BEN, then a payor must apply the presumption rules to determine the account's status. If the presumption rules lead to a conclusion that the account holder is a U.S. non-exempt recipient (generally individuals, partnerships, LLC among others) then backup withholding at 28% is required. Deposit interest remains exempt from 30% NRA withholding.

FATCA Implications

The preamble to the final regulations note that a non-U.S. jurisdiction's willingness to share information with the IRS under the provisions of the Hiring Incentives to Restore Employment Act of 2010 (which includes provisions commonly known as the

Foreign Account Tax Compliance Act (FATCA)), depends in large part on the ability of the U.S. to reciprocate and provide information to that jurisdiction permitting it to combat offshore evasion by its own residents.

PwC Observations: *Although the preamble to the final regulations indicates that the regulations are intended to facilitate the implementation of FATCA, the expanded information reporting requirement for U.S. deposit interest only applies with respect to payments made to NRAs and it does not apply to non-U.S. entities which are subject to FATCA information reporting. These rules also do not require the reporting of account balances which has been identified as a critical component to the FATCA reporting regime.*

FATCA requirements encourage foreign governments to overcome legal restraints to reporting information to the U.S. by their resident financial institutions. The final regulations are intended to facilitate intergovernmental cooperation by improving the IRS' ability to reciprocate in exchanging information. In addition, the final regulations are intended to enhance U.S. tax compliance by reducing the possibility of tax evasion by U.S. taxpayers who falsely claim to be NRAs.

PwC Observations: *The final regulations are in line with the joint statement released by the governments of the United States, France, Germany, Italy, Spain and the United Kingdom that was released with the proposed FATCA regulations on February 8, 2012, and emphasised that the U.S. is willing to reciprocate by automatically collecting and exchanging information on accounts maintained by U.S. financial institutions for residents of those countries.*

Confidentiality of Information

The preamble to the final regulations addresses several comments to the proposed regulations released in 2011 (that withdrew the 2002 proposed regulations) by addressing confidentiality issues and the potential for improper use of tax information. In particular, there were concerns raised that reporting of bank deposit interest could affect an NRA's decision about where to locate their investments and savings. In response to these comments, the Treasury and IRS indicated they believe there are significant legal limitations and administrative safeguards in place governing the exchange of tax information to protect the confidentiality and use of the information. For example:

- the information reported will only be exchanged with foreign governments that have information exchange agreements with the United States;
- the IRS is not obligated to exchange the information if there is concern regarding the use of the information even if an information exchange agreement exists; and
- the information collected is considered return information subject to the confidentiality rules under Internal Revenue Code Section 6103.

All of the information exchange agreements to which the U.S. is a party require that the information exchanged under the agreement be treated and protected as secret by the foreign government. The information exchange agreements also prohibit foreign governments from using the information exchanged for any purpose other than for the administration, collection, and enforcement of taxes covered by the agreement. Accordingly, the IRS will not exchange return information with a country that does

not impose tax on the income being reported since the information could not be used for the enforcement of tax laws within that country. Also, in situations when the IRS might exchange information with another jurisdiction, the IRS will evaluate the requesting country's current practices with respect to information confidentiality and also requires the requesting country to explain the intended use of the information.

Automatic Exchange of Information

The preamble to the final regulations also indicates that the IRS may exchange certain information on an automatic basis. However, they will not enter into an automatic exchange relationship with a jurisdiction unless the country's policies and practices have been reviewed and a determination is made that an automatic exchange relationship is appropriate.

Revenue Procedure 2012-24 identifies the countries with which the Treasury and IRS have determined it is appropriate to have an automatic exchange, which only includes Canada at this time. The identification of a country as having an information exchange agreement with the United States does not mean that the information will automatically be exchanged with the country.

Administrative Burden

The preamble to the final regulation also address comments related to the potential of additional administrative burdens to U.S. financial institutions. The IRS indicated that U.S. financial institutions are already required to report and withhold with respect to depositors who are U.S. citizens and resident individuals, and Canadian resident individuals. The IRS believes these institutions have systems to perform the required reporting and potential withholding described in the regulations. Furthermore, NRAs who maintain accounts in the U.S. are already required to complete a Form W-8BEN declaring their non-U.S. status and the country in which they reside. Consequently, the information collection requirements under the final regulations build on existing information reporting and collection systems being used by U.S. financial institutions, and therefore should not result in a significant burden to adapt those systems with respect to NRA depositors resident in countries with which the U.S. has an information exchange agreement. In addition, the final regulations provide that in order to avoid the potential burdens associated with the information reporting requirements, for any year for which the information reporting is required, a payor may elect to report deposit interest paid to all NRAs, instead of only deposit interest paid to those who reside in the specified countries.

PwC Observations: *Banks, savings institutions, credit unions, securities brokerages, and insurance companies that maintain deposit accounts may need to make changes to their information systems to accommodate the new reporting requirements in a short period of time. These changes are in addition to the new requirements associated with FATCA and the new basis reporting requirements which are discussed in previous [Global IRW Newsbriefs](#). Taken together these requirements will result in significant costs and administrative burdens on U.S. banking and other institutions to establish processes and systems to identify, capture, and report the information in a timely manner.*

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