



# IRS Service Team Hot Topics\*

## Reducing Risk: What every multinational company should know about international tax information reporting and withholding

### Do you...

- Pay dividends, interest, or royalties to nonresident foreign persons?
- License technology for use in the U.S. from nonresident foreign persons?
- Pay nonresident foreign persons for services performed in the U.S. (e.g., personal services, commissions, installation of machinery, and board of director fees)?
- Make pension payments to nonresident foreign persons under a U.S. plan?
- Make payments for legal settlements or litigation awards to nonresident foreign persons?
- Pay rent for real property located in the U.S. to nonresident foreign persons?
- Pay insurance proceeds from U.S. sources to nonresident foreign persons?
- Pay sponsorships fees to nonresident foreign persons?
- Have a financial services branch or subsidiary as part of your operations?
- Have a shared services company that makes payments of any type outlined above?

If you answered yes to any or all of these questions and you are not compliant with the international information reporting and withholding requirements, you may be subject to significant tax and penalties during your next audit.

### What the law says

Internal Revenue Code (IRC) sections 1441, 1442, and 1443 provide that nonresident foreign persons are subject to a 30% tax on U.S. source fixed or determinable annual or periodical income (FDAP). The law requires the 30% tax to be withheld from each U.S. source FDAP payment unless a reduced rate of withholding applies pursuant to an income tax treaty or the IRC.

Failure to properly withhold will result in the payor (also known as the withholding agent) being held liable for the 30% tax on U.S. source FDAP payments, plus penalties and interest.

## The issue

The IRS has identified withholding taxes under IRC sections 1441, 1442, and 1443 as an area where multinational companies are often noncompliant. Consequently, the IRS is ramping up efforts to become smarter, more efficient, and more aggressive at recognizing instances of noncompliance. Consider the following:

- Approximately 650 Agents have been trained to better recognize instances of noncompliance in the withholding tax area.
- These Agents are armed with a new audit guide that is now part of the Internal Revenue Manual (IRM) to assure consistent compliance and enforcement in this area.
- In 2006, the IRS concluded the Voluntary Compliance Program (VCP) in which over 400 organizations participated. As a result of the VCP, the IRS knows where to look for errors and knows which companies and industries are more likely to be noncompliant.
- Multinational companies are now required to file income tax returns using the Modernized e-File System ("MeF"). Because MeF must also be used to file international information returns to report intercompany transactions (i.e., Schedule M of Forms 5471 and 5472), agents will be able to more quickly identify noncompliance with withholding rules on U.S. source FDAP intercompany transactions.

## What does this mean to corporations?

Unfortunately, many multinational companies are not aware of their noncompliance with the international information reporting and withholding rules because they have not identified the areas within their company where U.S. source FDAP payments are being made to nonresident foreign persons. One of the primary challenges to compliance is that the corporate departments most susceptible to errors are frequently those out of the direct control and jurisdiction of the tax department.

To name a few:

- Accounts Payable
- Pension
- Treasury
- Corporate Actions

Noncompliant multinationals could be subject to 30% withholding tax on U.S. source FDAP payments, as well as significant interest and penalties. When combined, these amounts can quickly grow to substantial liabilities.

## PwC recommendations

Companies should assess their level of compliance with the international information reporting and withholding rules by performing a "health check" (similar to a mock audit). If deficiencies are found, proactively remediating those areas will drastically reduce exposure for withholding taxes and significant penalties. Although the VCP has concluded, companies can still leverage the benefits of this program in their efforts to come into compliance with the rules. The IRS will work with companies in their remediation efforts and, in most cases, will reduce penalties. To assure compliance on a going forward basis, it is of the utmost importance that companies (1) improve their internal systems and processes, (2) develop and implement new policies and procedures, and (3) better train all personnel responsible for implementing the international information and withholding rules.

## For more information

### Tax

Stuart Finkel (646) 471-0616  
Dominick Dell'Imperio (646) 471-2386  
Candace Ewell (202) 312-7694

### Advisory

Scott Dillman (646) 471-5764  
Regina Aries (617) 530-7631

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