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From COKALA Tax Group

Here is your eBulletin for this week from the world of tax information reporting and tax withholding.

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1. Foreign accounts – More discussion of the new bill in Congress and its potential impact in financial industry transactions and Accounts Payable transactions

The *Foreign Account Tax Compliance Act of 2009*, discussed here last week, is rumored to be on a fast track for passage by Congress by the end of this year because it addresses tax evasion problems that are of high importance to the current Administration and were described in the Treasury Department policy Green Book earlier this year. The more we review and discuss the provisions of the legislation, the more questions arise about its operational impact. (See the text of the bill at <http://finance.senate.gov/sitepages/legislation.htm> where it is the 10-27-09 posting; see the committee staff explanation of its many provisions at <http://www.ict.gov/publications.html?func=select&id=17> where it is number JCX-42-09.) The Act would begin to go into effect in 2010 if it becomes law as presently written. Our comments here pertain primarily to Section I of the Act, covering increased disclosure of beneficial owners of income.

Financial Industry: Payers of U.S.-source interest, OID, dividends, annuities, and other FDAP income to foreign financial institutions (banks and securities and investment entities including those trading in commodities and futures or forward contracts or options), and payers of a broader range of income types to foreign non-financial entities, would be required to impose 30 percent U.S. withholding unless certain new certifications were furnished regarding U.S. ownership of foreign accounts or entities – and these new requirements would be in addition to the terms of any Qualified Intermediary agreement existing between a foreign financial institution and the IRS. If a foreign financial institution was disclosing U.S.-owner information under a special agreement with the IRS, that would suffice instead of certifications to the U.S. payer. Or, if a foreign financial institution elected to perform Form 1099 reporting of its U.S. accountholders to the IRS, that would suffice. But outside of those situations, a U.S. payer to a foreign financial institution would be required to withhold 30 percent unless it obtained the name, address, TIN, account balance or value, and history of receipts/deposits/withdrawals, of each U.S. account holder in that foreign financial institution (except for accounts owned by individual natural persons and aggregating less than \$10,000 across all affiliated members of the institution). “Account” is defined as a depository account, a custodial account, and any equity or debt interest in the foreign financial institution. And, a U.S. payer to a foreign non-financial entity would be required to withhold 30 percent unless it obtained the name, address and TIN of U.S. owners of 10 percent or more of the entity, or a certification that there are no U.S. owners of 10 percent or more. For non-financial entity payments, the new rules would apply to “interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income, if such payment is from sources within the United States, and ... any gross proceeds from the sale of any property of a type which can produce interest or dividends from sources within the United States.” It is also noted that the new rules, if made effective, would apply to items like “portfolio interest” and bank deposit interest as well.

At a minimum, the IRS would need to address issues such as modifications to Forms W-8BEN and W-8IMY, changes in Form 1042-S or perhaps a new 1099 form or procedures for

reporting to the IRS the information obtained from a foreign payee on its U.S. accountholders or 10 percent owners, treatment of a foreign entity that has U.S. effectively connected income, and application in cases of withholding partnerships and U.S. expatriates.

Notional principal contracts: Section V of the Act would establish that notional principal contract payments are payments of U.S.-source dividends if the notional principal contract is directly or indirectly contingent upon, or determined by reference to, the payment of a dividend from sources within the United States. The payments treated as U.S.-source dividends would be the gross amounts used in computing any net amounts transferred to or from the taxpayer. Thus, any dividend-based amount under a swap contract would be treated as a payment, even though any actual payment is a net amount determined in part by other amounts (such as interest or a change in value of the referenced stock).

Accounts Payable: Those who make disbursements through Accounts Payable need to recognize that this new legislation would create new withholding and documentation rules applicable to payments to a “non-financial foreign entity”, which is defined simply as “any foreign entity which is not a financial institution”, and a “foreign entity” is defined as “any entity which is not a United States person”. The new rules would require a new certification that beneficial owners of the income do not have any United States owners of 10 percent or more of the foreign beneficial owner. Or, if the foreign beneficial owner of the income does have U.S. owners at or above the 10 percent level, then the name, address and U.S. Taxpayer Identification Number of those U.S. owners would have to be furnished to the payer. 30 percent withholding would be required if the payer did not receive either the certification of no substantial U.S. owners, or the list of name, address and TIN for each substantial U.S. owner. (However, withholding would max out at 30 percent: If 30 percent withholding was required under these new rules, no additional withholding specified in previously existing portions of I.R.C. Section 1441 would be required.)

These new documentation and withholding rules would apply (on top of the current regime for other certifications on Forms W-8, and irrespective of tax treaty claims) to payments of U.S.-source “interest, original issue discount, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits and income ... and any gross proceeds from the sale of any property of a type which can produce interest or dividends from sources within the United States.” Rents, royalties and payments for services are probably the types of payments to which AP would most frequently have to apply the new rules. We would look for changes in the Forms W-8, possible changes in Form 1042-S, possibly a new Form 1099 to report U.S. substantial owners, and new IRS regulations for guidance.

2. Form 1099-INT – For TY2010 reporting, two new boxes added to the form

The IRS has released a draft of Form 1099-INT, *Interest Income*, for Tax Year 2010 reporting. The draft contains an additional two boxes, 10a and 10b. 10a is designated *Tax credit bond code*; 10b is designated *CUSIP no.* These items of information have not been required on Forms 1099-INT through Tax Year 2009, but for reportable interest payments made in 2010 and beyond, the new boxes provide a place for the alphanumeric identifiers of specific securities and tax credit bond issues if that is what the reportable payment is derived from. No 2010 form instructions are yet available to show whether it is intended that CUSIP and tax credit bond code data will always be required or will be optional. The IRS electronic file format specifications would presumably have to be modified for 2010 to include the additional data. See the 2010 Form 1099-INT draft at <http://www.irs.gov/pub/irs-dft/f1099int--dft.pdf>.

3. Year-end reporting advance preparation – Things to do now

Include these items in your list of tasks to be accomplished before year-end closing, regarding data that will be the basis of your Form 1099 tax compliance:

- Search for reportable payees for which you do not have a Taxpayer Identification Number (a TIN, which means either a Social Security Number or an Employer Identification Number) in your records. If you did not get a TIN for a reportable payee at the time you set up the payee account prior to making a first payment to them, the federal tax regulations require you to ask for the TIN again before December 31 of that year, and again before December 31 of the following year if you still do not have a TIN. Use Form W-9 to solicit the TIN.

- For payees that (1) have not given you a TIN and (2) are reportable on a Form 1099-B, 1099-DIV, 1099-INT, 1099-MISC, 1099-OID, 1099-PATR, or on a W-G where regular gambling withholding has not been applied, verify that these payees are marked in your system as subject to backup withholding – and that you have backup withheld 28 percent of payments made this year, as required by federal tax regulations when the TIN is missing for those types of payments. Also check on payees that appeared on an IRS B Notice and became subject to backup withholding because they did not give you the new Form W-9 or other IRS or SSA documentation that the tax regulations require. If you are backup withholding, remember that backup withholding has its own deposit deadlines (different than payroll tax deposits) and must be identified as a “945” deposit (to keep it separate from “941” payroll tax deposits in IRS records).

- Use the free IRS on-line TIN Matching Program to verify the name-TIN combinations furnished to you by payees. Use of the TIN Matching Program is a routine part of account or vendor setup for many payers, but if that is not the case in your department and you need information about registration and use of the program, please contact us. For name-TIN combinations that return a result code of 2, 3 or 4, you know there is a problem and it is a risk-avoidance practice to solicit a new Form W-9. You are not required to solicit a new W-9 just because you used the TIN Matching Program, but doing so could help you avoid future B Notices and penalty assessments from the IRS.

- If you deducted backup withholding from payments this year, reconcile the amounts deducted with deposits made to the IRS. You may need to work with another department in your organization on this, depending on who makes and monitors tax deposits. A smart move is to request a transcript from the IRS showing liabilities and deposits for Form 945 non-payroll withholding. The appropriate person in your tax department has to order the transcript from the IRS. You want to verify that the non-payroll withholding (reportable to the IRS on Form 945 at the end of January) was not mixed up with Form 941 payroll withholding, and that the IRS credited the 945 withholding deposits on the correct dates.

- Search for payments made from Accounts Payable to employees, and verify, according to the tax rules, whether such payments are (1) not reportable, such as documented expense reimbursements under an accountable plan, or (2) some sort of fringe benefit or undocumented “reimbursement” that must be reported as employee income on a Form W-2. Coordinate with Payroll on W-2 reportable amounts.

- Search for data that suggests a payee marked in your system for Form 1099 reporting might actually be a foreign payee. A tax ID number that is formatted as an EIN and starts with 98- could be such an indicator. If you find these, you need to review the payee documentation and perhaps ask for additional information, because you may have a foreign payee subject to the separate tax rules for Form 1042-S reporting, a norm of 30 percent tax withholding, and documentation on a type of Form W-8.

Thank you for your business. It is a pleasure to serve you.

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