

Are You a Withholding Agent?

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The Internal Revenue Service (IRS) recently announced a compliance initiative to audit U.S. withholding agents. Approximately 400 IRS agents have been trained to complete the audits. Any person that has control, receipt, or custody of an amount subject to U.S. tax withholding, or who can disburse or make payments of an amount subject to withholding, is a withholding agent. A withholding agent must generally withhold U.S. tax on an amount subject to withholding made to a payee that is a foreign person, unless the agent can associate the payment with documentation (i.e., Form W-8 or Form W-9) upon which it can rely to treat the payment as made to a payee that is a U.S. person, or a beneficial owner entitled to a reduced rate of withholding.

An investment partnership should generally be considered a withholding agent. For the purposes of this discussion, the income subject to withholding is defined in the Treasury Regulations as Fixed or Determinable, Annual or Periodic Income (FDAP). The more common types of FDAP subject to withholding include interest, dividends and royalties. An investment partnership should have in its records a U.S. Form W-9 or U.S. Form W-8 for all investors. If neither a Form W-8 nor W-9 has been received, the partnership should generally withhold 30% of the FDAP income allocable to such investors.

Form W-9, Request for Taxpayer identification Number and Certification, should be completed by U.S. Persons. Form W-8BEN, Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding, should be provided by non-U.S. persons who are beneficial owners of an investment. The beneficial owner is generally the person that ultimately owns an investment. For example, individuals and corporations are generally considered beneficial owners, and partnerships and trusts are generally not considered beneficial owners. Form W-8IMY, Certificate of Foreign Intermediary, Foreign Flow-Through Entity, or Certain U.S. Branches for United States Tax Withholding, should be provided by foreign persons that are intermediaries between the U.S. withholding agent and the beneficial owner. A foreign partnership, including a foreign corporation for which a "check-the-box" election has been filed with the IRS

(i.e., the master fund in the typical master-feeder structure), would generally provide to a withholding agent a Form W-8IMY, Form W-9 for each U.S. investor and the appropriate Form W-8 for each foreign investor. In addition, the foreign partnership should generally include a schedule that identifies each beneficial owner's ownership percentage in the foreign partnership.

If an invalid Form W-8BEN is on file with a withholding agent, the investor will be subject to the same withholding rules as if no Form W-8BEN had been submitted. A Form W-8BEN with no U.S. TIN (Taxpayer Identification Number) will remain in effect for a period starting on the date the form is signed and ending on the last day of the third succeeding calendar year. After such date, the Form will be invalid. For example, a Form W-8BEN without a U.S. TIN that was signed on April 15, 2003 will expire on December 31, 2006. A Form W-8BEN with a current signature should be requested prior to the expiration date to avoid triggering the withholding rules, which would require withholding at 30% on all FDAP, regardless of treaty rates or exemption from withholding that would apply with a valid Form, including interest income that would be exempt under the portfolio interest exception. A Form W-8BEN with a U.S. TIN will remain in effect until a change of circumstances makes any information on the form incorrect, provided that the withholding agent reports at least one payment annually to the beneficial owner on Form 1042-S. If an investor's status changes at anytime, the investor is obligated to provide to the withholding agent a new Form W-8 or Form W-9 that reflects their new status.

The Internal Revenue Code allows a 90-day grace period allowing withholding agents to rely upon Forms W-8 and W-9 that have been transmitted by facsimile or other corroborative information regarding the country of resident of the beneficial owner.

Neither Form W-9 nor Form W-8 should be submitted to the IRS. However, if the IRS determines that a withholding agent failed to properly withhold taxes from a foreign person, the withholding agent could be liable for such taxes. In fact, even if an investor is able to

substantiate their withholding status and the withholding agent is able to demonstrate that no under-withholding occurred, the withholding agent may still be subject to an interest charge on the additional withholding that should have been processed given an invalid W-8 on file. Accordingly, it is important to maintain a current Form W-8 for each foreign investor.

The documentation failures that the IRS agents will be considering when auditing a withholding agent include invalid substitute forms, application of the 90-day grace period rule to the wrong payment types and, on joint accounts, use of two names on line 1 of Form W-8.

Form W-9 and instructions may be found on the IRS Web site at www.irs.gov/pub/irs-pdf/fw9.pdf?portlet=3. Form W-8BEN and instructions may be found on the IRS Web site at www.irs.gov/pub/irs-pdf/fw8ben.pdf and www.irs.gov/pub/irs-pdf/iw8ben.pdf, respectively. Form W-8IMY and instructions may be found on the IRS Web site at

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This discussion was intended to be a general summary of certain issues related to withholding agents. We suggest that you contact your tax advisor to determine whether you are a withholding agent and to ascertain your compliance obligations, if any.

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