

Lesson 12: Form 1042-S Walkthrough Part 10

Let's talk about other Forms 1042-S made to persons who are not recipients. One is our favorite – disregarded entities. If a withholding agent makes a payment to a disregarded entity that is not a hybrid entity making a treaty claim and the entity provides a reliable Form W-8BEN-E or ECI to the withholding agent that indicates it is the single non-U.S. owner of the disregarded entity, then the withholding agent must file a Form 1042-S in the name of the non-U.S. single owner. Here is an example, assume that a withholding agent makes a chapter 4 withholdable payment of interest to a non-U.S. limited liability company that is not an FFI. The LLC is wholly owned by a non-U.S. corporation that is an excepted nonfinancial entity for purposes of chapter 4. LLC is treated as a disregarded entity. Non-U.S. corporation provides withholding agent with a Form W-8BEN-E on which it states that it is the beneficial owner of the income paid to the LLC. Withholding agent reports the interest payment on Form 1042-S reflecting non-U.S. corporation as the recipient. An interesting note here is that the result would be the same if the LLC was a U.S. LLC!

Now, we learned earlier that a disregarded entity can claim to be a beneficial owner of a payment if it is a hybrid entity claiming treaty benefits. If a disregarded entity claims to be the beneficial owner on a reliable Form W-8BEN-E, then the withholding agent must complete a Form 1042-S treating the disregarded entity as the recipient using code 26, hybrid entity making treaty claim, as the chapter 3 status code.

Let's look at another example to highlight this situation. Now, it is a long one, so try to stay with the facts of this example. Assume a withholding agent makes a withholdable payment of interest to a hybrid entity organized in a certain Country with which the United States has an Income Tax Treaty in effect. The hybrid entity is treated as a partnership under the U.S. Code, but is treated as a corporation resident in that certain other country under local rules in that country. In our example, assume that the hybrid entity has two owners, each of which are non-U.S. corporations. We already know from our lesson on Forms W-8BEN-E that a hybrid entity with multiple owners may claim treaty benefits as well. In order to do so, it would provide the withholding agent with a Form W-8BEN-E that makes a reliable treaty claim. So, in

our example, assume that the hybrid entity provided the withholding agent with a Form W-8BEN-E that claims treaty benefits in its country of residence. It also provided a Form W-8IMY that includes its chapter 3 and chapter 4 status, as well as a Form W-8BEN-E from each of its two owners. The two owners are non-U.S. corporations, one is a nonparticipating FFI and the other is a participating FFI. The withholding statement allocates 80 percent of the payment to the participating FFI and 20 percent of the payment to the nonparticipating FFI.

Now, let's look at the portion of the payment that the withholding agent is making with respect to the non-U.S. corporation owner that is a participating FFI. Because the hybrid entity made a reliable treaty claim on Form W-8BEN-E, and because the non-U.S. corporate owner certified status as a participating FFI, then chapter 4 withholding does not apply with respect to any portion of that payment made to that owner. The withholding statement tells us that 80 percent of the payment will be made to the non-U.S. corporation that is a participating FFI. So, for this 80 percent of the payment, the hybrid entity is able to maintain its hybrid status, be treated as a corporation for purposes of its tax status in its resident country, and is eligible for treaty benefits. As such, it is the recipient of the income paid by the withholding agent. For this payment, the withholding agent completes a Form 1042-S treating the hybrid entity as a recipient. It would use code 26, hybrid entity making a treaty claim, as the chapter 3 recipient status code and would not enter a chapter 4 recipient status code.

For the remaining 20 percent of the payment, the withholding statement tells the withholding agent that the other owner is a non-U.S. corporation that is a nonparticipating FFI. We know that this chapter 4 status means that the non-U.S. corporation chooses not to be compliant with chapter 4 and, as such, is subject to 30 percent chapter 4 withholding on withholdable payments, which includes interest. So, when the withholding agent makes a payment of U.S. source interest to this owner, it cannot treat this portion of the payment as made to a hybrid entity that is eligible for treaty benefits. The withholding agent knows that it must withhold 30 percent under chapter 4. Because of this, the withholding agent must issue a separate Form 1042-S to the non-U.S. corporation that is a Nonparticipating FFI for 20 percent of the payment.

In this case, the hybrid entity will reflect as the intermediary and for the remaining 20 percent of the payment to the nonparticipating FFI, the withholding agent reports:

- Box 13f chapter 3 recipient code 15, corporation.
- Box 13g chapter 4 recipient code 15, nonparticipating FFI.
- Boxes 15a through 15i would include information for the hybrid entity as the intermediary.

Now, let's look at amounts paid to an NQI or flowthrough entity. Unless the entity is a nonparticipating FFI receiving a chapter 4 withholdable payment, here are the rules.

- Withholding agent will issue a Form 1042-S for each recipient on whose behalf the NQI or flow through entity acts as indicated on the withholding statement and Form W-8IMY.
- If withholding agent is making the payment through tiers of NQIs or flowthrough entities, then the withholding agent must complete a Form 1042-S for the recipients that receive a payment through the NQI or flowthrough entity.
- Withholding agent would complete the Form 1042-S using Boxes 15a through 15i for reporting the NQI or flowthrough entity information.

Let's have a look at an example. Assume a withholding agent makes a chapter 4 withholdable payment of interest to a reporting Model 1 FFI. This FFI provides a reliable Form W-8IMY with which it associates a withholding statement. The withholding statement allocates 80 percent of the payment to a Participating FFI and 20 percent of the payment to a pool of Nonparticipating FFIs. Reporting Model 1 FFI also provides the withholding agent with a Form W-8IMY for the Participating FFI with which it associates a withholding statement that allocates 100 percent of the payment to a recalcitrant pool-no indicia. This is a pool of recalcitrant account holders – or account holders that did not provide a reliable chapter 4 status and that do not have any information on file that indicates it might be a U.S. person, like a U.S. address or phone number. Withholding agent must complete a Form 1042-S for the interest allocated to the pool of Nonparticipating FFIs with Reporting Model 1 FFI as the recipient – remember this is our original flowthrough entity. The withholding agent must complete a second Form 1042-S for

the interest allocated to a pool of Recalcitrant account holders – no U.S. indicia with Participating FFI as the recipient.

So, what happens when a withholding agent makes a withholdable payment to an NQI or flowthrough entity that is a Participating FFI or deemed compliant FFI, but it cannot reliably associate payment or any party of the payment with a withholding statement or a reliable withholding certificate? The withholding agent would follow the presumption rules that we will talk about in more detail in our modules on chapter 3 and chapter 4. Generally, under these rules, the withholding agent would withhold 30 percent under chapter 4, because the payment is presumed made to a nonparticipating FFI. This is sort of the default presumption when you have a chapter 4 payment made to an entity that provided no documentation. The withholding agent would complete a Form 1042-S with the recipient name “unknown recipient” in Box 13a, chapter 3 recipient code 21 for unknown recipient in Box 13g, and chapter 4 recipient code 29 for the same. The name, country code, address, TIN, GIIN, and status codes of the FFI should reflect in Boxes 15a through 15i.