

## **Lesson 2: Form 1042-S - Amounts Not Subject to Reporting**

Now, let's have a look at amounts that are not reported on Form 1042-S.

First, interest and OID from short term obligations. When these amounts are payable 183 days or less from the date of original issue, then they generally are not required to be reported on Form 1042-S.

Next, interest on a registered obligation that is targeted to markets outside of the United States and that qualifies as portfolio interest is not subject to reporting if it is paid to a registered owner that is a financial institution or a member of a clearing organization and the withholding agent has received required certifications on Form W-8. Here, we note, that in this small circumstance, reporting is not required. Reporting is still required on interest paid on any registered obligation, regardless of where it is targeted, if the registered obligation is issued after December 31, 2015. This is related to chapter 4. We have not talked too much about portfolio interest, it is a type of interest that is exempt from chapter 3 withholding; however, reporting in most cases, generally is still required. Also, there is no exemption under chapter 4, so it is always reportable for purposes of being a chapter 4 withholdable payment.

Third, withholding agents do not report on Form 1042-S any amounts paid on a notional principal contract, other than a specified notional principal contract, if the amounts are not effectively connected with a trade or business in the United States. All amounts paid on these specified notional principal contracts are treated as dividend equivalent payments and should be reported as such on Form 1042-S.

Fourth, withholding agents do not have to report on Form 1042-S any interest paid on obligations sold between interest payment dates and the part of the purchase price of an OID obligation that is sold or exchanged in a transaction other than a redemption. This is unless the sale or exchange is part of the plan, the purpose of which is to avoid tax, and the withholding agent has actual knowledge of this plan. You will notice this concept of tax avoidance and

actual knowledge of withholding agents is very important as we continue our discussions on chapter 4. It is the basis and intent for drafting the chapter 4 rules.

Next, certain withholdable payments are not subject to reporting for chapter 3 purposes, so they are not required to be reported if withholding is not applied or required to be applied under chapter 4.

So, now you have a very good idea with many examples of what is subject to reporting on Form 1042-S and what is not. Let's move on to the requirement to withhold under chapters 3 and 4, which you probably already remember. Under chapter 3, a withholding agent must withhold 30 percent of any payment of an amount subject to withholding under those rules and made to a non-U.S. person. This rule applies unless the withholding agent can associate the payment with documentation to treat the payment as made to a non-U.S. person who is entitled to a reduced rate of withholding or exemption from withholding. You remember that the documentation a non-U.S. person generally provides is a Form W-8BEN, BEN-E, or 8233 to claim a reduced rate of withholding pursuant to an Income Tax Treaty in addition to other withholding certificates that establish non-U.S. status or an exemption from withholding. For purposes of chapter 4, a withholding agent withholds 30 percent of a chapter 4 withholdable payment made to an FFI that is or is presumed to be a nonparticipating FFI. Remember, those are the FFIs that have decided not to comply with chapter 4. These rules also apply to withholdable payments made to certain nonfinancial foreign entities that do not identify their substantial U.S. owners. By now many of these rules we mention should be familiar and we will continue to remind you of these rules to help reinforce them throughout the lessons!

It is important to note, especially when completing Form 1042-S, that a payment will be subject to withholding under chapter 3 or chapter 4, but not both. Remember, chapter 4 withholding takes precedence, so if an amount is subject to withholding under both sets of rules, the withholding agent apply chapter 4 withholding first. If chapter 4 withholding does not apply, then the withholding agent applies chapter 3 withholding where required.

Now, before we begin, let's talk about the amounts that a withholding agent will enter. The same rules as Form 1042 apply to Form 1042-S. All amounts must be in U.S. dollars and all amounts must be rounded to the nearest dollar. As an example, if the amount reported is \$100.50, then the withholding agent must enter \$101.