



# IRS Nationwide Tax Forum | 2023

## Recent Developments in Foreign Withholding and Information Reporting

# Objectives

Today our presentation will:

- Define the reporting obligations of a withholding agent under chapters 3 & 4 for Forms 1042 and 1042-S
- List the most recent changes to the Forms 1042 and 1042-S
- List the most common errors for Forms 1042 and 1042-S



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# Overview of Forms 1042 & 1042-S

# Overview of Forms 1042 & 1042-S

- Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons, is an annual income tax return filed to report total amounts paid, withheld, and deposited during the calendar year.
- Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, is an information return filed with the IRS and furnished to the recipients.

# Overview of Forms 1042 & 1042-S

- Forms 1042 and 1042-S report payments of U.S. source fixed determinable annual or periodical (FDAP) income paid to non-U.S. persons.
- Calendar year reporting
- March 15 deadline
  - Extension of time to file can be requested
  - An extension of time to furnish copy of Form 1042-S to the recipients is also available.

# Overview of Forms 1042 and 1042-S

- Form 1042, until TY2023, it was paper filed only.
  - Note: Certain filers of Form 1042 will be required to file electronically starting in 2024.
- Withholding agents must deposit any tax withheld with the IRS throughout the calendar year.
  - The timing of withholding dictates the timing of deposits.
  - All deposits must be made using Electronic Federal Tax Payment System (EFTPS).

# Overview of Forms 1042 and 1042-S

- For TY 2022, Form 1042-S must be electronically filed (e-filed) using the Filing Information Returns Electronically (FIRE) system if:
  - Withholding Agent is a financial institution, or
  - If total Forms 1042-S to be filed total 250 or more
- Final regulation on e-filing requirements expands the e-filing requirement for this form.

# Overview of Forms 1042 and 1042-S

- If paper filing Form(s) 1042-S, a separate Form 1042-T, Annual Summary and Transmittal of Forms 1042-S is required for each type of paper Form 1042-S that is being transmitted.



# Form 1042 & 1042-S Non-Compliance

- Significant penalties can apply for failure to comply with the Form 1042 and 1042-S reporting requirement under chapters 3 and 4.
- A withholding agent that does not timely file a Form 1042 or does not pay or deposit the tax when due may be liable for penalties and interest unless it can show that a failure to file (pay/deposit) was due to reasonable cause and not willful neglect.

# Form 1042 & 1042-S Non-Compliance

- Penalties that may apply for Form 1042 non-compliance:
  - Failure to file Form 1042 when due: 5% of the unpaid tax for each month (or partial month) the return is late, up to 25%
  - Failure to pay tax when due: .5% of the unpaid tax for each month (or partial month) the tax is unpaid, up to 25%.
  - Penalties may also be imposed for negligence, substantial understatement, and fraud.

# Form 1042 & 1042-S Non-Compliance

- Penalties that may apply for Form 1042 non-compliance (Cont.):
  - Failure to deposit tax withheld in a timely manner: ranges from 2% -10% of the tax liability not timely deposited, depending on the number of days a deposit is late.

# Form 1042 & 1042-S Non-Compliance

- Penalties that may apply for Form 1042-S non-compliance:
  - Failure to file timely and correct Form(s) 1042-S: penalty ranges between \$60 and \$310 per form (up to a maximum over \$3.7M in certain cases).
    - Same penalty applies for the failure to e-file when required.
  - Failure to furnish Form(s) 1042-S: penalty ranges between \$60 and \$310 per form (up to a maximum over \$3.7M in certain cases).

# Form 1042 & 1042-S Non-Compliance

- Penalties that may apply for Form 1042-S non-compliance (Cont.):
  - Intentional Disregard: If a withholding agent intentionally disregards the requirement to file and report correct information on Form(s) 1042-S, the penalty is increased to the greater of \$630 per form (for calendar year 2023) or 10% of the total amount required to be reported.
    - No maximum



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# Recent Developments

# Recent Developments

- Recent changes related to the Forms 1042 and 1042-S include the following:
  - New electronic filing requirements
  - Increased IRS enforcement efforts
  - Changes to Form 1042-S
  - Data Integrity Tool

# Recent Developments

- On February 21, 2023, final regulations were issued requiring certain taxpayers to file Forms 1042 and 1042-S electronically beginning in 2024.
- The final regulations introduced new requirement to e-file Form 1042 and include changes to the e-filing requirements for Form 1042-S.



# Recent Developments

## E-filing of Form 1042

- Under the new regulations the following withholding agents are required to e-file Form 1042:
  - A withholding agent that is a financial institution
  - A withholding agent that is a partnership with more than 100 partners
  - A withholding agent that files at least 10 returns of any type (e.g., Form 1042-S, 1099, W-2, etc.)
    - Exception for individual, estate and trust.

# Recent Developments

## E-filing of Form 1042

- The new e-filing requirements are effective for returns required to be filed in 2024 (i.e., TY2023 Forms 1042 and 1042-S).
- Form 1042 schema is already available in the Modernized E-file (MeF) platform.
  - Although not required, withholding agents can choose to file TY 2022 Form 1042 electronically.

# Recent Developments

## E-filing of Form 1042

- The business rules and schema for Form 1042 is available in the Secure Object Repository (SOR) and can be located at:  
<https://www.irs.gov/e-file-providers/valid-xml-schemas-and-business-rules-for-1042-modernized-e-file-mef>

# Recent Developments

## E-filing of Form 1042

- When e-filing Form 1042, any form(s) or schedule(s) required to be attached to Form 1042 must be submitted electronically as XML documents using the applicable schema or binary files (if schema not available).
- Available schemas for Form 1042 include: Form 1042-S, Schedule Q (Form 1042), Form 1099-B, Form 1099-DIV, Form 1099-G, Form 1099-INT, Form 1099-K, Form 1099-MISC, Form 1099-NEC, Form 1099-OID, Form 1099-PATR, and Form 1099-R.

# Recent Developments E-filing of Form 1042

- For example, filers of Form 1042 that need to attach Form(s) 1042-S or 1099 in support of Lines 67a and 67b, will be required to use the schemas for the applicable form(s) to include the information from the recipient copy of the Form(s) 1042-S or 1099 associated to the credit for tax withheld by other withholding agents being claimed.
- A filer can attach as many documents (XML) as needed.
  - Note that if Lines 67a and 67b are unsubstantiated the credit claimed will be disallowed.

# Recent Developments

## E-filing of Form 1042

- For more information about electronic filing see:
  - Publication 4163, Modernized e-file (MeF) Information for Authorized IRS e-file Providers for Business Returns
  - Publication 4164, Modernized e-file (MeF) Guide for Software Developers and Transmitters
  - Publication 5446, MeF Submission Composition Guide

# Recent Developments

## Form 1042-S e-filing changes

- Changes to e-filing requirement for Form 1042-S:
  - Reduce the 250-return threshold to 10.
  - Will require filers to aggregate across return types (e.g., Forms 1099, W-2, 1042-S, etc.) to determine whether filer meets the 10-return threshold and is therefore require to e-file.
  - Require partnerships with more than 100 partners to e-file.

# Recent Developments

## Increased IRS Enforcement Efforts

- Increase in IRS notices and letters identifying errors with Forms 1042 and 1042-S reporting.
- Use of data analytics to identify significant errors on Forms 1042 and 1042-S resulting in potential underwithholding and/or incorrect reporting.
- Notices to withholding agents under 1.1441-7(b)(1)



# Recent Developments

## Increased IRS Enforcement Efforts

- Some examples of the errors being identified in IRS notices/letters include:
  - Incorrect treaty claims
  - Failure to withhold when reporting to Unknown Recipients
  - Incorrect ECI exemption claims
  - Incorrect exemption claims based on recipient's QI status

# Recent Developments

## Increased IRS Enforcement Efforts

- **Incorrect Treaty Claims:** This identifies withholding agents that reported Forms 1042-S to recipients that claimed exemption from withholding based on treaty claims where the recipient's country is not a treaty country and less than 30% tax was withheld.
- **Incorrect reporting to Unknown Recipients:** This identifies withholding agents that reported payments subject to withholding on Forms 1042-S to "Unknown Recipients" but failed to withhold at the maximum 30%.

# Recent Developments

## Increased IRS Enforcement Efforts

- Incorrect ECI exemption claim: This identifies reporting to recipient's claiming the effectively connected income (ECI) exception, but no TIN is provided for the recipient.
  - The IRS is also identifying recipients claiming ECI exemption from withholding that have not filed an income tax return.

# Recent Developments

## Increased IRS Enforcement Efforts

- Incorrect QI status claims: This identifies withholding agents that reported Forms 1042-S to recipients claiming Qualified Intermediary (QI) status where no tax has been withheld and the IRS has found that such entities do not have a QI agreement.

# Recent Developments

## Increased IRS Enforcement Efforts

- IRS' Foreign Payments Practice (FPP) is sending letters identifying these errors and noting the potential underwithholding.
- Exam is also expanding its review to include many of these reporting errors and inconsistencies.
- FPP is also sending notices under Treas. Regs. sec. 1.1441-7 to notify withholding agents that they cannot longer rely on a recipient's claim that income is exempt from withholding because it is ECI.

# Recent Developments

## Increased IRS Enforcement Efforts

- Notices are also being sent to withholding agents notifying them that they cannot longer rely on a recipient's claim that they are a QI.
  - FPP will also be publishing a list of taxpayers that currently have a QI agreement with the IRS and can correctly claim that chapter 3 status (and withholding exemption claim based on such status when applicable).

# Recent Developments

## Changes to Forms 1042 and 1042-S

- Forms and associated instructions are updated annually
  - Codes may be removed or new codes may be added
  - Additional instructions or guidance may be provided
- Always review the Instructions to Form 1042 and 1042-S for the applicable year before completing these returns.

# Recent Developments

## Data Integrity Tool

- Free tool available for use by the public to check Form 1042-S for compliance with various tax rules.
- The tool is to be used PRIOR to final submission and is not used to submit 1042-S data to the IRS.
- See IRS.gov page :  
<https://www.irs.gov/businesses/international-businesses/form-1042-s-data-integrity-tool>



# Recent Developments Data Integrity Tool

Welcome

## Home

Quick Modules collects images or files from any source and processes these as transactions. A transaction is defined as a 1042-S submission that has been prepared and submitted by a withholding agent or an IRS User via a FIRE file, CSV file, PDF submission, or direct data entry into the system.

**You must file your 1042-S with the IRS after getting the report and correcting them as this system only checks for errors.**

### Upload History

Show  entries

Search:

Date Submitted	Source	1042-S Count	Links
7/25/2022 2:43:47 PM	CSV test July 2022.csv	9	<a href="#">Menu</a> <a href="#">Info</a>

Showing 1 to 1 of 1 entries

Previous **1** Next

Select Form

### Download Template

- 1042-S CSV Template
- 2019 Form 1042-S PDF
- 2020 Form 1042-S PDF
- 2021 Form 1042-S PDF

### Upload Files

Select a Form Type

Before uploading, please select the form type.



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# Common Errors & Best Practices

# Common Errors

- The IRS continues to identify reporting and/or withholding errors when processing Forms 1042 and 1042-S.
- These errors may :
  - Cause delays in processing of returns
  - Result in denial of refund/credit claims
  - Result in significant penalties

# Common Errors Form 1042

- Some of the most common errors we find when processing Form 1042 include:
  - Using the wrong version of the form (i.e., tax year)
  - Incomplete form (e.g., missing WA's chapter 3/4 status)
  - Deposits not timely made nor properly reported
  - Missing required attachments (e.g., lack of substantiation of Line 67)
  - Math errors

# Common Errors Form 1042 (Cont.)

- Form is not consistent with reported amounts on all Forms 1042-S filed by the withholding agent for the calendar year.
- Reporting amounts withheld and/or deposited with the IRS on lines 1-60 instead of the tax liability.
- Not filing Form 1042 when the withholding agent filed Form(s) 1042-S and/or made deposits.

# Common Errors Form 1042 (Cont.)

- Inaccurately reflecting the tax liability amount
- Inaccurately reflecting the timing of when the liability occurred
  - For example, reporting the tax liability in the total for the month (e.g., line 5 for the month of January) and leaving all other fields for that month blank.
- Reporting tax liabilities on lines 1-60 (ROFTL) but not reporting any liabilities on page 2, Lines 64b-d.

# Common Errors Form 1042-S

- Some of the most common errors we find when processing Form 1042-S include:
  - Mismatch between the copy of the Form 1042-S filed with the IRS and the copy provide to the recipients.
  - Incorrect claims
    - For example, reporting income is exempt from withholding under an income tax treaty but recipient's country code is not a treaty country.

# Common Errors Form 1042-S

- Missing required fields
  - Unique Form Identifier (UFI)
  - Chapter 4 exemption code and tax rate
  - Intermediary or Flowthrough Information
  - U.S. TIN when required (e.g., if claiming ECI exemption, treaty benefits, QI status, etc.)



# Common Errors Form 1042-S

- Joint Payees: Listing two or more recipients in Box 13a,
- Underwithholding
  - For example:
    - Reporting under chapter 4 (Box 3=“4”) but withholding less than 30%
    - Reporting less than 30% and no valid reason for reduced rate (e.g., no valid treaty or code exemption)

# Common Errors Form 1042-S

- Incorrect reporting to “Unknown Recipient”
  - Not withholding at max. 30% if reporting a payment subject to withholding
  - When reporting to “Unknown Recipient” recipient’s country code should be left blank.
- Using “UC” as country code to indicate unknown country.
  - “UC” is the country code for Curacao

# Best Practices

Before completing Forms 1042 & 1042-S:

- Refer to the Instructions and other Guidance early and often.
- Complete all required fields in a consistent manner.
- Ensure that all information entered when reporting the payment(s) correctly reflects the intent of the statute and regulations.
  - In most cases, withholding agents should rely on withholding documentation obtained (e.g., Forms W-8) to complete their Forms 1042-S submissions.

# Best Practices

- Ensure that the correct version of the Form(s) is being used.
- Ensure Forms are timely filed.
  - Request extension in a timely manner if needed.
- File in the correct format
  - If failed to file Form 1042 electronically when required, it will be treated as a failure to file.
  - Waiver process will be available and described in future instructions/guidance.

# Best Practices

- Verify math computations are correct
  - Rounding applies
  - No negative amounts allowed
- Ensure reporting on all Forms 1042-S being filed by the withholding agent for the calendar year is consistent with the amounts reported on Form 1042.
- Ensure reporting is correct and consistent throughout

# Best Practices

- Ensure that the copies of Forms 1042-S provided to the recipients are the same as the returns filed with the IRS.
- When filing Form 1042, ensure that all required attachments are included when applicable (e.g., recipient's copy of Form 1042-S to substantiate Line 67, Schedule Q if return is filed by a Qualified Derivatives Dealer, etc.).
- Consider using a tool, such as the Form 1042-S DATA Integrity Tool, to review the Form 1042-S data prior to completing Forms 1042-S.



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# Additional Resources

# Resources

- Available IRS presentations on Forms 1042 and 1042-S:
  - Understanding Form 1042-S, Foreign Person’s U.S. Source Income Subject to Withholding  
<https://www.irsvideos.gov/Individual/Resources/UnderstandingForm1042SForeignPersonsUSSourceIncomeSubjecttoWithholding>
  - Understanding Form 1042 - Annual Withholding Tax Return for U.S. Source Income of Foreign Persons  
<https://www.irsvideos.gov/Business/FilingPayingTaxes/UnderstandingForm1042AnnualWithholdingTaxReturnforUSSourceIncomeofForeignPersons>



## Resources (Cont.)

- Form 1042 Instructions
- Publication 515, Withholding of Tax on Nonresident Aliens and Foreign Entities
- Form 7004, Instructions for Application for Automatic Extension of Time to File Certain Business Income Tax , Information, and Other Returns
- Publication 906, Electronic Federal Tax Payment System
- [IRS.gov/Form1042](https://www.irs.gov/Form1042)

## Resources (Cont.)

- Form 1042-S Instructions
- Form 1042-T, Annual Summary and Transmittal of Forms 1042-S
- Publication 1187, Specifications for Electronic Filing of Form 1042-S
- Form 8809 Instructions, Application for Extension of Time to File Information Returns
- [IRS.gov/Form1042S](https://www.irs.gov/Form1042S)



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THANK YOU!