Withholding of Tax on Nonresident Aliens and Foreign Entities

For Withholding in 2002
Important Changes

Qualified intermediary employer identification number (QI-EIN). A foreign intermediary that has received a QI-EIN may represent on Form W-8IMY that it is a QI unless it revokes its QI-EIN. The IRS will revoke a QI-EIN if the QI agreement is not executed and returned to the IRS within a reasonable period of time.

See Foreign Intermediaries, for more information.

Lower withholding rate on partners. Generally, a partnership must pay a withholding tax on effectively connected taxable income that is allocable to its foreign partners. For 2002, the withholding rate is reduced to 38.6% (from 39.1% for 2001.)

See Partnership Withholding on Effectively Connected Income, for more information.

U.S.-Slovenia tax treaty. A new income tax treaty with Slovenia went into effect for taxes withheld at source for amounts paid or credited on or after September 1, 2001, and for other taxes, for tax periods beginning on or after January 1, 2002. Until further notice, you can rely upon Forms W–8 that contain a P.O. box as a permanent residence address provided you do not know, or have reason to know, that the person providing the form is a U.S. person or that a street address is available. You can rely on Forms W–8 for which there is a U.S. mailing address provided you received the form prior to December 31, 2001.

Reporting requirements. The regulations made significant changes to the method for reporting payments to foreign persons, particularly with respect to payments made to foreign intermediaries, partnerships, and trusts. In addition to discussing the rules that apply generally to payments made to foreign intermediaries, partnerships, and trusts, for more information, see Publication 966, EFTPS: A Full Range of Electronic Choices To Pay All Your Federal Taxes.

IRS taxpayer identification numbers for aliens. The IRS will issue an individual tax payer identification number (ITIN) to an alien who does not have and is not eligible to get a social security number (SSN). An ITIN is for tax use only. It does not entitle an alien to social security benefits or change his or her employment or immigration status under U.S. law.

For more information on ITINs, see U.S. Taxpayer Identification Numbers, later.

Hong Kong. Hong Kong and China continue to be treated as two separate countries for purposes of certain bilateral agreements, the Internal Revenue Code, and the Income Tax Regulations.

Photographs of missing children. The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 1–800–THE–LOST (1–800–843–5678) if you recognize a child.

Introduction

This publication is for withholding agents who pay income to foreign persons, including non-resident aliens, foreign corporations, foreign partnerships, foreign trusts, foreign estates, foreign governments, and international organizations. Specifically, it describes the persons responsible for withholding (withholding agents), the types of income subject to withholding, and the information return and tax return filing obligations of withholding agents. In addition to discussing the rules that apply generally to payments of U.S. source income to foreign persons, it also contains sections on the withholding that applies to the disposition of U.S. real property interests and the withholding by partnerships on income effectively connected with the active conduct of a U.S. trade or business.

Comments and suggestions. We welcome your comments about this publication and your suggestions for future editions.

You can e-mail us while visiting our web site at www.irs.gov.

You can write to us at the following address:

Internal Revenue Service
Technical Publications Branch
W:CAR:MP:FP:P
1111 Constitution Ave. NW
Washington, DC 20224

We respond to many letters by telephone. Therefore, it would be helpful if you would include your daytime phone number, including the area code, in your correspondence.

Useful Items

You may want to see:

Publication

15 Circular E, Employer’s Tax Guide
15–A Employer’s Supplemental Tax Guide
15–B Employer’s Tax Guide to Fringe Benefits
51 Circular A, Agricultural Employer’s Tax Guide
519 U.S. Tax Guide for Aliens
901 U.S. Tax Treaties

Form (and Instructions)

SS–4 Application for Employer Identification Number
W–2 Wage and Tax Statement
W–4 Employee’s Withholding Allowance Certificate
W–4P Withholding Certificate for Pension or Annuity Payments
W–7 Application for IRS Individual Taxpayer Identification Number
941 Employer’s Quarterly Federal Tax Return
1042 Annual Withholding Tax Return for U.S. Source Income of Foreign Persons
1042–B Foreign Person’s U.S. Source Income Subject to Withholding
1042–T Annual Summary and Transmittal of Form 1042–S

See How To Get Tax Help, near the end of this publication for information about getting publications and forms.
Withholding of Tax

Generally, a foreign person is subject to U.S. tax on its U.S. source income. Most types of U.S. source income received by a foreign person are subject to U.S. tax of 30%. A reduced rate, including exemption, may apply if there is a tax treaty between the foreign country’s country of residence and the United States. The tax is generally withheld (NRA withholding), from the payment made to the foreign person.

The term “NRA withholding” is used in this publication descriptively to refer to withholding required under sections 1441, 1442, and 1443 of the Internal Revenue Code. Generally, NRA withholding describes the withholding regime that requires U.S. persons to withhold on a payment made to a foreign person holding U.S. source income. Payments to all foreign persons, including nonresident alien individuals, foreign corporations, and foreign governments, may be subject to NRA withholding.

NRA withholding does not include withholding done under section 1445 of the Code (see U.S. Real Property Interest, later) or under section 1446 of the Code (see Partnership Withholding on Effectively Connected Income, later).

Withholding Agent

You are a withholding agent if you are a U.S. or foreign person that has control, receipt, custody, disposal, or payment of any item of income of a foreign person that is subject to withholding. A withholding agent may be an individual, corporation, partnership, trust, association, or any other entity, including any foreign intermediary, foreign partnership, or U.S. branch of a foreign bank and insurance companies. You may be a withholding agent even if there is no requirement to withhold from a payment or even if another person has withheld the required amount from the payment.

Although several persons may be withholding agents for a single payment, the full tax is required to be withheld only once. Generally, the U.S. person who pays an amount subject to NRA withholding is the person responsible for withholding. However, other persons may be required to withhold. For example, a payment made by a flow-through entity or nonqualified intermediary that knows, or has reason to know, that the full amount of NRA withholding was not done by the person from which it receives a payment is required to do the appropriate withholding since it also falls within the definition of a withholding agent. In addition, withholding must be done by any qualified intermediary in accordance with the terms of its qualified intermediary withholding agreement, discussed later.

Liability for tax. As a withholding agent, you are personally liable for any tax required to be withheld. This liability is independent of the liability of the foreign person to whom the payment is made. If you fail to withhold and the foreign payee fails to satisfy its U.S. tax liability, any tax that you do not withhold may be assessed against the payee. However, if the foreign payee satisfies its tax liability, you may still be held liable for interest and penalties for your failure to withhold.

Determination of amount to withhold. You must withhold on the gross amount subject to NRA withholding. You cannot reduce the gross amount subject to withholding. A payment is made only to a payee that is a foreign person. However, a withholding agent that can reliably associate the payee with the terms of its qualified intermediary tax return on Form 1042. (See Foreign Person Subject to Form 1099 Reporting, later, for more information.)

When to withhold. Withholding is required at the time you make a payment of an amount subject to withholding. A payment is made to a payee that is a foreign person if that person realizes income whether or not there is an actual transfer of cash or other property. A payment is considered made to a payee if it is paid for that person’s benefit. For example, a payment made to a creditor of a person in satisfaction of that person’s debt to the creditor is considered made to the person. A payment is also considered made to a person if it is made to that person’s agent.

U.S. partnership withholding. A partnership or other flow-through entity that collects for a U.S. person is not required to withhold if it is paid for that person’s benefit. However, if a partnership distributes that income, the partnership must withhold on the foreign partner’s distributive share of income. If the distribution is made to a foreign person that is subject to Form 1099 reporting if (1) the U.S. person pays an amount subject to withholding and (2) the IRS notifies you that the payee is a foreign person. You are required to report payments subject to withholding on Form 1099 (see Payment Made to Foreign Persons, later).

Withholding and Reporting Obligations

You are required to report payments subject to NRA withholding on Form 1042–S and to file a tax return on Form 1042. (See Returns Required, later.) An exception from reporting may apply to individuals who are not required to withhold from a payment and who do not make the payment in the course of their trade or business.

Form 1099 reporting and backup withholding. You may also be responsible as a payer for reporting on Form 1099 payments made to a U.S. person. You must withhold 30% from a reportable payment made to a U.S. person that is subject to Form 1099 reporting if (1) the recipient is a U.S. person, (2) the person identifies itself on its W-9, and (3) the IRS notifies you that the person is a foreign person that is subject to withholding. A payment is made to a person if it is paid for that person’s benefit. For example, a payment made to a creditor of a person in satisfaction of that person’s debt to the creditor is considered made to the person. A payment is also considered made to a person if it is made to that person’s agent.

U.S. real property interest. A withholding agent is a U.S. person that is subject to withholding if the payment is made to a foreign person that does not have a U.S. real property interest in the U.S. property to be paid. If the foreign person is a U.S. person, the withholding agent is the person that pays the foreign person, whether or not the payment is paid from a U.S. source. If the foreign person is not a U.S. person, the withholding agent is the person that is required to file Form 1099 reporting and backup withholding. The applicable tax will be withheld from the payment made to the foreign person. It does not apply to payments made to U.S. persons.

Withholding on Effectively Connected Income

Effective connected income by partnership. Generally, a foreign partnership is a partner- ship (whether U.S. or foreign) is also responsible for withholding on its income effectively connected with a U.S. trade or business that is allocable to foreign partners. See Partnership Withholding on Effectively Connected Income, later, for more information.

U.S. real property interest. A withholding agent is a U.S. person that is subject to withholding if the payment is made to a foreign person that does not have a U.S. real property interest in the U.S. property to be paid. If the foreign person is a U.S. person, the withholding agent is the person that pays the foreign person, whether or not the payment is paid from a U.S. source. If the foreign person is not a U.S. person, the withholding agent is the person that is required to file Form 1099 reporting and backup withholding. The applicable tax will be withheld from the payment made to the foreign person. It does not apply to payments made to U.S. persons.
Identifying the Payee

Generally, the payee is the person to whom you make the payment, regardless of whether that person is the beneficial owner of the income. However, there are situations in which the payee is a person other than the one to whom you actually make a payment.

U.S. agent of foreign person.

If you make a payment to a U.S. person and you have actual knowledge that the U.S. person is receiving the payment as an agent of a foreign person, you must treat the payment as made to the foreign person. However, if the U.S. person is a financial institution, you may treat the institution as the payee provided you have no reason to believe that the institution will not comply with its own obligation to withhold.

If the payment is not subject to NRA withholding (e.g., gross proceeds from the sales of securities), you must treat the payment as made to a U.S. person and not as a payment to a foreign person. You may be required to report the payment on Form 1099 and, if applicable, backup withholding.

Disregarded entities.

A business entity that is not a corporation and that has a single owner may be disregarded as an entity separate from its owner (a disregarded entity) for federal tax purposes. The payee of a payment made to a disregarded entity is the owner of the entity.

If the owner of the entity is a foreign person, you must apply NRA withholding unless you can treat the foreign owner as a beneficial owner entitled to a reduced rate of withholding. If the owner is a U.S. person, you do not apply NRA withholding. However, you may be required to report the payment on Form 1099 and, if applicable, backup withholding. You may assume that a foreign entity is a disregarded entity unless you can reliably associate the payee with documentation provided by the owner or you have actual knowledge or reason to know that the foreign entity is a disregarded entity.

Flow-Through Entities

The payees of payments (other than income effectively connected with a U.S. trade or business) made to a foreign flow-through entity are the owners or beneficiaries of the flow-through entity. This rule applies for purposes of NRA withholding and for Form 1099 reporting and backup withholding. Income that is, or is deemed to be, effectively connected with the conduct of a U.S. trade or business of a flow-through entity, is treated as paid to the entity.

All of the following are flow-through entities.

• A foreign partnership (other than a withholding foreign partnership and partnerships claiming treaty benefits as entities that are not fiscally transparent).

• A foreign simple or foreign grantor trust (other than a withholding foreign trust), and foreign simple and foreign grantor trusts claiming treaty benefits as entities that are not fiscally transparent.

• An entity receiving income for which treaty benefits are claimed by an interest holder in the entity and the entity is considered fiscally transparent.

See Fiscally transparent entity, later.

Generally, you treat a payee as a flow-through entity if it provides you with a Form W–8BEN (see Documentation, later) on which it claims such status. You may also be required to treat the entity as a flow-through entity under the presumption rules, discussed later.

You must determine whether the owners or beneficiaries of a flow-through entity are U.S. or foreign persons, how much of the payment relates to each owner or beneficiary, and, if the owner or beneficiary is foreign, whether a reduced rate of NRA withholding applies. You make these determinations based on the documentation and other information (contained in a withholding statement) that is associated with the flow-through entity’s Form W–8BEN. If you do not have all of the information that is required to reliably associate a payment with a specific payee, you must apply the presumption rules. See Documentation and Presumption Rules, later.

Withholding foreign partnerships and withholding foreign trusts are not flow-through entities.

Foreign partnerships.

A foreign partnership is any partnership that is not organized under the laws of any state of the United States or the District of Columbia or any partnership that is treated as foreign for income tax purposes. The payee of a payment made to a foreign partnership is the partnership itself. The partnership provides you with a Form W–8BEN from the foreign partnership. In addition, Forms W–8BEN from the U.S. citizen or the foreign corporation and a Form W–9 from the U.S. citizen. The partnership also gives you a complete withholding statement that enables you to associate a portion of the interest payment with the partnership. You must treat all three partners as the payees of the interest payment as if the payments were made directly to them. Report the payment to the nonresident alien and the foreign corporation on Forms 1042–S and Form 1042–INT.

Example 1. A nonwithholding foreign partnership has three partners: a nonresident alien individual, a foreign corporation, and a U.S. citizen. You make a payment of U.S. source interest to the first partnership. It gives you a Form W–8BEN with which it associates Forms W–8BEN from the nonresident alien and the foreign corporation and a Form W–9 from the U.S. citizen. The partnership also gives you a complete withholding statement that enables you to associate a portion of the interest payment with the partnership and with the other two partners. You must treat all three partners as the payees of the interest payment as if they were the owners of the income. You make a payment of U.S. source interest to the second partnership. It gives you a valid Form W–8BEN with which it associates a Form W–8BEN from the foreign corporation and a Form W–8IMY from the second partnership. In addition, Forms W–8BEN from the foreign corporation and a Form W–8IMY from the second partnership.

The payees of a payment made to a foreign trust are the owners of the trust. Generally, a foreign grantor trust is a foreign trust as a result of the withholding statements, you must treat them as the payees of the interest.

Example 3. You make a payment of U.S. source dividends to a withholding foreign partnership. The partnership has two partners, both foreign corporations. You can reliably associate the payment with a valid Form W–8BEN from the partnership on which it represents that it is a withholding foreign partnership. You may treat the partnership as the payee of the dividends.

Foreign simple and grantor trust. A trust is foreign unless it meets both of the following tests.

• A court within the United States is able to exercise primary supervision over the administration of the trust.

• One or more U.S. persons have the authority to control all substantial decisions of the trust.

Generally, a foreign simple trust is a foreign trust that is required to distribute all of its income annually. A foreign grantor trust is a foreign trust that is treated as a grantor trust under sections 671 through 679 of the Internal Revenue Code. The payees of a payment made to a foreign simple trust are the beneficiaries of the trust.

The payees of a payment made to a foreign grantor trust are the owners of the trust. However, the payee of a foreign simple or grantor trust itself if the trust is claiming treaty benefits as an entity if it is not fiscally transparent and that it meets all the other requirements for claiming treaty benefits. If a partner is a foreign flow-through entity or a foreign intermediary, you apply the payee determination rules to that partner to determine the payees.

Example 1. A nonwithholding foreign partnership has three partners: a nonresident alien individual, a foreign corporation, and a U.S. citizen. You make a payment of U.S. source interest to the partnership. It gives you a Form W–8BEN with which it associates Forms W–8BEN from the nonresident alien and the foreign corporation and a Form W–9 from the U.S. citizen. The partnership also gives you a complete withholding statement that enables you to associate a portion of the interest payment with the partnership and with the other two partners. You must treat all three partners as the payees of the interest payment as if they were the owners of the income. You make a payment of U.S. source interest to the first partnership. It gives you a valid Form W–8BEN with which it associates a Form W–8BEN from the foreign corporation and a Form W–8IMY from the second partnership. In addition, Forms W–8BEN from the foreign corporation and a Form W–8IMY from the second partnership.

The payees of a payment made to a foreign trust are the owners of the trust. Generally, a foreign grantor trust is a foreign trust as a result of the withholding statements, you must treat them as the payees of the interest.

Example 3. You make a payment of U.S. source dividends to a withholding foreign partnership. The partnership has two partners, both foreign corporations. You can reliably associate the payment with a valid Form W–8BEN from the partnership on which it represents that it is a withholding foreign partnership. You may treat the partnership as the payee of the dividends.

Foreign simple and grantor trust. A trust is foreign unless it meets both of the following tests.

• A court within the United States is able to exercise primary supervision over the administra-
determination is made separately for interest, dividends, royalties, etc.). The interest holder in an international financial institution (or any other person that acts as an agent under a qualified intermediary) that has assumed primary withholding responsibility for a payment as the payee, and you are not required to withhold.

An intermediary is a custodian, broker, nominee, or any other person that acts as an agent for another person. A foreign intermediary is either a qualified intermediary or a nonqualified intermediary. Generally, determine whether an entity is a qualified intermediary or a nonqualified intermediary based on the representations the intermediary makes on a Form W–8IMY.

You must determine whether the customers or account holders of a foreign intermediary are U.S. or foreign persons, and, if the account holder or customer is foreign, whether a reduced rate of NRA withholding applies. You make these determinations based on the foreign intermediary’s Form W–8IMY and associated information and documentation. If you do not have the necessary documentation, you must rely on backup withholding rules, which is of a type specified in an attachment to the QI agreement, the documentary evidence that is not of the type specified in the attachment to the agreement. A QI is required to provide the U.S. withholding agent with information about the “know your customer” rules that apply to the QI to the extent the QI knows the information is incorrect.

The QI withholding agreement and procedures necessary to complete the QI application are set forth in Revenue Procedure 2000–12 found in Cumulative Bulletin 2000–1. Also see Notice 2001–4.

The revenue procedure, notice, and other information can be found at our web site www.irs.gov.

Documentation. A QI is not required to forward documentation obtained from foreign account holders to the U.S. withholding agent from whom the QI receives a payment of U.S. source income. The QI maintains such documentation at its location and provides the U.S. withholding agent with withholding rate pools. A withholding rate pool is a payment of a single type of income that is subject to a single rate of withholding.

A QI is required to provide the U.S. withholding agent with information regarding U.S. persons subject to Form 1099 information reporting unless the QI assumes the primary obligation to do Form 1099 reporting and backup withholding. If a QI obtains documentary evidence under the “know your customer” rules that apply to the QI under local law, the documentary evidence is of a type specified in an attachment to the QI agreement, the documentary evidence remains valid until a change in circumstances or the QI knows the information is incorrect. This indefinite validity period does not apply to Forms W–8 or to documentary evidence that is not of the type specified in the attachment to the agreement.

Collective refund procedures. A QI may seek a refund on behalf of its direct account holders. The direct account holders, therefore, are not required to file returns with the IRS to obtain refunds, but rather may obtain them from the QI.

U.S. branches of foreign banks and foreign insurance companies. Special rules apply to a U.S. branch of a foreign bank subject to Federal Reserve Board supervision or a foreign insurance company subject to state regulatory supervision. If you are a U.S. person, you may treat the branch as a U.S. person for purposes of the U.S. tax law. If you are a QI, you are not required to withhold. Even though you agree to treat the branch as a U.S. person, you must report the payment on Form 1042–S. A financial institution organization in a U.S. possession is treated as a U.S. branch. The special rules discussed in this section apply to any possessions financial institution.
If you are paying a U.S. branch an amount that is not subject to NRA withholding, treat the payment as made to a foreign person, irrespec-
tive of any agreement to treat the branch as a U.S. person for amounts subject to NRA with-
holding. Consequently, amounts not subject to NRA withholding that are paid to a U.S. branch
are not subject to Form 1099 reporting or to backup withholding.

Alternatively, a U.S. branch may provide you with a Form W–8IMY with which it associates the
documentation of the persons on whose behalf it acts. In this situation, the payees are the
persons on whose behalf the branch acts pro-
vided you can reliably associate the payment with valid documentation from those persons.
See Nonqualified Intermediaries under Docu-
mentation, later.

If the U.S. branch does not provide you with a Form W–8IMY, then you should treat a pay-
ment subject to NRA withholding as made to the foreign person of which the branch is a part and
the income is effectively connected with the con-
duct of a trade or business in the United States.

Foreign Persons
A payee is subject to NRA withholding only if it is a foreign person. A foreign person includes a
nonresident alien individual, foreign corporation, foreign partnership, foreign trust, a foreign es-
state, and any other person that is not a U.S. person. It also includes a foreign branch of a
U.S. financial institution if the foreign branch is a
qualified intermediary. Generally, the U.S. branch of a foreign corporation or partnership is
 treated as a foreign person.

Nonresident alien. A nonresident alien is an individual who is not a U.S. citizen or a resident alien.
A resident of a foreign country under the residence article of an income tax treaty is a nonresi-
dent alien individual for purposes of with-
holding.

Married to U.S. citizen or resident alien. Nonresident alien individuals married to U.S. citizens or residents may choose to be treated as
resident aliens for certain income tax pur-
poses. However, these individuals are still sub-
ject to the NRA withholding rules that apply to nonresident aliens for all income except wages.
Wages paid to these individuals are subject to the withholding rules that apply to U.S. citizens and residents and not the NRA withholding
rules. See Publication 15 (Circular E).

Resident alien. A resident alien is an individ-
ual that is not a citizen or national of the United States and who meets either the green card test
or the substantial presence test for the calendar year.

Green card test. An alien is a U.S. resi-
dent if the individual was a lawful perma-
nent resident of the United States at any
time during the calendar year. This is known as the green card test because these aliens hold immigrant visas (also known as green cards).

Substantial presence test. An alien is con-
sidered a U.S. resident if the individual meets the substantial presence test for the calendar year. Under this test, the individ-
ual must be physically present in the United States on at least:

1) 31 days during the current calendar year, and
2) 183 days during the current year and the 2 preceding years, counting all the days of
physical presence in the current year, but only ½ the number of days of presence in the
first preceding year, and only ¼ the number of days in the second preceding year.

Generally, the days the alien is in the United States as a teacher, student, or trainee on an
"F", "J", "M", or "O" visa are not counted. This
exception is for a limited period of time.

For more information on resident and non-
resident status, the tests for residence, and the exceptions to them, see Publication 519.

Note. If your employee is late in notifying
you that his or her status changed from nonresi-
dent alien to resident alien, you may have to
make an adjustment to Form 941 if that em-
ployee was exempt from withholding of social
security and Medicare taxes as a nonresident alien. For more information on making adjust-
ments, see Section 13 of Publication 15 (Cir-
cular E).

Resident of Puerto Rico. Even if an alien is
a bona fide resident of Puerto Rico for the entire year and must pay taxes generally in the same
way as a U.S. citizen, the alien is treated as a nonresident alien for the withholding rules ex-
plained here. U.S. citizens who are residents of
Puerto Rico are not subject to NRA withholding.

Foreign corporations. A foreign corporation is one that does not fit the definition of a domes-
tic corporation. A domestic corporation is one
that was created or organized in the United States or under the laws of the United States, any of its states, or the District of Columbia.

Guam or Northern Mariana Islands corporations. A corporation created or organ-
ized in, or under the laws of, Guam or the Com-
monwealth of the Northern Mariana Islands
(CNMI) is not considered a foreign corporation for the purpose of withholding tax for the tax year if:

1) At all times during the tax year less than
25% in value of the corporation’s stock is
owned, directly or indirectly, by foreign persons,
and

2) At least 20% of the corporation’s gross in-
come is derived from sources within Guam or
the CNMI for the 3-year period ending with the close of the preceding tax year of the
corporation (or the period the corpo-
ration or any predecessor has been in ex-
istence, if less), and

3) No substantial part of the income of the
corporation is derived, directly or indirectly, to
satisfy obligations to a person who is not a
bona fide resident of the Virgin Islands, American Samoa, Guam, the CNMI, or the United States.

Foreign private foundation. A foun-
dation that was created or organized under the
laws of a foreign country is a foreign private
foundation. Gross investment income from
sources within the United States paid to a quali-

died foreign private foundation is subject to NRA withholding of a 4% excise tax (unless ex-
empted by a treaty) rather than the ordinary statutory 30% income tax.

Other foreign organizations, associations, and charitable institutions. An organization
may be exempt from income tax under section
501(a) of the Internal Revenue Code even if it
was formed under foreign law. Generally, you
do not have to withhold tax on payments of income
to these foreign tax-exempt organizations un-
less the IRS has determined that they are for-
ing foreign private foundations.

Payments to these organizations, however, must be reported on Form 1042–S, even though no tax is withheld.

You must withhold tax on the unrelated busi-
ness income (as described in Publication 598,
Tax on Unrelated Business Income of Exempt
Organizations) of foreign tax-exempt organiza-
tions in the same way that you would withhold tax on similar income of nonexempt organiza-
tions.

U.S. branches of foreign persons. In gen-
eral, a payment to a U.S. branch of a foreign
person is a payment made to the foreign person.
You may, however, treat payments to U.S. branches of foreign banks or foreign insurance
companies (discussed earlier) that are subject
to U.S. regulatory supervision as payments made to a U.S. person, if you and the U.S. branch
have agreed to do so and their agree-
ment is evidenced by a withholding certificate,
Form W–8IMY. For this purpose, a financial
institution organized under the laws of a U.S.
possesion is treated as a U.S. branch.

Documentation
Generally, you must withhold 30% from the gross amount paid to a foreign payee unless you
can reliably associate the payment with valid
Beneficial Owners

If all the appropriate requirements have been established on a Form W–8BEN, W–8ECI, W–8EXP or, if applicable, on documentary evidence, you may treat the payee as a foreign beneficial owner.

Form W–8BEN. Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding, is used by a foreign person to:

1) Establish foreign status.
2) Claim that such person is the beneficial owner of the income for which the form is being furnished, and
3) If applicable, claim a reduced rate of, or exemption from, withholding under an income tax treaty.

Form W–8BEN may also be used to claim that the foreign person is exempt from Form 1099 reporting and backup withholding for income that is not subject to NRA withholding. For example, a foreign person may provide a Form W–8BEN to a broker to establish that the gross proceeds from the sale of securities are not subject to Form 1099 reporting or backup withholding.

Claiming treaty benefits. You may apply a reduced rate of withholding to a foreign person that provides a Form W–8BEN claiming a reduced rate of withholding under an income tax treaty only if the person provides a U.S. TIN and certifies that:

• It is a resident of a treaty country.
• It is the beneficial owner of the income.
• If it is an entity, it derives the income within the meaning of section 894 of the Internal Revenue Code (it is not fiscally transparent), and
• It meets any limitation on benefits provision contained in the treaty, if applicable.

If the foreign beneficial owner claiming a treaty benefit is related to you, the foreign beneficial owner must also certify on Form W–8BEN that it will file Form 8833, Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b), if the amount subject to NRA withholding received during a calendar year exceeds, in the aggregate, $500,000.

An entity derives income for which it is claiming treaty benefits only if the entity is not treated as fiscally transparent for that income. See Fiscally transparent entities discussed earlier under Flow-Through Entities.

Limitations on benefits provisions generally prohibit third country residents from obtaining treaty benefits. For example, a foreign corporation may not be entitled to a reduced rate of withholding unless a minimum percentage of its owners are citizens or residents of the United States or the treaty country.

The exemptions from, or reduced rates of, U.S. tax vary under each treaty. You must check the provisions of the tax treaty that apply. Tables at the end of this publication show the countries with which the United States has income tax treaties and the rates of withholding that apply in cases where all conditions of the particular treaty articles are satisfied.

If a nonresident alien individual has made an election with his or her U.S. citizen or resident spouse to be treated as a U.S. resident for income tax purposes, the nonresident alien may not claim to be a foreign resident to obtain the benefits of a reduced rate of, or exemption from, U.S. income tax under an income tax treaty.

If you know, or have reason to know, that an owner of income is not eligible for treaty benefits claimed, you may not apply the treaty rate. You are not, however, responsible for misstatements on a Form W–8, documentary evidence, or statements accompanying documentary evidence for which you did not have actual knowledge, or reason to know that the statements were incorrect.

Marketable securities. A Form W–8BEN provided to claim treaty benefits does not need a U.S. TIN if the foreign beneficial owner is claiming the benefits on income from marketable securities. For this purpose, income from a marketable security consists of the following items.

• Dividends and interest from stocks and debt obligations that are actively traded.
• Dividends from any redeemable security issued by an investment company registered under the Investment Company Act of 1940 (mutual fund).
• Dividends, interest, or royalties from units of beneficial interest in a unit investment trust that are (or were upon issuance) publicly offered and are registered with the SEC under the Securities Act of 1933.
• Income related to loans of any of the above securities.

Form W–8ECI, Certificate of Foreign Person’s Claim for Exemption From Withholding on Income Effectively Connected With the Conduct of a Trade or Business in the United States, is used by a foreign person to:

1) Establish foreign status.
2) Claim that such person is the beneficial owner of the income for which the form is being furnished, and
3) Claim that the income is effectively connected with the conduct of a trade or business in the United States (See Effectively Connected Income, later.)

Effectively connected income for which a valid Form W–8ECI has been provided is generally not subject to NRA withholding.

Form W–8EXP, Certificate of Foreign Government or Other Foreign Organization for United States Tax Withholding, is used by a foreign government, international organization, foreign central bank of issue, foreign tax-exempt organization, foreign private foundation, or government of a U.S. possession to:

1) Establish foreign status.
2) Claim that such person is the beneficial owner of the income for which the form is being furnished, and
3) Claim a reduced rate of, or an exemption from, withholding as such an entity.
Foreign Intermediaries and Foreign Flow-Through Entities
Payments made to a foreign intermediary or foreign flow-through entity are treated as made to the payees on whose behalf the intermediary or entity acts. The Form W–8IMY provided by a foreign intermediary or flow-through entity must be accompanied by additional information for you to be able to reliably associate the payment with a payee. The additional information required depends on the type of intermediary or flow-through entity and the extent of the withholding responsibilities it assumes.

Form W–8IMY. Certificate of Foreign Intermediary, Foreign Flow-Through Entity, or Certain U.S. Branches for Which It Claims Treaty Benefits and That It Assumes Primary NRA Withholding Responsibility and/or Back-up Withholding Responsibility

You may rely on documentary evidence given you by a nonqualified intermediary or a single rate of withholding. A qualified intermediary foreign beneficial owner that is an entity must give you a withholding statement, discussed later.

Documentary Evidence.
You may apply a reduced rate of withholding to income from marketable securities (discussed earlier) paid outside the United States to an offshore account if the beneficial owner gives you documentary evidence in place of a Form W–8BEN. To claim treaty benefits, the documentary evidence must be one of the following:

1) A certificate of residence that:
   a) Is issued by a tax official of the treaty country of which the foreign beneficial owner claims to be a resident,
   b) States that the person has filed its most recent income tax return as a resident of that country, and
   c) Is issued within 3 years prior to being presented to you.

2) Documentation for an individual that:
   a) Includes the individual’s name, address, and photograph,
   b) Is an official document issued by an authorized governmental body, and
   c) Is issued no more than 3 years prior to being presented to you.

3) Documentation for an entity that:
   a) Includes the name of the entity,
   b) Includes the address of its principal office, and
   c) Is an official document issued by an authorized governmental body.

In addition to the documentary evidence, a foreign beneficial owner that is an entity must provide a statement that it derives the income for which it claims treaty benefits and that it meets one or more of the conditions set forth in a limitation on benefits article, if any, (or similar provision) contained in the applicable treaty.
unless the alternative procedure applies, sub-
ject to Form 1099 reporting and/or backup with-
holding. The QI must provide a Form W–9 or, in
absence of the form, the name, address, and
TIN, if available, for such person.

Primary NRA and Form 1099 responsibility
assumed.
If you make a payment to a QI that
assumes primary NQI withholding respon-
sibility and primary Form 1099 reporting and
backup withholding responsibility, you can relia-
ably associate a payment with valid documenta-
tion provided that you receive a valid Form W–8IMY. It is not necessary to associate the payment with withholding rate pools.

Example. You make a payment of divi-
dends to a QI. It has 5 customers: (1) two are
foreign persons who have provided documenta-
tion entitling them to a 15% rate of withholding on dividends; two are foreign persons subject to a 30% rate of withholding on dividends; and one is a U.S. individual who provides it with a Form W–9. Each customer is entitled to 20% of the dividend payment. The QI does not assume any primary withholding responsibility. The QI gives you a Form W–8IMY with which it associates the Form W–9 and a withholding statement that allocates 40% of the dividend to a 15% withhold-
ing rate pool, 40% to a 30% withholding rate pool, and 20% to the U.S. individual. You should report on Forms 1042–S $40 of the payment as made to a 15% rate dividend pool and 40% of the payment as made to a 30% rate dividend pool. The portion of the payment allocable to the U.S. individual (20%) is reportable on Form 1099–DIV.

Nonqualified Intermediaries

If you are making a payment to a nonqualified intermediary, foreign flow-through entity, or U.S. branch, that is using Form W–8IMY to transmit information about the branch’s account holders or customers, you can treat the payment (or a portion of the payment) as reliably associated with valid documentation from a specific payee only if, prior to making the payment:

• You can allocate the payment to a valid Form W–8IMY.

• You can reliably determine how much of the payment is allocable to valid documentation
• You have sufficient information to report the payment on Form 1042–S or Form 1099, if reporting is required.

The QI, flow-through entity, or U.S. branch must give you certain information on a withhold-
ing statement that is associated with the Form W–8IMY. A withholding statement must be up-
dated to keep the information accurate prior to each payment. Generally, a withholding statement must contain the following information:

1) The name, address, and TIN (if any, or if required) of each person for whom docu-
mentation is provided.

2) The type of documentation (documentary evidence, Form W–8, or Form W–9) for every person for whom documentation has been provided.

3) The status of the person for whom the documentation has been provided, such as whether the person is a U.S. exempt recipient (U.S. person exempt from Form 1099 reporting), U.S. non-exempt recipient (U.S. person subject to Form 1099 report-
ing), or a foreign person. For a foreign person, the statement must indicate whether the person is a beneficial owner or a foreign intermediary, flow-through en-
tity, or a U.S. branch.

4) The type of recipient the person is, based on the recipient codes used on Form 1042–S.

5) Information allocating each payment, by income type, to each payee (including U.S. exempt and U.S. non-exempt recipients) for whom documentation has been pro-
vided.

6) The rate of withholding that applies to each foreign person to whom a payment is made.

7) A foreign payee’s country of residence.

8) If a reduced rate of withholding is claimed, the basis for a reduced rate of withholding (e.g., portfolio interest, treaty benefit, etc.).

9) In the case of treaty benefits claimed by entities, whether the applicable limitation on benefits statement and the statement that the foreign person derives the income for which treaty benefits are claimed, have been made.

10) The name, address, and TIN (if any) of any other NQI, flow-through entity, or U.S. branch from which the payee will directly receive a payment.

11) Any other information a withholding agent requests to fulfill its reporting and withhold-
ing obligations.

Alternative procedure. Under this alternative procedure the QI can give you the information that allocates each payment to each foreign and U.S. exempt recipient by January 31 following the calendar year of payment, rather than prior to the payment being made as otherwise re-
quired. To take advantage of this procedure, the QI must: (1) inform you, on its withholding statement, that it is using the alternative proce-
dure, and (2) obtain your consent. You must receive the withholding statement with all the required information (other than item 5) prior to making the payment.

The alternative procedure cannot be used for payments to U.S. non-exempt recipients. Therefore, an NQI must al-
ways provide you with allocation information for all U.S. non-exempt recipients prior to a pay-
ment being made.

Pooled withholding information.
If an NQI uses the alternative procedure, it must provide you with withholding rate pool information, as opposed to individual allocation information, prior to the payment of a reportable amount. A withholding rate pool is a payment of a single type of income (as determined by the income categories on Form 1042–S) that is subject to a

single rate of withholding. For example, an NQI that has foreign account holders receiving royal-
ties and dividends, both subject to the 15% rate, will provide you with information for two with-
holding rate pools (one for royalties and one for dividends). The NQI must provide you with the payee specific allocation information (informa-
tion allocating each payment to each payee) by January 31 following the calendar year of pay-
ment.

Failure to provide allocation information.

If an NQI fails to provide you with the payee specific allocation information for a withholding rate pool by January 31, you must not apply the alternative procedure to any of the NQI’s Form W–8IMY with which it associates withholding rate pools from that date forward. Un-
less the NQI provides all the required information, including account holder specific allocation information, prior to any payments being made, you must treat the payees as un-
documented and apply the presumption rules, discussed later. An NQI is deemed to have failed to provide specific allocation information if it does not give you such information for more than 10% of any one withholding rate pool.

However, if you receive such information by February 14, you may make the appropriate adjustments to repay any excess withholding incurred between February 1 and on or before February 14.

If the NQI fails to allocate more than 10% of the payment to a withholding rate pool by Febru-
ary 14 following the calendar year of payment, you must file a Form 1042–S for each account holder in the pool on a pro-rata basis. For exam-
ple, if there are four account holders in a with-
holding rate pool that receives a $100 payment and the NQI fails to allocate more than $10 of the payment, you must file four Forms 1042–S, one for each account holder in the pool, showing $25 of income to each. You must also check the “Pro-rata Basis Reporting” box at the top of each form. If, however, the nonqualified intermediary provides allocation information for 90% or more of the payments to a withholding rate pool, the pro-rata reporting method is not required. In-
stead, you must file a Form 1042–S for each account holder for whom you have allocation information and report the unallocated portion of the payment on a Form 1042–S issued to “un-
known recipient.”

Standards of Knowledge

You must withhold in accordance with the pre-
scriptions rules (discussed later) if you know or have reason to know that a Form W–8 or docu-
mentary evidence provided by a payee is unreli-
able or incorrect. If you rely on an agent to obtain documentation, you are considered to know, or have reason to know, the facts that are within the knowledge of your agent.

Reason to Know

Generally, you are considered to have reason to
know that a claim of U.S. status or of a reduced
rate of withholding is incorrect if statements con-
tained in the withholding certificate or other doc-
umentation, or other relevant facts of which you have knowledge, would cause a reasonably pru-
dent person in your position to question the claims made.
Financial institutions (including a regulated investment company) are treated as having reason to know documentation is unreliable or incorrect for payments on marketable securities only in the circumstances discussed next. If the documentation is considered unreliable or incorrect, you must get new documentation. However, you may rely on the original documentation if you receive the additional statements and/or documentation discussed. The circumstances, discussed next, also apply to a withholding agent that is not a financial institution or making a payment on marketable securities. However, these withholding agents are not limited to these circumstances in determining if they have reason to know that documentation is unreliable or incorrect. These withholding agents cannot base their determination on the receipt of additional statements or documents, they need to get new documentation.

**Withholding Certificates**

You have reason to know that a Form W–8 provided by a direct account holder that is a foreign person is unreliable or incorrect if:

1) The Form W–8 is incomplete with respect to any item on the form that is relevant to the claims made by the account holder,

2) The Form W–8 contains any information that is inconsistent with the account holder’s claim,

3) The Form W–8 lacks information necessary to establish entitlement to a reduced rate of withholding, or a reduced rate is claimed, or

4) You have information not contained on the form that is inconsistent with the claims made on the form.

**Establishment of foreign status.** You have reason to know that a Form W–8 or Form W–8BEN or Form W–EXP is unreliable or incorrect to establish a direct account holder’s status as a foreign person if:

1) The Form W–8 has a permanent residence address in the United States,

2) The Form W–8 has a mailing address in the United States,

3) You have a residence or mailing address as part of your account information that is an address in the United States,

4) The person providing the certificate notifies you of a new residence or mailing address in the United States, or

5) If the Form W–8 is provided with respect to an offshore account, the account holder has standing instructions directing you to pay amounts from its account to an address or account maintained in the United States.

**Claim of reduced rate of withholding under treaty.** You have reason to know that a Form W–8BEN provided by a direct account holder to claim a reduced rate of withholding under a treaty is unreliable or incorrect for purposes of establishing the account holder’s residency in a treaty country if:

1) The permanent residence address on the Form W–8BEN is not in the treaty country or the beneficial owner notifies you of a new permanent residence address that is not in the treaty country,

2) The permanent residence address on the Form W–8BEN is in the treaty country but the withholding certificate (or your account information) contains a mailing address that is not in the treaty country, or

3) The account holder has standing instructions for you to pay amounts from its account to an address or an account not in the treaty country.

You may, however, rely on a Form W–8BEN as establishing an account holder’s claim of a reduced rate of withholding under a treaty if any of the following apply:

1) If the permanent residence address is not in the treaty country and:
   a) The account holder provides a reasonable explanation for the permanent residence address outside the treaty country, or
   b) You possess or obtain documentary evidence that establishes residency in a treaty country.

2) If the mailing address is not in the treaty country and:
   a) You possess or obtain additional documentation (that does not contain an address outside the treaty country) supporting the beneficial owner’s claim of residence in the treaty country,
   b) You possess or obtain documentation that establishes that the beneficial owner is an entity organized in a treaty country.
   c) You know that the address outside the treaty country is a branch of a bank or insurance company that is a resident of the treaty country, or
   d) You obtain a written statement from the beneficial owner that reasonably establishes its entitlement to treaty benefits.

3) If you have instructions to pay amounts outside the treaty country, and the account holder gives you a reasonable explanation, in writing, establishing residence in the applicable treaty country.

**Documentary Evidence**

You have reason to know that documentary evidence provided by a direct account holder that is a foreign person is unreliable or incorrect if:

1) The documentary evidence does not reasonably establish the identity of the person presenting the documentary evidence,

2) The documentary evidence contains information that is inconsistent with the account holder’s claim of a reduced rate of withholding, or

3) You have account information that is inconsistent with the account holder’s claim of a reduced rate of withholding.

**Establishment of foreign status.** You have reason to know that documentary evidence is unreliable or incorrect to establish a direct account holder’s status as a foreign person if:

- You receive the Form W–8 from an individual and:
  - You possess or obtain documentary evidence (that does not contain a U.S. address) that was provided within the last three years, was valid when provided, supports the claim of foreign status, and the beneficial owner provides you with a reasonable explanation in writing supporting the account holder’s foreign status, or
  - If the account is maintained at your office outside the United States, you are required to report annually a payment to the account holder on a tax information statement filed with the tax authority of the country in which your office is located and that country has an income tax treaty in effect with the United States.

- You receive the Form W–8 from an entity that is not a flow-through entity and:
  - You have in your possession or obtain documentation that substantiates that the entity is organized or created under foreign law, or
  - If the account is maintained at your office outside the United States, you are required to report annually a payment to the account holder on a tax information statement filed with the tax authority of the country in which your office is located and that country has an income tax treaty in effect with the United States.

- You may treat an account holder that has provided standing instructions to make payments with respect to its offshore account to a U.S. account or U.S. address as a foreign person if the account holder provides you with a reasonable explanation in writing that supports the account holder’s foreign status.
1) The only mailing or residence address on documentary evidence provided after December 31, 2000, is an address at a financial institution (unless the financial institution is the beneficial owner), an in-care-of address, or a P.O. box.

2) You have a mailing or residence address for the account holder in the United States or if the account holder notifies you of a new address in the United States.

3) The account holder has standing instructions directing you to pay amounts from the account to an address or account maintained in the United States.

You may, however, rely on documentary evidence as establishing an account holder’s foreign status if any of the following apply:

1) If the mailing or residence address is in the United States, you receive the documentary evidence from an individual, and

   a) You possess or obtain additional documentary evidence (that does not contain a U.S. address) supporting the claim of foreign status and a reasonable explanation in writing supporting the account holder’s foreign status.

   b) You possess or obtain a Form W-8 that contains a permanent residence address and mailing address outside the United States (or if a mailing address is inside the United States the account holder provides a reasonable explanation in writing, supporting the account holder’s foreign status, or the Form W-8 was received before December 31, 2001), or

   c) The account is maintained at your office outside the United States and you are required to report annually a payment to the account holder on a tax information statement filed with the tax authority of the country in which your office is located and that country has an income tax treaty in effect with the United States.

2) If the mailing or residence address is in the United States, you receive the documentary evidence from an entity (other than a flow-through entity) and:

   a) You possess or obtain documentation to substantiate that the entity is actually organized under the laws of a foreign country.

   b) You obtain a valid Form W-8 that contains a permanent residence address and mailing address outside the United States (or if a mailing address is inside the United States, the account holder provides additional documentary evidence sufficient to establish the account holder’s foreign status, or the Form W-8 was received before December 31, 2001), or

   c) The account is maintained at an office outside the United States and you are required to report annually a payment to the account holder on a tax information statement filed with the tax authority of the country in which your office is located and that country has an income tax treaty in effect with the United States.

3) If you have instructions to pay amounts to an address or an account in the United States and the account holder provides you with a reasonable explanation, in writing, that supports the account holder’s foreign status.

Claim of reduced rate of withholding under treaty. You have reason to know that documentary evidence provided by a direct account holder to claim a reduced rate of withholding under a treaty is unreliable or incorrect for purposes of establishing the account holder’s residency in a treaty country if:

1) You have a mailing or residence address for the account holder that is outside the applicable treaty country.

2) The only address that you have (whether in or outside the treaty country) is a P.O. box, an in-care-of address, or the address of a financial institution (that is not the beneficial owner of the income), or

3) You possess or obtain additional documentary evidence (that does not contain a U.S. address) supporting the account holder’s claim of reduced rate of withholding under a treaty if any of the following apply.

1) If the mailing or residence address is outside the treaty country and:

   a) You possess or obtain additional documentary evidence supporting the account holder’s claim of residence in the treaty country (and the documentary evidence does not contain an address outside the treaty country, an in-care-of address, or the address of a financial institution),

   b) You possess or obtain documentary evidence that establishes that the account holder is an entity organized in a treaty country, or

   c) You obtain a valid Form W-8 that contains a permanent residence address and mailing address outside the United States.

   d) You possess or obtain documentary evidence that establishes that the account holder is an entity organized in a treaty country and: 2) If the mailing or residence address is in the treaty country and the account holder gives you a reasonable explanation, in writing, establishing residence in the applicable treaty country.

Indirect Account Holders

A financial institution that receives documentation from a payee through a nonqualified intermediary, a flow-through entity, or a U.S. branch of a foreign bank or insurance company subject to U.S. or state regulatory supervision has reason to know that the documentary evidence is unreliable or incorrect if a reasonably prudent person in the financial institution’s position would question the claims made. This standard requires, but is not limited to, compliance with the following rules.

Withholding statement. You must review the withholding statement provided with Form W-8 and verify that the information is consistent with the information on the withholding statement.

Withholding certificate. If you receive a Form W-8 for a payee in association with a Form W-8BIM, you must review each Form W-8 and verify that the information is consistent with the information on the withholding statement.

Alternatively, you may apply the presumption rules, discussed later, to the payee.

Documentary evidence. If you receive documentary evidence for a payee in association with a Form W-8BIM, you must review the documentary evidence provided by the nonqualified intermediary, flow-through entity or U.S. branch to determine that there is no obvious indication that the payee is a U.S. person subject to Form 1099 reporting or that the documentary evidence does not establish the identity of the person who provided the documentation (for

<table>
<thead>
<tr>
<th>Chart A. Presumption Rules in the Absence of Documentation</th>
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<td>Estate or trust and its beneficiaries or owner</td>
</tr>
<tr>
<td>Foreign tax-exempt organizations (including private foundations)</td>
</tr>
</tbody>
</table>
example, the documentary evidence does not appear to be an identification document).

### Presumption Rules

If you cannot reliably associate a payment with valid documentation, you must apply certain presumption rules or you may be liable for tax, interest, and penalties. If you comply with the presumption rules, you are not liable for tax, interest, and penalties even if the rate of withholding that should have been applied based on the payee’s actual status is different from that presumed.

The presumption rules apply to determine the status of the person you pay as a U.S. or foreign person and other relevant characteristics, such as whether the payee is a beneficial owner or intermediary, and whether the payee is an individual, corporation, partnership, or trust. You are not permitted to apply a reduced rate of NRA withholding based on a payee’s presumed status if documentation is required to establish a reduced rate of withholding. For example, if the payee of interest is presumed to be a foreign person, you may not apply the portfolio interest exception or a reduced rate of withholding under a tax treaty since both exceptions require documentation.

If you rely on your actual knowledge about a payee’s status and withhold an amount less than that required under the presumption rules or do not report a payment that is subject to reporting under the presumption rules, you may be liable for tax, interest, and penalties. You should, however, rely on your actual knowledge if doing so results in withholding an amount greater than would apply under the presumption rules or in reporting an amount that would not be subject to reporting under the presumption rules.

The presumption rules, in the absence of documentation, for the subject matter are discussed in the regulation section indicated on Chart A.

### Income Subject to NRA Withholding

This section explains how to determine if a payment is subject to NRA withholding. A payment is subject to NRA withholding if it is from sources within the United States, and it is either:

- Fixed or determinable annual or periodical (FDAP) income, or
- Certain gains from the disposition of timber, coal, and iron ore, or from the sale or exchange of patents, copyrights, and similar intangible property.

In addition, a payment is subject to NRA withholding if withholding is specifically required, even though it may not constitute U.S. source income or FDAP income. For example, corporate distributions may be subject to NRA withholding even though a portion of the distribution may be a return of capital or capital gain not otherwise subject to NRA withholding.

### Source of Income

Generally, income is from U.S. sources if it is paid by domestic corporations, U.S. citizens or resident aliens, or entities formed under the laws of the United States or a state. Income is also from U.S. sources if the property that produces the income is located in the United States or the services for which the income is paid were performed in the United States. A payment is treated as being from sources within the United States if the source of the payment cannot be determined at the time of payment, such as fees for personal services paid before the services have been performed. In this situation, you are required to withhold the amount necessary to assure that the tax withheld will not be less than 30% of U.S. source income. Or, you may make a reasonable estimate of the amount from U.S. sources and put a corresponding portion of the amount due in escrow until the amount from U.S. sources can be determined, at which time withholding becomes due. Other source rules are summarized in Chart B and explained in detail in the separate discussions under Withholding on Specific Income, later.

### Types of Income

- **Dividends**
- **Interest**
- **Rents**
- **Royalties**
- **Pensions due to personal services performed**
- **Scholarships and fellowship grants**

### Amounts not subject to NRA withholding

The following amounts are not subject to NRA withholding.

1. **Portfolio interest on bearer obligations or foreign-targeted registered obligations** if those obligations meet certain requirements. See Interest, later.
2. **Bank deposit interest** that is not effectively connected with the conduct of a U.S. trade or business. See Interest, later.
3. **Original issue discount on obligations payable 183 days or less from the date of original issue**. See Original issue discount, later.
4. **Nonbusiness gambling income of a nonresident alien** playing blackjack, baccarat, craps, roulette, or big-6 wheel in the United States. See Gambling winnings, under Other Income, later.
5. **Amounts paid as part of the purchase price of an obligation sold between interest payment dates**. See Interest, later.
6. **Original issue discount paid on the sale of an obligation other than a redemption**. See Original issue discount, later.
7. **Insurance premiums paid on a contract issued by a foreign insurer.**

### Personal service income

If the income is for personal services performed in the United States, it is U.S. source income if the services are performed inside the territorial limits of the United States and wages of an alien seaman for personal services performed in a mine or on an oil or gas well located or being developed on the continental shelf of the United States are treated as from sources in the United States. Income from the performance of services directly related to the use of a vessel or aircraft is

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**Chart B. Summary of Source Rules for FDAP Income**

<table>
<thead>
<tr>
<th>Type of Income</th>
<th>Source Determined by</th>
</tr>
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<td>Pay for personal services</td>
<td>Where services are performed</td>
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<td>Dividends</td>
<td>Type of corporation (U.S. or foreign)</td>
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<tr>
<td>Interest</td>
<td>Residence of payor</td>
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<td>Rents</td>
<td>Where property is located</td>
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<td>Royalties—Patents, copyrights, etc.</td>
<td>Where property is used</td>
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<td>Where property is located</td>
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<tr>
<td>Pensions due to personal services performed</td>
<td>Where services were performed while a nonresident alien</td>
</tr>
<tr>
<td>Scholarships and fellowship grants</td>
<td>Generally, residence of payor</td>
</tr>
</tbody>
</table>

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### Example

Jean Blanc, a citizen and resident of Canada, is employed as a professional hockey player by a U.S. hockey club. Under Jean’s contract, he received $150,000 for 242 days of pay during the year. This includes days spent at pre-season training camp, days spent in the regular season, and playoff game days. Of the 242 days, 194 days were spent performing services in the United States and 48 days performing services in Canada. The amount of U.S. source income is $120,246 ([194 * 242] * $150,000).

### Territorial limits

Wages received for services rendered inside the territorial limits of the United States and wages of an alien seaman earned on a voyage along the coast of the United States are regarded as from sources in the United States. Wages or salaries for personal services performed in a mine or on an oil or gas well located or being developed on the continental shelf of the United States are treated as from sources in the United States.
Scholarships, fellowships, and grants. Other team from negotiating with the player and or credited during the tax year, to a non-Scholarships, fellowships, and grants. other team is pay for a covenant not to compete.

Income (FDAP)

Life insurance contract on the life of a terminally U.S. trade or business, or chronically ill individual before death ... under contract to a viatical settle-option premiums but not including original ment provider. See Publication 525, but is effectively connected with a

Annual or Periodical

example, effectively connected income includethe extent they exceed the cost of the policy. rents from real property if the alien chooses to

Installment payments. Income can be FDAP income whether it is paid in a series of repeated payments or in a single lump sum. For example, $5,000 in royalty income would be FDAP in-

Purses paid to nonresident alien boxers for prize fights in the United States. Prizes awarded to nonresident alien professional golfers in golf tournaments in the United States.

Purses paid to nonresident alien for activities conducted outside the United States. The part of pensions attributable to $5,000 in royalty income would be FDAP income. Generally, when a foreign person

The compensation element is sourced the income whether it is paid in a series of repeated payments or in a single lump sum. For example, $5,000 in royalty income would be FDAP in-

Effectively Connected Income

Generally, when a foreign person engages in a trade or business in the United States, all in-

Racing purses. Racing purses are FDAP income without regard to U.S. or foreign sta-

Withholding on Specific Income

Different kinds of income are subject to different withholding requirements.

Compensation for personal services. The portion attributable to $5,000 in royalty income would be FDAP income. Generally, when a foreign person

Withholding of tax at 30% on the source interest or dividend income from the se-

withholding if it is not effectively connected with a U.S. trade or business and that the income is includible in the owner’s gross income.

Covenant not to compete. Payment received for a promise not to compete is FDAP income. Its source is the place where the promise for-

Signing on. A fee paid to a professional athlete, such as a soccer or hockey player for “signing on” with the effect of preventing any other team from negotiating with the player and preventing the player from negotiating with any other team is pay for a covenant not to compete. The source is the place where the right to play is given up. If a league is made up of both foreign and U.S. teams, the fee is from sources partly in and partly outside the United States. The part of the fee that is from foreign sources is subject to NRA withholding. If there is no reasonable basis for an allocation of the fee, the entire sign-on fee is income from the United States and is subject to NRA withholding.

Prizes awarded to nonresident alien artists for pictures exhibited in the United States. Prizes awarded to nonresident alien professional golfers in golf tournaments in the United States.

Pensions and annuities. • Alimony. • Real property income, such as rents, other than gains from the sale of real property. • Royalties. • Scholarships and fellowship grants. • Other grants, prizes and awards. • A sales commission paid or credited monthly. • A commission paid for a single transaction. • The distributable net income of an estate or trust that is FDAP income and that must be distributed currently, or has been paid or credited during the tax year, to a nonresident alien beneficiary.

Within the United States is treated as foreign source in-

The compensation element is sourced the same as compensation from the performance of personal services. The portion attributable to services performed in the United States is U.S. source income, and the portion attributable to services performed outside the United States is foreign source income.

The earnings element of a pension payment is U.S. source income if the trust is a U.S. trust.

FDAP income is all income except:

1) Gains from the sale of real or personal property (including market discount and option premiums but not including original issue discount), and

2) Items of income excluded from gross in-

come without regard to U.S. or foreign sta-

tus of the owner of the income, such as tax-exempt municipal bond interest and qualified scholarship income.

The following items are examples of FDAP income.

• Compensation for personal services.

• Dividends.

• Interest.

• Original issue discount.

• Pensions and annuities.

Alimony.

Real property income, such as rents, other than gains from the sale of real property.

Royalties.

Scholarships and fellowship grants.

Other grants, prizes and awards.

A sales commission paid or credited monthly.

A commission paid for a single transaction.

The distributable net income of an estate or trust that is FDAP income and that must be distributed currently, or has been paid or credited during the tax year, to a nonresident alien beneficiary.

A distribution from a partnership that is FDAP income, or such an amount that, although not actually distributed, is includi-

able in the gross income of a foreign part-

ner.

Taxes, mortgage interest, or insurance premiums paid to or for the account of, a nonresident alien landlord by a tenant under the terms of a lease.

Prizes awarded to nonresident alien artists for pictures exhibited in the United States. Prizes awarded to nonresident alien professional golfers in golf tournaments in the United States.

Installment payments. Income can be FDAP income whether it is paid in a series of repeated payments or in a single lump sum. For example, $5,000 in royalty income would be FDAP in-

come whether paid in 10 payments of $500 each or in one payment of $5,000.

Insurance proceeds. Income derived by an insured nonresident alien from U.S. sources upon the surrender of, or at the maturity of, a life insurance policy, is FDAP income and is subject to NRA withholding. The proceeds are income to the extent they exceed the cost of the policy.

However, certain payments received under a life insurance contract on the life of a terminally ill individual before death (acceler-

ated death benefits) may not be subject to tax. This also applies to certain payments received for the sale or assignment of any portion of the death benefit under contract to a viatical settle-

ment provider. See Publication 525, Taxable and Nontaxable Income, for more information.

Racing purses. Racing purses are FDAP in-

come and racetrack operators must withhold 30% on any purse paid to a nonresident alien racehorse owner in the absence of definite infor-

mation contained in a statement filed together with a Form W–8BEN that the owner has not raced, or does not intend to enter, a horse in another race in the United States during the tax year. If available information indicates that the racehorse owner has raced a horse in another race in the United States during the tax year, then the statement and Form W–8BEN filed for that year are ineffective. The owner may be exempt from withholding of tax at 30% on the

purse if the owner gives you Form W–8ECI, which provides that the income is effectively connected with the conduct of a U.S. trade or business and that the income is includible in the owner’s gross income.

Covenant not to compete. Payment received for a promise not to compete is FDAP income. Its source is the place where the promise for-

feared his or her right to act. Amounts paid to a nonresident alien for his or her promise not to compete in the United States are subject to NRA withholding.

Signing on. A fee paid to a professional athlete, such as a soccer or hockey player for “signing on” with the effect of preventing any other team from negotiating with the player and preventing the player from negotiating with any other team is pay for a covenant not to compete. The source is the place where the right to play is given up. If a league is made up of both foreign and U.S. teams, the fee is from sources partly in and partly outside the United States. The part of the fee that is from foreign sources is subject to NRA withholding. If there is no reasonable basis for an allocation of the fee, the entire sign-on fee is income from the United States and is subject to NRA withholding.

Effective Income

Generally, when a foreign person engages in a trade or business in the United States, all in-

come from sources within the United States other than fixed or determinable annual or peri-

odical (FDAP) income, discussed earlier, is con-

sidered effectively connected with a U.S. business. FDAP income may or may not be effectively connected with a U.S. business. For example, effectively connected income includes rents from real property if the alien chooses to treat that income as effectively connected with a U.S. trade or business.

The factors to be considered in establishing whether FDAP income and similar amounts are effectively connected with a U.S. trade or business include:

1) Whether the income is from assets used in, or held for use in, the conduct of that trade or business, or

2) Whether the activities of that trade or busi-

ness were a material factor in the realiza-

tion of the income.

Income from securities. There is a special rule determining whether income from securities is effectively connected with the conduct of a U.S. banking, financing, or similar business.

If the foreign person’s U.S. office actively and materially participates in soliciting, negotiat-

ing, or performing other activities required to arrange the acquisition of securities, the U.S. source interest or dividend income from the se-

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Chart C. Withholding Tax Rates

(Note: You must withhold tax at the following rates on payments of income unless a reduced rate or exemption is authorized under a tax treaty. The President may apply higher tax rates on income paid to residents or corporations of foreign countries that impose burdensome or discriminatory taxes on U.S. persons.)

<table>
<thead>
<tr>
<th>Type of Income</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable part of U.S. scholarship or fellowship grant paid to holder of “F,” “J,” “M,” or “Q” visa (see Scholarship and Fellowship Grants, later)</td>
<td>14%</td>
</tr>
<tr>
<td>Gross investment income from interest, dividends, rents, and royalties paid to a foreign private foundation</td>
<td>4%</td>
</tr>
<tr>
<td>Pensions—part paid for personal services (see Pensions, Annuities, and Alimony, later)</td>
<td>Graduated rates in Circular A or Circular E</td>
</tr>
<tr>
<td>Wages paid to a nonresident alien employee (see Pay for Personal Services Performed, later)</td>
<td></td>
</tr>
<tr>
<td>Each foreign partner’s share of effectively connected income of the partnership (see Partnership Withholding on Effectively Connected Income, later)</td>
<td>38.6% or 35%</td>
</tr>
<tr>
<td>Distributions of effectively connected income to foreign partners by publicly traded partnerships (see Publicly Traded Partnerships, later)</td>
<td>38.6%</td>
</tr>
<tr>
<td>Dispositions of U.S. real property interests (see U.S. Real Property Interest, later)</td>
<td>10% (or other amount)</td>
</tr>
<tr>
<td>All other income payments subject to withholding</td>
<td>30%</td>
</tr>
</tbody>
</table>

Interest

Interest from U.S. sources paid to foreign payees is subject to NRA withholding. When making a payment on an interest bearing obligation, you must withhold on the gross amount of stated interest payable on the interest payment date, even if the payment or a portion of the payment may be a return of capital rather than interest.

A substitute interest payment made to the transferee of a security in a securities lending transaction or a sale-repurchase transaction is treated the same as the interest on the transferred security.

Interest paid by U.S. obligors—general (Income Code 1). With specific exceptions, such as portfolio interest, you must withhold on interest paid or credited on bonds, debentures, notes, open account indebtedness, government obligations, certain deferred payment arrangements (as provided in section 483 of the Internal Revenue Code) or other evidences of indebtedness of U.S. obligors. U.S. obligors include the U.S. Government or its agencies or instrumentalities, any U.S. citizen or resident, any U.S. corporation, and any U.S. partnership.

If, in a sale of a corporation’s property, payment of the bonds or other obligations of the corporation is assumed by the buyer, that buyer, whether an individual, partnership, or corporation, must deduct and withhold the taxes that would be required to be withheld by the selling corporation as if there had been no sale or transfer. Also, if interest coupons are in default, the tax must be withheld on the gross amount of interest whether or not the payment is a return of capital or the payment of income.

A resident alien paying interest on a margin account maintained with a foreign brokerage
firm must withhold from the interest whether the interest is paid directly or constructively.

Interest on bonds of a U.S. corporation paid to a foreign corporation not engaged in a trade or business in the United States is subject to NRA withholding even if the interest is guaranteed by a foreign corporation that made payment outside the United States.

Domestic corporations must withhold on interest credited to foreign subsidiaries.

Original issue discount (Income Code 30). Original issue discount paid on the redemption of an obligation is subject to NRA withholding. Original issue discount paid as part of the purchase price of an obligation sold or exchanged, other than in a redemption, is not subject to NRA withholding unless the purchase is part of a plan the principal purpose of which is to avoid tax and the withholding agent has actual knowledge or reason to know of the plan. Withholding by a person other than the issuer of an obligation (or the issuer’s agent) is not required unless the obligation is issued after December 31, 2000.

The original issue discount subject to NRA withholding is the taxable amount of original issue discount. The taxable amount is the original issue discount accrued while the obligation was held by the foreign beneficial owner up to the time the obligation was sold or exchanged or a payment was made, reduced by any original issue discount that was previously taxed. If a payment was made, the tax due on the original issue discount may not exceed the payment reduced by the tax imposed on the portion of the payment that is qualified stated interest.

If you cannot determine the taxable amount, you must withhold on the entire amount of original issue discount accrued from the date of issue until the date of redemption (or sale or exchange, if subject to NRA withholding) determined on the basis of the most recently published Publication 1212, List of Original Issue Discount Instruments.

For more information on original issue discount, see Publication 550, Investment Income and Expenses.

Reduced Rates of Withholding on Interest

Certain interest is subject to a reduced rate of tax or exemption from withholding.

Portfolio interest. Interest and original issue discount that qualifies as portfolio interest is not subject to NRA withholding. To qualify as portfolio interest, the interest must be otherwise subject to NRA withholding, must be paid on obligations issued after July 18, 1984, and must meet certain other requirements.

Obligations not in registered form. Interest on an obligation that is not in registered form (bearer obligation) is portfolio interest if the obligation is foreign-targeted. A bearer obligation is foreign-targeted if:

1) There are arrangements to ensure that the obligation will be sold, or resold in connection with the original issue, only to a person who is not a United States person,

2) Interest on the obligation is payable only outside the United States and its possessions, and

3) The face of the obligation contains a statement that any United States person who holds the obligation will be subject to limits under the United States income tax laws.

Documentation is not required for interest on bearer obligations to qualify as portfolio interest. In some cases, however, you may need documentation for purposes of Form 1099 reporting and backup withholding.

Obligations in registered form. Portfolio interest includes interest paid on an obligation that is in registered form, and for which you have received documentation that the beneficial owner of the obligation is not a United States person.

If the registered obligation is not targeted to foreign markets, you must receive documentation on which you may rely to treat the payee as a foreign person that is the beneficial owner of the interest. The documentation required is a valid Form W–BEN (a valid Form W–8EXP from an entity that completes the Form W–8EXP for other purposes is also acceptable) or, if allowable, valid documentary evidence. See Publication 1212, List of Original Issue Discount Instruments.

For more information on original issue discount, see Publication 550, Investment Income and Expenses.

Ten-percent owners. Interest paid to a foreign person that owns 10% or more of the total combined voting power of all classes of stock of a corporation, or 10% or more of the capital or profits interest in a partnership, that issued the obligation on which interest is paid is not portfolio interest. Generally, the constructive ownership of stock rules apply in determining if a person is a 10% shareholder of a corporation.

Banks. Except in the case of interest paid on an obligation of the United States, interest paid to a bank on an extension of credit made pursuant to a loan agreement entered into in the ordinary course of the bank’s trade or business does not qualify as portfolio interest.

Controlled foreign corporations. Interest paid to a controlled foreign corporation from a person related to the controlled foreign corporation is not portfolio interest.

Contingent interest. Portfolio interest generally does not include contingent interest. Contingent interest is interest that is determined by reference to any of the following:

• Any receipts, sales, or other cash flow of the debtor or related person.

• Income or profits of the debtor or related person.

• Any change in value of any property of the debtor or a related person.

• Any dividend, partnership distributions, or similar payments made by the debtor or a related person.

The term "related person" is defined in section 871(h)(4)(B) of the Internal Revenue Code.

The contingent interest rule does not apply to any interest paid or accrued on any indebtedness with a fixed term that was issued:

• On or before April 7, 1993, or

• After April 7, 1993, pursuant to a written contract in effect on that date and at all times thereafter before that indebtedness was issued.

Interest on real property mortgages (Income Code 2). Certain treaties (for example, the U.S.—Egypt treaty) permit a reduced rate of tax or exemption for interest paid or credited on real property mortgages. This is interest paid on any type of debt instrument that is secured by a mortgage or deed of trust on real property located in the United States, regardless of whether the mortgagor (or grantor) is a U.S. citizen or a U.S. business entity.

Interest paid to controlling foreign corporations (Income Code 3). Certain treaties (for example, the U.S.—Greece treaty) permit a reduced rate or exemption for interest paid by a domestic corporation to a controlling foreign corporation. The interest may be on any type of debt including open or unsecured accounts payable, notes, certificates, bonds, or other evidences of indebtedness. A controlling foreign corporation is a corporation of the treaty country that controls, directly or indirectly, more than 50% of the entire voting power of the paying corporation.

Interest paid by foreign corporations (Income Code 4). If a foreign corporation is engaged in a U.S. trade or business, any interest paid by the foreign corporation’s trade or business in the United States (branch interest) is subject to NRA withholding as if paid by a domestic corporation (without considering the “payer having income from abroad” exception). As a result, the interest paid to foreign payees is generally subject to NRA withholding. In addition, if “allocable interest” exceeds the branch interest paid, the excess interest is also subject to tax and reported on the foreign corporation’s income tax return, Form 1120–F. See Instructions for Form 1120–F for more information.

If there is no treaty provision that reduces the rate of withholding on branch interest, you must withhold tax at the statutory rate of 30% on the interest paid by a foreign corporation’s U.S. trade or business.
In general, payees of interest from a U.S. trade or business of a foreign corporation are entitled to reduced rates of, or exemption from, tax under a treaty in the same manner and subject to the same conditions as if they had received the interest from a domestic corporation. However, a foreign corporation that receives interest paid by a U.S. trade or business of a foreign corporation must also be a qualified resident of its country of residence to be entitled to benefits under that country’s tax treaty. If the foreign corporation is a resident of a country that has entered into an income tax treaty since 1987 that contains a limitation on benefits article, the foreign corporation need only satisfy the limitation on benefits article in that treaty to qualify for a reduced rate of tax.

Alternatively, a payee may be entitled to treaty benefits under the payor’s treaty if there is a provision that applies specifically to interest paid by the payor foreign corporation. This provision may exempt all or a part of this interest. Some treaties provide for an exemption regardless of the payee's residence or citizenship, while others provide for an exemption according to the payee's status as a resident or citizen of the payor's country. A foreign corporation that pays interest must be a qualified resident (under section 884 of the Internal Revenue Code) of its country of residence for the payor’s treaty to exempt payments from tax by the foreign corporation. However, if the foreign corporation is a resident of a country that has entered into an income tax treaty since 1987 that contains a limitation on benefits article, the foreign corporation need only satisfy the limitation on benefits article in that treaty to qualify for the exemption.

Interest on deposits (Income Code 29). Foreign persons are not subject to withholding on interest that is not connected with a U.S. trade or business if it is from:

1) Deposits with persons carrying on the banking business, 
2) Deposits or withdrawable accounts with savings institutions chartered and supervised under federal or state law as savings and loan or similar associations, such as credit unions, if the interest or withdrawal is not subject to NRA withholding.

An interest exemption does not require a Form W-8BEN. However, a Form W-8BEN may be required for purposes of Form 1099 reporting and backup withholding.

The deposit interest exception does not apply to Form 1042–S to report certain payments of interest on deposits. See Deposit interest paid to alien individuals who are residents of Canada under Returns Required, later.

Interest from foreign business arrangements. In general, interest received from a resident alien individual or a domestic corporation is not subject to NRA withholding if it is at least 80% of the payer’s gross income from all sources has been from active foreign business for the 3 tax years of the payer before the year in which the interest is paid, or for the applicable part of the 3 years. Active foreign business income is gross income which is:

1) Derived from sources outside the United States, and
2) Attributable to the active conduct of a trade or business in a foreign country or possession of the United States by the individual or corporation.

However, limits apply if the recipient is considered to be a related person (see section 861(c) of the Internal Revenue Code). A foreign beneficial owner does not need to file a Form W–8 or documentary evidence for this exception. However, documentation may be required for purposes of Form 1099 reporting and backup withholding.

Sales of bonds between interest dates. Amounts paid as part of the purchase price of an obligation sold or exchanged between interest payment dates is not subject to NRA withholding. This does not apply if the sale or exchange is part of a plan the principal purpose of which is to avoid tax and you have actual knowledge or reason to know of the plan. The exemption from NRA withholding applies even if you do not have any documentation from the payee. However, documentation may be required for purposes of Form 1099 reporting and backup withholding.

Short-term obligations. Interest and original issue discount paid on an obligation that was issued at a discount and that is payable 183 days or less from the date of its original issue (without regard to the period held by the tax-payer) is not subject to NRA withholding. This exemption applies even if you do not have any documentation from the payee. However, documentation may be required for purposes of Form 1099 reporting and backup withholding.

Income from U.S. Savings Bonds of residents of the Ryukyu Islands or the Trust Territory of the Pacific Islands. Interest from a Series E, Series EE, Series H, or Series HH U.S. Savings Bond is not subject to NRA withholding if the nonresident alien individual acquires the bond while a resident of the Ryukyu Islands or the Trust Territory of the Pacific Islands.

Dividends. The following types of dividends paid to foreign payees are generally subject to NRA withholding:

1) Represents a nontaxable distribution payable in stock or stock rights.
2) Represents a distribution in part or full payment in stock or stock rights.
3) Is not paid out of current or accumulated earnings and profits, based on a reasonable estimate of the anticipated amount of earnings and profits for the tax year of the distribution.
4) Represents a capital gain dividend or an exempt interest dividend by a regulated investment company, or
5) Is subject to withholding under section 1445 of the Internal Revenue Code (withholding on dispositions of U.S. real property interests), if the foreign corporation is a U.S. real property holding corporation or a real estate investment trust (REIT).

The election is made by actually reducing the amount of withholding at the time the distribution is paid.

Dividends paid by a domestic corporation (an "80/20" company). Generally, a percentage of any dividend paid by a domestic corporation that received at least 80% of its gross income from the active conduct of a foreign business for a testing period to the payee is not subject to NRA withholding. The testing period is the 3 tax years before the year in which the dividends are declared or paid, or a shorter period if the corporation was not in existence for 3 years. The percentage is reduced by dividing the corporation's foreign gross income for the testing period by the corporation's total gross income for that period.

Main business in Puerto Rico or the Virgin Islands. Dividends paid by a domestic corporation that generally conducts its business activities in Puerto Rico or the Virgin Islands, and that has chosen the Puerto Rico economic activity credit or the possession tax credit are not subject to NRA withholding.

Consent dividends. If you receive a Form 872, Consent of Shareholder To Include Specific Amount in Gross Income, from a nonresident alien individual or foreign shareholder who agrees to treat the amount as a taxable dividend, you must pay and report on Form 1042 and Form 1042–S any withholding tax you would have withheld if the dividend had been actually paid.

Dividends qualifying for direct dividend rate (Income Code 7). A treaty may reduce the rate of withholding on dividends from that which generally applies under the treaty if the shareholder directly owns the required percentage, although some treaties permit the percentage to be met by direct or indirect ownership. The preferential rate may apply to the payment of a deemed dividend under section 304(a)(1) of the Internal Revenue Code. Under some treaties, the preferential rate for dividends qualifying for the direct dividend rate applies only if no more than a certain percentage of the paying corporation’s
gross income for a certain period consists of dividends and interest other than dividends and interest from subsidiaries or from the active conduct of a banking, financing, or insurance business. A foreign person claiming the non-portfolio stock trade rate should complete line 10 of Form W–8BEN regarding special rates and conditions.

Consent dividends. If you receive a Form 972 from a foreign parent corporation, which agrees to treat the amount as a tax-exempt dividend, you must pay and report on Form 1042 and Form 1042–S any withholding tax you would have withheld if the dividend had been actually paid.

Dividends paid by foreign corporations. Dividends paid by a foreign corporation are generally subject to NRA withholding. If 25% or more of its gross income is effectively connected (or treated as effectively connected) with a U.S. trade or business for the 3 tax years (or shorter period) before the year in which the dividends are paid, taxes should be withheld in the same ratio that the effectively connected gross income bears to the total gross income of the foreign corporation. If less than 25% of the corporation’s gross income is effectively connected with a U.S. trade or business, then the dividends are not subject to NRA withholding. The payment to a foreign corporation by a foreign corporation of a deemed dividend holding. The payment to a foreign corporation by sources within the United States. However, then the dividends are not subject to the branch profits tax.

Many tax treaties exempt certain types of gains from U.S. income tax. The conditions and annuities that you pay that are from personal services also may include rents for the use or lease of tangible personal property, including real property, but do not include personal services in the United States. You may, however, apply withholding at graduated rates to the portion of a distribution that arises from the performance of services in the United States after December 31, 1986.

Interest, dividends, and annuities are treated as separate categories forever. You may apply a reduced rate of withholding when the branch profits tax is prohibited by a treaty.

Corporation subject to branch profits tax. If a foreign corporation is subject to branch profits tax for any tax year, withholding is not required on any dividends paid by the corporation out of its earnings and profits for that tax year. Dividends may be subject to NRA withholding if they are attributable to any earnings and profits when the branch profits tax is prohibited by a treaty.

A foreign person may claim a treaty benefit on dividends paid by a foreign corporation to the extent the dividends are paid out of earnings and profits in a year in which the foreign corporation was not subject to the branch profits tax. However, you may apply a reduced rate of withholding under an income tax treaty only under rules similar to the rules that apply to treaty benefits claimed on branch interest paid by a foreign corporation. You should check the specific treaty provision.

Gains

You generally do not need to withhold on gains from the sale of real or personal property because it is not FDAP income. However, see U.S. Real Property Interest, later.

Capital gains (Income Code 9). You must withhold at 30%, or if applicable, a reduced treaty rate, on the gross amount of the following items:

1) Gains on disposal of timber, coal, or domestic iron ore with a retained economic interest, unless an election is made to treat those gains as income effectively connected with a U.S. trade or business.

2) Gains on contingent payments received from the sale or exchange after October 4, 1966, of patents, copyrights, secret processes and formulas, goodwill, trademarks, trade brands, franchises, and other like property.

3) Gains on certain transfers of all substantial rights to, or an undivided interest in, patents if the transfers were made after October 4, 1966, and

4) Certain gains from the sale or exchange of original issue discount obligations issued after March 31, 1972. For more on withholding on original issue discount obligations, see Interest, earlier.

If you do not know the amount of the gain, you must withhold an amount necessary to assure that the amount withheld will not be less than 30% of the recognized gain. The amount to be withheld, however, must not be more than 30% of the amount payable because of the transaction.

Unless you have reason to believe otherwise, you may rely upon the written statement of the person entitled to the income as to the amount of gain. The statement, prepared according to regulations, must show the computation of the gain.

Tax treaties. Many tax treaties exempt certain types of gains from U.S. income tax. The conditions for allowing the exemptions vary under each treaty. For example, under some treaties, a nonresident alien individual may not be present in the United States for more than a specified period for the exemption to apply. Be sure to carefully check the provision of the treaty that applies before allowing an exemption from withholding.

Royalties

In general, you must withhold tax on the payment of royalties from sources in the United States. However, certain types of royalties are given reduced rates or exemptions under some tax treaties. Accordingly, these different types of royalties are treated as separate categories for withholding purposes.

Industrial royalties (Income Code 10). This category of income includes royalties for the use of, or the right to use, patents, trademarks, secret processes and formulas, goodwill, franchises, “know-how,” and similar rights. It also may include rents for the use or lease of personal property. Under certain tax treaties, different rates may apply to royalties for information concerning industrial, commercial, and scientific know-how.

Motion picture or television copyright royalties (Income Code 11). This category refers to royalties paid for the use of motion picture and television copyrights.

Other royalties (e.g., copyright, recording, publishing) (Income Code 12). The category refers to royalties paid for the use of copyrights on books, periodicals, articles, etc., except motion picture and television copyrights.

Real Property Income and Natural Resources Royalties (Income Code 13) You must withhold tax on income (such as rents and royalties) from real property located in the United States and held for the production of income, unless the foreign payee elects to treat this income as effectively connected with a U.S. trade or business. If the foreign payee chooses to treat this income as effectively connected, the payee must give you Form W–8ECI (discussed earlier). This real property income includes royalties from mines, wells, or other natural deposits, as well as ordinary rents for the use of real property. For withholding that applies to the disposition of U.S. real property interests, see U.S. Real Property Interest, later.

Pensions, Annuities, and Alimony (Income Code 14)

The following rules apply to withholding on pensions, annuities, and alimony of foreign payees.

Pensions and annuities. Generally, you must withhold tax on the gross amount of pensions and annuities that you pay that are from sources within the United States. However, most tax treaties provide that private pensions and annuities are exempt from withholding.

In the absence of a treaty exemption, you must withhold at the statutory rate of 30% on the entire distribution that is from sources within the United States. You may, however, apply withholding at graduated rates to the portion of a distribution that arises from the performance of services in the United States after December 31, 1986. You may apply a reduced rate of withholding under an income tax treaty only under rules similar to the rules that apply to treaty benefits claimed on branch interest paid by a foreign corporation.

No withholding. Do not withhold tax on an annuity payment to a nonresident alien if at the time of the first payment from the plan, 90% or more of the employees eligible for benefits under the plan are citizens or residents of the United States and the payment is:

1) For the nonresident’s personal services performed outside the United States, or

2) For personal services by a nonresident individual present in the United States for 90 days or less during each tax year, whose pay for those services does not exceed $3,000, and the personal services are performed for:

a) A nonresident alien individual, foreign partnership, or foreign corporation not engaged in a trade or business in the United States, or

b) An office or place of business of a U.S. resident or citizen which is maintained outside the United States.
Grants (Income Code 15) Reduced withholding. These rules, but less than 90% of the employees subject to 30% withholding. The type and rule above print on all proofs including departmental reproduction proofs. MUST be removed before printing.

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The foreign person entitled to the payments must provide you with a Form W–8BEN that contains the Tin of the foreign person.

Alimony payments. Generally, alimony payments made to a nonresident alien are taxable and subject to NRA withholding whether the recipients are residing abroad or are resident in the United States.

Many tax treaties, however, provide for an exemption from withholding for alimony payments. These treaties are shown in Table 1, by a footnote reference under Income code number 14.

Alimony payments made to a nonresident alien by a U.S. ancillary administrator of a nonresident alien estate are from foreign sources and are not subject to withholding.

Scholarships and Fellowship Grants (Income Code 15)

A scholarship or fellowship grant is an amount given to an individual for study, training, or research, and which does not constitute compensation for personal services. Whether a fellowship grant from U.S. sources is subject to NRA withholding depends on the nature of the payments and whether the recipient is a candidate for a degree.

Candidate for a degree. Do not withhold on a qualified scholarship from U.S. sources granted to a nonresident alien temporarily present in the United States if the recipient is a candidate for a degree. A qualified scholarship means any amount paid to an individual as a scholarship or fellowship grant to the extent that, in accordance with the conditions of the grant, the amount is to be used for the following expenses:

1) Tuition and fees required for enrollment or attendance at an educational organization, and

2) Fees, books, supplies, and equipment required for courses of instruction at the educational organization.

The payment of a qualified scholarship to a nonresident alien is not reportable and is not subject to NRA withholding. However, the portion of a scholarship or fellowship grant paid to a nonresident alien which does not constitute a qualified scholarship is reportable on Form 1042–S and is subject to NRA withholding. For example, those portions of a scholarship devoted to travel, room, and board are subject to NRA withholding and are reported on Form 1042–S. The withholding rate is 14% on taxable days if the grant is from U.S. sources if the following requirements are met:

1) The grant must be for study, training, or research at an educational organization in the United States, and
2) The grant must be made by:
   a) A tax-exempt organization operated for charitable, religious, educational, etc. purposes;
   b) A foreign government;
   c) A U.S. state, local government or agency, or
   d) An international organization, or a binaional or multinational educational or cultural organization created or continued by the Mutual Educational and Cultural Exchange Act of 1961 (known as the Fulbright-Hays Act).

If the grant does not meet both (1) and (2) above, you must withhold at 30% on the amount of the grant that is from U.S. sources.

Reduced withholding. Nonresident alien students or grantees who receive U.S. source grants or scholarships may be entitled to reduced withholding on the taxable part of the grant or scholarship under an alternate withholding procedure. The student or grantee must have been admitted into the United States on an "F," "J," "M," or "Q" visa. This alternate withholding procedure is not mandatory.

Under this alternate withholding procedure, the student or grantee can also enter on line 4 the instructions given here and forward it to you, the payer of the scholarship, or your designated withholding agent. You may rely on the information on Form W–4 unless you know or have reason to know it is incorrect. You must file a Form 1042–S (discussed later) for each student or grantee who gives you, or your withholding agent, a Form W–4.

Each student or grantee who files a Form W–4 must file an annual U.S. income tax return to be allowed the exemptions and deductions claimed on that form. If the individual is in the United States during more than one tax year, he or she must attach a statement to the Form W–4 indicating that the individual has filed a U.S. income tax return for the previous year. If he or she has not been in the United States long enough to file a return, the individual must attach a statement to the Form W–4 saying that a timely U.S. income tax return will be filed.

The student or grantee can also enter on line 4 the amount of the grant that is from U.S. sources if away-from-home expenses or other itemized deductions (discussed later).

The actual expenses or the per diem allowance shown on line A of the worksheet in addition to the personal exemption amount.

The student or grantee can claim other exemptions that will be deductible on Form 1040NR. These include student loan interest, certain state and local income taxes, charitable contributions, casualty losses, and moving expenses.

Generally, zero (0%) should be shown on line B of the worksheet. But, a student or grantee who qualifies under Article 21(2) of the United States–India Tax Treaty is entitled to the standard deduction if he or she does not claim away-from-home expenses or other itemized deductions (discussed later).

Generally, zero (0%) should be shown on lines C and D of the worksheet. But, an additional daily exemption amount may be allowed for the spouse and each dependent if the student or grantee is:

1) A resident of Canada, Mexico, Japan, or South Korea,
2) A U.S. national (a citizen of American Samoa, or a Northern Mariana Islander who is not a tax resident of the United States but has been physically present in the United States for more than one tax year), or
3) Eligible for the benefits of Article 21(2) of the United States—India Income Tax Treaty.

These additional amounts should be entered on lines C and D, as appropriate.

As lines E, F, and G of the worksheet do not apply to nonresident aliens subject to this procedure, there should be no entries on those lines.

The nonresident alien student or grantee may deduct away-from-home expenses (meals, lodging, and transportation) on Form W–4 if he or she expects to be away from home for one year or less. The amount of the claimed expenses should be the anticipated actual amount, if known. If the amount of the expenses is not known at the time the Form W–4 is filed with you, the current per diem allowance in effect for participants in the Career Education Program under the Federal Travel Regulations may be claimed on Form W–4. The allowable amount is $18.00 per day.

The actual expenses of the per diem allowance shown on line A of the worksheet in addition to the personal exemption amount.

The student or grantee can claim other exemptions that will be deductible on Form 1040NR. These include student loan interest, certain state and local income taxes, charitable contributions, casualty losses, and moving expenses.

Generally, zero (0%) should be shown on line E of the worksheet. But, a student or grantee who qualifies under Article 21(2) of the United States–India Tax Treaty is entitled to the standard deduction if he or she does not claim away-from-home expenses or other itemized deductions (discussed later).

Generally, zero (0%) should be shown on lines F and G of the worksheet. But, an additional daily exemption amount may be allowed for the spouse and each dependent if the student or grantee is:

1) A resident of Canada, Mexico, Japan, or South Korea,
2) A U.S. national (a citizen of American Samoa, or a Northern Mariana Islander who is not a tax resident of the United States but has been physically present in the United States for more than one tax year), or
3) Eligible for the benefits of Article 21(2) of the United States—India Income Tax Treaty.

These additional amounts should be entered on lines F and G, as appropriate.

As lines H, I, and J of the worksheet do not apply to nonresident aliens subject to this procedure, there should be no entries on those lines.

The nonresident alien student or grantee may deduct away-from-home expenses (meals, lodging, and transportation) on Form W–4 if he or she expects to be away from home for one year or less. The amount of the claimed expenses should be the anticipated actual amount, if known. If the amount of the expenses is not known at the time the Form W–4 is filed with you, the current per diem allowance in effect for participants in the Career Education Program under the Federal Travel Regulations may be claimed on Form W–4. The allowable amount is $18.00 per day.

The actual expenses of the per diem allowance shown on line H of the worksheet in addition to the personal exemption amount.

The student or grantee can claim other exemptions that will be deductible on Form 1040NR. These include student loan interest, certain state and local income taxes, charitable contributions, casualty losses, and moving expenses.

Generally, zero (0%) should be shown on line I of the worksheet. But, a student or grantee who qualifies under Article 21(2) of the United States–India Tax Treaty is entitled to the standard deduction if he or she does not claim away-from-home expenses or other itemized deductions (discussed later).

Generally, zero (0%) should be shown on line J of the worksheet. But, an additional daily exemption amount may be allowed for the spouse and each dependent if the student or grantee is:

1) A resident of Canada, Mexico, Japan, or South Korea,
2) A U.S. national (a citizen of American Samoa, or a Northern Mariana Islander who is not a tax resident of the United States but has been physically present in the United States for more than one tax year), or
3) Eligible for the benefits of Article 21(2) of the United States—India Income Tax Treaty.

These additional amounts should be entered on lines I and J, as appropriate.

As lines K, L, and M of the worksheet do not apply to nonresident aliens subject to this procedure, there should be no entries on those lines.

The nonresident alien student or grantee may deduct away-from-home expenses (meals, lodging, and transportation) on Form W–4 if he or she expects to be away from home for one year or less. The amount of the claimed expenses should be the anticipated actual amount, if known. If the amount of the expenses is not known at the time the Form W–4 is filed with you, the current per diem allowance in effect for participants in the Career Education Program under the Federal Travel Regulations may be claimed on Form W–4. The allowable amount is $18.00 per day.

The actual expenses of the per diem allowance shown on line K of the worksheet in addition to the personal exemption amount.

The student or grantee can claim other exemptions that will be deductible on Form 1040NR. These include student loan interest, certain state and local income taxes, charitable contributions, casualty losses, and moving expenses.

Generally, zero (0%) should be shown on line L of the worksheet. But, a student or grantee who qualifies under Article 21(2) of the United States–India Tax Treaty is entitled to the standard deduction if he or she does not claim away-from-home expenses or other itemized deductions (discussed later).

Generally, zero (0%) should be shown on line M of the worksheet. But, an additional daily exemption amount may be allowed for the spouse and each dependent if the student or grantee is:

1) A resident of Canada, Mexico, Japan, or South Korea,
2) A U.S. national (a citizen of American Samoa, or a Northern Mariana Islander who is not a tax resident of the United States but has been physically present in the United States for more than one tax year), or
3) Eligible for the benefits of Article 21(2) of the United States—India Income Tax Treaty.

These additional amounts should be entered on lines L and M, as appropriate.
After receipt and acceptance of the Form W–4, the payer must withhold at the graduated rates in Publication 15 (Circular E) as if the grant or scholarship income were wages. The gross amount of the income is reduced by the total amount of exemptions and deductions on the Form W–4 and the withholding tax is figured on the rest.

When completing Form 1042–S for the student or grantee, enter the gross scholarship or fellowship grant in box 2, enter the withholding allowance amount from line H of the Personal Allowances Worksheet of Form W–4 in box 3, and show the net of these two amounts in box 4.

Pay for services rendered. Pay for services rendered as wages to an alien who also is the recipient of a scholarship or fellowship grant usually is subject to graduated withholding according to the rules discussed later in Wages Paid to Employees—Graduated Withholding. This includes taxable amounts an individual who is a candidate for a degree receives for teaching, doing research, and carrying out other part-time employment required as a condition for receiving the scholarship or fellowship grant.

Grants given to students, trainees, or researchers which require the performance of personal services are subject to the same tax withholding and reporting obligations that apply to other classes of aliens. Illegal aliens who are nonresident aliens and who receive income from performing services which are personal services are not subject to income tax on those amounts.

Disburse the grant. Withholding agents who pay grants that are in fact wages must report such grants on Forms 1099–MISC, W–4, and W–2 and withhold income tax on them at the graduated rates. Withholding agents may not allow tax treaty exemptions that apply to scholarships and fellowships to be applied to grants which are really wages. It is the responsibility of the withholding agent to determine whether a grant is “wages” or a “scholarship or fellowship,” and to report and withhold on the grant accordingly. An alien student, trainee, or researcher may not claim a scholarship or fellowship treaty exemption against income which has been reported to him on Form W–2 as wages.

Per diem paid by the U.S. Government. Per diem for subsistence paid by the U.S. Government (directly or by contract) to a nonresident alien engaged in a training program in the United States under the Mutual Security Act of 1954 is not taxable. Per diem paid by the U.S. Government is not considered income from sources within the United States. Those made for activities conducted outside the United States are treated as income from foreign sources. These provisions do not apply to salaries or other pay for services.

Grant. The purpose of a grant must be to achieve a specific objective, produce a report or other similar product, or improve or enhance a literary, artistic, musical, scientific, teaching, or other similar capacity, skill, or talent of the grantee. A grant must also be an amount which does not qualify as a scholarship or fellowship. The grantor must not intend the amount to be given to the grantee for the purpose of aiding the grantee to perform study, training, or research.

Prizes and awards. Prizes and awards are amounts received primarily in recognition of religious, charitable, scientific, educational, artistic, literary, or civic achievement, or are received as the result of entering a contest. A prize or award that does not qualify for tax purposes under any of the conditions is not taxable.

1) The recipient was selected without any action on his or her part to enter the contest or proceeding.
2) The recipient is not required to render substantial future services as a condition to receive the prize or award, and
3) The prize or award is transferred by the payer to a governmental unit or tax-exempt charitable organization as designated by the recipient.

Targeted grants and achievement awards. Targeted grants and achievement awards received by nonresident aliens for activities conducted outside the United States are treated as income from foreign sources. Targeted grants and achievement awards are issued by exempt organizations or by the United States (or one of its instrumentalities) and who receive income from performing services which are personal services are subject to the same tax withholding and reporting obligations that apply to other classes of aliens. Illegal aliens who are nonresident aliens and who receive income from performing personal services are subject to 30%.
withholding unless exempt under some provi-
sion of law or a tax treaty. Illegal aliens who are
resident aliens and who receive income from
performing dependent personal services are
subject to the same reporting and withholding
obligations which apply to U.S. citizens who
receive the same kind of income.

Form 8233. Exemption From Withholding on
Compensation for Independent (and Certain
Dependent) Personal Services of a Nonresident
Alien Individual, is used by a nonresident alien
dividend to claim a tax treaty exemption from
withholding on some or all compensation paid for:

1) Independent personal services (self-employment),
2) Dependent personal services, or
3) Personal services income and noncom-
pensation from the United States.

Persons providing independent personal
services can use Form 8233 to claim the per-
sonal exemption amount.

Form W-4, Employee’s Withholding Allow-
ance Certificate, is used by a person providing
dependent personal services to claim the per-
sonal exemption amount, but not a tax treaty
exemption. Nonresident alien individuals are
subject to special instructions for completing the
Form W-4. See the discussion under Wages
Paid to Employees—Graduated Withholding,
later.

Pay for independent personal services (In-
come Code 16). Independent personal ser-
vice(s) (a term commonly used in tax treaties) are
personal services performed by an independent
nonresident alien contractor as contrasted with
those performed by an employee. This category
of pay includes payments for professional ser-
vice, such as fees of an attorney, physician, or
accountant made directly to the person perform-
ing the services. It also includes honoraria paid
to colleges and universities visiting teachers,
lecturers, and researchers.

Pay for independent personal services is
subject to NRA withholding and reporting as
follows:

30% rate. You must withhold at the statutory
rate of 30% on all payments unless the alien
enters into a withholding agreement or receives a
final payment exemption (discussed later).

The amount of pay subject to 30% withhold-
ing may be reduced by the personal exemption
amount ($3,000 for 2002) if the alien gives you a
properly completed Form 8233. A nonresident
alien is allowed only one personal exemption.
However, individuals who are residents of Ca-
 nada, Mexico, Japan, or South Korea, or are
U.S. nationals (defined below) are generally en-
titiled to the same exemptions as U.S. citizens.

Student or scholarship appointments covered
by Article 21(2) of the United States—India In-
come Tax Treaty may claim an additional ex-
emption for their spouse if a joint return is not
filed, and if the spouse has no gross income for
the year and is not the dependent of another
taxpayer. They may also claim additional ex-
ceptions for children who reside with them in
the United States at any time during the year,
but only if the dependents are U.S. citizens or
nationals or residents of the United States, Ca-
 nada, or Mexico. They may not claim exemp-
tions for dependents who are admitted to the
United States on “F-2,” “J-2,” or “M-2” visas
unless such dependents have become resident aliens.

Each allowable exemption must be prorated
according to the number of days during the tax
year during which the alien performs services in
the United States. Multiply the number of these
days by $8.22 (the daily exemption amount for
2002) to figure the prorated amount. Residents
of Japan and South Korea must make a further
provision of their additional exemptions based
on their gross income effectively connected with
a U.S. trade or business. The rules for this pro-
ration are discussed in detail in Publication 519.

A U.S. national is an individual who owes his
sole allegiance to the United States, but who is
not a U.S. citizen. Such an individual is usually a
citizen of American Samoa, a Northern Mari-
a Islander who chose to become a U.S. na-
tional.

Example 1. Hans Schmidt, who is a resi-
dent of Germany, worked (not as an employee) for
a U.S. company in the United States for 100
days during 2002 before returning to his coun-
try. He earned $6,000 for the services performed
(not considered wages) in the United States.
Hans is married and has three dependent chil-
dren. His wife did not work and had no income
subject to U.S. tax. Hans is allowed $822 as a
deduction against the payments for his personal
services performed in the United States (100
days × $8.22). Tax must be withheld at 30% on
the rest of his earnings, $5,178 ($6,000 – $822).

Example 2. If, in Example 1, Hans were a
resident of Canada or Mexico or a national of
the United States, working under contract with
a domestic corporation, $4,110 (100 days × $8.22
day for each of five exemptions) would be
allowed against the payments for personal ser-
vices performed in the United States. Tax must
be withheld at 30% on the rest of his earnings,
$1,890 ($6,000 – $4,110).

Withholding agreements. Pay for personal
services of a nonresident alien who is engaged
during the tax year in the conduct of a U.S. trade
or business may be wholly or partially exempted
from withholding at the statutory rate if an agree-
ment has been reached between the Commiss-
ioner or his delegate and the alien individual as
unto the amount of withholding required. This
agreement will be effective for payments cov-
ered by the agreement that are made after the
agreement is executed by all parties. The alien
individual must agree to timely file an income tax
return for the current tax year.

Final payment exemption. The final pay-
ment of compensation for personal services
may be wholly or partially exempted from
withholding at the statutory rate. This exemp-
tion does not apply to wages paid to an employee.
The nonresident alien must have been engaged
during the tax year in the conduct of a U.S. trade
or business. This exemption is available only
once during an alien individual’s tax year. It
applies to the last payment of compensation,
other than wages, for personal services ren-
dered in the United States that the individual
expects to receive from any withholding agent
during the tax year.

To obtain the final payment exemption, the
nonresident alien, or the alien’s agent, must file
the forms and the statement required by the
Commissioner or his delegate. This informa-
tion includes, but is not limited to, the follow-
ing items:

1) A statement by each withholding agent
from whom amounts of gross income ef-
fectively connected with the conduct of a
U.S. trade or business have been received
by the alien individual during the tax year.
It must show the amount of income paid
and the amount of tax withheld. The with-
holding agent must sign each statement and
include a declaration that it is made under
penalties of perjury.

2) A statement by the withholding agent from
whom the final payment of compensation
for personal services will be received
showing the amount of final payment and
the amount that would be withheld if a final
payment exemption is not granted. The
withholding agent must sign the statement
and include a declaration that it is made
under penalties of perjury.

3) A statement by the individual that he or
she does not intend to receive any other
amounts of gross income effectively con-
ected with the conduct of a U.S. trade or
business during the current tax year.

4) The amount of tax that has been withheld
(or paid) under any other provision of the
Code or regulations for any income effec-
tively connected with the conduct of a U.S.
trade or business during the current tax year.

5) The amount of any outstanding tax liabili-
ties, including any interest and penalties,
from the current tax year or prior tax peri-
ods.

6) The provision of any income tax treaty
under which a partial or complete exemp-
tion from withholding may be claimed, the
country of the individual’s residence, and a
statement of sufficient facts to justify an
exemption under that treaty.

The alien individual must give a statement,
signed and verified by a declaration that it is
made under the penalties of perjury, that all the
information provided is true, and that to his or
her knowledge no relevant information has been
omitted.

If satisfied with the information provided,
the Commissioner or his delegate will determine
the amount of the alien individual’s tentative income
tax for the tax year on gross income effectively
connected with the conduct of a U.S. trade or
business. Ordinal and necessary business ex-
penses may be taken into account if proved to
the satisfaction of the Commissioner or his dele-
gate.

The Commissioner or his delegate will pro-
vide the individual with a letter to you, the with-
holding agent, stating the amount of the final
payment of compensation for personal services
that is exempt from withholding, and the amount
that would otherwise be withheld that may be
paid to the individual due to the exemption.

The amount of pay exempt from withholding
cannot be more than $5,000. The alien individual
must give two copies of the letter to you and must also
Wages Paid to Employees—Graduated Withholding

Salaries, wages, or any other pay for personal services (referred to collectively as wages) paid to nonresident alien employees are subject to graduated withholding in the same way as for U.S. citizens and residents if the wages are effectively connected with the conduct of a U.S. trade or business. Any wages paid to a nonresident alien individual for personal services performed as an employee for an employer are generally exempt from withholding if the wages are subject to graduated withholding. Also exempt from the 30% withholding is pay for personal services performed as an employee for an employer if it is effectively connected with the conduct of a U.S. trade or business and is specifically excepted from wages. See Pay that is not wages, later.

Employer-employee relationship. For pay for personal services to qualify as wages, there must be an employer-employee relationship. Under the common law rules, every individual who performs services subject to the will and control of an employer, both as to what shall be done and how it shall be done, is an employee. It does not matter that the employer allows the employee considerable discretion and freedom of action, as long as the employer has the legal right to control both the method and the result of the services. If an employer-employee relationship exists, it does not matter what the parties call the relationship. It does not matter if the employee is called a partner, coadventurer, agent, or independent contractor. It does not matter how the pay is measured, how the individual is paid, or what the payments are called. Nor does it matter whether the individual works full-time or part-time.

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Pay that is not wages. Employment for which the pay is not considered wages (for graduated income tax withholding) includes, but is not limited to, the following items:

1) Agricultural labor if the total cash wages paid to an individual worker during the year is less than $150 and the total paid to all workers during the year is less than $2,500. But even if the total amount paid to all workers is $2,500 or more, wages of less than $150 per year paid to a worker are not subject to income tax withholding if certain conditions are met. For these conditions, see Publication 51 (Circular A), Agricultural Employer’s Tax Guide.

2) Services of a household nature performed in or about the private home of an employer, or in or about the clubrooms or house of a local college club, fraternity, or sorority. A local college club, fraternity, or sorority does not include an alumni club or chapter and may not be operated primarily as a business enterprise. Examples of these services include those performed as a cook, janitor, housekeeper, governess, gardener, or houseparent.

3) Certain services performed outside the course of the employer’s trade or business for which cash payment is less than $50 for the calendar quarter.

4) Services performed as an employee of a foreign government, without regard to citizenship, residence, or where services are performed. These include services performed by ambassadors, other diplomatic and consular officers and employees, and nondiplomatic representatives. They do not include services for a U.S. or Puerto Rican corporation owned by a foreign government.

5) Services performed within or outside the United States by an employee or officer (regardless of citizenship or residence) of an international organization designated under the International Organizations Immunities Act.

6) Services performed by a duly ordained, commissioned, or licensed minister of a church, but only if performed in the exercise of the ministry and not as an employee of the United States, a U.S. possession, or a foreign government, or any of their political subdivisions. These also include services performed by a member of a religious order in carrying out duties required by that order.

7) Tips paid to an employee if they are paid in any medium other than cash or, if in cash, they amount to less than $20 in any calendar month in the course of employment.

Services performed outside the United States. Compensation paid to a nonresident alien (other than a resident of Puerto Rico, discussed later) for services performed outside the United States is not considered wages and is not subject to graduated withholding or 30% withholding.
Withholding exemptions. The amount of wages subject to graduated withholding may be reduced by the personal exemption amount ($3,000 for 2002). The personal exemptions allowed in figuring wages subject to graduated withholding are the same as those discussed earlier under Pay for independent personal services, except that an employee must claim them on Form W–4.

Special instructions for Form W–4. A nonresident alien, a U.S. citizen or resident alien, or a domestic corporation, if the labor or services are personal services performed for an office or the international projects exception applies to 1) A nonresident alien individual, ... in a foreign country or in a U.S. possession by a domestic corporation, ... or a U.S. citizen or resident.

You can exempt the payment from withholding if you can reliably associate the payment with: during the tax year in question. for information, see the instructions for these forms.

Reporting requirements for wages and withheld taxes paid to nonresident aliens. The employer must report the amount of wages and deposits of withheld income and social security and Medicare taxes by filing Form 8104. Household employers should see Publication 926, Household Employer’s Tax Guide, for information on reporting and paying employment taxes on wages paid to household employees.

Form W–2. The employer must also report on Form W–2 the wages subject to NRA withholding and the withheld taxes. You must give copies of this form to the employee. Wages exempt from tax under a tax treaty may still be reported in the state and local wages blocks of Form W–2 if such wages are subject to state and local taxation. For more information, see the instructions for these forms.

Trust fund recovery penalty. If you are a person responsible for withholding, accounting for, or depositing or paying employment taxes, and willfully fail to do so, you may be held liable for a penalty equal to the full amount of the unpaid trust fund tax, plus interest. A responsible person for this purpose can be an officer of a corporation, a partner, a sole proprietor, or an employee of any form of business. A trustee or agent with authority over the funds of the business can also be held responsible for the penalty.

Federal unemployment tax (FUTA). The employer must pay FUTA and file Form 940 or 950–EZ, Employer’s Annual Federal Unemployment (FUTA) Tax Return. Only the employer pays this tax; it is not deducted from the employee’s wages. In certain cases, wages paid to domestic corporation, if the labor or services are performed for a domestic corporation, ... or a U.S. resident.

If the total pay is more than $3,000, the entire amount is income from sources in the United States and is subject to U.S. tax. Also, compensation paid for labor or services performed in the United States by a nonresident alien in connection with the individual’s temporary presence in the United States and is subject to U.S. tax. For this purpose, a foreign employer means:

1) A nonresident alien individual, foreign partnership, or foreign corporation, or
2) An office or place of business maintained in a foreign country or in a U.S. possession by a domestic corporation, a domestic partnership, or an individual U.S. citizen or resident.

You can exempt the payment from withholding if you can reliably associate the payment with a Form W–BEN containing the taxpayer identification number of the payee.

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who commutes from a home in Canada or Mex- 
ico to work in the United States. If an individual 
works at a fixed point or points in the United 
States (such as a factory, store, office, or desig- 
nated area or areas), the wages for services 
performed as an employee for an employer are 
subject to withholding.

Exception 4. Compensation paid for ser- 
vices performed in Puerto Rico by a nonresident 
alien who is a resident of Puerto Rico for an 
employer (other than the United States or one of 
its agencies) is not subject to withholding.

Compensation paid for either of the following 
types of services is not subject to withholding if 
the alien does not expect to be a resident of 
Puerto Rico during the entire tax year.

1) Services performed outside the United 
States but not in Puerto Rico by a nonresi- 
dent alien who is a resident of Puerto Rico 
for an employer other than the United States 
or one of its agencies, or

2) Services performed outside the United 
States by a nonresident alien who is a 
resident of Puerto Rico, as an employee of 
the United States or any of its agencies.

To qualify for the exemption from withholding 
for any tax year, the employee must give 
the employer a statement showing the employee’s 
name and address and certifying that the em- 
ployee:

1) Is not a citizen or resident of the United 
States, and

2) Is a resident of Puerto Rico who does not 
expect to be a resident for that entire tax 
year.

The statement must be signed and dated by 
the employee and contain a written declaration 
that it is made under penalties of perjury.

Tax treaties. Pay for dependent personal 
services under some tax treaties is exempt from 
U.S. income tax only if both the employer and 
the employee are treaty country residents and 
the nonresident alien employee performs the 
services while temporarily living in the United 
States (usually for not more than 183 days). 
Other treaties provide for exemption from U.S. 
tax on pay for dependent personal services if 
the employer is any foreign resident and the 
employee is a treaty country resident and the 
nonresident alien employee performs the 
services while temporarily in the United States.

Pay for teaching (Income Code 18). This 
category is given a separate income code num- 
ber because many tax treaties provide at least 
partial exemption from withholding and from 
U.S. tax. Pay for teaching means payments to a 
nonresident alien professor, teacher, or re- 
searcher by a U.S. university or other accredited 
educational institution for teaching or research 
work at the institution.

Graduated rates. Graduated withholding of 
income tax usually applies to all wages, salaries, 
and other pay for teaching and research paid by 
a U.S. educational institution during the period 
the nonresident alien is teaching or performing 
research at the institution.

A nonresident alien temporarily in the United 
States as a nonimmigrant on an “F” visa is not subject to social 
security and Medicare taxes on pay for services 
performed to carry out the purpose for which the 
alien was admitted to the United States. Social 
security and Medicare taxes should not be with- 
held or paid on this amount. However, if an alien 
is considered a resident alien, as discussed ear- 
er, that pay is subject to social security and 
Medicare taxes even though the alien is still in 
one of the nonimmigrant statuses mentioned 
above. The graduated rate rule also applies to 
Form W-2 (wages, salaries, and other pay for 
dependent or independent self-employment) 
taxes paid by the employer. Alien 
teachers, researchers, and other alien employ-

ers temporarily present in the United 
States (such as a factory, store, office, or desig-
nated area or areas), the wages for services 
performed by residents of Puerto Rico, as 
employees of the United States or any of its 
agencies.

To qualify for the exemption from withholding for any tax year, the employee must give the employer a statement showing the employee’s name and address and certifying that the employee:

1) Is not a citizen or resident of the United States, and

2) Is a resident of Puerto Rico who does not expect to be a resident for that entire tax year.

The statement must be signed and dated by the employee and contain a written declaration that it is made under penalties of perjury.

Tax treaties. Pay for dependent personal services under some tax treaties is exempt from U.S. income tax only if both the employer and the employee are treaty country residents and the nonresident alien employee performs the services while temporarily living in the United States (usually for not more than 183 days). Other treaties provide for exemption from U.S. tax on pay for dependent personal services if the employer is any foreign resident and the employee is a treaty country resident and the nonresident alien employee performs the services while temporarily in the United States.

Pay for teaching (Income Code 18). This category is given a separate income code number because many tax treaties provide at least partial exemption from withholding and from U.S. tax. Pay for teaching means payments to a nonresident alien professor, teacher, or researcher by a U.S. university or other accredited educational institution for teaching or research work at the institution.

Graduated rates. Graduated withholding of income tax usually applies to all wages, salaries, and other pay for teaching and research paid by a U.S. educational institution during the period the nonresident alien is teaching or performing research at the institution.

A nonresident alien temporarily in the United States as a nonimmigrant on an “F” visa is not subject to social security and Medicare taxes on pay for services performed to carry out the purpose for which the alien was admitted to the United States. Social security and Medicare taxes should not be withheld or paid on this amount. This exemption from social security and Medicare taxes also applies to employment performed under Curric- ular Practical Training and Optional Practical Training, on or off campus, by foreign students in “F–1,” “J–1,” “M–1” or “Q” nonimmigrant status as long as the employment is authorized by the Immigration and Naturalization Service. However, if an alien is considered a resident alien, as discussed earlier, that pay is subject to social security and Medicare taxes even though the alien is still in one of the nonimmigrant statuses mentioned above. The graduated rate rule also applies to FUTA (unemployment) taxes paid by the employer.

Any student who is enrolled and regularly attending classes at a school may be exempt from social security, Medicare, and FUTA taxes on pay for services performed for that school. See Publication 15 (Circular E).

Tax treaties. Many tax treaties provide an exemption from U.S. income tax and from with- holding on compensation paid to nonresident alien students or trainees during training in the United States for a limited period. In addition, some treaties provide an exemption from tax and withholding for compensation paid by the U.S. Government or its contractor to a nonresi- dent alien student or trainee who is temporarily present in the United States as a participant in a program sponsored by the U.S. Government (see Table 2). However, a withholding agent who is a U.S. resident, a U.S. Government agency, or its contractor must report the amount of pay on Form 1042–S.

Claimants must give you either Form W–BEN or 8233, as applicable, to obtain these treaty benefits.

Artists and Athletes (Income Code 20)

Because many tax treaties contain a provision for pay to artists and athletes, a separate cate- gory is assigned these payments for withholding purposes. This category includes payments made for performances by public entertainers (such as singers, actors, motion picture, radio, or televisi- 
on artists, or musicians) or athletes.

Withholding rate. You must withhold tax at a 30% rate on payments to artists and athletes for services performed as independent contractors. See Pay for independent personal services, ear- lier, for information. You must withhold tax at graduated rates on payments to artists and athletes for services performed as employees. See Pay for dependent personal services, ear- lier, for more information. However, in any situa- tion where the nature of the relationship between the payor of the income and the artist or athlete is not ascertainable, you should with- hold at a rate of 30%.

Central withholding agreements. Nonres-ident alien entertainers or athletes performing or participating in athletic events in the United States may be able to enter into a withholding agreement with the IRS for reduced withholding provided certain requirements are met. Under no circumstances will a withholding agreement reduce taxes withheld to less than the alien’s anticipated income tax liability.

Nonresident alien entertainers or athletes re- questing a central withholding agreement must provide the following information.
Gambling winnings (Income Code 28).

Tax treaties. Under many tax treaties, compensation paid to public entertainers or athletes for services performed in the United States is exempted from U.S. income tax on income directly related to the use of a vessel or aircraft. The income that is not subject to NRA withholding may be exempt based on factors that cannot be determined until after the end of the year.

Other Income

For the discussion of Income Codes 24, 25, and 26, see U.S. Real Property Interest, later. For the discussion of Income Code 27, see Publicly Traded Partnerships, later.

Gambling winnings (Income Code 28).

In general, nonresident aliens are subject to NRA withholding at 30% on the gross proceeds from gambling won in the United States if that income is not effectively connected with a U.S. trade or business and is not exempted from withholding. Generally, each withholding agent must agree to withhold income tax from payments made to the nonresident alien; to pay over the withheld tax to the IRS on the dates and in the amounts specified in the agreement; and to have the IRS approve the agreements. Each withholding agent must agree to withhold income tax from payments made to the nonresident alien; to pay over the withheld tax to the IRS on the dates and in the amounts specified in the agreement; and to have the IRS approve the agreements. Each withholding agent will have to file Form 1042 and Form 1042–S for each tax year in which income is paid to a nonresident alien covered by the withholding agreement. The IRS will credit the withheld tax payments, posted to the withholding agent's Form 1042 account, in accordance with the Form 1042–S. Each nonresident alien covered by the withholding agreement must agree to file Form 1040NR or, if he or she qualifies, Form 1040NR–EZ.

A request for a central withholding agreement should be sent to the following address at least 90 days before the agreement is to take effect:

Compliance Area Director, Area 15, 950 L'Enfant Plaza South, SW 20244.

U.S. source gross transportation income includes 50% of all transportation income from transportation that either begins or ends in the United States. For personal service income other than income derived from, or in connection with, a vessel, the use must be between the United States and a U.S. possession.

The recipient of U.S. source gross transportation income must pay tax at the rate of 4% unless the income is effectively connected with the conduct of a U.S. trade or business. If the income is effectively connected with a U.S. trade or business, it is taxed on a net basis at a graduated rate of tax.

Other income (Income Code 50).

Use this category to report U.S. source FDAP income that is not reportable under any of the other income categories. Examples of income that may be reportable under this category are commissions, insurance proceeds, patronage distributions, prizes, and racing purses.

As discussed earlier under Income Subject to NRA Withholding, every kind of FDAP income from U.S. sources that is not effectively connected with a U.S. trade or business is subject to NRA withholding unless the income is specifically exempt under the Code or a tax treaty. You generally must withhold at the 30% rate on this income.

Foreign Governments and Certain Other Foreign Organizations

Investment income earned by a foreign government is not included in the gross income of the foreign government and is not subject to U.S. withholding tax. Investment income means income from investments in the United States in stocks, bonds, or other financial instruments held for investment purposes by governments, foreign financial institutions, exempt international organizations, or a government of a U.S. possession.

Income received by a foreign government from the conduct of a commercial activity or from sources other than those stated above is subject to NRA withholding. Income received by a foreign government from the conduct of a commercial activity or from sources other than those stated above is subject to NRA withholding. Income received by a foreign government from the conduct of a commercial activity or from sources other than those stated above is subject to NRA withholding. Income received by a foreign government from the conduct of a commercial activity or from sources other than those stated above is subject to NRA withholding. Income received by a foreign government from the conduct of a commercial activity or from sources other than those stated above is subject to NRA withholding. Income received by a foreign government from the conduct of a commercial activity or from sources other than those stated above is subject to NRA withholding. Income received by a foreign government from the conduct of a commercial activity or from sources other than those stated above is subject to NRA withholding. Income received by a foreign government from the conduct of a commercial activity or from sources other than those stated above is subject to NRA withholding.

The recipient of U.S. source gross transportation income must pay tax at the rate of 4% unless the income is effectively connected with the conduct of a U.S. trade or business. If the income is effectively connected with a U.S. trade or business, it is taxed on a net basis at a graduated rate of tax.

Foreign Governments and Certain Other Foreign Organizations

Investment income earned by a foreign govern-
exemption if the name of the payee is one that is designated as an international organization by executive order.

A foreign organization that is a tax exempt organization under section 501(c) of the Internal Revenue Code is not subject to a withholding tax on amounts that are not income includible under section 512 of the Internal Revenue Code as unrelated business taxable income. However, if a foreign organization is a foreign private foundation, it is subject to a 4% withholding tax on all U.S. source investment income. For a foreign tax-exempt organization to claim a exemption from withholding because of its tax exempt status under section 501(c), or to claim withholding at a 4% rate, it must provide you with a Form W–8ECI. However, if a foreign organization is claiming an exemption from withholding under an income tax treaty, or the income is unrelated business taxable income, the organization must provide a Form W–8BEN or Form W–8ECI. Income paid to foreign tax-exempt organizations are subject to reporting on Form 1042–S.

### U.S. Taxpayer Identification Numbers

As the withholding agent, you must generally request that the payee provide you with its U.S. taxpayer identification number (TIN). You must include the payee's TIN on forms, statements, and other tax documents. The payee's TIN may be any of the following.

- An individual may have a social security number (SSN). If the individual does not have, and is eligible for, an SSN, he or she must use Form SS–5 to get an SSN. The Social Security Administration will tell the individual if he or she is eligible to get an SSN.
- An individual may have an IRS individual taxpayer identification number (ITIN). If the individual does not have, and is not eligible for, an SSN, he or she must apply for an ITIN by using Form W–7.
- Any person other than an individual, and any individual who is an employer or who is engaged in a U.S. trade or business as a sole proprietor, must have an employer identification number (EIN). Use Form SS–4 to get an EIN.

A TIN must be on a withholding certificate if the beneficial owner is claiming any of the following.

- Tax treaty benefits (other than for income from marketable securities, discussed earlier).
- Exemption for effectively connected income.
- Exemption for certain annuities (see Pen- sions, Annuities, and Alimony, earlier).
- Exemption based on exempt organization or private foundation status.

In addition, a TIN must be on a withholding certificate from a person claiming to be any of the following.

- Qualified intermediary.
- Withholding foreign partnership.
- Foreign grantor trust with no more than 5 grantors unless the grantor trust is an ac- count holder of a qualified intermediary. See Notice 2001–4.
- Exempt organization.
- U.S. branch of a foreign person treated as a U.S. person (see section 1.1441–1(b)(2)(iv) of the regulations).
- U.S. person.

### Depositing Withheld Taxes

This section discusses the rules for depositing income tax withheld on FDAP income. The de- posits discussed here do not apply to the following items.

- Tax withheld on pay subject to graduated withholding as discussed earlier. (See Form 941 for the deposit rules.)
- Tax withheld on pensions and annuities subject to graduated withholding or the 10% tax on nonperiodic distributions. (See Form 945 for the deposit rules.)
- Tax withheld on a foreign partner's share of effectively connected income of a part- nership. See Partnership Withholding on Effectively Connected Income, later.
- Tax withheld on dispositions of U.S. real property interests by foreign persons. See U.S. Real Property Interest, later.
- Tax withheld on household employee. See Schedule H (Form 1040), Household Em- ployment Taxes, to report social security and Medicare taxes, and any income tax withheld, on wages paid to a nonresident alien household employee.

### When Deposits Are Required

A deposit required for any period occurring in one calendar year must be made separately from a deposit for any period occurring in an- other calendar year. A deposit of this tax must be made separately from a deposit of any other type of tax.

The amount of tax you are required to with- hold determines the frequency of your deposits. The following rules show how often deposits must be made.

1. If at the end of a calendar year the total amount of undeposited taxes is less than $200, you may either deposit the entire amount or remit it with Form 1042 by the due date of your Form 1042.

2. If at the end of any month the total amount of undeposited taxes is $200 or more but less than $2,000, you must deposit the taxes within 15 days after the end of the month. If you made a deposit of $2,000 or more during the month (except December) under rule 3 below, carry over any end of the month balance of less than $2,000 to the next month. If you made a deposit of $2,000 or more during December, any end of December balance of less than $2,000 should be paid directly to the IRS along with your Form 1042 by the due date.

3. If at the end of any quarter-monthly period the total amount of undeposited taxes is $2,000 or more, you must deposit the taxes within 3 banking days after the end of the quarter-monthly period. (A quarter-monthly period ends on the 7th, 15th, 22nd, and last day of the month.) In figuring banking days, exclude any local holidays observed by authorized financial institutions, as well as Saturdays, Sun- days, and legal holidays.

You are considered to meet the deposit re- quirements in (3) if:

1. You deposit at least 90% of the actual tax liability for the deposit period, and
2. You deposit any underpayment with the first deposit that you must make after the 15th day of the following month, if the quarter-monthly period is in a month other than December. You must deposit any un- derpayment of $200 or more for a quarter-monthly period that occurs during December by January 31.

### Electronic deposit requirement.

You must use the Electronic Federal Tax Payment System (EFTPS) to make electronic deposits of all de-pository tax liabilities you incur after 2001, if you meet either of the following conditions:

- You had to make electronic deposits in 2001.
- You deposited more than $200,000 in fed- eral depository taxes in 2000.

If you do not meet these conditions, you may choose to make electronic deposits.

To participate in EFTPS, you must first enroll. To receive an enrollment form, call 1–800–945–8400 or 1–800–555–4477.

### Federal tax deposit coupons.

If you do not make electronic deposits, you must deposit the income tax withheld on fixed or determinable annual or periodic income using Form 8109, Federal Tax Deposit Coupon, according to the instructions provided with the form. If you do not have your coupons when a deposit is due, con- tact your local IRS office.

To eliminate possible late payment penalty charges, be prepared to show that the payment was mailed by the second day before the due date.

### Deposits made by foreign corpora- tions.

If you use a Form 8109, show the "Amount of Deposit" in U.S. dollars.

Send the completed coupon with a bank draft in U.S. dollars to:

Financial Agent
Federal Tax Deposit Processing
P.O. Box 970030
St. Louis, MO 63197.

### Obtaining coupon book.

A prescribed book of Federal Tax Deposit Coupons (Form
You use your own funds for this repayment. You calendar year that you overwithheld tax for the You must furnish a Form 1042 following calendar year.

If you discover that during a 90 day period that begins on the date of ments from which it withheld tax of $200. On The Forms 1042 and 1042 period first. You can designate the deposit pe- hold employee reported on Schedule Hshow a tax withheld of $30 in box 7 and $15 as

For example, if you already deposits the $30, the corporation re- paid James $15 before the end of February. During 2002, M Corporation made no other payments from which tax had to be withheld. On its timely filed 2002 Form 1042, M Corporation reports $15 as its total tax liability and $30 as its total deposits. M Corporation requests that the $15 overpayment be credited to its 2003 Form 1042 rather than refunded.

The Form 1042–S that M Corporation files for the dividend paid to James in 2002 must show a tax withheld of $30 in box 7 and $15 as an amount repaid in box 8. In June 2003, M Corporation made pay- ments from which it withheld tax of $200. On July 15, 2003, M Corporation deposited $185, that is, $200 less the $15 credit claimed on the Form 1042 for 2002. M Corporation timely filed its Form 1042 for 2003, showing tax liability of $200, $185 deposited, and $15 credit from 2002.

Set-off procedure. Under the set-off proce- dure, you repay the beneficial owner or payee the amount overwithheld by reducing the amount you would have been required to with- hold on later payments you make to that person. These later payments must be made before the next:

• The date you actually file Form 1042–S for the calendar year in which the amount was overwithheld, or

• March 15 of the year after the calendar year in which the amount was overwithheld.

On Form 1042 and Form 1042–S for the calendar year in which the amount was overwithheld, show the reduced amount as the amount required to be withheld.

Overwithholding discovered at a later date. If you discover after March 15 of the following calendar year that you overwithheld tax for the prior year, do not adjust the amount of tax re- ported on Forms 1042–S (and Form 1042) or on any deposit or payment for that prior year. Do not repay the beneficial owner or payee the amount overwithheld.

In this situation, the recipient will have to file a U.S. income tax return (Form 1040NR or Form 1040NR–EZ or Form 1120–F) or, if a tax return has already been filed, a claim for refund (amended Form 1040NR or 1120–F) to recover the amount overwithheld.

Returns Required
Every withholding agent, whether U.S. or for- eign, must file Forms 1042 and 1042–S to re- port payments of amounts subject to NRA withholding unless an exception applies. Do not use Forms 1042 and 1042–S to report tax with- held on the following:

• Wages or salaries subject to graduated income tax withholding (see Wages Paid to Employees—Graduated Withholding, earlier under Pay for Personal Services Performed);

• Any portion of a U.S. or foreign partnership’s effectively connected taxable income allocable to a foreign partner (see Partnership Withholding on Effectively Connected Income, later);

• Dispositions of U.S. real property interests by foreign persons (see U.S. Real Prop- erty, later);

• Pensions, annuities, and certain other de- fered income reported on Form 945, and

• Income, social security, and Medicare taxes witheld on wages paid to a house- hold employee reported on Schedule H (Form 1040).

The Forms 1042 and 1042–S must be filed by March 15 of the year following the calendar year in which you discovered the overwithholding. M Corporation requests that the amount subject to reporting was paid. If March 15 falls on a Saturday, Sunday, or legal holiday, the due date is the next business day.

Form 1042. Every U.S. and foreign withhold- ing agent that is required to file a Form 1042–S must also file an annual return on Form 1042. You must file Form 1042 even though you were not required to withhold any income tax.

You must file Form 1042 with the:

• Internal Revenue Service Center

Philadelphia, PA 19055.

Form 1042–S. Every U.S. and foreign with- holding agent must file a Form 1042–S for amounts subject to NRA withholding unless an exception applies. The form can be filed mag- netically, electronically, or on paper. A separate Form 1042–S is required for each recipient of income to whom you made payments during the preceding calendar year regardless of whether you withheld or were required to withheld tax. You must use a separate Form 1042–S for each type of income that you paid to the same recipi- ent. See Statements to recipients, later.

You must furnish a Form 1042–S for each recipi ent even if you did not withhold tax be- cause you repaid the tax withheld to the recipi-
ent or because the income payment was exempt from tax under the Internal Revenue Code or under a U.S. income tax treaty.

Joint owners. If all the owners provide doc-
umentation that permits them to receive the same reduced rate of withholding (for example, under an income tax treaty) you should apply the reduced rate of withholding. You are required, however, to report the payment on one Form 1042–S to the person whose status you rely upon to determine the withholding rate. If, how-
ever, any one of the owners requests its own Form 1042–S, you must furnish Form 1042–S to the person who requests it. If more than one Form 1042–S is issued for a single payment, the total amount paid and tax withheld reported on all Forms 1042–S cannot exceed the total amounts paid to joint owners.

Form 1042–T. If Form 1042–S is filed on paper, it must be filed with Form 1042–T. You may need to file more than one Form 1042–T. See the instructions for that form for more infor-
mation.

Magnetic media reporting. Withholding agents or their agents generally must use mag-
netic or electronic media to file 250 or more Forms 1042–S with the IRS. You are en-
couraged to file electronically or magnetically, even if you are not required to.

A completed Form 4419, Application for Fil-
ing Information Returns Magically/ Electroni-
cally, should be filed with the Martinsburg Computing Center at least 30 days before the due date of the return. Returns may not be filed magnetically or electronically until the applica-
tion has been approved by the IRS.

For information and instructions on filing Forms 1042–S on magnetic media, get Publica-
tion 1187, Specifications for Filing Form 1042–S, Foreign Person’s U.S. Source Income Subject to Withholding Magically/ Electroni-
cally.

Deposit interest paid to alien individuals who are residents of Canada. If you pay deposit interest of $10 or more to a nonresident alien individual who resides in Canada and is not a U.S. citizen, you may have to report it on Form 1042–S. This reporting requirement generally applies to payments that are not paid by a financial institution that is not char-
tained in a bank’s office in the United States, and b) is not effectively connected with a trade or business in the United States. However, this reporting requirement does not apply to in-
terest paid on certain bearer certificates of de-
posit as described in section 1.6049–8(b) of the regulations if you pay that interest outside the United States.

How to report. Although you only have to report on Form 1042–S the deposit interest paid to residents of Canada who are not U.S. citi-
zens, you can comply by reporting payments to all foreign persons receiving bank deposit interest, if that way is easier for you.

Determining residency. You determine whether a payee is a Canadian resident based on the permanent residence address required to be provided on the Form W–8BEN. If you have actual knowledge that the payee is a U.S. per-
son, you must report the payment on Form 1099–INT.

Statements to recipients. You must furnish a statement to each recipient for whom you are filing a Form 1042–S (or magnetic media report) by the due date for filing Forms 1042 and 1042–S with the IRS. You may use a copy of the official Form 1042–S for this purpose. Or, you may provide recipients with the information to-gether with, or on, other (commercial) state-
ments or notices. These statements must clearly identify the type of income (as described in the official form), the amount of tax withheld, the withholding rate (including 0% if exempt), and the country involved. You may include more than one type of income on the copies of the Form 1042–S that you provide to the recipient of the income. You may, however, include more than one income line on the copy of the form filed with the IRS.

You must get prior annual approval to use a substitute Form 1042–S unless it meets the requirements listed in Publication 1167. Substit-
tute Printed, Computer-Prepared and Computer-Generated Tax Forms and Sched-
ules. Get Publication 1167 for more information.

Extension of time to file. You may request an extension of time to file Form 1042 by filing Form 2758, Application for Extension of Time to File Certain Excise, Income, Information, and Other Returns. You may request an extension of time to file Form 1042–S by filing Form 8809, Re-
quest for Extension of Time to File Information Returns. You should send Forms 2758 and 8809 far enough in advance of the due date of Forms 1042 and 1042–S to allow the IRS time to consider your application and to reply before the due date of the return.

Penalties. The penalty for not filing Form 1042 when due (including extensions) is usually 5% of the unpaid tax for each month or part of a month the return is late, but not more than 25% of the unpaid tax.

A penalty may be imposed for failure to file Form 1042–S when due (including extensions) or for failure to provide complete and correct information. The amount of the penalty depends on when you file a correct Form 1042–S. The penalty for each Form 1042–S is:

• $15 if you file a correct form within 30 days, with a maximum penalty of $75,000 per year ($250,000 for a small business),

• $30 if you file after 30 days but before August 2, with a maximum penalty of $150,000 ($50,000 for a small business), or

• $50 if you file after August 1 or do not file a correct form, with a maximum penalty of $250,000 per year ($100,000 for a small business).

A small business is a business that has aver-
age annual gross receipts of not more than $5 million for the most recent 3 tax years (or for the period of its existence, if shorter) ending before the calendar year in which the Forms 1042–S are due.

If you fail to provide a complete and correct statement to each recipient, a penalty of $50 for each failure may be imposed. The maximum penalty is $100,000 per year. If you intentionally disregard the requirement to report correct infor-
mation, the penalty for each Form 1042–S (or statement to recipient) is the greater of $100 or 10% of the total amount of the items that must be reported, with no maximum penalty.

Failure to file on magnetic media. If you are required to file on magnetic media but you fail to do so, and you do not have an approved waiver, you may be subject to a penalty of $50 per form for failure to file Form 1042–S on magnetic media unless you show reasonable cause. The penalty applies separately to original and corrected returns.

Partnership

Withholding on Effectively Connected Income

A partnership (foreign or domestic) that has in-
come effectively connected with a U.S. trade or business (or income treated as effectively con-
nected) must pay withholding tax on the effec-
tively connected taxable income that is allocable to its foreign partners. A publicly traded partner-
ship must withhold tax on actual distributions of effectively connected income, unless it chooses to withhold under these rules. See Publicly Traded Partnerships, later.

This withholding tax does not apply to in-
come that is not effectively connected with the partnership’s U.S. trade or business. That in-
come is subject to NRA withholding tax, as dis-
cussed earlier in this publication.

Who Must Withhold

The partnership, or a withholding agent for the partnership, must pay the withholding tax. A partnership that must pay the withholding tax but fails to do so, may be liable for the payment of the tax and any penalties and interest.

Foreign Partner

The partnership must determine whether a part-
ner is a foreign partner. A foreign partner can be a nonresident alien individual, foreign corpora-
tion, foreign partnership, or foreign estate or trust.

A partnership may rely on a partner’s certifi-
cation of nonforeign status and assume that a partner is not a foreign partner if the partner provides a certification to the partnership that:

1) States that the partner is not a foreign per-
son,

2) Gives the partner’s name, U.S. taxpayer identification number, and address,

3) States that the partner will notify the part-
nership within 60 days of a change to for-
egnment, and

4) Is signed under penalties of perjury.

Sample certifications are contained in section 5.04 of Revenue Procedure 89–31, in Cumula-

The partnership must keep the certification 5 years after the last tax year in which the partner-
ship relied on it.
Unless the partnership knows that the certification is incorrect, it may rely on it until one of the following happens.

1) The third year after the partnership’s tax year in which the certification was made ends.

2) The partner notifies the partnership that it has become a foreign partner.

3) The partnership learns that the partner is a foreign partner.

Publicly Traded Partnerships

38.6% for all other partners, such as individuals, whether a partner is a foreign partner using the States Treasury. Payments must be made in the 4th month after the close of the tax year. If a number has not been assigned by the due date of the partnership’s tax year, Form 8805 must be publicly traded partnership must use Forms 8804, 8805, and 8813. Any additional withholding tax owed for the partnership’s tax year is paid (in U.S. currency) one. If a number has not been assigned by the due date of the first withholding tax payment, the partnership should enter the date the number was applied for on Form 8813 when making its payment. As soon as the partnership receives its TIN, it must immediately provide that number to the IRS.

To ensure proper crediting of the withholding tax when reporting to the IRS, the partnership must include each partner’s U.S. TIN on Form 8805. If there are partners in the partnership without identification numbers, the partnership should inform them of the need to get a number. See U.S. Taxpayer Identification Numbers, earlier.

Publicly Traded Partnerships

A publicly traded partnership that has effectively connected income, gain, or loss must pay withholding tax on any distributions of that income to its foreign partners. The amount of each foreign partner for the partnership’s tax year is paid (in U.S. currency) one. If a number has not been assigned by the due date of the first withholding tax payment, the partnership should enter the date the number was applied for on Form 8813 when making its payment. As soon as the partnership receives its TIN, it must immediately provide that number to the IRS.

To ensure proper crediting of the withholding tax when reporting to the IRS, the partnership must include each partner’s U.S. TIN on Form 8805. If there are partners in the partnership without identification numbers, the partnership should inform them of the need to get a number. See U.S. Taxpayer Identification Numbers, earlier.

A single failure may be imposed. The maximum penalty is $100,000 per year ($25,000 for a small business).

Publicly Traded Partnerships

A publicly traded partnership that has effectively connected income, gain, or loss must pay withholding tax on any distributions of that income to its foreign partners. The amount of each foreign partner for the partnership’s tax year is paid (in U.S. currency) one. If a number has not been assigned by the due date of the first withholding tax payment, the partnership should enter the date the number was applied for on Form 8813 when making its payment. As soon as the partnership receives its TIN, it must immediately provide that number to the IRS.

To ensure proper crediting of the withholding tax when reporting to the IRS, the partnership must include each partner’s U.S. TIN on Form 8805. If there are partners in the partnership without identification numbers, the partnership should inform them of the need to get a number. See U.S. Taxpayer Identification Numbers, earlier.

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distributions. The partnership makes this election by filing Forms 8804, 8805, and 8813 and by complying with the payment and reporting requirements for those forms, as discussed earlier. Once the election has been made, it can be revoked only with the consent of the IRS.

Distributions subject to NRA withholding. If the election to withhold on effectively connected taxable income is not made, the partnership must withhold tax on any actual distributions of money or property to foreign partners. In the case of a partnership that receives a partnership distribution from another partnership (a tiered partnership), the distribution also includes the tax withheld from that distribution.

If the distribution is in property other than money, the partnership cannot release the property until it has enough funds to pay over the withholding tax.

A publicly traded partnership that complies with these withholding requirements satisfies the requirements discussed later under U.S. Real Property Interest. Distributions subject to withholding include:

1) The fair market value of U.S. real property interests distributed to a partner and potentially subject to withholding under section 1445(e)(4) of the Internal Revenue Code,
2) Amounts subject to NRA withholding under section 1445(e)(1) of the Internal Revenue Code on distributions pursuant to an election under section 1.1445–5(c)(3) of the regulations, and
3) Amounts not subject to NRA withholding under section 1445 of the Internal Revenue Code because the distributee is a partnership or is a foreign corporation that has made an election to be treated as a domestic corporation.

Excluded amounts. Partnership distributions are first considered to be paid out of the following types of income in the order listed. To the extent the partnership has this type of income, it is excluded from the distributions subject to withholding discussed in this section.

1) Amounts of noneffectively connected income distributed by the partnership and subject to NRA withholding under section 1445–5(c)(3)(iv) of the regulations.
2) Amounts attributable to recurring dispositions of crops and timber that are subject to NRA withholding under section 1.1445–5(c)(3)(iv) of the regulations.
3) Amounts attributable to the disposition of a U.S. real property interest subject to the withholding rules discussed next under U.S. Real Property Interest.

For more information about the withholding requirements for publicly traded partnerships, see Revenue Procedure 89–31 in Cumulative Bulletin 1989–1.

U.S. Real Property Interest

The disposition of a U.S. real property interest by a foreign person (the transferor) is subject to income tax withholding. The transferee is the withholding agent. If you are the transferee, you must find out if the transferor is a foreign person. If the transferee is a foreign person and you fail to withhold, you may be held liable for the tax.

A foreign person is a nonresident alien individual, foreign corporation, foreign partnership, foreign trust, or foreign estate. It does not include a resident alien individual.

The term transferor means any foreign person that disposes of a U.S. real property interest by sale, exchange, gift, or any other transfer. A transfer includes distributions to shareholders of a corporation, partners of a partnership, and beneficiaries of a trust or estate.

The term transferee means any person, foreign or domestic, that acquires a U.S. real property interest by purchase, exchange, gift, or any other transfer.

The term U.S. real property interest means an interest, other than as a creditor, in real property (including an interest in a mine, well, or other natural deposit) located in the United States or the Virgin Islands, as well as certain personal property that is associated with the use of real property (such as farming machinery). It also means any interest, other than as a creditor, in any domestic corporation unless it is established that the corporation was at no time a U.S. real property holding corporation during the shorter of the period during which the interest was held, or the 5-year period ending on the date of disposition. If the fair market value of the property distributed to a foreign person (the transferor) is subject to NRA withholding under section 1.1445–5(c)(3)(iv) of the regulations, and the amount of any liability assumed by the transferee or to which the property is subject immediately before and after the transfer.

Foreign corporations. A foreign corporation that distributes a U.S. real property interest is subject to withholding on the remainder of the distribution (or on any smaller amount if a withholding certificate is obtained and the amount of the distribution that is a return of capital is established).

The same procedure must be used for all distributions made during the year. A different procedure may be used each year.

Partnerships. If a domestic partnership that is not publicly traded disposes of a U.S. real property interest at a gain, the gain is treated as effectively connected income and is subject to the rules explained earlier under Partnership Withholding on Effectively Connected Income.

A publicly traded partnership that disposes of a U.S. real property interest must withhold tax on distributions to foreign partners, unless it elects to withhold based on effectively connected taxable income allocable to foreign partners as discussed earlier under Publicly Traded Partnerships.

Trusts and estates. You are a withholding agent if you are a trustee, beneficiary, or executor of a trust or estate having one or more foreign beneficiaries. You must establish a U.S. real property interest account. You enter in the account all gains and losses realized during the taxable year of the trust or estate from dispositions of U.S. real property interests. You must withhold 35% on any distribution to a foreign beneficiary that is attributable to the balance in the real property interest account on the day of the distribution. A distribution from a trust or estate to a beneficiary (foreign or domestic) will be treated as attributable first to any balance in

Domestic corporations. A domestic corporation must withhold a tax equal to 10% of the fair market value of the property distributed to a foreign shareholder if:

1) The shareholder’s interest in the corporation is a U.S. real property interest, and
2) The property distributed is either in re-deemption of stock or in liquidation of the corporation.

U.S. real property holding corporations. Distributions from a domestic corporation that is a U.S. real property holding corporation (USRPHC) is generally subject to NRA withholding and withholding under the U.S. real property interest provisions. This also applies to a corporation that was a USRPHC at any time during the shorter of the period during which the U.S. real property interest was held, or the 5-year period ending on the shorter period.

A USRPHC can satisfy both withholding provisions if it withholds under one of the following procedures:

- Apply NRA withholding to the portion of the distribution, whether or not any portion of the distribution represents a return of basis or capital gain. If a reduced tax rate applies under an income tax treaty, then the rate of withholding must not be less than 10%, unless the treaty specifies a lower rate for distributions from a USRPHC.
- Apply NRA withholding to the portion of the distribution that the USRPHC estimates is a dividend. Then, withhold 10% on the remainder of the distribution (or on a smaller amount if a withholding certificate is obtained and the amount of the distribution that is a return of capital is established).

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the U.S. real property interest account and then to other amounts.

A trust with more than 100 beneficiaries may elect to withhold from each distribution 35% of the amount attributable to the foreign beneficiary’s proportionate share of the current balance of the trust’s real property interest account. This election does not apply to publicly traded trusts or real estate investment trusts (REITs). For more information about this election, see section 1.1445–5(c) of the regulations.

Publicly traded trusts and REITs must withhold on distributions of U.S. real property interests to foreign persons. The withholding rate is 35%. For more information, see section 1.1445–8 of the regulations.

Additional information. For additional information on the withholding rules that apply to corporations, trusts, estates, and REITs, see section 1445 of the Internal Revenue Code and the related regulations. For more information on additional information on the withholding rules that apply to partnerships, see the previous discussion.

You may also write to the:

Internal Revenue Service Center
P.O. Box 21086
Drop Point 8731 FIRPTA Unit
Philadelphia, PA 19114–0586.

Exceptions. You do not have to withhold if any of the following apply.

1) You (the transferee) acquire the property for use as a home and the amount realized (sales price) is not more than $300,000. You or a member of your family must have definite plans to reside at the property for at least 50% of the number of days the property is used by any person during each of the first two 12-month periods following the date of transfer. When counting the number of days the property is used, do not count the days the property will be vacant.

2) The property disposed of (other than certain dispositions of nonpublicly traded interests) is an interest in a domestic corporation if any class of stock of the corporation is regularly traded on an established securities market. However, if the class of stock had been held by a foreign person who beneficially owned more than 5% of the fair market value of that class at any time during the previous 5-year period, then that interest is a U.S. real property interest if the corporation qualifies as a USRPHC. For more information, see section 1.1445–6 of the regulations. The certifications are not effective in the case of a domestic corporation if any class of stock of the corporation is regularly traded on an established securities market. However, if the class of stock had been held by a foreign person who beneficially owned more than 5% of the fair market value of that class at any time during the previous 5-year period, then that interest is a U.S. real property interest if the corporation qualifies as a USRPHC.

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4) The transferor gives you a certification stating, under penalties of perjury, that the transferor is not a foreign person and containing the transferor’s name, U.S. tax-payer identification number, and home address (or office address, in the case of an entity).

5) You receive a withholding certificate from the Internal Revenue Service that excuses withholding. See Withholding Certificates, later.

6) The transferor gives you written notice that no recognition of any gain or loss on the transfer is required because of a nonrecognition provision in the Internal Revenue Code or a provision in a U.S. tax treaty. You must file a copy of the notice by the 20th day after the date of transfer with the Internal Revenue Service Center, P.O. Box 21086, Drop Point 8731 FIRPTA Unit, Philadelphia, PA 19114–0586.

7) The amount the transferor realizes on the transfer of a U.S. real property interest is zero.

8) The property is acquired by the United States, a U.S. state or possession, a political subdivision, or the District of Columbia.

9) The grantor realizes an amount on the grant or lapse of an option to acquire a U.S. real property interest. However, you must withhold on the sale, exchange, or exercise of that option.

10) The disposition (other than certain dispositions of nonpublicly traded interests) is of publicly traded partnerships or trusts. However, if an interest in a publicly traded partnership or trust was owned by a foreign person with a greater than 5% interest at any time during the previous 5-year period, then that interest is a U.S. real property interest if the partnership or trust would otherwise qualify as a USRPHC if it were a corporation, and you must withhold on it.

Certifications. The certifications in items (3) and (4) are not effective if you have actual knowledge, or receive a notice from an agent, that they are false. If you are required by regulations to furnish a copy of the certification to the IRS and you fail to do so in the time and manner prescribed, the certifications are not effective.

Liability of agents. If you receive either of the certifications discussed in item (3) or (4) and the transferor’s agent or your agent (the transferor’s agent) has actual knowledge that the certification is false, or in the case of (3), that the corporation is a foreign corporation, the agent must notify you, or the agent will be liable for the tax. The agent’s liability is limited to the amount of compensation the agent gets from the transaction.

An agent is any person who represents the transferor or transferee in any negotiation with another person (or another person’s agent) relating to the transaction, or in settling the transaction. A person is not treated as an agent if the person only performs one or more of the following acts related to the transaction:

- Receipt and disbursement of any part of the consideration,
- Recording of any document,
- Typing, copying, and other clerical tasks,
- Obtaining title insurance reports and reports concerning the condition of the property, or
- Transmitting documents between the parties.

Reporting and Paying the Tax

Transferees must use Forms 8288 and 8288–A to report and pay to the IRS any tax withheld on the acquisition of U.S. real property interests. These forms must also be used by corporations, partnerships, estates, and trusts that must withhold on distributions and other transactions involving U.S. real property interests.

For partnerships disposing of U.S. real property interests, the manner of reporting and paying over the tax withheld is the same as discussed earlier under Partnership Withholding on Effectively Connected Income.

For publicly traded trusts and real estate investment trusts, you must use Forms 1042 and 1042–S for reporting and paying over tax withheld on distributions from dispositions of U.S. real property interests. Use Income Codes 24, 25, and 26 on Form 1042–S for transactions involving these entities.

Form 8288, U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests.

The tax withheld on the acquisition of a U.S. real property interest from a foreign person is reported and paid using Form 8288. Form 8288 also serves as the transmittal form for copies A and B of Form 8288–A. A Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests.

Generally, you must file Form 8288 by the 20th day after the date of the transfer.

If an application for a withholding certificate (discussed later) is submitted to the IRS before or on the date of a transfer and the application is still pending with the IRS on the date of transfer, the correct withholding tax must be withheld, but does not have to be reported and paid over immediately. The amount withheld (or lesser amount as determined by the IRS) must be reported and paid over within 20 days following the day on which a copy of the withholding certificate or notice of denial is mailed by the IRS.

If the principal purpose of applying for a withholding certificate is to delay paying over the withheld tax to the IRS, the transferee will be subject to interest and penalties. The interest and penalties will be assessed for the period beginning on the 21st day after the date of transfer and ending on the day the payment is made.

Form 8288–A. The withholding agent must prepare a Form 8288–A for each person from whom tax has been withheld. Each transferor or distributee is notified of the amount of withholding tax paid to the IRS. Attach copies A and B of Form 8288–A to Form 8288. IRS will stamp
Withholding Certificates

The amount that must be withheld from the dis-

position of a U.S. real property interest can be

adjusted pursuant to a withholding certificate

issued by the IRS. The transferee, the trans-

feree’s agent, or the transferor may request

a withholding certificate. The IRS will generally

act on these requests within 90 days after re-

ceipt of a complete application.

A withholding certificate may be issued due to:

1) A determination by the IRS that reduced

withholding is appropriate because either:

a) The amount that must be withheld would be

more than the transferor’s maximum tax liability, or

b) Withholding of the reduced amount would not jeopardize collection of the tax

2) The exemption from U.S. tax of all gain realized by the transferee, or

3) An agreement for the payment of tax pro-

viding security for the tax liability, entered into by the transferee or transferor.

Categories. All applications for withholding certificates are divided into six basic categories. Either the transferee or the transferor may enter an agreement for the payment of tax. The agreement is a contract between the IRS and any other person and consists of two necessary elements. Those elements are:

1) A detailed description of the rights and ob-

ligations of each, and

2) A security instrument or other form of se-

curity acceptable to the Commissioner or his delegate.

For more information on the agreement for the payment of tax, including a sample agree-


There are four major types of security ac-

ceptable to the IRS. They are:

1) Bond with surety or guarantor,

2) Bond with collateral,

3) Letter of credit, and

4) Guarantee (corporate transferors).

The IRS may, in unusual circumstances and at its discretion, accept any additional form of se-

curity that it finds to be adequate.

Format for Applications

Use Form 8288–B, Application for Withholding Certificate for Dispositions by Foreign Persons of U.S. Real Property Interests, to apply for a withholding certificate under categories (1), (2), and (3).
For more information on acceptable security instruments, including sample forms of these instruments, see section 5 of Revenue Procedure 2000–35.

Category (5) applications. A blanket withholding certificate may be issued if the transferor holding the U.S. real property interests provides an irrevocable letter of credit or a guarantee and enters into a tax payment and security agreement with the IRS. A blanket withholding certificate excuses withholding concerning multiple dispositions of those property interests by the transferor or the transferor’s legal representative during a period of no more than 12 months.

For more information, see section 9 of Revenue Procedure 2000–35.

Category (6) applications. These are nonstandard applications and may be of the following types.

Agreement for payment of tax with nonconforming security. An applicant seeking to enter into an agreement for the payment of tax but wanting to provide a nonconforming type of security must include the following in the application:

1) The information required for Category (4) applications, discussed earlier,

2) A description of the nonconforming security proposed by the applicant, and

3) A memorandum of law and facts establishing that the proposed security is valid and enforceable and that it adequately protects the government’s interest.

Other nonstandard applications. An application for a withholding certificate not previously described must explain in detail the proposed basis for the issuance of the certificate and set forth the reasons justifying the issuance of a certificate on that basis.

Availability of records. The applicant must make available to the IRS, within the time prescribed, all information required to verify that representations relied upon in accepting the agreement are accurate, and that the obligations assumed by the applicant will be performed pursuant to the agreement. Failure to provide requested information promptly will usually result in rejection of the application, unless the IRS grants an extension of the target date.

Amendments to Applications
An applicant for a withholding certificate may amend an otherwise complete application by sending an amending statement to the Commissioner or his delegate. There is no particular form required, but the amending statement must provide the following information:

1) The name, address, and taxpayer identification number (if any) of the person providing the amending statement specifying whether that person is the transferee or transferor,

2) The date of the original application for a withholding certificate that is being amended,

3) A brief description of the real property interest for which the original application for a withholding certificate was provided, and

4) The basis for the amendment including any change in the facts supporting the original application for a withholding certificate and any change in the terms of the withholding certificate.

The statement must be signed and accompanied by a penalties of perjury statement (discussed earlier under Format for Applications).

If an amending statement is provided, the time in which the IRS must act upon the application is extended by 30 days. If the amending statement substantially changes the original application, the time for acting upon the application is extended by 60 days. If an amending statement is received after the withholding certificate has been signed by the Commissioner or his delegate but has not been mailed to the applicant, the IRS will have a 90-day extension of time in which to act.

**Tax Treaty Tables**

The United States has income tax treaties (or conventions) with a number of foreign countries under which residents (sometimes limited to citizens) of those countries are taxed at a reduced rate or are exempt from U.S. income taxes on certain income received from within the United States.

Three tables follow:

**Table 1** lists the withholding rates on income other than personal service income.

**Table 2** lists the different types of personal service income that are entitled to an exemption from, or reduction in, withholding.

**Table 3** shows where the full text of each treaty and protocol may be found in the Cumulative Bulletins if it has been published.

These tables are not meant to be a complete guide to all provisions of every income tax treaty. For detailed information, you must consult the provisions of the tax treaty that apply to the country of the nonresident alien to whom you are making payment.

Income that is exempt under a treaty is not subject to withholding at source under the statutory rules discussed in this publication.
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<th>Code</th>
<th>Name</th>
<th>Country of residence</th>
<th>Income code number</th>
<th>Income tax rate on income from investments in U.S. sourced income (U.S. dollar and equivalents)</th>
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The figures and rules above pertain to foreign personal service income. They must be removed before printing.
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<th>Royalties</th>
<th>Natural Resources</th>
<th>Copyright royalties</th>
<th>Pensions</th>
<th>Other Income and Royalties</th>
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**Note:** The table above is a continuation of the withholding tax rates on income other than personal service income under Chapter 3, Internal Revenue Code, and income tax.
No U.S. tax is imposed on a percentage of any dividend paid by a U.S. corporation that received at least 80% of its gross income from a foreign business for 5 years prior to the date it received the dividend. (See sections 871(1)(B) and 881(b) of the Internal Revenue Code.)

The reduced rate applies to dividends paid by a subsidiary to a foreign parent corporation that has the required percentage of stock ownership. In some cases, the income of the subsidiary must meet certain requirements (e.g., a certain percentage of its total income must consist of income other than dividends and interest). In the case of Italy, the reduced rate is 10%, if the foreign corporation owns 10% to 50% of the voting stock (for a 12-month period) of the company paying the dividends.

The exemption or reduction in rate applies only if the recipient is subject to tax on this income in the country of residence. Otherwise a 30% rate applies.

Exemption does not apply to U.S. Government (federal, state, or local) pensions and annuities; a 30% rate applies to these pensions and annuities. U.S. government pensions paid to an individual who is both a resident and citizen of China, Denmark, Estonia, Finland, Hong Kong, India, Ireland, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Russia, Slovenia, South Africa, Spain, Switzerland, Thailand, Turkey, the United Kingdom, or Venezuela are exempt from U.S. tax. U.S. government pensions paid to an individual who is both a resident and citizen of Kazakhstan, New Zealand, or Sweden are exempt from U.S. tax.

No withholding is required on capital gains other than those listed earlier under Capital Gains, even if the gain is subject to U.S. tax.

Includes alimony.

The exemption or reduction in rate does not apply if the recipient has a permanent establishment in the United States and the property giving rise to the income is effectively connected with this permanent establishment. Under certain treaties, the exemption or reduction in rate also does not apply if the property giving rise to the income is effectively connected with a fixed base in the United States from which the recipient performs independent personal services. Even with the treaty, if the income is effectively connected with a trade or business in the United States by the recipient, the recipient will be considered as not having a permanent establishment in the United States under IRC section 884(c).

The exemption or reduction in rate does not apply if the recipient is engaged in a trade or business in the United States through a permanent establishment that is in the United States. However, if the income is not effectively connected with a trade or business in the United States by the recipient, the recipient does not have a permanent establishment in the United States for the purpose of applying the reduced treaty rate to that item of income. (IRC section 894(b).)

The rate is 5% for royalties on the use of any copyright of literary, artistic, or scientific work, including software.

Exemption is not available if the royalty is paid from a fund, under an employee's pension or annuity plan, if contributions to it are deductible under U.S. tax laws in determining taxable income of the employer.

The rate is 15% for interest determined with reference to the profits of the issuer or one of its associated enterprises.

Annuities that were purchased while the annuitant was not a resident of the United States are not taxable in the United States. The reduced rate applies for 3 years prior to the date the annuity was purchased. Under common law, interest that does not qualify as portfolio interest is treated as a dividend and is subject to the rates under income codes 6 and 7, as appropriate.

The exemption applies only to interest on credits, loans, and other indebtedness connected with the financing of trade between the United States and U.S. member countries. It does not include interest from the conduct of a general banking business.

The exemption applies only to gains from the sale or other disposition of property acquired by gift or inheritance. The exemption does not apply if the recipient was a resident of the United States when the pension was earned or when the annuity was purchased.

Annuities paid in return for other than the recipient's personal services are exempt.

Gains from the sale of property owned by the Canadian resident on September 26, 1986, not as part of the business property of the corporation, and not as part of a partnership, the rate of 15% on the increase in value of the tax is limited to the appreciation after 1984. Capital gains, including unrealized gains of a personal nature belonging to a firm established or fixed base of the taxpayer in the United States, are exempt.

The reduced rate for royalties with respect to tangible personal property is 7%. The rate on capital gains for reporting purposes.

Tax imposed on 70% of gross royalties for rentals of industrial or scientific equipment.

The rate in column 6 applies to dividends paid to a regulated investment company (RIC) or a real estate investment trust (REIT). However, that rate applies to dividends paid by a REIT only if the beneficial owner of the dividends is an individual holding less than a 10% interest (25% in the case of the Netherlands, Portugal, Luxembourg, and Tunisia) in the REIT.

Royalties not taxed at the 5% or 8% rate are taxed at a 10% rate. (See footnotes (g) and (h).)

The exemption does not apply to contingent interest that does not qualify as portfolio interest. Generally, this is interest based on receipts, sales, income, or changes in the value of property. The rate is 15% for interest on loans granted by banks or similar financial institutions. For Thailand, the 10% rate also applies to interest from an arm's length sale on credit of equipment, merchandise, or services.

This is the rate for royalties for the use of, or right to use, industrial, commercial, and scientific equipment. The rate for royalties for information concerning industrial, commercial, and scientific knowledge is 10% and is subject to the rate in column 6, but use Income Code 10 for reporting purposes.

Exemption applies to U.S. Government (federal, state, or local) pensions only if the individual is both a resident and national of France and is not a U.S. national.

Exemption does not apply to cinematographic films, or works on film, tape, or other means of reproduction for use in radio or television broadcasting.

Under certain treaties, the reduced rates of withholding may not apply to a foreign corporation unless a minimum percentage of its owners are citizens or residents of the United States or the treaty country.

Exemption or reduction in rate does not apply to an excess inclusion for a residual interest in a real estate mortgage investment conduit (REMIC).

The rate in column 6 applies to dividends paid by a regulated investment company (RIC). Dividends paid by a real estate investment trust (REIT) are subject to a 30% rate.

Under the treaty the exemption or reduction in rate does not apply if the recipient has a permanent establishment in the U.S. and the income is effectively connected with this permanent establishment. Instead, tax is not withheld at source and the provisions of Article 8 (Business Profits) apply. Additionally, even if interest income is not effectively connected with a U.S. permanent establishment, the recipient may choose to treat this income as not subject to U.S. tax.

The rate is 4.95% if the interest is beneficially owned by a person that is both a resident and national of the United States and is not a U.S. national.

The exemption or reduction in rate applies only if the recipient is engaged in a trade or business in the United States and the recipient has a permanent establishment in the United States. (See Article 8 of the treaty.) The rate is 10% if the interest is paid on a loan granted by a bank or similar financial institution. For Thailand, the 10% rate applies to dividends paid by a REIT only if the beneficial owner of the dividends is (a) an individual not a resident of the United States, (b) a person holding not more than 5% of any class of the REIT’s stock and the dividends are paid on stock that is publicly traded or (c) a person holding not more than a 10% interest in the REIT and the REIT is diversified.

Generally, if the person was receiving pension distributions before March 31, 2000, the distributions continue to be exempt from U.S. tax.

The rate is 10% if the income is not effectively connected with a trade or business in the United States by the recipient, the recipient does not have a permanent establishment or fixed base in the United States from which the recipient performs independent personal services. Even with the treaty, if the income is effectively connected with a trade or business in the United States by the recipient, the recipient will be considered as not having a permanent establishment in the United States under IRC section 884(c).

The rate is 15% for interest determined with reference to the profits of the issuer or one of its associated enterprises.
Table 2. Compensation for Personal Services Performed in United States Exempt from Withholding and U.S. Income Tax Under Income Tax Treaties

<table>
<thead>
<tr>
<th>Country</th>
<th>Code</th>
<th>Category of Personal Services</th>
<th>Maximum Presence in U.S.</th>
<th>Required Employer or Payer</th>
<th>Maximum Amount of Compensation</th>
<th>Treaty Article Citation</th>
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<td><strong>Australia</strong></td>
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<td>183 days</td>
<td>Any contractor</td>
<td>No limit</td>
<td>14</td>
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<td>15</td>
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<tr>
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Table 2. (Continued)

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<th>Country</th>
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<th>Maximum Presence in U.S.</th>
<th>Required Employer or Payer</th>
<th>Maximum Amount of Compensation</th>
<th>Treaty Article Citation</th>
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<td></td>
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<td>U.S. Government</td>
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<td>22(3)</td>
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<td>Any foreign resident contractor</td>
<td>No limit</td>
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<td>Any foreign resident</td>
<td>No limit</td>
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<td></td>
<td>Remittances or allowances</td>
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<td>Any foreign resident</td>
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<td>U.S. Government or its contractor</td>
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<td>20</td>
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<td>Maximum Amount of Compensation</td>
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<td>--------------------------</td>
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<td>Venezuelan resident</td>
<td>$8,000</td>
<td>21(2)</td>
</tr>
</tbody>
</table>
The exemption does not apply if the employee’s compensation is borne by a permanent establishment or in some cases a fixed base that the employer has in the United States.

The exemption applies if the employer is a permanent establishment in the treaty country but is not a resident of the treaty country.

This exemption does not apply in certain cases if the employee is a substantial owner of that employer and the employer is engaged in certain defined activities.

The exemption is also extended to journalists and correspondents who are temporarily in the United States for periods not exceeding 2 years and who receive compensation from abroad.

Also exempt are amounts of up to $10,000 received from U.S. sources to provide ordinary living expenses. For students, the amount will be less than $10,000, determined on a case-by-case basis.

Withholding at 30% may be required because the factors on which it is computed are based may not be determinable until after the close of the tax year. However, see withholding agreements, if any, between the United States and the treaty country.

Personal services must be performed under a contract entered into by the United States or foreign government, or its political subdivisions or local authorities.

Reimbursed expenses are not taken into account in figuring any maximum compensation to which the exemption applies. For Japan and Trinidad and Tobago, only reimbursed travel expenses are disregarded in figuring maximum compensation.

Exemption does not apply to the extent income is attributable to the recipient’s fixed U.S. base. For residents of Japan, this fixed base must be maintained in the U.S. for more than 183 days during the tax year for the exemption not to apply, for residents of Belgium, Iceland, Korea, and Norway, the fixed base must be maintained for more than 180 days; for residents of Morocco, the fixed base must be maintained for more than 89 days.

Does not apply to fees of a foreign director of a U.S. corporation.

Does not apply to compensation for research work for other than the U.S. educational institution involved.

Applies to any additional period that a full-time student needs to complete the educational requirements as a candidate for a postgraduate or professional degree from a recognized educational institution.

17 Applies only to full-time student or trainee.

18 Fees paid to a resident of the treaty country for services performed in the United States as a director of a U.S. corporation are subject to U.S. tax.

19 Does not apply to compensation paid to public entertainers (actors, artists, musicians, etc.), for Cannes and U.K. resident public entertainers, the exemption does not apply if the gross receipts (including reimbursements) are more than $15,000 in any year.

20 Does not apply to compensation paid to public entertainers in excess of $100 a day.

21 Does not apply to payments from the National Institutes of Health under its Visiting Associate Program and Visiting Scientist Program.

22 Exemption applies only if the compensation is subject to tax in the country of residence.
### Table 3. List of Tax Treaties

<table>
<thead>
<tr>
<th>Country</th>
<th>Official Text Symbol</th>
<th>General Effective Date</th>
<th>Citation</th>
<th>Applicable Treasury Explanations or Treasury Decision (T.D.)</th>
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<td>TIAS</td>
<td>Jan. 1, 1999</td>
<td></td>
<td></td>
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<td>Protocol</td>
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<td>Jan. 1, 1994</td>
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<td>Protocol</td>
<td>TIAS 11254</td>
<td>Various</td>
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<td>Protocol</td>
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<td>Jan. 1, 1996</td>
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1. Treaties and Other International Act Series.
2. Information on treaty can be found in Publication 597, Information on the United States—Canada Income Tax Treaty.
3. The United States—People’s Republic of China income tax treaty does not apply to Hong Kong.
5. Most of these treaties can be viewed online at http://www.irs.gov
How To Get Tax Help

You can get help with unresolved tax issues, order free publications and forms, ask tax questions, and get more information from the IRS in several ways. By selecting the method that is best for you, you will have quick and easy access to tax help.

Contacting your Taxpayer Advocate. If you have a problem with an IRS problem that you have attempted to deal with an IRS problem unsuccessfully, you should contact your Taxpayer Advocate.

The Taxpayer Advocate represents your interests and concerns within the IRS by protecting your rights and resolving problems that have not been fixed through normal channels. While Taxpayer Advocates cannot change the tax law or make a technical tax decision, they can clear up problems that resulted from previous contacts and ensure that your case is given a complete and impartial review.

To contact your Taxpayer Advocate:
- Call the Taxpayer Advocate at 1–877–777–4778.
- Call the IRS at 1–800–829–1040.
- Call, write, or fax the Taxpayer Advocate office in your area.
- Call 1–800–829–4059 if you are a TTY/TTD user.

For more information, see Publication 1546, The Taxpayer Advocate Service of the IRS.

Free tax services. To find out what services are available, get Publication 910, Guide to Free Tax Services. It contains a list of free tax publications and an index of tax topics. It also describes other free tax information services, including tax education and assistance programs and a list of TeleTax topics.

Personal computer. With your personal computer and modem, you can access the IRS on the Internet at www.irs.gov. While visiting our web site, you can:
- Find answers to questions you may have.
- Download forms and publications or search for forms and publications by topic or keyword.
- View forms that may be filled in electronically, print the completed form, and then save the form for recordkeeping.
- View Internal Revenue Bulletins published in the last few years.
- Search regulations and the Internal Revenue Code.
- Receive your electronic newsletters on hot tax issues and news.
- Get information on starting and operating a small business.
- You can also reach us with your computer using File Transfer Protocol at ftp.irs.gov.

TaxFax Service. Using the phone attached to your fax machine, you can receive forms and instructions by calling 703–368–9694. Follow the directions from the prompts. When you order forms, enter the catalog number for the form you need. The items you request will be faxed to you.

For help with transmission problems, call the FedEx Help Desk at 703–487–4608.

Phone. Many services are available by phone.
- Ordering forms, instructions, and publications. Call 1–800–829–3676 to order current and prior year forms, instructions, and publications.
- Asking tax questions. Call the IRS with your tax questions at 1–800–829–1040.
- TTY/TTD equipment. If you have access to TTY/TTD equipment, call 1–800–829–4059 to ask tax questions or to order forms and publications.
- TeleTax topics. Call 1–800–829–4477 to listen to pre-recorded messages covering various tax topics.

Evaluating the quality of our telephone services. To ensure that IRS representatives give accurate, courteous, and professional answers, we evaluate the quality of our telephone services in several ways.
- A second IRS representative sometimes monitors live telephone calls. That person only evaluates the IRS assistant and does not keep a record of any taxpayer's name or tax identification number.
- We sometimes record telephone calls to evaluate IRS assistants objectively. We hold these recordings no longer than one week and use them only to measure the quality of assistance.
- We value our customers' opinions. Throughout this year, we will be surveying our customers for their opinions on our service.

Walk-in. You can walk in to many post offices, libraries, and IRS offices to pick up certain forms, instructions, and publications. Some IRS offices, libraries, grocery stores, copy centers, city and county governments, credit unions, and office supply stores have an extensive collection of products available to print from a CD-ROM or photocopy from reproducible proofs. Also, some IRS offices and libraries have the Internal Revenue Code, regulations, Internal Revenue Bulletins, and Cumulative Bulletins available for research purposes.

Mail. You can send your order for forms, instructions, and publications to the Distribution Center nearest to you and receive a response within 10 weekdays after your request is received. Find the address that applies to your part of the country.
- Western part of U.S.: Western Area Distribution Center Rancho Cordova, CA 95743–0001
- Central part of U.S.: Central Area Distribution Center P.O. Box 8903 Bloomington, IL 61702–8903
- Eastern part of U.S. and foreign addresses: Eastern Area Distribution Center P.O. Box 85074 Richmond, VA 23261–5074

CD-ROM. You can order IRS Publication 1796, Federal Tax Products on CD-ROM, and obtain:
- Current tax forms, instructions, and publications.
- Prior-year tax forms and instructions.
- Popular tax forms that may be filled in electronically, printed out for submission, and saved for recordkeeping.
- Internal Revenue Bulletins.

The CD-ROM can be purchased from National Technical Information Service (NTIS) by calling 1–877–233–6767 or on the Internet at www.irs.gov. The first release is available in mid-December and the final release is available in late January.

IRS Publication 3207, Small Business Resource Guide, is an interactive CD-ROM that contains information important to small businesses. It is available in mid-February. You can get one free copy by calling 1–800–829–3676 or visiting the IRS web site at www.irs.gov.
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