

January 7, 2011

# Information Reporting – Interest Paid to Nonresident Alien Individuals on Bank Deposits

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## IRS Issues Proposed Regulations on Interest or Original Issue Discount (“OID”) Paid to Nonresident Alien Individuals on Bank Deposits

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### SUMMARY

Earlier today the IRS published proposed regulations (the “Proposed Regulations”) that, if finalized in their current form, would require banks to report annually to the Internal Revenue Service the amount of interest and OID earned by nonresident alien individuals on their bank deposits located in the U.S. While banks are already required to report the amount of interest earned on the bank deposits of individuals that are U.S. citizens or residents, the only nonresident alien individuals currently subject to such reporting are residents of Canada. The Proposed Regulations would expand that rule to apply to all nonresident aliens. The proposed rules are intended to strengthen the exchange of information programs the U.S. has with other countries as well as increase taxpayer compliance by making it more difficult for U.S. individuals to avoid information reporting (e.g., by claiming to be a nonresident alien). Interest paid on deposits of nonresident aliens will continue to be free from withholding, unless, as is currently the case, the nonresident alien fails to provide the proper forms or other identifying documentation required to establish their status as a nonresident alien (generally a Form W-8BEN).

The Final Regulations are proposed to be effective for payments made after December 31 of the year in which the regulations are finalized. Comments have been requested on the Proposed Regulations and a public hearing is scheduled for April 28, 2011.

## BACKGROUND

Bank deposit interest paid to a nonresident alien on an account maintained in the U.S. that is not effectively connected with a U.S. trade or business is exempt from U.S. withholding tax and also has generally been exempt from the reporting requirements otherwise applicable to interest<sup>1</sup> except, with respect to reporting, in the case of accounts in the U.S. held by Canadian residents.

Regulations proposed in 2001 would have extended this rule to bank deposit interest paid to all nonresident alien individuals. These proposed rules were withdrawn in 2002 and replaced with a narrower set of proposed rules that would have extended the reporting obligation only to residents of certain designated countries.<sup>2</sup> The 2002 proposed regulations were never finalized.

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## DISCUSSION

The Proposed Regulations would extend the existing information reporting requirements to interest paid to, and OID earned by, any nonresident alien individual with respect to a deposit maintained at an office in the United States (“Bank Deposit Interest”). In addition, the IRS has withdrawn the regulations proposed in 2002.

The preamble to the Proposed Regulations listed a number of reasons why extending the information reporting to Bank Deposit Interest paid to *any* nonresident alien individual is now appropriate. According to the IRS, there is a growing global consensus regarding the importance of cooperative information exchange for tax purposes, and the preamble suggests that, as a result, limiting the reporting obligation only to taxpayers in designated countries (as was proposed in the 2002) is no longer appropriate.<sup>3</sup> Thus, requiring routine reporting to the IRS of all U.S. bank deposit interest paid to a nonresident alien individual will strengthen the United States exchange of information program. Further, the IRS states that the Proposed Regulations “will help to improve voluntary compliance by U.S. taxpayers by making it more difficult to avoid the U.S. information reporting system (such as through false claims of foreign status).”

Reporting would be done on Forms 1042 and 1042-S, which are generally the forms used to report payments of U.S. source interest income to nonresident aliens.

As is currently the case, nonresident alien and backup withholding will not to apply to such payments unless the account holder fails to provide the required identifying information.

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<sup>1</sup> Reporting on payments to non-US people is generally required under Code Section 1461 (on Forms 1042 and 1042-S) and reporting on payments to US people is generally required by Code Section 6049 (Form 1099 reporting).

<sup>2</sup> Fmr. Prop. Treas. Reg. § 1.6049-8(a)(1).

<sup>3</sup> The preamble gives as an example the understanding that information exchanges will not be limited by bank secrecy or the absence of a domestic tax interest.

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The Final Regulations are proposed to be effective for payments made after December 31 of the year in which the regulations are finalized.

The IRS has requested comments generally on the Proposed Regulations including comments on (i) whether the information collected will have practical utility, (ii) the accuracy of their estimation of the burden of the new information collection obligations (particularly on small financial institutions), (iii) how that burden might be minimized, (iv) how the quality and utility of the information collected might be improved and (v) estimates of compliance costs.

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