

## INFORMATION RETURNS FOR NRA WITHHOLDING TAXES - FORMS 1042 AND 1042 S

### **Introduction:**

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 an Internal Revenue Code Section provides for a lower rate, or there is a tax treaty between the foreign person'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 area descriptively to refer to withholding required under sections 1441, 1442, and 1443 of the Internal Revenue Code and the filing of Form 1042 and related Form 1042-S.

The objective of this newsletter is to understand the basic concept of these withholding forms with specific emphasis on penalty provisions for non-filing or wrong filing or delayed filing of these forms.

### **Purpose of Forms 1042 and 1042-S**

U.S. withholding agents are generally required to file an annual federal withholding tax return on Form 1042 to report gross U.S.-source income paid to foreign persons and related withholding tax liabilities. U.S. withholding agents must attach Forms 1042-S to the Form 1042 reporting the name and address of, amounts paid to, and amounts, if any withheld from each foreign person's U.S. source income. Both the forms are calendar year forms and need to be prepared on the calendar year basis irrespective of the tax year followed by the withholding agent.

A 1042S needs to be filed even if no taxes were withheld due to the exemption for income and that is effectively connected with any US trade and business. If a withholding agent is required to file 1042 he is also required to file 1042 which is an annual tax return.

There should be separate 1042 S filed to the same recipient if the rate at which tax is withheld is different. Also there should be separate 1042 S for each type of income that you have paid to the same recipient.

### **Due Date of filing Forms 1042 and 1042-S**

The Forms 1042 and 1042-S must be filed by March 15 of the year following the calendar year in which the income subject to reporting was paid. If the date March 15th falls on a Saturday, Sunday, or legal holiday, the due date is the next business day.

An automatic 6- month extension of time can be taken to file Form 1042 by filing Form 7004- Application for automatic extension of time to file certain business Income Tax, Information, and Other Returns. File Form 7004 on or before the due date of Form 1042. Form 7004 does not extend the time of payment of tax.

An automatic extension of 30 days from the original due date can be taken for filing form 1042 S. The extension is taken up by filling up the form 8809 but before the original due date of filing of the form 1042-S. Additional extension can be requested of not more than 30 days by submitting a second Form 8809 before the end of the first extension period. The second extension will be permitted by the IRS only if the IRS is satisfied about the reasons for which the extension is sought.

### **Interest and Penalties for late filing and payment of tax Form 1042**

**Interest:** Interest is charged on taxes not paid by the person on the due date even if an extension of time to file the form is granted, as extension is given by IRS for filing of return and not taxes. Interest is also charged on penalties imposed for failure to file, negligence, fraud and substantial understatements of tax from the due date (including extensions) to the date of payment. Section 6621 states that interest rate charged in case of underpayment is generally sum of short term federal rate and 3% points.

**Late Filing Penalty:** The penalty for not filing the Form 1042 when due (including extension) is 5% of the unpaid tax for each month or part of a month the return is late, up to a maximum of 25% of the unpaid tax.

**Late Payment Penalty:** The penalty for not paying tax when due is usually 0.5 % of unpaid tax for each month or part of the month the tax is unpaid. The penalty cannot exceed a maximum of 25% of the unpaid tax.

**Late Deposit Penalty:** Deposits made:

1-5 days late - 2% 6-15 days late -5% More than 16 days late - 10%

The penalty is 15% if the deposit is not made within 10 days after IRS issues notice

### **Penalties for late filing and payment of tax Form 1042-S**

The following penalties apply to the person required to file 1042-S. The penalties apply to both paper filers and to electronic/magnetic media filers.

#### **Late Filing of Correct Form 1042-S with IRS**

A penalty may be imposed for failure to file each correct and complete Form 1042-S when due (including extensions) unless you can show that the failure was due to reasonable cause and not willful neglect. The penalty, based on when you file a correct Form 1042-S is:

## Tax year 2011

Particulars	Filing within 30 days from March 15,		Filing after 30 days from due date but before August 1		Filing After August 1	
	Penalty Amount per 1042S Form	Maximum Amount	Penalty Amount per 1042S Form	Maximum Amount	Penalty Amount per 1042S Form	Maximum Amount
Others	\$ 30	\$250,000	\$ 60	\$ 500,000	\$100	1,500,000
Small Business *	\$ 30	\$ 75,000	\$ 60	\$ 200,000	\$100	500,000

\*Small businesses-those with average annual gross receipts of \$5 million or less for the three most recent tax years ending before the calendar year in which the form is due.

Failure to provide correct statements and to furnish 1042S to the recipients without any reasonable cause, would lead to a penalty of \$50 when such return is due. The penalty may also be imposed for failure to include all required information or for furnishing incorrect information on Form 1042-S. The maximum penalty is \$100,000 for all failures to furnish correct recipient statements during a calendar year.

**Comment:** US tax payers should consider the necessary withholding tax implications and the consequent reporting requirements when making payments to a foreign person.

An entity having a reporting unit with a zero or negative carrying amount would not perform Step 1 of the goodwill impairment test.

### Disclaimer:

These materials and the information ('this information') contained herein are provided by KNAV and are intended to provide general information on a particular subject or subjects and are not an exhaustive treatment of such subject(s). This information is not intended to constitute accounting, tax, legal, investment, consulting, or other professional advice or services and should not be relied upon as the sole basis for any decision which may affect you or your business. No reader should act on the basis of any information contained in this publication without considering and, if necessary, taking appropriate advice upon their own particular circumstances. None of KNAV, its member firms, or its and their respective affiliates shall be responsible for any loss and any special, indirect, incidental, consequential, or punitive damages or any other damages whatsoever whether in an action of contract, statute, tort (including, without limitation, negligence), or otherwise, sustained by any person who relies on this information. If any of the foregoing is not fully enforceable for any reason, the remainder shall nonetheless continue to apply.

## About KNAV

KNAV is India's first multi-national firm of accountants and business advisors with operations in India, US, UK, Canada, France, Switzerland & Netherlands. Our partners and professionals are qualified in various countries including India, US, Canada, UK and Ireland allowing us to provide you with seamless service across Asia, North America and Europe.