



The IRS releases early draft of the 2019 Form 1042-S and associated draft instructions

Closing the distance

On September 27, 2018, the IRS released a draft [2019 Form 1042-S](#). The new form includes new box 7c regarding prior year withholding with respect to a partnership interest and new income code 55 for taxable life insurance benefits. The draft instructions to the 2019 Form 1042-S provide guidance on the use of box 7c and the new income code 55.

New Box 7c on Form 1042-S

The filer will have to check box 7c on 2019 Form 1042-S if the filer is a partnership that received an amount subject to withholding during the preceding calendar year and the filer is withholding in the subsequent year on the amount that was includible in a foreign partner's distributive share in that preceding calendar year. The box must be checked only if filer designated the deposit as attributable to the preceding year.

The addition of box 7c addresses an issue created by the partnership "lag method". Under Treas. Reg. §1.1441-5, a U.S. partnership is generally required to withhold tax on an amount subject to withholding that is includible in the gross income of a foreign partner. Generally, withholding is required at the time of a distribution of such income. However, under the so called "lag method", if the partnership does not make a distribution during the calendar year in which the income is earned, the partnership is required to withhold on the foreign partner's distributive share of the income on the earlier of: (1) The date on which the foreign partner is provided with Schedule K-1 (Form 1065); or (2) the due date for furnishing Schedule K-1 (Form 1065) to the foreign partner.

When the lag method is applied, the tax withheld on the foreign partner's distributive share of income should be shown as a liability on the partnership's Form 1042 for the year in which the withholding is actually done rather than on the Form 1042 for the year that the partnership earns the income (i.e., the preceding year). This creates a mismatch between the income shown on the foreign partner's Schedule K-1 for the year in which the income is earned and the year in which the income and withholding are reported on Form 1042-S (i.e., the subsequent year).

The mismatch described above caused some issues for investors. For instance, the investors have tried to take a credit for the tax on the distributive share of their income in prior year against the tax reported on Form 1042-S in a subsequent year, but these credits have been denied because of the year mismatch. Now, by checking the box 7c on Form 1042-S, the investors will be notifying the IRS that the withholding should be treated as applicable in the preceding year; hence, the issues related to the foreign partner receiving the tax credit for the withholding in the year of income inclusion should now be resolved.

New Income Code 55 for Taxable Death Benefits

A new income code 55 was also added to the draft 2019 Form 1042-S. This code must be used to report taxable death benefits, such as benefits paid on an insurance contract that was acquired on a transfer for valuable consideration.

The IRS released draft 2019 Form 1042-S and the associated draft instructions as a courtesy for information purposes. These drafts may change before the final 2019 Form 1042-S and the instructions for it are released. Therefore, taxpayers should not rely on these drafts. Before the release of the final 2019 Form 1042-S, taxpayers may provide comments on these drafts to the IRS through the following web-site: [Comment on Tax Forms and Publications](#).

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