

FATCA Update

Draft Forms 1042 and 1042-S

Global Financial Services Industry



The IRS released draft Forms 1042 and 1042-S incorporating the new reporting requirements imposed by FATCA and the reciprocal Intergovernmental Agreements (IGAs) that U.S. Treasury has been signing to implement FATCA in certain jurisdictions. While the Form 1042 remains identical to the prior versions, the Form 1042-S has undergone substantial changes. The most notable changes include the following:

- Chapter 3 and chapter 4 status code fields to identify the chapter 3 and chapter 4 status of the withholding agent, recipient (replaces the recipient code), and any intermediaries or flow-through entities;
- Fields to identify whether the form relates to chapter 3 or chapter 4 reporting along with an exemption code field and tax rate field for chapter 4 amounts;
- Global Intermediary Identification Number (GIIN) fields for the withholding agent and any intermediaries or flow-through entities;
- Foreign tax identification number fields for withholding agents and any intermediaries or flow through entities;
- Check box to indicate that tax is not deposited under the escrow procedure which is optional under chapter 4 if the character or source of payment is unknown for a certain period of time or for a Foreign Financial Institutions' (FFI's) dormant accounts;
- A field for the recipient's date of birth, which is a byproduct of reciprocal reporting requirements for certain countries that have entered into a reciprocal IGA with the U.S. Treasury;
- Removed the type of Taxpayer Identification Number (TIN) check box fields for U.S. TINs (e.g. Employer Identification Number (EIN), Social Security Number (SSN) or Individual Taxpayer Identification Number (ITIN), etc.) on box 12 and box 14b;

- A field for tax assumed by withholding agent in box 9. The use of this field is unclear; and
- Removal of the “optional” language for the recipient account number field on box 19. This may serve a dual purpose to allow the U.S. to identify relevant account numbers for the withholding agent and be able to report account number information for reciprocal IGA reporting.

The following highlights the differences on the new Form 1042-S from the prior version:

Chapter 3 check box to indicate the IRS code section applicable for the 1042-S

Chapter 4 check box, exemption code, and tax rate fields

Field to identify tax assumed by withholding agent

Check box to indicate that tax is not deposited under escrow procedure

Removed TIN type check boxes

Chapter 3 and 4 codes to identify recipient's status (replaces the single recipient code in prior versions)

Foreign TIN and Country Code fields for the withholding agent

Chapter 3 and 4 codes to identify withholding agent's status

GIIN field for any intermediary or flow-through entity

Removed "Optional" language

Foreign TIN field for any intermediary or flow-through entity

Chapter 3 and 4 codes to identify an intermediary's status

Recipient's date of birth field for reciprocal IGA reporting

In addition to the changes to the face of Form 1042-S, the income codes, exemption codes, and chapter 3 and chapter 4 status codes (formerly just the recipient codes) have undergone substantial changes. For the income codes, the following new codes have been added or changed:

- Income code 22 – new income type for interest paid on deposit with a foreign branch of a domestic corporation or partnership. Under the final regulations, this type of income is now considered U.S. source, however an exception to withholding applies until January 1, 2017 if paid by certain branches not acting as intermediaries with respect to the interest payment;
- Income code 21 – new income type for capital gain dividends;

- Income code 40 – modified income to include all dividend equivalent payments under IRC section 871(m), not just U.S. source dividend equivalent payments;
- Income code 44 – Added new income type for transportation and freight income; and
- Income code 50 – Added new income type for income that was previously reported under an escrow procedure (for unknown payment character or source, or an FFI's dormant accounts)

As noted in the changes for the 1042-S, the exemption codes have been split into chapter 3 and chapter 4. For chapter 3, the IRS added income code 09 for territory Financial Institutions (FIs) treated as U.S. persons and code 12 for payees subject to chapter 4 withholding. The addition of exemption code 12 bolsters the fact that chapter 3 withholding is not applicable if chapter 4 withholding applies. Due to the addition of the 09 code, withholding agents or service providers currently reporting on the Form 1042-S will need to update the mapping for exemptions 10 and 11 (former 09 and 10). For chapter 4, the IRS added exemption codes for the various types of income exempt from withholding under FATCA including grandfathered payments, effectively connected income, excluded nonfinancial payments, and foreign reportable amounts. Other codes were included for payments made to payees not subject to withholding such as dormant accounts, recalcitrant account holders in an IGA country, etc.

Finally, the recipient codes have been updated and renamed to “status codes” (separated for chapter 3 and chapter 4) for recipients, withholding agents, and any intermediaries or flow through entities. The IRS also included sub-categories within the chapter 3 and chapter 4 status codes to identify pooled reporting.

The release of the draft reporting Forms 1042 and 1042-S is welcome guidance to many withholding agents and service providers concerned over the new requirements and their effect on existing reporting processes and systems. However, the new Forms 8966 and the electronic reporting requirements for both forms have yet to be released and are significant components for withholding agents and service providers to begin updating systems and processes. Moreover, the instructions for the Form 1042-S, which are helpful to understanding the new forms, have not been released. For example, on its face, it is unclear how participating FFIs will report aggregate payments made to non-participating FFIs in 2016 and 2017 (for payments in 2015 – 2016) on the new Form 1042-S. As new guidance is released, withholding agents and service providers should continue to analyze how the new requirements will affect ongoing and future changes to systems, processes, and procedures.

The complete draft Forms 1042 and 1042-S are attached along with a separate document highlighting the changes on the Form 1042-S as pictured above. We will continue to keep you up to date and informed as FATCA continues to evolve.

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