



Tax Reform: Changes to Federal Withholding Tax Rules

Global information reporting update

The legislation (P.L. 115-97) commonly referred to as the 2017 Tax Reform Act (“the Act”) was signed into law by President Trump on December 22, 2017. Portions of the new law change withholding tax rates, effective January 1, 2018, and implement new withholding requirements.

Background

U.S. withholding obligations arise in a number of scenarios:

- Payors may need to perform backup withholding when instructed to by the IRS or when proper documentation is not provided by a payee;
- Withholding agents who pay income to foreign persons may be required to withhold tax from those payments;
- Partnerships may need to withhold on income that is effectively connected with the active conduct of a U.S. trade or business; and
- Withholding agents may need to withhold on the disposition of U.S. real property interests or partnership interests.
- The withholding obligations and the rates of withholding depend on many factors including the type of income, payee, and the documentation provided by the payee. Documentation of payees is generally provided using a Form W-9 for U.S. persons or a Form W-8 for non-U.S. persons. 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 that is subject to withholding.
- The following discussion outlines changes made by the Act to the U.S. federal information reporting regimes.

Withholding Rate Changes

Backup Withholding

A payor is required to deduct withholding tax from withholdable payments such as interest, dividends, services, royalties, gross proceeds, etc., when a U.S. person or someone that is presumed to be a U.S. Person fails to provide a U.S. Taxpayer Identification Number (“TIN”) in the manner required or if instructed by the IRS. Usually withholding agents collect Form W-9 (*Request for Taxpayer Identification Number and Certification*) from payees in order to document the TIN.

The backup withholding rate is derived from the individual federal tax rate tables. The Act reduced the backup withholding rate from 28% to 24% for payments made on or after January 1, 2018.

Nonresident Alien (“NRA”) Withholding

Payments to NRA recipients, including individuals, corporations and other entities, are generally subject to NRA withholding for fixed, determinable, annual or periodical (“FDAP”) income as required under chapter 3 and chapter 4 (“FATCA”). If valid documentation (typically the Form W-8 series) is not received, the withholding agent generally must withhold 30% of the payments. In cases where valid documentation is received, the rate may be reduced under an applicable income tax treaty or under tax code exemptions (e.g., portfolio interest.)

The 30% rate for NRA withholding is unchanged by the Act.

Effectively Connected Income (“ECI”) Withholding

A partnership (foreign or domestic) that has income effectively connected with a U.S. trade or business must pay a withholding tax on the effectively connected income that is allocable to its foreign partners.

The rates used for ECI are generally based on the highest applicable tax rate determined by the type of income and whether or not the recipient is a corporation. As a result of the Act, the rates changed as follows.

Entity type	Rates prior to 1/1/18			Rates on or after 1/1/18		
	Ordinary Income	Long-term Capital Gain	Section 1250 Gain	Ordinary Income	Long-term Capital Gain	Section 1250 Gain
Foreign corporate recipient	35%	35%	35%	21%	21%	21%
Foreign non-corporate recipient (individuals, complex trusts)	39.6%	20%	25%	37%	20%	25%

Withholding Obligations

Foreign Partnership Dispositions

The Act added two new sections to the Internal Revenue Code (“IRC”), IRC section 864(c)(8) and IRC section 1446(f). IRC section 864(c)(8) treats a gain or loss on the sale of a partnership interest by a foreign taxpayer as effectively connected to the extent it does not exceed certain defined limits. New IRC section 1446(f) provides coordinating withholding requirements on the sale or disposition of partnership interests by foreign and undocumented U.S. taxpayers if any portion of the gain on the disposition would be treated as effectively connected income (“ECI”) under section 864(c)(8). No withholding is required if a non-foreign affidavit is furnished stating, under penalty of perjury, the U.S. TIN and that the transferor is not a foreign person.

Withholding is required by the transferee (the acquirer). If a transferee fails to withhold the required amount, the partnership shall be required to deduct and withhold from distributions to the transferee a tax in an amount equal to the amount the transferee failed to withhold (plus interest as applicable on such amount).

The applicable withholding rate on such dispositions is 10%, beginning January 1, 2018. Withholding is required on the amount realized on the disposition (i.e., effectively the gross proceeds), regardless of the amount of the gain on the sale. IRS Notice 2018-08, issued on December 29, 2017, suspended the withholding on sales or dispositions of publicly traded partnership (“PTP”) interests until further guidance is issued. However, the Notice does not apply to any non-PTP interest. As such, all relevant withholding is applicable to distributions from those entities.

It is still uncertain how this withholding is to be reported. Further guidance is anticipated from the IRS. In the meantime, taxpayers should evaluate the impact of this change and plan for their approach for any dispositions.

Deloitte Tax is ready to help

The Deloitte Tax Global Information Reporting practice leads in experience with reporting matters pertaining to withholding tax issues. We are immediately available to assist you in meeting these new rules as well as your other information reporting needs.

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