



Information Reporting & Withholding

2019 DRAFT Form 1042 and Instructions



Who is Impacted

Any withholding agent, making payments of United States source fixed, determinable, annual, or periodical (FDAP) income to non-U.S. persons (non-resident aliens/NRAs) who file Forms 1042, *Annual Withholding Tax Return for U.S. Source Income of Foreign Persons*, will be interested in the [2019 DRAFT Form 1042](#) and its accompanying [2019 DRAFT Form 1042 Instructions](#) that were published over the last week.

What changed

In our August 2019 [article](#), we provided a quick refresher of the December 13, 2018, proposed regulations under chapters 3 (NRA withholding and reporting) and 4 (Foreign Account Tax Compliance Act (FATCA)) of the Internal Revenue Code. Certain of those proposed rules impact Form 1042 reporting. As such, we are delighted to share some of the updates from the new [2019 DRAFT Form 1042](#), published on September 5, 2019, and its accompanying [2019 DRAFT Form 1042 Instructions](#), published on September 9, 2019.

Reliance on December 2018 proposed regulations.

For 2019, a withholding agent may rely on the following provisions of these proposed regulations in connection with completing Form 1042.

- A partnership or trust that withholds in a subsequent year with respect to the share of income from a prior year for a non-U.S. partner or beneficiary, may designate the deposit of the withholding as attributable to the preceding year and report the associated amounts on Forms 1042 and 1042-S for the preceding year.
- A withholding agent can now make adjustments to overwithholding using either the reimbursement or setoff procedures until the extended due date for filing Form 1042-S (unless the Form 1042-S has already been filed or furnished). The withholding agent may also use the extended due date for filing a Form 1042 to claim a credit for any adjustments made to overwithholding.

In accordance with first of these new rules, we have a new section in the Draft Instructions for *Withholding and reporting in a subsequent year*. This section clarifies reporting under this proposed rule. Here, the partnership or trust will be required to report the associated amount and tax withheld on Forms 1042 and 1042-S for the preceding year. If a partnership withholds on the share of income of a non-U.S. partner after March 15 of the subsequent year, then the due date for filing the applicable Form(s) 1042-S is September 15 of the subsequent year. As an example, a partnership that withholds on the undistributed income of a non-U.S. partner on April 1, 2020, and that income is for the 2019 calendar year, then the partnership may designate the deposit as made for 2019 and report the liability and tax withheld on the 2019 Form 1042 and the 2019 Form 1042-S for the partner. The chapter 3 status code of the partnership or trust must reflect its status as a partnership or trust (including as a Withholding Foreign Partnership (WP) or Withholding Foreign Trust (WT)) and any amount withheld in the subsequent year that is designated for the prior year should be reported on line 65b as paid in a subsequent year.

www.complyexchange.com



It is important to note that a U.S. partnership or trust may apply the proposed regulations for 2019 in lieu of the reporting in the prior paragraph. Further, a non-U.S. partnership or trust may apply the proposed regulation that withholds in accordance with the prior paragraph.

New rules for Qualified Derivatives Dealers (QDD).

Section 4. Dividend Equivalent Payments by a Qualified Derivatives Dealer (QDD). Here, the Draft Instructions update guidance to include the new Schedule Q (Form 1042) for each QDD. The Internal Revenue Services published a [Draft 2019 Schedule Q \(Form 1042\)](#) as of August 6, 2019. This new Schedule Q (Form 1042) replaces the former 'attached statement' that included similar information for prior reporting years. Now, the taxpayer must complete and attach Schedule Q (Form 1042) even if the QDD has zero tax liability. There is an additional section in the Draft Instructions with guidance on this new Schedule Q (1042). It is important to note that in addition to filing a separate Schedule Q (Form 1042) for each QDD, if the taxpayer has a tax year other than the calendar year, the taxpayer must file separate Schedules Q (Form 1042) — one for the portion of the calendar year in the first tax year and a second one for the portion in the second tax year. The Draft Instructions replace references to the original attachment with the new Schedule Q (Form 1042).

New Schedule Q (Form 1042), Tax Liability of Qualified Derivatives Dealer (QDD). If the taxpayer, or any branch of the taxpayer, is a QDD, then the taxpayer must attach to Form 1042 a Schedule Q for each QDD, even if the QDD has zero tax liability. The new Schedule Q (Form 1042) replaces the statement that was required when reporting this information on prior year Forms 1042.

Who must file. In related news, the Draft Instructions added a seventh bullet point to include that a taxpayer that was, or had a branch that was, a QDD during the preceding year must file Form 1042.

Other Updates in the Draft 2019 Form 1042 Instructions

Rounding off to whole dollars. The Draft Instructions now require taxpayers to round off to the whole dollar. Previously, the Instructions stated that the taxpayer 'can' round off cents to whole dollars.

Chapter 3 Status Code. The Draft Instructions include a note that warns withholding agents not to use code 01 (U.S. Withholding Agent FI) or 02 (U.S. Withholding Agent Other) as their chapter 3 status code. Instead, they must use the applicable code that is most specific to their status (for example, chapter 3 status code 12 (Qualified Intermediary)).

Further, the Draft Instructions delete all references to a U.S. financial institution using its own withholding agent chapter 3 code (code 01) for purposes of completing the Form 1042. The guidance is narrowed to advise withholding agents to use their specified chapter 4 status codes on Form 1042-S for payments made. A U.S. financial institution should continue to use its own withholding agent chapter 4 status code (code 01) for purposes of completing Form 1042 if there are any payments made by the U.S. home office reflected on the form. Otherwise, use chapter 4 status code 50 (U.S. Withholding Agent-Foreign branch of FI) unless a more specific status code applies (for example, chapter 4 status code 07 (Registered Deemed-Compliant FFI-Reporting Model 1 FFI)).



Lines 1 through 60. The Draft instructions add bold print emphasis in the following manner (some taxpayers may not have been calculating correctly):

Lines 1 through 60 must show the withholding agent's record of federal tax liability for payments made during the applicable quartermonthly period. Withholding agents should report the **tax liability** for each period, rather than the amount of tax actually deposited with the IRS. **As such, the sum of lines 5, 10, 15, 20, 25, 30, 35, 40, 45, 50, 55, and 60 should be reported on lines 64b through 64d, as applicable (see instructions for lines 64b through 64d, later).**

Lines 64b and 64c. The Draft Instructions add additional clarification as to how the taxpayer must calculate the sum of the amounts reported on the Record of Federal Tax Liability. There is an additional line to include, line 64b, Total Net Tax Liability Under Chapter 3, should reflect the sum of lines 5, 10, 15, 20, 25, 30, 35, 40, 45, 50, 55, and 60. Again, there must have been some miscalculations over the last few years!

2019 Form 1042 Deadline. March 15, 2020, falls on a Sunday, and, as such, taxpayers must mail Form 1042 by March 16, 2020, to the Internal Revenue Service. All references to March 15 have been updated to March 16, 2020, for these purposes.

Updates to the Draft 2019 Form 1042

The most notable update to the Form 1042 itself is in Section 4, Dividend Equivalent Payments by a QDD. The only real change is to substitute the Schedule Q (Form 1042) for the attachment that was used for reporting this information in prior years.

How to Implement

Below are a few items to consider as you review the 2019 Draft Forms and Instructions:

- Comment on these draft forms if you have any questions, concerns, or suggestions!
- Keep watching the IRS website for updates (and our month end articles that highlight new guidance published by the IRS each month!)
- Become familiar with the new Schedule Q (Form 1042) and confirm that your systems will be able to pull in all of the required information easily.
- Confirm tax reporting vendors are aware of updates to 2019 Forms 1042 and that they support the new Schedule Q (Form 1042).
- For partnerships, discuss underwithholding procedures with key stakeholders, and the elimination of the lag method. Identify where investors may need clarification and notification regarding the new process and how it impacts their claim for credit or refund positively.
- Discuss overwithholding procedures with relevant department heads (Tax, Legal, Risk, etc.).
- Update process and procedure manuals to incorporate any changes required.
- Update training materials and presentations to staff.

Have you already implemented these items? Do they impact your business? Let us know what you have done to prepare. Comment on [LinkedIn](#) or [email us](#)!

www.complyexchange.com

THIS DOCUMENT CONTAINS GENERAL INFORMATION ONLY AND IS NOT A SUBSTITUTE FOR ACCOUNTING, TAX, OR ANY OTHER PROFESSIONAL ADVICE OR SERVICES. BEFORE MAKING ANY DECISION OR TAKING ANY ACTION THAT MAY AFFECT YOUR BUSINESS, YOU SHOULD CONSULT A QUALIFIED PROFESSIONAL ADVISOR.



References

[2018 Form 1042](#)

[2018 Instructions for Form 1042](#)

[Draft 2019 Schedule Q \(Form 1042\)](#)

www.complyexchange.com

THIS DOCUMENT CONTAINS GENERAL INFORMATION ONLY AND IS NOT A SUBSTITUTE FOR ACCOUNTING, TAX, OR ANY OTHER PROFESSIONAL ADVICE OR SERVICES. BEFORE MAKING ANY DECISION OR TAKING ANY ACTION THAT MAY AFFECT YOUR BUSINESS, YOU SHOULD CONSULT A QUALIFIED PROFESSIONAL ADVISOR.