

Tax Withholding on Pension Distributions to Nonresident Aliens

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What are withholding rules for nonresident aliens?

- Normal pension withholding rules do not apply to payments to nonresident aliens
- Must withhold at 30% rate unless exception applies
- Nonresident alien
 - Not U.S. citizen
 - Green card test or substantial presence test

What are withholding rules for nonresident aliens? (continued)

- General Rule
 - A nonresident alien is subject to income tax on U.S. source income
 - A pension that is attributable to employer contributions (and earnings) for services performed in U.S. is considered U.S. source income
 - If pension is attributable to employer contributions for services performed outside the U.S., only the “earnings” are considered U.S. source income
 - Must withhold 30% tax on pension payments to nonresident alien unless withholding agent can reliably document that payment is entitled to a reduced rate of withholding or no withholding

What is “reliable documentation”?

- “Effectively connected” income
 - Documentation that shows pension payments are “effectively connected” with a trade or business in the U.S. e.g. attributable to services as an employee in U.S. (including pension but not earnings from U.S. trust)
 - If so, must withhold at “graduated withholding rates” – not normal pension withholding
 - Note a minister in the exercise of his/her ministry is not treated as an employee

What is “reliable documentation”? (continued)

- Nonresident alien must have furnished withholding agent with Form 8ECI that documents portion of distribution that is “effectively connected”
- A nonresident alien minister engaged in his/her ministry in the US may file Form 8233 with pension trust to claim exemption from withholding
 - Income from services are treated as self-employment income and not subject to 30% withholding

What is “reliable documentation”? (continued)

- No withholding if at time of first pension payment 90% of members of U.S. plan are U.S. Citizens and payment is to a nonresident alien for services performed outside the U.S.
- Treaty Income
 - If U.S. has treaty with foreign country, the residents of that country are taxed at reduced or no U.S. tax
 - Qualify for relief from 30% withholding by providing withholding agent, Form W-8BEN

What are reporting obligations?

- Amounts paid to foreign persons and any tax withheld must be reported on Form 1042 S by withholding agent to the person
- Withholding agent also must file Form 1042 return with U.S. whether or not tax was withheld

What are consequences of violations?

- Withholding agent is liable for actual taxes owed by nonresident alien, if taxes are not paid
- Penalty for each failure to report

What is voluntary correction?

- IRS had offered a voluntary correction program under Rev. Proc. 2004-59 to correct tax withholding and report obligations
- Deadline for submission was recently extended to March 31, 2006

QUESTIONS?

- Questions