

Chief Counsel Advice concludes when late-received documentation can support portfolio interest exemption

On 22 August 2014, the IRS released [CCA 201434021](#), discussing the time frame within which a withholding agent (WA) may obtain late documentation proving that a foreign person is entitled to the portfolio interest exemption from withholding.

Background

Sections 1441 and 1442 (and the regulations thereunder) generally require a WA to withhold at source 30% of payments of interest, dividends, rents, royalties and other "fixed or determinable annual or periodic" (FDAP) income from sources in the US to foreign persons. This rate of withholding decreases if the WA can reliably associate the payment with documentation upon which it can rely to treat the payment as being made to a beneficial owner that is a foreign person entitled to an exemption from, or a reduced rate of, withholding. One such example is interest on certain "portfolio debt" obligations issued after 18 July 1984, which are exempt from withholding tax (the portfolio interest exemption).

Under Section 1461, if the WA does not obtain that documentation, or is otherwise barred from doing so, it is ultimately liable for the payment of tax. Specifically, under Treas. Reg. Section 1.871-14(c)(3), to claim that interest qualifies for the portfolio interest exemption, the documentary evidence must be furnished before the expiration of the foreign beneficial owner's period of limitation for claiming a refund of tax on the interest. Section 6511(a) defines the period of limitation and provides that a taxpayer can claim a tax refund within the later of: (1) three years from the time a tax return is filed or two years from the time the tax was paid, or (2) if no return was filed, after two

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years from the time the tax was paid. For this purpose, Section 6513(b)(3) states that, when a tax is withheld at the source, the tax is deemed paid by the recipient of the income on the last day prescribed for filing a return under Section 6012. Thus, the WA is barred from obtaining the documentation to support the portfolio interest exemption after this time and will be held liable for the tax due (and possibly for additional interest and penalties).

Analysis

In CCA 201434021, the WA (US payor) made payments of interest to two foreign individuals and did not withhold any tax on these payments. The WA did not have, however, the required documentation to reliably associate or support a claim for portfolio interest at the time it made the payments. The first individual did not file a US tax return or pay any tax for the year the payments were made. The second individual filed a US tax return reporting unrelated taxable income and paid the required tax.

Regarding the first individual, since he or she had not filed a US tax return and no tax was either paid or deemed paid on the payment, his or her statute of limitations had not started or expired. As a result, the IRS Chief Counsel's Office ruled in the CCA that the WA was permitted to obtain documentation to support a claim for the portfolio interest exemption.

Regarding the second individual, since he or she had timely filed a US tax return reporting taxable income unrelated to the interest income and

paid the tax due on such income, such a filing of a tax return and payment of tax started the statute of limitations under Section 6511(a). As a result, the IRS Chief Counsel's Office ruled in the CCA that the WA was permitted to obtain documentation to support the claim for the portfolio interest exemption only before the individual's limitation period expires.

In either case, because the WA received the documentation after the date of the payment, it may also be required to provide additional proof under Treas. Reg. Section 1.1441-1(b)(7)(ii) if "the delays in obtaining the withholding certificate affect its reliability."

Implications

CCA 201434021 provides an interesting and generally favorable interpretation of the regulation because it focuses on the foreign individual's statute of limitations rather than the WA's statute of limitations. In most withholding tax cases, the foreign individual will not have filed a tax return. Thus, if no tax is actually withheld, no statute of limitations will apply. A WA would be well advised, however, to withhold on payments unless it can obtain the required documentation prior to the payment date. This is especially true in light of the history of the regulations regarding the imposition of interest and penalties upon a WA when the required documentation was obtained subsequent to the payment. Prior to 2006, a WA that did not withhold tax when it did not have sufficient documentation to do

so, but later obtained the required documentation, could be liable for interest on the tax even if that tax was ultimately not imposed. The IRS changed this rule retroactively in October 2006 to specify that if it is ultimately demonstrated that no tax was due, the WA would not be liable for interest and penalties on the tax that was not, in fact, due. The IRS has subsequently suggested, however, that there may be limits to this leniency in the future. While CCA 201434021 makes no insinuation that interest or penalties could be assessed in this case, WAs should be mindful of IRS suggestions of possible future changes.

Some question exists as to whether the WA's statute of limitations for claiming a refund is the more appropriate benchmark. That is, if the WA is unable to obtain the required documentation, it would be liable for the underwithholding under Section 1461, and would be the most likely target of an IRS audit. Thus, it would seem a more natural interpretation of the regulation to determine the period for which documentation may be obtained by reference to the WA's statute of limitations. Additionally, it could prove administratively challenging to reference a foreign individual's statute of limitations because a WA would generally have no ability to determine when or if the statute of limitations began for a foreign individual and thus when it would be permitted to obtain the required documentation. It remains to be seen whether the IRS will issue further advice on the topic.

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