

Now Is the Time to Consider Voluntary Disclosure: Advancement of the IRS Campaign on Withholding Tax Noncompliance for Forms 1042, 1042-S

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Campaign for Compliance

Last year the IRS announced a new campaign to target “Withholding and International Individual Compliance” regarding Forms 1042 and 1042-S. Those who make payments of certain U.S.-source income to foreign persons must comply with withholding, deposit, and reporting requirements. The IRS campaign promised to address “withholding agents who make such payments but do not meet all their compliance duties.”

In accordance with this promise, the IRS initiated the campaign, uncovering several thousand noncompliant withholding agents for the 2017 tax year alone. Letters addressing this noncompliance are now being sent to withholding agents on an “ongoing, rolling basis,” according to Kimberly Schoebacher, IRS Acting Director for Foreign Payments of the Large Business and International Division.

For those with tax withholding and Forms 1042 and 1042-S reporting requirements, now is the time to come forward and voluntarily disclose previous noncompliance to try to avoid penalties. Schoebacher stated that once a campaign letter is received, penalty abatement is unavailable.

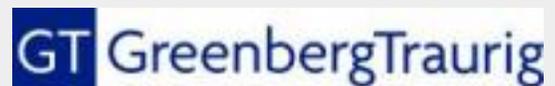
Procedures for Disclosure

In February 2019, the IRS released Memo LB&I-04-0219-002, describing procedures for withholding agents to submit delinquent withholding tax returns. The Memo states that “Foreign Payments Practice (FPP) has created a central point of contact where withholding agents can submit delinquent withholding tax returns” and pay their withholding obligations.

Only withholding agents, as defined in Treas. Reg. § 1.1441-7(a)(1), are qualified to use these procedures. “Qualified intermediaries,” “withholding foreign partnerships,” or “withholding foreign trusts,” are subject to other procedures. Moreover, the procedure will not apply if the withholding agent used it for prior years.

Pursuant to the Memo, the withholding agent must submit the delinquent withholding tax returns, including related information returns, with full payment of the tax due. It must also attach a statement that includes:

1. An explanation of the areas or business for which there was noncompliance of tax, withholding, and reporting obligations on payments to foreign persons;
2. An explanation of how the noncompliance was discovered;
3. A description of corrective procedures implemented to ensure future compliance; and
4. A copy of the procedures described in paragraph (3) as communicated to employees or other responsible parties of the withholding agent. The withholding agent cannot have filed delinquent returns using these procedures in prior years.



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With the voluntary disclosure filing, the withholding agent must report and remit all unpaid tax and will be required to pay interest and penalties which will not be abated by the IRS.

Like other voluntary disclosure regimes, this process for filing delinquent returns applies to only six years of delinquent returns. Additional years can only be filed under this program with IRS managerial approval.

Pitfalls for the Unwary

In addition to the requirements for those who can participate, the IRS laid out limitations in the disclosure process. For example, the IRS will not issue Closing Agreements, even for those who comply with the submission requirements. Also, the IRS reserves the right to “verify” that the corrections attested to have been made. These “verifications” will not rise to the level of an examination, but the verification process could trigger a determination that an exam is warranted, and the submission of the returns under this program will not preclude an examination.

Any taxpayer currently under examination with respect to liabilities related to withholding tax filings is ineligible for this disclosure regime. If a taxpayer has received a notification from the IRS of an impending examination or referral to examination, it will not be permitted to use these procedures.

All submissions seeking penalty relief will also be required to provide a specific request for penalty removal and must establish a reasonable cause defense. The penalty relief request must include, at a minimum, the following items establishing reasonable cause:

- A description of the current procedures the withholding agent uses to determine tax, withholding, and reporting obligations regarding payments to foreign persons. A description of the failures in the withholding agent's tax, withholding, and reporting procedures for payments to foreign persons, why the failures occurred, and the years affected by such failures.
- The number of persons affected by such failures and how the number was determined.
- A calculation of the total amount of taxes the withholding agent failed to withhold, pay, or report, not including interest and penalties, for tax periods open for assessment or collection under the provisions of IRC section 6501. This calculation should identify any adjustments under IRC section 1463 for tax already paid and provide documentation of the same.
- A list of the documents being provided with the submission.
- A required penalties of perjury statement:

– The following declaration must accompany the submission, any information submitted after the original submission, or any subsequent change in the submission: “Under penalties of perjury, I declare that I have examined this submission, including the accompanying documents listed below, and to the best of my knowledge and belief the facts presented in support of this request are true, correct, and complete.”

– The declaration must be signed by the withholding agent, not the withholding agent's representative, as stated under Treas. Reg. § 301.6651-1 (c).

Along with meeting all the above requirements, any withholding agent filing a delinquent return through these procedures must also include extensive “related information” including:

- The related information returns, or a schedule of the returns if filed electronically. Information returns on Form 1042-S must indicate the withholding tax was paid by the withholding agent unless the withholding agent actually withheld the tax.
- If there are more than 25 information returns, a spreadsheet tying the information returns to the primary return must be included.
- A properly completed Form 2848, if applicable.

Now Is the Time

With enhanced enforcement of delinquent withholding taxes, now is the time to take advantage of the disclosure procedures to correct any noncompliance. Taxpayers who fail to voluntarily report previous noncompliance and who receive a campaign letter regarding their failure to withhold payments to foreign payees risk losing the chance to avoid penalties.

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