April 26, 2012

Final Regulations on Reporting of U.S. Interest Earned by NRAs

On April 17, the Internal Revenue Service (IRS) issued final regulations (T.D. 9584) regarding the reporting to the IRS of U.S. bank deposit interest earned by nonresident aliens. These regulations, which go into effect January 1, 2013, are consistent with the recent trend by the IRS to gather more tax-related information that it can exchange with other jurisdictions.

Nonresident alien individuals are generally not subject to U.S. taxation on interest income from deposits maintained at U.S. offices of certain financial institutions (U.S. bank deposit interest) unless the interest is "effectively connected" with the conduct of a U.S. trade or business. These financial institutions include banks and certain savings institutions and insurance companies.

The new regulations do not change the way the interest income of nonresident alien individuals is taxed--they affect only the reporting to the IRS of U.S. bank deposit interest earned by these individuals. Whereas such interest was previously not reported to the IRS, the new regulations now require U.S. financial institutions to report annually to the IRS any U.S. bank deposit interest earned by nonresident aliens beginning January 1, 2013.

The regulations apply only to nonresident alien individuals who are residents of the 80 countries that have tax information sharing agreements with the United States, as listed in Rev. Proc. 2012-24, also issued on April 17.

The revenue procedure divides the listing into two categories. In the first category are countries to which the United States is not obligated to, but may, provide the information obtained as a result of the new regulations. In evaluating whether to provide these countries with such information, the IRS will evaluate the requesting country's current practices with respect to information confidentiality and then require the requesting country both to explain how it intends to use that information and to justify how that information is pertinent to the intended permitted use.

In the second category is one country--Canada--with which the United States has already entered into an agreement to exchange deposit interest information automatically. Though only Canada currently has an automatic information exchange agreement in place, the U.S. Treasury Department announced in February that it is currently negotiating similar agreements with France, Germany, Italy, Spain and the United Kingdom.