Presentation on 2014 Form 1042-S Issues

As a courtesy to its students, Northwestern University has asked PricewaterhouseCoopers to present this briefing summarizing recent issues with IRS notices related to 2014 Form 1040NR filings and 2014 Form 1042-S withholding tax. This briefing contains general information only and does not constitute legal advice.

Northwestern University has not reviewed the materials for accuracy or completeness. Northwestern University does not guarantee the accuracy of the information or its applicability to any particular student’s personal situation. Students should not rely on the information in this briefing but should consult with legal and accounting professionals of their own choosing.
Agenda

Objectives
General Tax Overview
Issue Overview
IRS Notices
Northwestern’s Response
Tips for IRS Communication
Questions
Objectives
Objectives

The purpose of this presentation is to:

- Discuss the general requirements of US information reporting and withholding rules
- Discuss the current IRS Notices related to 2014 Form 1040NR and 1040NR-EZ
- Discuss IRS interactions and possible resolutions to the current notices
General Overview
General Tax Overview

US and non-US persons subject to income tax

• US Persons
  - Taxed on Worldwide Income,
  - May File Jointly, Claim Standard Deduction or Itemized Deductions, and Claim Exemptions for Dependents;
  - Generally No Treaty Exemptions Available

• Non US Persons
  - Taxed Only on US Source Income or
  - Income Effectively Connected With a US Trade or Business, Limited Itemized Deductions and Exemptions;
  - May Claim Treaty Exemptions If Requirements Met
General Overview
Taxing Student Financial Assistance

- Financial assistance that you receive above
  - tuition,
  - required fees,
  - books,
  - supplies and
  - equipment required for your course instruction is “non-qualified” scholarship and grants which are subject to tax.

- Financial assistance (scholarship, fellowship, grant, etc.) is not subject to US tax if:
  - You are a candidate for a degree at an eligible education institution, and
  - You use the scholarship, fellowship or grant to pay “qualified education expenses”.

April 2016
**General Overview**

Qualified Education Expenses

Tuition and fees required to enroll at or attend an eligible educational institution, and

Course related expenses such as required fees, books, supplies and equipment that are required for the courses at the educational institution. These items must be required of all the students in the course of instruction.
General Overview

Non-Qualified Education Expenses

- Room and Board
- Travel
- Equipment not required by the course

Non-qualified amounts are subject to 30 percent withholding tax. If additional documentation is provided, the tax rate can be reduced to 14 percent or zero.
**Tax Treatment of Scholarship and Fellowship Payments**

<table>
<thead>
<tr>
<th>IF you use the payment for...</th>
<th>AND you are...</th>
<th>THEN the payment is...</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A degree candidate</td>
<td>Not a degree candidate</td>
</tr>
<tr>
<td>Tuition</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Fees</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Books</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Supplies</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Equipment</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Room</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Board</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Travel</td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>

1. Does not include payments received for past, present, or future services.
2. Payments used for any expenses indicated in this column are tax free only if the terms of the scholarship or fellowship do not prohibit the expense.
3. If required of all students in the course.

Do not rely on this table alone. Refer to the text for complete details.
General Overview

Income Tax Return Obligation

• Form 1040NR or 1040NR-EZ
  - Required if:
    ◦ Income tax was withheld but a lower rate of tax applies
  - Not Required if:
    ◦ Income is $4,000 or less,
    ◦ Interest income from US banks/savings institutions, or
    ◦ Entirely tax-free scholarships or fellowships;

• Forms 1042-S or W-2
  - Information returns that report income and withholding tax
  - Either or both are attached to your return
**Issue Overview**

**IRS Actions**

- IRS Notice 2015-10
  - IRS announces changes to processing credits and refunds claimed on Form 1042-S
  - Focused on actions needed to:
    - Identify identity theft
    - Identify fraudulent claims
- IRS implemented automated matching systems
  - Forms 1042-S must match exactly Form 1042-S filed with the IRS
  - Any mismatched information will generate an IRS notice
  - IRS evaluating withholding tax deposits
    - Limits credits and refunds to amount actually received
**Issue Overview**

**University actions**

- **2014 Form 1042-S**
  - Timely tax deposits made by Northwestern University
  - Timely filed by Northwestern University
    - Contracted with service provider to file
    - Electronic file prepared by service provider reported erroneous information
- **2014 Form 1040NR and 1040NR-EZ**
  - Provided income tax filing assistance to students
- Students from many universities affected by service provider error
  - More than 5000 students nationwide effected
Issue Overview

Student Actions

- 2014 Form 1040NR
  - Timely filed by students
  - Forms 1042-S attached to returns

- IRS Notices
  - Deny withholding tax credits
  - Assess additional tax
**IRS Notices**

**Overview**

General IRS notice process

- IRS always communicates in writing
- Multiple notices are sent every 30-45 days
- If no taxpayer response the IRS will do one of the following:
  - Federal Tax Lien
    - Usually for tax liability of $10,000 or more
  - Levy
    - Seizure of property or assets
      - Bank accounts
      - Garnishment of wages
**IRS Notices**

*Notices CP 21C and 22A*

The IRS is sending multiple types of notices

- **Notice CP21C**
  - Notifies of a change to 2014 Form 1040NR or 1040NR-EZ
  - Increase in tax
  - Notice is informational only – no response required

- **Notice CP22A**
  - Notifies of a change to 2014 Form 1040NR or 1040NR-EZ
  - Potential decrease in withholding tax credit
  - Potential failure to pay penalty and interest
  - Requests a response by call or in writing
Changes to your 2014 Form 1040NR

**Amount due: $2,141.09**

Based on the information you provided, we changed your 2014 Form 1040NR to correct your:

- account information.

As a result, you owe $2,141.09.

**Billing Summary**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Account balance before this change</td>
<td>$-370.44</td>
</tr>
<tr>
<td>Decrease in credit</td>
<td>$2,380.00</td>
</tr>
<tr>
<td>Increase in failure-to-pay penalty</td>
<td>$80.38</td>
</tr>
<tr>
<td>Increase in interest</td>
<td>$51.15</td>
</tr>
<tr>
<td><strong>Amount due by March 7, 2016</strong></td>
<td><strong>$2,141.09</strong></td>
</tr>
</tbody>
</table>
What you need to do immediately — continued

If you don’t agree with the changes

- Call 1-800-829-8374 to review your account. You can also contact us by mail. Fill out the Contact information section, detach, and send it to us with any correspondence or documentation.

- If we don’t hear from you, we’ll assume you agree with the information in this notice.

If you’ve already paid your balance in full within the past 14 days or made payment arrangements, please disregard this notice.

If we don’t hear from you

- If you don’t pay $2,141.09 by March 7, 2016, interest will increase, and additional penalties may apply.

Penalties

We are required by law to charge any applicable penalties.

<table>
<thead>
<tr>
<th>Date received</th>
<th>Months late</th>
<th>Unpaid amount</th>
<th>Penalty rate</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>02/29/2016</td>
<td>08</td>
<td>$2,009.56</td>
<td>0.50%</td>
<td>$80.38</td>
</tr>
</tbody>
</table>

Total failure-to-pay $80.38
IRS Notices
Letter 5532C

The IRS is sending multiple types of notices

- Letter 5532C
  - Notifies decrease in withholding reported on Form 1042-S
  - Identifies Northwestern as issuer of Form 1042-S
  - Indicates the need to contact Northwestern
  - Identifies that information on Form 1042-S does not match the IRS records
  - Informs that additional correspondence will be sent
  - Provides an opportunity to contact the IRS by calling or in writing if there is disagreement with the adjustment
Dear TAXPAYER:

We are responding to the Form 1040NR, U.S. Nonresident Alien Income Tax Return, you filed for the tax period listed above.

We are notifying you that we reduced or eliminated the amount shown on Form 1040NR, U.S. Nonresident Alien Income Tax Return, Line 62d in the amount of $3,067.00 for the tax period listed above.

The information you supplied does not match the information we received from Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, filed by your withholding agent.

You would need to contact your withholding agent to correct any error on the Form 1042-S you were issued.
We are providing an explanation only for adjustments to credits shown on your tax return that you based on the amount shown on Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, attached to the return.

We'll send you a letter with the change to the refund or amount you owe that you reported on your return. The recomputed amount will reflect the adjustments to credits shown on your tax return that you based on the amount shown on Form 1042-S attached to your return, and any other adjustments we determine after your return is processed. This letter will contain contact information.

After resolving any 1042-S mismatch issues with your withholding agent, if you still need to contact the IRS, include a copy of this letter and any other letter received showing a recomputed amount on your return, and provide in the spaces below, your telephone number and the hours we can reach you.

Keep a copy of this letter for your records.

Telephone number ( )________________________ Hours________________
Northwestern University’s Response
Northwestern University’s Response

- Students informed the University about IRS notices
- Evaluated the possible reasons for notices
  - Evaluated Form 1042-S filing
  - Met with students to identify discrepancies
- Connected with Form 1042-S service provider
  - Received notification file submitted to IRS had errors
- Retained an advisor (PwC)
- Correspondence to the IRS
- Provided support to students
  - FAQs
  - IRS Communication Tips
**2014 Form 1042-S**

<table>
<thead>
<tr>
<th>Form 1042-S</th>
<th>Foreign Person's U.S. Source Income Subject to Withholding</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>1 Income</td>
<td>2 Gross income</td>
</tr>
<tr>
<td>code</td>
<td>3 Chap. 3:</td>
</tr>
<tr>
<td></td>
<td>3a Exemption code</td>
</tr>
<tr>
<td></td>
<td>3b Tax rate</td>
</tr>
<tr>
<td></td>
<td>4 Chap. 4:</td>
</tr>
<tr>
<td></td>
<td>4a Exemption code</td>
</tr>
<tr>
<td></td>
<td>4b Tax rate</td>
</tr>
<tr>
<td>5 Withholding allowance</td>
<td></td>
</tr>
<tr>
<td>6 Net income</td>
<td></td>
</tr>
<tr>
<td>7 Federal tax withheld</td>
<td></td>
</tr>
<tr>
<td>8 Tax withheld by other agents</td>
<td></td>
</tr>
<tr>
<td>9 Tax assumed by withholding agent</td>
<td></td>
</tr>
<tr>
<td>10 Total withholding credit</td>
<td></td>
</tr>
<tr>
<td>11 Amount repaid to recipient</td>
<td></td>
</tr>
<tr>
<td>12a Withholding agent's EIN</td>
<td></td>
</tr>
<tr>
<td>12b Ch. 3 status code</td>
<td></td>
</tr>
<tr>
<td>12c Ch. 4 status code</td>
<td></td>
</tr>
<tr>
<td>13a Withholding agent's name</td>
<td></td>
</tr>
<tr>
<td>13b Withholding agent's Global Intermediary Identification Number (GIIN)</td>
<td></td>
</tr>
<tr>
<td>13c Country code</td>
<td>13d Foreign taxpayer identification number, if any</td>
</tr>
<tr>
<td>13e Address (number and street)</td>
<td></td>
</tr>
<tr>
<td>13f City or town, state or province, country, ZIP or foreign postal code</td>
<td></td>
</tr>
<tr>
<td>13g Recipient's U.S. TIN, if any</td>
<td></td>
</tr>
<tr>
<td>13h Ch. 3 status code</td>
<td>13i Ch. 4 status code</td>
</tr>
<tr>
<td>14a Recipient's name</td>
<td>14b Recipient's country code</td>
</tr>
<tr>
<td>14c Address (number and street)</td>
<td></td>
</tr>
<tr>
<td>14d City or town, state or province, country, ZIP or foreign postal code</td>
<td></td>
</tr>
<tr>
<td>15a Intermediary or flow-through entity's EIN, if any</td>
<td></td>
</tr>
<tr>
<td>15b Ch. 3 status code</td>
<td>15c Ch. 4 status code</td>
</tr>
<tr>
<td>16a Intermediary or flow-through entity's name</td>
<td></td>
</tr>
<tr>
<td>16b Intermediary or flow-through entity's GIIN</td>
<td></td>
</tr>
<tr>
<td>16c Country code</td>
<td>16d Foreign tax identification number, if any</td>
</tr>
<tr>
<td>16e Address (number and street)</td>
<td></td>
</tr>
<tr>
<td>16f City or town, state or province, country, ZIP or foreign postal code</td>
<td></td>
</tr>
<tr>
<td>17 Recipient's GIIN</td>
<td>18 Recipient's foreign tax identification number, if any</td>
</tr>
<tr>
<td>19 Recipient's account number</td>
<td></td>
</tr>
<tr>
<td>20 Recipient's date of birth</td>
<td></td>
</tr>
<tr>
<td>21 Payer's name</td>
<td>22 Payer's TIN</td>
</tr>
<tr>
<td>24 State income tax withheld</td>
<td></td>
</tr>
<tr>
<td>25 Payer's state tax no.</td>
<td></td>
</tr>
<tr>
<td>26 Name of state</td>
<td></td>
</tr>
</tbody>
</table>

For Privacy Act and Paperwork Reduction Act Notice, see instructions.
Tips for IRS Communication
**Tips for IRS Communication**

Do not ignore IRS Notices

When calling the IRS keep the following in mind:

- Indicate all notice(s) you received from IRS.
- Indicate any communication you have had with the IRS (calls or letters).
- Indicate you have verified that the amount of income and federal tax withheld as reported on your 2014 Form 1042-S, Copy C, and attached to your 2014 Form 1040NR or 1040NR-EZ matches what Northwestern reported on its electronic FIRE file of Form 1042-S, Copy A.
**Tips for IRS Communication**

When calling the IRS keep the following in mind:

- Indicate that the institution’s software vendor, Thompson Reuters, is finalizing a resolution with the IRS for any electronic file submission irregularities filed with the IRS and that the Northwestern University will take appropriate steps with respect to its electronic file submission as soon as a resolution has been decided upon with the IRS.

- Ask for a 6-8 week hold be put on your account to avoid additional notices issued by the IRS.
**Tips for IRS Communication**

**Requesting an IRS Hold or Freeze**

**Calling v. writing**

- **Calling**
  - Confirmation that hold or freeze has been granted
  - Long wait times
  - Lack of written confirmation
  - Halts IRS notice and collection activity for a period of time

- **Writing**
  - Record of request
  - Lack of written confirmation
  - Halts IRS notice and collection activity for a period of time

- Calling or writing will not stop a notice that is scheduled to be sent
Tips for IRS Communication
Publications/Information

• Helpful IRS Publications
  - Publication 17: Your Federal Income Tax
  - Publication 519: U.S. Tax Guide For Aliens
  - Publication 901: U.S. Tax Treaties
  - Publication 970: Tax Benefits for Education

• Internet Addresses:
Questions...