

IRS REPORTING FOR A FOREIGN CHARITY

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If a foreign charity invests in the United States and earns US source investment income, a 30 percent withholding tax may be imposed at source unless an exemption applies under the US Internal Revenue Code or a tax treaty. In order to claim a withholding tax exemption, the foreign charity must provide the US withholding agent (the US investment firm that pays the income to the charity) with either IRS form W-8BEN-E (“Certificate of Status of Beneficial Owner for United States Tax Withholding and Reporting (Entities)”) or IRS form W-8EXP (“Certificate of Foreign Government or Other Foreign Organization for United States Tax Withholding and Reporting”). The different versions of form W-8 are generally used for various US withholding tax purposes, including the new FATCA withholding tax regime.

Form W-8 is intended to provide the withholding agent that pays the US-source income with information to confirm whether US withholding taxes apply to the payment of the investment income to the charity. Even though the charity may be tax exempt under the domestic law of the jurisdiction in which it was formed, any US-source income paid to the charity may still be subject to US tax unless the charity obtains US tax-exempt status by applying to the IRS or by obtaining a legal opinion from US counsel. Alternatively, the charity may qualify for an exemption under a tax treaty such as the Canada-US treaty.

Forms W-8BEN-E and W-8EXP frequently cause confusion for a foreign charity that receives US-source income. Withholding agents often assume that a foreign charity should complete form W-8EXP to claim a withholding tax exemption. However, most often the charity may choose either form to avoid the otherwise required 30 percent withholding tax on investment income.

Form W-8BEN-E is used if the charity claims an exemption from withholding under a tax treaty (such as the Canada-US treaty). Form W-8EXP is used if the charity claims a withholding tax exemption as a tax-exempt organization as defined in Code section 501(c)(3). If the charity chooses to file form W-8EXP (and not form W-8BEN-E), it must either (1) certify that it received tax-exempt status from the IRS or (2) include an opinion from US counsel concluding that the charity meets the requirements of section 501(c)(3). The charity must also provide an affidavit

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with sufficient financial data to show that the charity is not, under IRS rules, a private foundation. It is generally easier and less costly to claim a treaty exemption than it is to apply to the IRS for exempt status or obtain a legal opinion from US counsel. Nevertheless, some withholding agents request that the organization provide form W-8EXP.

In addition to using a form W-8 to claim a withholding tax exemption under a treaty or the Code, a foreign charity may also need to certify its FATCA status on a form W-8. This area is also complicated for many foreign charities because the form contains various FATCA statuses to choose from and because the Canada-US intergovernmental agreement (IGA) and the US Treasury regulations sometimes provide inconsistent definitions. For example, the US Treasury regulations characterize a non-profit organization (NPO) as an “excepted NFFE” for FATCA purposes, but the Canada-US IGA characterizes an NPO as an “active NFFE.” Either status should provide an exemption from FATCA withholding, but it is often not clear which definition is operative.

Form W-8 is not filed with the IRS, but it must still be accurately completed and provided to the withholding agent to avoid US withholding tax on the income paid to the charity. If a foreign charity does not provide the form to its withholding agent or provides an inaccurate form, the withholding agent may withhold 30 percent tax at source. FATCA withholding may also apply if a form W-8 is not provided.

A foreign charity may also need to file a US income tax return. There is no IRS counterpart to form 1120-F (“U.S. Income Tax Return of a Foreign Corporation”) for a foreign charity. Forms 990 (“Return of Organization Exempt from Income Tax”) and 990-PF (“Return of a Private Foundation”) must be used if a foreign charity is required to file a US return.

Canadian practitioners should be aware of the intricacies of the IRS compliance rules for foreign charities. If a Canadian charity earns US-source income or has other US activities, careful consideration should be given to which IRS forms are required.