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US withholding tax on payments to foreign persons: key facts

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Most US-source income paid to foreign persons is taxed at 30%, withheld at source, unless a treaty or the Code reduces it. The right W-8 form decides the rate.

Country reference

- Country: United States (planned expansion country)
- Authorities: Internal Revenue Service (IRS)
- Topic: Withholding on US-source income of foreign persons (NRA withholding)
- Key date: Forms 1042 and 1042-S filed annually
- Law: Internal Revenue Code sections 1441 to 1443 and 1471 to 1474

The basic rule

- Most US-source income received by a foreign person, such as dividends, interest, royalties and rents, is taxed at 30%, generally withheld from the payment.
- A lower rate or exemption may apply under the Code or a tax treaty.
- The rules cover foreign individuals, companies and governments.
- FATCA withholding under sections 1471 to 1474 sits alongside these rules.

Forms

- W-8BEN: foreign individuals.
- W-8BEN-E: foreign entities.
- W-8ECI: income effectively connected with a US trade or business.
- W-8EXP: foreign governments and certain other organisations.
- W-8IMY: intermediaries and flow-through entities.
- Reporting: withholding agents file Form 1042 and Form 1042-S.

Separate regimes

- FIRPTA withholding on US real property dispositions (section 1445).
- Withholding on foreign partners in US partnerships (sections 1446 and 1446(f)).

Points for Gulf investors

- There is no comprehensive US income tax treaty with the UAE or Saudi Arabia, so the 30% rate often applies to dividends from US companies.
- Portfolio interest and bank deposit interest can be exempt if the conditions are met.

- Structures through treaty countries need real substance and must pass treaty anti-abuse tests.

What to do now

- Keep W-8 forms current; most expire after three years.
- Check the rate applied on each income stream against the treaty position.
- Model the 30% cost before choosing between debt and equity for US investments.

Our take

Withholding is where most US tax leaks for Gulf investors. The structure chosen at entry decides the rate for years, so plan before the first dollar is invested.

Sources

- IRS: NRA withholding

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