2014 US DISCLOSURES OF FOREIGN ACCOUNTS

International Taxation Practice Group

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Foreign Account Tax Compliance Act (FACTA) enacted as part of the HIRE Act on 3/18/2010

– “*The most significant piece of legislation enacted in a generation with respect to international tax compliance*” (Commissioner Shulman, 12/10/10 luncheon address).

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Additional Withholding Rules on Payments to Foreign Entities

- Present rules
  - Designed to collect tax on certain payments of US source income to non-US persons
  - 30% (or lower treaty rate) on US source Fixed, Determinable, Annual or Periodic Income (FDAP) including:
    - Interest, dividends, rents and royalties.
    - Salaries, annuities, commissions.

Additional Withholding Rules on Payments to Foreign Entities – cont.

- Exemptions:
  - Interest on bank deposits, debt obligations and OID.
  - Capital gains (unless Effectively Connected (EC income) with a US trade or business).
  - Recipient is exempt or eligible for a reduced rate under treaty.
    - » Most interest income not otherwise exempt.
    - » Dividend withholding reduced to 5 or 15%.
    - » Royalties reduced to 5% or zero.
    - » EC income if recipient certifies that it will file US income tax return.
    - » Exemption is self-certifying (W-8BEN).
    - » No US reporting requirements for exempt payments.
    - » Qualified Intermediary (QI)-Foreign institutions can enter into agreement with IRS to monitor its own clients thereby not divulging their identities (Know-You-Customer rule). QI agreements set to expire on 12/31/12 automatically extended to 12/31/13

Additional Withholding Rules on Payments to Foreign Entities – cont.

- New Statutory Withholding Rules (New Chapter 4, IRC Secs. 1471 & 1472).
  - Goal is to collect zero tax under these provisions.
  - While created as a withholding regime, enacted as an attempt to disclose US owners of foreign accounts.
    - Withholding used as a penalty provision.
  - Payer of income required to withhold 30% tax on all payments of US source income (whether taxable or not) to a Foreign Financial Institution (FFI) or certain other Non-Financial Foreign Entities (Non-FFE) unless such institution meets certain requirements.

Additional Withholding Rules on Payments to Foreign Entities – cont.

- Entities Subject to New Rules
  - FFI defined as a non-US entity that accepts deposits, holds financial accounts for other people's benefit or is primarily engaged in the business of investment or trading in securities, partnership interests, commodities or any interest in such securities.
    - Banks
    - Brokerage accounts
    - Hedge funds, partnerships, trust funds, private equity funds, et. al.
    - Family investment vehicles.
    - Notice 2011-34 created a new definition for Private Banking Account
  - Non-FFEs – Any other non-US entity not included within definition of FFI.

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Additional Withholding Rules on Payments to Foreign Entities – cont.

- Payments subject to 30% withholding
  - All FDAP income as above.
  - All interest income (including OID) even though not necessarily taxable to a non-US person.
  - Gross proceeds on sale of assets generating FDAP income (i.e. stocks and securities regardless of basis or existence of actual gain).
  - Income EC with a US trade or business exempt.

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Additional Withholding Rules on Payments to Foreign Entities – cont.

- How to Avoid Withholding Regime.
  - Belong to a class of FFI that the Treasury determines should be exempt or has limited opportunities for tax evasion.
  - Treasury added the following exempt accounts (Notice 2010-60)
    - » Holding companies for non-financial enterprises.
    - » Start-up companies.
    - » Liquidating non-financial entities.
    - » Non-financial entities emerging from reorganization or bankruptcy.
    - » Hedging centers of non-financial groups.
    - » Certain non-US retirement plans.
    - » Insurance companies solely providing term life insurance, property or casualty insurance. Not life insurance policies with cash values.
    - » Small FFI's defined as small family trusts with small number of direct or indirect account holders.

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Additional Withholding Rules on Payments to Foreign Entities – cont.

- Establish that it has no US accounts under procedures to be determined.
  - May be difficult to prove a negative especially with dual status individuals and determination of US ownership of foreign entities.
- Enter into an FFI agreement with the IRS.
  - Obtain identification information to determine if owner is a US person.
  - Will accept electronic submission no later than 1/1/13
  - Will need to be executed by 6/30/13 to avoid withholding in 2014.

Additional Withholding Rules on Payments to Foreign Entities – cont.

- US citizen, resident alien, US entity.
- US Owned Foreign Entity.
- Foreign Trust with a US owner of at least a 10% interest.
- Comply with verification and due diligence procedures to be established.
- Annually report the following information to IRS.
  - Name, address ID# of account holder or substantial US owner.
  - Account number.
  - Maximum account value in US $'s.
  - Withdrawals from account.

Additional Withholding Rules on Payments to Foreign Entities – cont.

- Attempt to obtain waiver from foreign jurisdiction if foreign law precludes disclosing such information. If such waiver cannot be obtained, close out the account.
- Withhold 30% US tax on US source income attributable to all accounts in which the owner refuses to identify itself or fails to obtain the waiver of disclosure under Foreign Law. (Recalcitrant Account Holder).
- These rules are in addition to the QI rules.
- Participating FFI's will be issued a special FFI EIN by the Treasury to pay in the required withholding.

• De minimus exception exists if aggregate value of all accounts held is under $50,000. Existing depositary account owned by a natural person with a year end value of less than $50,000 will meet exception.

Additional Withholding Rules on Payments to Foreign Entities – cont.

- Non-FFEs probably included just to identify US owners.
  - If Non-FFE is engaged in security trading, will be an FFI.
  - If Non-FFE is engaged in an active trade or business, will be exempt by statute.
- Can elect to comply with 1099 reporting regime.
  - Will have to report US as well as foreign source income.
  - Will still have to determine identity of US owners.
- Effective for payments made after 12/31/2012. Notice 2011-34 extended effective date to payments made after 1/1/2014. New withholding rules will apply for FDAP payments in 2014 and gross proceeds on stock sales in 2015.

Notice 2011-31 Rules

- Pre-existing Accounts
  - Determine if account holder us a US Person, Recalcitrant Account Holder or Non-US person.
    - May rely on information in files and use current computer system unless known to be unreliable.
    - Document retention policy.
  - Private Banking Account
    - Definition
    - Identify Chief Compliance Officer
    - If known to be US person, obtain W-9 along with waiver on permission to disclose information to IRS.

Private Banking Account (Continued)

- If not known, review files for evidence of US indicia
  - » US citizen or resident alien
  - » Born in US
  - » US Mailing address
  - » Standing instructions to forward funds to US bank.
  - » US “in care of” or “hold mail” mailing address.
  - » Gave Power of Attorney to US person.
- If no US indicia, obtain W-8BEN
- Create & maintain listing if client s & status.
- After 3rd year of FFI agreement, perform annual re-review.
- If account exceeds $500,000, review should be more diligent.
- CCO certification:
  - » Existence of procedures
  - » No complicit activities.
  - » Policy in place for employees.

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Pass-Through Payments

- Need to calculate pass-through percentage
  - Assets on balance sheet plus certain off balance sheet assets.
  - No reduction for liabilities
  - US asset is one giving rise to a pass through payment.
  - Debt or equity interest in a US corporation a US asset.
  - For 2nd tier pass-through entity, use that entity's percentage (if published)
  - Custodian accounts-calculate pass-through percentage using assets in that account only.
- Special ruled for controlled groups and affiliates.

Issues still to be addressed

  - Credit/refund procedures for US taxpayers eligible for reduced treaty rates or for withholding on amounts not subject to US tax.
  - What is a “small family trust”?
  - Is exception for certain entities to be made on a year to year basis?
  - Will short term debt obligations eventually be exempt?
  - Only way for a foreign entity to avoid these rules is to not invest in the US as the payment of US income triggers these rules. Will this be a future problem for US stock market?

- Treasury expects to have first set of proposed regulations in this area by 12/31/11 with finalization thereof by the summer of 2011

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