2013 US DISCLOSURES OF FOREIGN ACCOUNTS

Presented By:

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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.
  - 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.

Additional Withholding Rules on Payments to Foreign Entities – cont.

- Exemptions – cont:
  - 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).

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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.
  - Non-FFEs- Any other non-US entity not included within definition of FFI.

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.

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.
  - 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.

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.

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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. Due to difficulty of identifying common owners of various accounts, FFI's will probably ignore this exception.

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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

Additional Withholding Rules on Payments to Foreign Entities – cont.

- Notice 2010-60 Published 8/27/10
  - Exempted following entities
    - 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.
  - Included within definition of FFI's
    - CFC's
    - US branches of FFI's
  - Grandfathered obligations outstanding as of 3/18/2012
  - Most of notice deals with procedures FFI's must follow to identify account holders.

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Additional Withholding Rules on Payments to Foreign Entities – cont.

– 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?
  - Identification procedures appear to require a massive re-documentation effort, in electronic format, on the part of the FFI. Expected push back by such institutions that do not presently have this information in this format may need to be addressed.
  - 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?

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Additional Withholding Rules on Payments to Foreign Entities – cont.

- Treasury expects to have first set of proposed regulations in this area sometime during the 1st quarter of 2011 with finalization thereof by the end of the year.

- Additional foreign provisions under FACTA
  - If any US Beneficiary's interest in a foreign trust is contingent on a future event, such individual will still be deemed to be a beneficiary.
  - The fair market value attributable to the use of any property owned by a foreign trust by a US person will be deemed to constitute a constructive receipt if such use is uncompensated.
  - Minimum penalty for failure to file Form 3520 increased to $10,000.

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