

HIRE ACT/FATCA FOREIGN PROVISIONS

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I. NEW WITHHOLDING OBLIGATIONS - PAYMENTS TO FOREIGN ENTITIES

A. Foreign Financial Institution (FFI) Withholding & Disclosures [§1471]

1. Summary.

a) Foreign institutions will be required to enter into an agreement with the U.S. to disclose the identify of any U.S. person, or foreign entities with substantial U.S. owners, with an account at the institution or its affiliates.

(1) An exception exists for accounts of individuals under \$50,000.

(2) Accounts include depository accounts, custodial accounts, and equity or debt interests in the financial institution.

(3) Substantial ownership generally means more than 10% ownership.

b) The foreign institution will have to annually report on the account balance.

c) If they don't agree to make such disclosures, the foreign institution will be subject to a 30% withholding tax on U.S. source withholdable income.

(1) Such income includes interest (including any original issue discount), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income. [Code §1473]

(2) It also includes the proceeds from the sale or disposition of any property which can produce interest or dividends from sources within the United States.

(3) Does not apply to effectively connected income or most foreign source income.

2. Operating Rules.

a) A withholding agent must deduct and withhold 30% from a "withholdable payment" to a "foreign financial institution." Code §1471(a).

b) UNLESS the foreign financial institution (FFI) meets the IRS agreement requirements of Code §1471(b).

(1) General agreement requirements - the FFI must agree with the IRS (Code §1471(b)(1)):

(a) to obtain such information regarding each holder of each account maintained by such institution as is necessary to determine which (if any) of such accounts are "United States accounts,"

(i) Notice 2010-60, Section III.B.2.a. provides mechanisms for determining "United States account" status of preexisting individual accounts.

(ii) Notice 2010-60, Section III.B.2.b. provides mechanisms for determining "United States account" status of new individual accounts.

(iii) Notice 2010-60, Section III.B.3.a. provides mechanisms for determining "United states account" status of preexisting entity accounts.

(iv) Notice 2010-60, Section III.B.3.b. provides mechanisms for determining "United states account" status of new entity accounts.

(b) to comply with such verification and due diligence procedures as the Secretary may require with respect to the identification of "United States accounts,"

(c) in the case of any United States account maintained by the FFI to report on an annual basis the information described in Code §1471(c), Such reportable items are:

(i) The name, address, and TIN of each account holder which is a "specified United States person;"

(ii) In the case of any account holder which is a "United States owned foreign entity," the name, address, and TIN of each "substantial United States owner" of such entity;

(iii) The account number;

(a) Must be the actual account number, or if there is none, a serial or other number the FFI assigns to it that is unique. Notice 2010-60, Section IV.A.

(iv) The account balance or value; and

(a) This reporting can be avoided if FFI elects to report as if it was a U.S. person. Code §1471(c)(2).

(I) BUT STILL MUST COMPLY WITH CODE §§1471(C)(A) & (B) INFORMATION REPORTING (ABOVE). NOTICE 2010-60, SECTION IV.D.

(II) INSTEAD WILL REPORT AS REQUIRED UNDER CODE §§6041, 6042, 6045, AND 6049.

(b) Reporting will likely have to be done in U.S. dollars. Notice 2010-60, Section IV.B.

(c) For deposit and custodial accounts, reporting likely to be based on highest month-ending balance during the year. Notice 2010-60, Section IV.B.

(v) Except to the extent provided by the Secretary, the gross receipts and gross withdrawals or payments from the account.

(a) This reporting can be avoided if FFI elects to report as if it was a U.S. person. Code §1471(c)(2).

(vi) The IRS is developing a form which will be used for this reporting. It will be an electronic form. Notice 2010-60, Section IV.A.

(d) to deduct and withhold a tax equal to 30 percent of—

(i) any pass thru payment which is made by the FFI to a "recalcitrant account holder," or another FFI which does not meet the requirements of Code §1471(b), and

(ii) in the case of any pass thru payment which is made by the FFI to an FFI which has in effect an election under Code §1471(b)(3) with respect to such payment, so much of such

payment as is allocable to accounts held by "recalcitrant account holders" or FFI's which do not meet the requirements of Code §1471(b).

(iii) ALTERNATIVELY, the FFI can elect to have withholding applied by the payor withholding agent as to payments to a "recalcitrant account holder," or another FFI which does not meet the requirements of Code §1471(b). Code §1471(b)(3).

(a) In this case, the agreement with the IRS shall require the FFI to notify the withholding agent with respect to each such payment of the FFI's election and such other information as may be necessary for the withholding agent to determine the appropriate amount to deduct and withhold from such payment, and it will also include a waiver of any right under any treaty of the United States with respect to any amount deducted and withheld pursuant to this election.

(e) to comply with requests by the Secretary for additional information with respect to any United States account maintained by the FFI, and

(f) if a foreign law would prevent the reporting of any information referred to in Code §1471(b) or (c) with respect to any United States account maintained by such FFI—

(i) to attempt to obtain a valid and effective waiver of such law from each holder of such account, and if one cannot be obtained within a reasonable period of time to close such account.

(2) Alternative methods of meeting agreement requirements ("deemed compliant FFI").

(a) The FFI complies with Treasury procedures to ensure the FFI does not maintain U.S. accounts, and meets such other Treasury requirements with respect to accounts of other FFI's maintained by the FFI (Code §1471(b)(2)(A)), or

(i) Such a "deemed compliant FFI" will not be a NFFE. Notice 2010-60, Section II.

(b) The FFI is in a class of institutions which the Treasury has determined need not be subject to these requirements. Code §1471(b)(2)(B).

(i) Such a "deemed compliant FFI" will not be a NFFE. Notice 2010-60, Section II.

c) or, UNLESS the payment is to certain persons, namely (Code §1471(f)):

(1) A foreign government or subdivision thereof,

(2) An international organization,

(3) A foreign central bank of issue, or

(4) Any other class of persons identified by the Secretary as posing a low risk of tax evasion

(a) Certain foreign retirement plans will come under this under future Regulations. Notice 2010-60, Section II.C.

3. Observations.

- a) Makes an FFI subject to significant reporting to the IRS. Query how many foreign institutions will be willing to take on this burden.
- b) Foreign institutions which are prohibited by local law from disclosing customer information may be forced to cease making investments into the U.S. that generate this type of income, or else be faced with a 30% tax that might otherwise not apply.

B. Nonfinancial Foreign Entity (NFFE) Withholding & Disclosures [§1472]

1. Nonfinancial foreign entities are required to disclose to withholding agents, the name, address and tax identification number of their U.S. substantial owners, or advise that there no such owners. The withholding agent will then report this to the IRS.

- a) There are exemptions for publicly-held and certain other foreign corporations.
- b) Substantial ownership generally means more than 10% ownership.

2. If a withholding agent does not get this information, they are obligated to impose a 30% withholding tax.

- a) Such income subject to withholding includes interest (including any original issue discount), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income. [§1473]
- b) It also includes the proceeds from the sale or disposition of any property which can produce interest or dividends from sources within the United States.
- c) Does not apply to effectively connected income or most foreign source income.

3. Operating Rules.

- a) Withholding agent must withhold 30% of a "withholdable payment" to a non-financial foreign entity (NFFE) if such entity or another NFFE is the beneficial owner. Code §1472(a).
- b) Exception - no withholding required if: (Code §1472(b))
 - (1) The beneficial owner or the payee provides the withholding agent with (1) a certification of no "substantial United States owners", or (2) the name, address, and TIN of each substantial United States owner, which information is provided to the IRS, and

(a) Generally, "substantial" means 10%. Code §1473(b)(2).

(2) The agent does not know or has no reason to know the above information is incorrect.

c) Exception for other described payments: (Code §1472(c))

(1) If beneficial owner is: (Code §1472(c)(1) - "excepted NFFE")

- (a) A publicly traded corporation, and members of its expanded affiliated group,
- (b) A possessions entity wholly owned by bona fide residents,
- (c) A foreign government entity,
- (d) An international organization entity,
- (e) A foreign central bank, or
- (f) Other classes of persons identified by the Secretary.

(2) Or, payments identified by the Secretary as having a low risk of tax evasion. Code §1472(c)(2).

4. COMMENTS

a) U.S. payors of FDAP income to foreign entities, and U.S. buyers of assets from foreign entity sellers that can produce U.S. source dividends or interest (e.g., shares of stock in U.S. corporations and debt obligations issued by U.S. persons), will need to obtain the requisite documentation from the payee, or be subject to the 30% withholding obligation. This is a big trap for unwary U.S. persons who may have to fund such payments out of their own pockets if they pay over such proceeds to foreign entities without knowledge of their withholding obligation.

b) The withholding tax, when applicable, would appear to override all U.S. tax incentives to the contrary, including treaty reductions and the portfolio interest exemption.

c) The obligations for avoiding withholding on a payment to an NFFE are much less onerous than for a payment to an FFI.

d) Query how will apply to a payment to a disregarded entity owned by an individual, since the rules only apply to payments to entities.

C. Definitions

1. Financial Account. Code §1471(d)(2).

- a) Custodial account, or
- b) Depository account,
- c) Nonpublicly traded equity or debt interests in the FFI.

2. Financial Institution (FI). Code §1471(d)(5).

- a) Any entity that—

(1) Accepts deposits in the ordinary course of a banking or similar business,

(a) Under Regulations to be issued, these will include banks under Code §585(a)(2) (including banks as defined in Code §581 and any corporation to which Code §581 would apply except for the fact that it is a foreign corporation), savings banks, commercial banks, savings and loan associations, thrifts, credit unions, building societies and other cooperative banking institutions. Notice 2010-60, Section II.A.1.

(b) The fact that an entity is subject to the banking and credit laws of the United States, a State, a political subdivision thereof, or a foreign country, or to supervision and examination by agencies having regulatory oversight of banking or similar institutions, is relevant to but not necessarily determinative of whether that entity qualifies as a financial institution.

(2) As a substantial portion of its business, holds financial assets for the account of others, or

(a) Under Regulations to be issued, these will include broker-dealers, clearing organizations, trust companies, custodial banks, and entities acting as custodians with respect to the assets of employee benefit plans. Notice 2010-60, section II.A.2.

(b) The fact that an entity is subject to the banking and credit laws or broker-dealer regulations of the United States, a State, a political subdivision thereof, or a foreign country, or to supervision and examination by agencies having regulatory oversight of banking or similar institutions, is relevant to but not necessarily determinative of whether that entity qualifies as a financial institution.

(3) Is engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities or any interest (including a futures or forward contract or option) in such securities, partnership interests, or commodities.

(a) Regulations to be issued will provide that this category includes, but is not limited to, mutual funds (or their foreign equivalent), funds of funds (and other similar investments), exchange-traded funds, hedge funds, private equity and venture capital funds, other managed funds, commodity pools, and other investment vehicles. Notice 2010-60, Section II.A.3.

(b) Although the statute refers to the “business” of investing, reinvesting, or trading, the concept of “business” is intended to be different in scope and content from the concept of a “trade or business” as used in other sections of the Code. For example, isolated transactions that might not give rise to a trade or business for other purposes may cause an entity to be engaged primarily in the business of investing, reinvesting, or trading in securities, depending on such factors as the magnitude and importance of the transaction in comparison to the entity's other activities.

(c) Regulations to be issued will negate the requirement for an FFI Agreement for entities with only a small number of direct or indirect account holders, such as a family trust. Notice 2010-60, Section III.B.3.

b) Expected Regulatory Exceptions and Treatment.

(1) **HOLDING COMPANIES.** A foreign entity the primary purpose of which is to act as a holding company for a subsidiary or group of subsidiaries that primarily engage in a trade or business other than that of a "financial institution". Notice 2010-60, Section II.B.1.

(a) E.g., traditional holding company of operating subsidiaries.

(b) This class of excepted entities will not, however, include any entity functioning as an investment fund, such as a private equity fund, venture capital fund, leveraged buyout fund or any investment vehicle whose purpose is to acquire or fund the start-up of companies and then hold those companies for investment purposes for a limited period of time.

(2) **START-UP COMPANIES.**

(a) A foreign start-up entity that is investing capital into assets with the intent to operate a business other than that of a financial institution, but is not yet operating such a business, will be excluded from the definition of financial institution for the first 24 months after its organization. Notice 2010-60, Section II.B.1.

(i) Not applicable to a venture fund or other investment fund that invests in start-up entities.

(3) **NON-FINANCIAL ENTITIES THAT ARE LIQUIDATING OR EMERGING FROM REORGANIZATION OR BANKRUPTCY.** Notice 2010-60, Section II.B.1.

(4) **HEDGING/FINANCING CENTERS OF A NON-FINANCIAL GROUP.**

(5) **INSURANCE COMPANIES.**

(a) If they issue contracts without cash values, such as property and casualty and term life policies. Notice 2010-60, Section II.B.2.

(6) **U.S. TERRITORIES.** FFI's in U.S. territories will be subject to special rules. Notice 2010-60, Section II.B.4.

3. Foreign Financial Institution (FFI). Code §1471(d)(4).

a) A "financial institution" which is a foreign entity.

(1) Even if it is a CFC. Notice 2010-60, Section II.D.2.

(2) Except as otherwise provided by the Secretary, such term shall not include a financial institution which is organized under the laws of any possession of the United States.

b) Unless excepted by Regulations. If excepted by Regulations, the entity will be a NFFE. Notice 2010-60, Section II.

c) Types:

(1) Participating

(a) A FFI that enters into the required agreement with the IRS, which includes obligations to disclose information regarding U.S. account holders.

(2) Deemed-compliant

(a) FFI's that meet Code §1471(b) exceptions from compliance.

(3) Non-Participating

(a) A FFI that does not enter into the requisite agreement with the IRS, and is thus subject to withholding.

(4) Those FFI's specifically excluded in Code §1471(f).

4. Non-Financial Foreign Entity (NFFE).

a) Any foreign entity which is not a financial institution.

b) But note exception above for deemed compliant FFI's under Code §1471(b)(2).

c) Expected Regulatory Exceptions.

(1) The same as those described for FFI's.

See also: [Expected Regulatory Exceptions and Treatment](#).

5. Recalcitrant Account Holder. Code §1471(d)(6).

a) An account holder that does not:

(1) comply with reasonable information requests that allow the FFI to determine if the account is a "United States account" or to provide name, address and TIN info, or

(2) fails to provide a waiver of a foreign law that prevents reporting of required information.

6. Specified United States Person (Code §1473(3)). All United State persons except:

a) A bank,

b) A common trust fund, or

c) A publicly traded corporation and members of its expanded affiliated group

d) A regulated investment trust,

e) A REIT,

f) Any trust which is exempt from tax under Code § 664(c) , or is described in Code § 4947(a)(1)

g) Exempt organizations and individual retirement plans,

- h) States, possessions, agencies, and political subdivisions,
- i) The United States or any wholly owned agency or instrumentality thereof.

7. Substantial United States Owner. (Section 1473(2))

- a) In the case of a trust—(I) any "specified United States person" treated as an owner of any portion of such trust under subpart E of part I of subchapter J of chapter 1, and (II) to the extent provided by the Secretary in regulations or other guidance, any specified United States person which holds, directly or indirectly, more than 10 percent of the beneficial interests of such trust.
- b) With respect to any corporation, any "specified United States person" which owns, directly or indirectly, more than 10 percent of the stock of such corporation (by vote or value),
- c) With respect to any partnership, any "specified United States person" which owns, directly or indirectly, more than 10 percent of the profits interests or capital interests in such partnership, and
- d) Insert 0% instead of 10 percent for certain financial institutions.
- e) COMMENT: Thus incorporates the definition and exclusions of the defined term "specified United States person."

8. United States Account. Code §1471(d)(1).

- a) Any "financial account" which is held by one or more "specified United States persons" or "United States owned foreign entities."
- b) Excludes deposit accounts of natural persons if aggregate balance is not over \$50,000.

(1) Thus, FFI's can ignore smaller accounts.

9. United States Owned Foreign Entity. Code §1471(d)(3).

- a) Foreign entity which has one or more "substantial United States owners."

10. Withholdable Payment (Code §1473(1)):

- a) U.S. source FDAPI, or
 - (1) Subject to special sourcing rule for foreign branches of domestic financial institutions.
 - (2) Thus, there is substantial overlap with Code §1441 withholding.

- b) Gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources within the United States.

c) Exception: effectively connected income.

d) No exception for U.S. branches of FFI.

(1) FFI rules applies to U.S. branches, except as to specific payments that are ECI. Notice 2010-60, Section II.D.

(a) E.g., the ECI exclusion is generally inapplicable to withholdable payments that a U.S. branch of an FFI receives on behalf of its account holders, rather than for its own account. The ECI exclusion is also inapplicable to withholdable payments that a U.S. branch of an FFI is paid for its own account and that are not taken into account under Code §§ 871(b)(1) or 882(a).

(b) However, when a U.S. branch of an FFI receives a withholdable payment as an intermediary, however, Treasury and the IRS are considering permitting the U.S. branch to document its account holders for chapter 4 withholding purposes under the requirements to be imposed on USFIs.

11. Withholding Agent (Code §1473(4)).

a) All persons having control, receipt, custody, disposal or payment of any withholdable payment.

D. Withholding Agent & Other Determinations.

1. Payors will need to make the following determinations as to payees to be able to determine whether to withhold and how to report:

a) U.S. Entity Payee (no withholding)

(1) How determine?

(a) Presumably through Form W-9 and using procedures for other determinations of U.S. vs. foreign status of a payee.

b) FFI Payee. Then have to further determine if payee entity is:

(1) Participating FFI (no withholding).

(a) How determine?

(i) IRS will likely issue FFI EINs to participating FFI's to identify themselves to withholding agents. Notice 2010-60, Section III.B.

(ii) Until a system is in place, withholding agents and FFI's will be permitted to rely on certification issued by FFI's as to being a participating FFI, unless reason to know it is incorrect. Notice 2010-60, Section III.

(2) Code §1471(f) entity (no withholding).

(3) Deemed compliant FFI (no withholding & will not be a NFFE).

(4) Nonparticipating FFI (withholding).

c) NFFE Payee. Then have to determine or receive:

- (1) No substantial U.S. owner (no withholding).
 - (2) Receives substantial U.S. owner information (no withholding - must report to IRS).
 - (3) Excepted NFFE (no withholding).
 - (4) Code §1472(c)(2) low risk entity (no withholding).
 - (5) Other NFFE (withholding).
 - (6) Note that deemed compliant FFI will not be an NFFE.
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2. A U.S. financial institution (USFI) will need to make a number of determinations of entities that receive withholdable payments.

- a) See the rules at Notice 2010-60, Section III.C. for a detailed mechanism for identifying account holder entities as U.S. vs. foreign, as participating FFI's, non-participating FFI's, deemed-compliant FFI's, Code §1471(f) entities, excepted NFFEs and other NFFEs.
- b) Different rules apply for preexisting and new accounts.

3. A participating FFI will need to make a number of determinations as to its account holders and payees in order to comply with its FFI Agreement with the IRS.

- a) See the rules at Notice 2010-60, Section III.B. for highly detailed rules to determine U.S. account status, U.S. person and U.S. owned foreign entity status, FFI status, NFFE status, recalcitrant account holder status, and other required determinations that will need to be made by a participating FFI as to its account holders and payees. Different rules and presumptions apply for existing and new accounts, and individual and entity accounts.
- b) Such determinations will include obtaining or reviewing Forms W-9, Forms W-8BEN, account records as to indicia of U.S. ownership, etc.
- c) If a participating FFI is making a payment to an NFFE, in determining the status of the NFFE and its obligations as a withholding agent, the participating FFI is required to use these rules and not the general certification rules applicable to other payees to NFFEs. Notice 2010-60, Section III.B.4.

4. Comments.

- a) Notice 2010-60 only provides guidance on how to make some, but not all of these determinations. Presumably, additional guidance will be forthcoming in the future.

E. Credits & Refunds

1. Withholdings credited as tax paid by beneficial owner (as payments under Code §§1441-1446). Code §1474(b)(1).

a) Credits in excess of actual tax due are eligible for refund.

(1) Including by reason of excess withholding over a reduced treaty rate of tax, or a full refund if the payment is eligible for the portfolio interest obligation exemption.

(2) Credits or refunds allowed only to the extent that the beneficial owner provides to the IRS such required information as needed to demonstrate whether such beneficial owner is a United States owned foreign entity and the identity of any substantial United States owners of such entity. Code §1474(b)(3).

2. However, no credit is allowed to a FFI that is the beneficial owner of the withheld upon payment. Code §1472(b)(2).

a) Except to the extent that the withholding exceeds an applicable treaty rate.

F. Effective Dates

1. Chapter 4 shall not require any amount to be deducted or withheld from any payment under any obligation outstanding on March 18, 2012, or from the gross proceeds from any disposition of such an obligation.

a) Treasury and the IRS intend to issue regulations relating to the term "obligation." Notice 2010-60, Section I. These regulations will provide:

(1) An "obligation" means any legal agreement that produces or could produce withholdable payments.

(2) An "obligation" will not include any instrument treated as equity for U.S. tax purposes, or any legal agreement that lacks a definitive expiration or term.

(a) Thus, for example, savings deposits, demand deposits, and other similar accounts are not obligations.

(b) A legal agreement that produces withholdable payments does not include brokerage, custodial and similar agreements to hold financial assets for the account of others and to make and receive payments of income and other amounts with respect to such assets.

(3) Any material modification of an obligation will result in the obligation being treated as newly issued.

(a) In the case of an obligation that constitutes indebtedness for U.S. tax purposes, a material modification means any significant modification of the debt instrument as defined in Treas.Reg. §1.1001-3.

2. Apply to payments after December 31, 2012.

II. FBAR-ESQUE FOREIGN ASSET DISCLOSURES ENACTED.

A. Summary.

1. The Code now has its own foreign asset disclosure requirements.

a) Previously, FBAR reporting rules existed (and continue to exist) under Title 31 of the U.S. Code, and not Title 26 (the Internal Revenue Code).

b) Perceived problems with this included:

(1) Collection of delinquent penalties can only be accomplished through court proceedings. The expedited collection and enforcement powers available under the Internal Revenue Code are not available to IRS in the enforcement of FBAR civil penalties.

(2) Because of non-disclosure restraints, i.e. the FBAR requirement doesn't arise under a tax provision, information on income tax returns, including the Schedule B information regarding foreign bank accounts, is not readily available to those within the IRS who administer FBAR compliance, despite the fact that Federal returns and return information may be the best source of information for this purpose.

B. Specifics.

1. Who Must Report.

a) Any individual who holds an interest in a "specified foreign financial asset." Code §6038D(a).

(1) If the aggregate of such assets exceeds \$50,000 (or such higher prescribed value). Code §6038D(a).

(a) Unclear if trigger if exceed \$50,000 at any time during the year, or whether taxpayer must hold in excess of \$50,000 throughout the year.

(b) Contrast this \$50,000 threshold with the \$10,000 FBAR threshold.

(2) If the IRS determines that an individual has a specified foreign financial asset, it can presume the \$50,000 threshold is met if insufficient proof is provided otherwise. Code §6038D(e).

(3) The IRS may extend this reporting to domestic entities by regulation or other guidance if the entity is formed or availed of to hold specified foreign financial assets.

2. How to Report

a) Attach to the individual's income tax return. Code §6038D(a).

3. What is a "Specified Foreign Financial Asset?" Code §6038D(b).

a) A "financial account" (using Code §1471(d)(2) definition) maintained by a FFI (using Code §1471(d)(4) definition), and

b) The following assets not held in a financial institution (using Code §1471(d)(5) definition):

(1) A stock or security issued by a non-U.S. person,

(2) Any financial instrument or contract held for investment that has a non-U.S. person issuer or counterparty, and

(3) Any interest in a foreign entity (as defined in Code §1473).

(4) NOTE: Thus, such assets held in a domestic financial institution are not reportable.

c) According to the Committee Reports, an individual is not required under this provision to disclose interests that are held in a custodial account with a U.S. financial institution.

4. What to Report. Code §6038D(c).

a) For an "account," the name and address of the financial institution in which such account is maintained and the number of such account.

b) For a "stock or security," the name and address of the issuer and such information as is necessary to identify the class or issue of which such stock or security is a part.

c) For any other instrument, contract, or interest—

(1) Such information as is necessary to identify such instrument, contract, or interest, and

(2) The names and addresses of all issuers and counterparties with respect to such instrument, contract, or interest.

d) For all assets, the maximum value of the asset during the taxable year.

e) NOTE: Per the Committee Report, an individual is not required to identify separately any stock, security instrument, contract, or interest in a foreign financial account disclosed under the provisions.

5. Penalties. Code §6038D(d).

a) \$10,000 penalty.

b) For continuing failure 90 days after IRS mails a notice of failure to file, \$10,000 for each subsequent 30 day failure, up to \$50,000 maximum.

c) There is a reasonable cause exception.

(1) Foreign law prohibitions against disclosure of the required information cannot be relied upon to establish reasonable cause.

6. Effective Date.

a) For tax years beginning after Mar. 18, 2010.

C. Observations.

1. Note that "any interest in a foreign entity" is a very broad reporting requirement.

a) Thus, for example, foreign trust reporting may be broader than FBAR reporting.

2. Obviously, there is a substantial overlap with the FBAR.

a) The FBAR reporting rules are unchanged.

3. Note there is no exception for nonresident aliens or residents of possessions. However, the Act does provide that the IRS may issue regulations exempting such persons. Code §6038D(h).

4. Unclear how will apply to interests in disregarded entities and whether U.S. owner would need to report on assets held also by the disregarded entity.

III. STATUTE OF LIMITATIONS EXTENSIONS.

A. Indefinite Suspensions.

1. Summary.

a) Generally, taxes are required to be assessed within 3 years after a taxpayer's return is filed.

b) However, under prior law the statute of limitations did not run as to certain foreign transactions if certain required information returns were not filed, namely -

(1) Return of a U.S. person who controls a foreign corporation or foreign partnership (Code §6038);

(2) 25% foreign-owned corporation's return of transactions with related parties (Code § 6038A);

(3) Return of U.S. person who transfers property to a foreign corporation or partnership (Code §6038B);

(4) Return of officers, directors, or 10% shareholders of foreign corporations (Code §6046);

(5) Return of person who acquires, disposes of, or has substantial changes in, interests in foreign partnerships (Code §6046A);

(6) Return regarding transfer to or creation of a foreign trust (Code §6048).

c) Instead, such statute of limitations did not expire until 3 years after the required information was furnished to the IRS.

d) The Act now adds to this list the following information reporting -

(1) Election by a PFIC shareholder to have the PFIC taxed as a qualifying electing fund (QEF) (Code § 1295(b));

(2) Annual report by U.S. person that is a PFIC shareholder (new under the Act) (Code §1298(f));

(3) Self-reporting of specified foreign financial assets (new under the Act) (Code §6038D).

e) The Act now clarifies that the suspension of the statute of limitations applies with respect to any "tax return, event, or period" to which the information relates.

(1) However, pursuant to an amendment by the Education jobs Act of 2010, if the failure to report was due to reasonable cause and not wilful neglect, all items on the return are not subject to the expanded statute - only items related to the failure.

(a) Such related items include (1) adjustments made to the tax consequences claimed on the return with respect to the transaction that was the subject of the information return; (2) adjustments to any item to the extent the item is affected by the transaction even if it is otherwise unrelated to the transaction; and (3) interest and penalties that are related to the transactions or the adjustments made to the tax consequences.

2. Code.

a) Code §6501(c).

3. Comments.

a) Thus, the filing of an income tax return by the taxpayer will not result in the standard 3 year statute of limitation, if one of the enumerated foreign reporting requirements are not met.

b) The Act revision, by insertion of the term "tax return" as to items for which the suspension applies, suspends the statute of limitations for all items reported on the taxpayer's income tax return - even those unrelated to the missing foreign reporting.

(1) Except if the filing was due to reasonable cause.

c) Incomplete filings may trigger these rules.

d) Note the retroactive effective date.

4. Effective Date.

a) For returns filed after March 18, 2010, and returns filed before then if the assessment period specified in Code §6501 hadn't expired as of March 18, 2010.

B. 6 Year Statute.

1. Summary:

a) A new six-year limitations period for assessment of tax on understatements of income attributable to foreign financial assets. Code §6501(e)(1).

(1) Essentially is an extension of the existing 6 year statute of limitations for 25%+ omissions from gross income.

b) Applies to returns filed if the taxpayer omits from gross income an amount properly includible if:

(1) The amount is attributable to one or more assets which should have been reported under Code §6038D (or would have been required but for the \$50,000 dollar threshold in Code §6038D(a) and without regard to certain other exceptions in Code §6038D relating to duplicative reporting), and

(2) The amount is in excess of \$5,000.

c) May also apply to domestic entities formed or used to hold foreign financial assets that are subject to Code §6038D reporting. Committee Reports.

(1) Also applies to partnerships. Code §6229(c)(2).

2. Effective Date.

a) Returns filed after March 18, 2010, and returned filed before that if the assessment period specified in Code §6501 had not expired as of March 18, 2010.

C. COMMENT: Thus, U.S. taxpayers investing abroad incur a doubled statute of limitations simply by choosing to invest abroad instead of in the U.S., and further have an unlimited statute of limitations as to items they do not properly report.

IV. EXTENDED NO INTEREST PERIOD FOR REFUNDS

A. The 45 day period of no interest on refunds of overpayments on taxes withheld upon payments to foreign persons is extended to 180 days. Code §6611(e)(4).

V. FOREIGN TARGETED OBLIGATIONS NO LONGER EXEMPT FROM VARIOUS REGISTRATION REQUIREMENTS

A. Summary.

1. Under existing law, if a "registration-required obligation" isn't issued in registered form, then:

- a) no interest deduction is allowed to the payor;
- b) no tax exemption as state or local bond interest is allowed;
- c) a 1% excise tax is imposed; and
- d) if the excise tax is not applicable, gains from sale may be converted to ordinary income and loss deductions may be disallowed.

2. However, "registration-required obligations" did not include foreign targeted obligations.

3. For obligations issued after March 18, 2012, the above exception for foreign targeted obligations to the foregoing penalty provisions for obligations not issued in registered form will apply. Code §§149(a), 163(f)(2)(A), 163(f)(3), & 4701(b)(1).

- a) However, the exception for foreign targeted obligations to the application of the excise tax does continue in effect if:
 - (1) There are arrangements reasonably designed to ensure that the obligation will be sold (or resold in connection with the original issue) only to a person who isn't a U.S. person, (Code Sec. 4701(b)(1)(B)(i))
 - (2) Interest on the obligation is payable only outside the U.S. and its possessions, and (Code Sec. 4701(b)(1)(B)(ii))
 - (3) On the face of the obligation there is a statement that any US person who holds the obligation will be subject to limitations under the U.S. income tax laws. (Code Sec. 4701(b)(1)(B)(iii))

4. Thus, bearer debt obligations targeted to foreign persons will be subject to the foregoing limitations if they otherwise meet the definition of a "registration-required obligation."

- a) A "registration-required observation" generally means an obligation that is of a type offered to the public, has a maturity at issue of more than one year, and for most purposes is not issued by a natural person.

5. A dematerialized book entry system will be treated as a book entry system that satisfies the registration requirement for interest deduction purposes. Code §163(f).

- a) Thus, a debt obligation that is formally in bearer form will be treated as held in a book entry system as long as the debt obligation may be transferred only by book entries and the holder of the obligation isn't able to withdraw the obligation from the

book entry system and get a physical certificate in bearer form in the ordinary course of business.

VI. UNCOMPENSATED USE OF FOREIGN TRUST PROPERTY AS A DEEMED DISTRIBUTION

A. Summary.

1. A deemed distribution occurs from a foreign trust if the trust permits the use of any trust property directly or indirectly by the U.S. grantor, a U.S. beneficiary, or any person related to a U.S. grantor or U.S. beneficiary.

a) UNLESS and to the extent that the trust is paid the fair market value of the use of the property within a reasonable period of time of the use.

2. The amount of the distribution is the fair market value of the use of the property.

3. A later return of the property treated as a distribution is disregarded.

4. The deemed distribution impacts -

a) Whether the trust is a simple or complex trust;

b) Computing the distribution deduction;

c) Determining income of the beneficiaries;

d) Computing accumulation distributions (and the interest charge on accumulation distributions).

5. Similar "deemed distribution" treatment to loans of cash or marketable securities, as under prior law.

B. Code.

1. Code §643(i).

C. Comments.

1. Thus, use of trust property will require fair market rent to be paid.

2. The ability to avoid accumulation distributions via use of trust property is now foreclosed.

3. You cannot wait and pay rent only if an IRS examination arises, due to requirement that the rent be paid within a reasonable period of time of the use.

4. If the foreign trust has a U.S. grantor, new similar rules under Code Section 679 apply, such that the deemed distribution may create a U.S. beneficiary and trigger a grantor trust.

D. Effective Date.

1. Loans made, and uses of property, after March 18, 2010.

VII. INCREASE IN MINIMUM PENALTY FOR FAILURE TO REPORT ON FOREIGN TRUSTS

A. Failures to report on certain foreign trust transactions have been subject to a 35% penalty as to the amount required to be disclosed. A minimum \$10,000 penalty is now imposed.

B. Code.

1. Code §6677(a).

C. Comments.

1. Existing law limits penalties to the gross reportable amount. Since the IRS may now impose the \$10,000 minimum penalty before it has information to calculate the gross reportable amount, if the \$10,000 penalty exceeds the gross reportable amount the IRS is obligated to refund the difference.

D. Effective Date.

1. Notices and returns required to be filed after December 31, 2009.

VIII. NEW PFIC REPORTING REQUIREMENTS

A. Summary.

1. Previously, a U.S. shareholder of a PFIC was required to file Form 8621 only in tax years which he or she (1) recognized gain on a direct or indirect disposition of PFIC stock, (2) received certain direct or indirect distributions from a PFIC or (3) made a reportable election.
2. Under the Act, unless otherwise provided by the IRS, each U.S. person who is a PFIC shareholder must file an annual report containing the information required by IRS.

B. Code.

1. Code §1298(f). Reporting requirement. Except as otherwise provided by the Secretary, each United States person who is a shareholder of a passive foreign investment company shall file an annual report containing such information as the Secretary may require.

C. Comments.

1. U.S. shareholders of the PFIC may also be subject to the disclosure of information reporting requirements for foreign financial assets under new Code §6038D. The Committee Report anticipates that the IRS will coordinate the reporting to avoid duplicative reporting.

D. Effective Date.

1. March 18, 2010.

IX. DETERMINATION OF WHETHER FOREIGN TRUSTS HAVE U.S. BENEFICIARIES FOR CODE §679 PURPOSES

A. Background.

1. Code §679 treats a foreign trust with a U.S. grantor and a U.S. beneficiary as a grantor trust as to the portion funded by the U.S. grantor. The Act expands statutory law to determine when a foreign trust has (or is presumed to have) a U.S. beneficiary.

B. Contingent Interests.

1. Summary.

a) An amount shall be treated as accumulated for the benefit of a United States person in a foreign trust even if the United States person's interest in the trust is contingent on a future event.

2. Code.

a) 679(c)(1). In general. For purposes of this section , a trust shall be treated as having a United States beneficiary for the taxable year unless —

(1) (A) under the terms of the trust, no part of the income or corpus of the trust may be paid or accumulated during the taxable year to or for the benefit of a United States person, and (B) if the trust were terminated at any time during the taxable year, no part of the income or corpus of such trust could be paid to or for the benefit of a United States person. For purposes of subparagraph (A) , an amount shall be treated as accumulated for the benefit of a United States person even if the United States person's interest in the trust is contingent on a future event.

3. Effective Date.

a) March 18, 2010.

C. Someone Has Power to Determine Beneficiaries.

1. Summary.

a) If any person has discretion (under the trust instrument, by power of appointment, or otherwise) of making a distribution from the trust to, or for the benefit of, any person, then the trust will be treated as having a beneficiary who is a U.S. person unless—

(1) the terms of the trust specifically identify the class of persons to whom discretionary distributions may be made, and

(2) none of those persons are U.S. persons during the tax year.

2. Code.

a) Code §679(c)(4). Special rule in case of discretion to identify beneficiaries. For purposes of paragraph (1)(A), if any person has the discretion (by authority given in the trust agreement, by power of appointment, or otherwise) of making a distribution from the trust to, or for the benefit of, any person, such trust shall be treated as having a beneficiary who is a United States person unless—

(1) (A) the terms of the trust specifically identify the class of persons to whom such distributions may be made, and (B) none of those persons are United States persons during the taxable year.

3. This provision is intended to be consistent with existing Treasury Regulations. Committee Reports to section 531 of the Act.

4. Comments

a) TRAP: The power holder need not be U.S.

b) TRAP: A trust protector with power to force a distribution to a beneficiary can trigger this power.

5. Effective Date.

a) March 18, 2010.

D. Incorporation of Agreements and Understandings into the Trust Agreement

1. Summary.

a) if any U.S. person who directly or indirectly transfers property to the trust is directly or indirectly involved in any agreement or understanding (whether written, oral, or otherwise) that may result in the income or corpus of the trust being paid or accumulated to or for the benefit of a U.S. person, then the agreement or understanding will be treated as a term of the trust.

2. Code.

a) Code §679(c)(5). Certain agreements and understandings treated as terms of the trust.

(1) For purposes of paragraph (1)(A) , if any United States person who directly or indirectly transfers property to the trust is directly or indirectly involved in any agreement or understanding (whether written, oral, or otherwise) that may result in the income or corpus of the trust being paid or accumulated to or for the benefit of a United States person, such agreement or understanding shall be treated as a term of the trust.

3. For this purpose, It is assumed that a transferor of property to the trust is generally directly or indirectly involved with agreements regarding the accumulation or disposition of the income and corpus of the trust. Committee Reports to section 531 of the Act.

4. Effective Date.

a) March 18, 2010.

E. Below Market Loans and Uncompensated Use of Trust Property.

1. Summary

a) A loan of cash or marketable securities, or the use of other trust property, directly or indirectly, to or by any U.S. person, is treated as paid or accumulated for the benefit of a U.S. person for Code §679 purposes (and will thus result in there being a U.S. beneficiary).

(1) UNLESS and to the extent that the loan is repaid with a market rate of interest or fair market rent is paid for use of property within a reasonable period of time.

2. Code

a) 679(c)(6)

3. Comments.

a) Similar rules apply to create deemed distributions for other trust tax purposes for uncompensated loans and use of trust property.

4. Effective Date.

a) Loans made, and uses of property, after March 18, 2010.

F. Presumption of U.S. Beneficiaries.

1. Summary.

a) A rebuttable presumption is created that a foreign trust has U.S. beneficiaries.

2. Code.

a) Code §679(d). (d) Presumption that foreign trust has United States beneficiary. If a United States person directly or indirectly transfers property to a foreign trust (other than a trust described in section 6048(a)(3)(B)(ii)), the Secretary may treat such trust as having a United States beneficiary for purposes of applying this section to such transfer unless such person—

(1) (1) submits such information to the Secretary as the Secretary may require with respect to such transfer, and (2) demonstrates to the satisfaction of the Secretary that such trust satisfies the requirements of subparagraphs (A) and (B) of subsection (c)(1) .

3. Effective Date.

a) To transfers after the date of enactment.

X. ENHANCED REPORTING FOR FOREIGN GRANTOR TRUSTS

A. Summary.

1. Presently, if a U.S. person is treated as the owner of any portion of a foreign trust under the grantor trust rules, they are required to ensure that the TRUST makes any required return for the year and that it provides required information to each U.S. person that is treated as the owner of any portion of the trust or who receives a distribution from the trust. Code §6048(b)(1).

a) But the U.S. person had no direct reporting requirement.

2. Now, such U.S. grantors must submit such information as the IRS requires with respect to the foreign trust.

B. Code.

1. Code §6048(b)(1).

C. Effective Date.

1. Tax years beginning after March 18, 2010.

XI. DIVIDEND EQUIVALENTS [CODE §871(L)]

A. Dividend equivalent payments from U.S. payors to foreign persons are treated now as actual dividend payments for withholding and other purposes. Code §871(l).

B. A dividend equivalent payment is:

1. Any substitute dividend made pursuant to a securities lending or a sale-repurchase transaction that (directly or indirectly) is contingent upon, or determined by reference to, the payment of a dividend from sources within the U.S.;

a) To curb abusive securities lending transactions that effectively converted U.S. source dividends into nontaxable foreign source income.

2. Any payment made pursuant to a specified notional principal contract (defined below) that (directly or indirectly) is contingent upon, or determined by reference to, the payment of a dividend from sources within the U.S.; or

a) Previously, were sourced by the recipient's country of residence and thus avoided withholding.

3. Any other payment that IRS determines is substantially similar to these types of payments such as certain forward contracts or other financial contracts that reference stock of U.S. corporations.

C. If the payments go through a chain, the IRS may reduce the tax to prevent over-withholding. Code §871(l)(5).

XII. PORTFOLIO INTEREST EXCEPTION

A. The portfolio interest exception from U.S. tax and withholding will no longer apply to nonregistered obligations. Code §§871(b)(2), 871(h)(3)(A), & 881(c)(2).

B. Effective for debt obligations issued after March 18, 2012.

XIII. ELECTRONIC FILING MAY BE REQUIRED FOR WITHHOLDING AGENTS.

A. The Act provides an exception to the general annual 250 returns threshold and permits IRS to issue regulations to require filing on magnetic media for any return filed by a financial institution with respect to any taxes withheld by the financial institution for which it is personally liable, as to withholdings under Code §§1461 or 1474(a), with corresponding authorization for penalties for noncompliance. Code §6011(e)(40); Code §6724(c).

B. Effective for returns due (without regard to extensions) after March 18, 2010

XIV. PENALTIES.

A. Summary.

1. An underpayment attributable to any UNDISCLOSED FOREIGN FINANCIAL ASSET understatement is subject to the Code §6662 penalty, except the penalty is imposed at 40% and not 20%. Code §6662(b)(7).

2. "Undisclosed foreign financial asset" - any asset with respect to which information was required to be provided under Code §6038, Code §6038B, Code §6038D, Code §6046A, or Code §6048 for that tax year but was not provided by the taxpayer as required under the provisions of those sections.

- a) Code §6038 - a U.S. person who controls a foreign corporation or partnership must furnish IRS with certain information about the entity.
- b) Code §6038B - requires information reporting by U.S. persons who make certain “outbound” transfers to foreign entities.
- c) Code §6046A - returns must be filed by a U.S. person who acquires or disposes of certain foreign partnership interests or whose proportional interest in a foreign partnership changes substantially.
- d) Code §6048 - requires certain information reporting with respect to foreign trusts.

B. Observation.

- 1. The 40% penalty is imposed even in the absence of aggravating circumstances.**
- 2. Many of the reporting items that are now subject to this penalty preexisted the Act.**

C. Effective Date.

- 1. Tax years beginning after March 18, 2010.**