



The Foreign Account Tax Compliance Act of 2009

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The Act would require foreign financial institutions and nonfinancial foreign entities to report to the IRS all income earned by U.S. customers or be subject to a 30-percent withholding tax.

On October 27, 2009, the Foreign Account Tax Compliance Act of 2009 was introduced in the House by Ways and Means Committee Chair Charles B. Rangel (D-NY) (H.R. 3933) and in the Senate by Finance Committee Chair Max Baucus (D-MT) (S. 1934). Subsequently, Congressman Rangel attached the Act to the Tax Extenders Act of 2009 to offset the cost of the tax incentives extended. The Act would impose significant tax-withholding penalties on foreign financial institutions that do not disclose holdings by U.S. individuals or firms and would create new information reporting requirements. The Act would raise \$8.5 billion over 10 years and would be effective January 1, 2011. However, because of the complexity of the Act and the time it will take for the Treasury to provide guidance on numerous issues and for foreign financial institutions to implement and comply with the Act and the Treasury's guidance, the effective date of the legislation may have to be postponed for a couple of years.

Background

The Act builds upon the Stop Tax Haven Abuse Act (S. 505, H.R. 1265) that was the result of work by a Homeland Security subcommittee chaired by Senator Carl Levin (D-MI), a draft of a narrower targeted proposal by Senator Baucus in March of 2009 and the Obama administration's offshore anti-evasion proposals described in the green book explanation of the president's fiscal 2010 budget. The provision in Senator Baucus' earlier draft requiring all U.S. entities to report the amount and destination of cross-border wire transfers is the most significant proposal omitted from the Act.

Central Feature of the Act – 30-percent Withholding

The central feature of the Act is the imposition of a 30 percent (30%) withholding tax on payments to a foreign financial institution of U.S. source income and gross proceeds from the sale of any equity or debt instrument that could produce U.S. source income held by the foreign financial institution – whether as nominee or as beneficial owner – unless the foreign financial institution agrees to disclose the identity of any U.S. individual with an account at the institution (or the institution's affiliates) and to annually report on the account balance, gross receipts and withdrawals from such account. The foreign financial institutions would also be required to disclose and report on foreign entities that have substantial U.S. owners and on the U.S. owners themselves.

Under the Act a 30 percent withholding tax would be imposed upon “withholdable payments” made after December 31, 2010, to a foreign financial institution or nonfinancial foreign entity that does not comply with the disclosure requirements of the Act. The withholding tax would apply to a foreign financial institution with respect to the U.S. securities held for its own account or for the account of its customers, whether non-U.S. customers or U.S. customers.

A “withholdable payment” is defined as U.S. source interest, dividends and other fixed or determinable, annual or periodical, gains, profits and income. In addition, withholdable payments would include gross proceeds from the sale of property that could produce U.S. source interest or dividends. “Foreign financial institutions” comprise foreign banks or similar deposit taking institutions, any foreign entity custodian business and any foreign entity engaged in the business of investing or trading in securities, partnership interests, commodities or interests or derivatives. Foreign financial institutions would also include non-U.S. hedge funds, private equity funds, securitization vehicles and other investment funds.

Disclosure Agreement Under the Act

To avoid the withholding regime the foreign financial institution would have to enter into an agreement with the Treasury to identify all U.S. accounts held by it or its affiliates and to annually report to the Treasury specific information concerning each such account. Further the foreign financial institution would have to comply with requests by the Treasury for additional information regarding each U.S. account and would have to attempt to obtain from each holder of a U.S. account a waiver of any bank secrecy law that would otherwise prevent such report and if a waiver is not obtained, to close the account. For these purposes, a “U.S. account” is any financial account held by a U.S. person or a U.S. owned foreign entity. A U.S. person is any U.S. individual, corporation, partnership, trust or other entity, other than a publicly traded corporation. A “U.S.-owned foreign entity” is a foreign entity that has one or more substantial U.S. owners. A substantial U.S. owner is defined as a U.S. person that owns, directly or indirectly, a greater than 10 percent stock interest by vote or value in a corporation, or a 10 percent capital or profits interest in a partnership, or treated portion of a trust under the grantor trust rules, or any interest in a foreign investment entity. A “financial account” includes any depository or custodial account of the foreign financial institution and any non-publicly traded equity or debt interest in the foreign financial institution.

Reporting Requirements

A foreign financial institution would have to report information with respect to each U.S. person who holds a financial account with the foreign financial institution and each U.S. person that owns greater than a 10-percent interest in a nonfinancial foreign entity that in turn holds a U.S. account with the foreign financial institution. For each such U.S. person the foreign financial institution annually would be required to report, the name, address and taxpayer identification number (TIN) of each U.S. person, the account balance, the gross receipts, both U.S. source and foreign source amounts and withdrawals or payments from the account. Alternatively, the foreign financial institution could elect to provide full Form 1099 reporting concerning each U.S. account maintained with the foreign financial institution. The same reporting requirements would apply for each U.S. account maintained with any affiliated foreign financial institution.

Identical reporting and withholding requirements regarding foreign financial institutions would apply to foreign entities that are not financial institutions. Unless the nonfinancial foreign entity certified to the withholding agent that it did not have any direct or indirect substantial U.S. owners or reported the name, address and taxpayer identification number of each substantial U.S. owner, the 30-percent withholding on withholdable payments would be imposed.

Refunds of Withholding

The new withholding taxes on payments to foreign financial institutions and nonfinancial foreign entities that do not agree to make the disclosures are intended to function like back-up withholding tax, so that beneficial owners would be eligible to claim a refund or credit for any withholding in excess of their substantive tax liabilities. A foreign financial institution that is the beneficial owner of a withholdable payment would be able to obtain a refund, but only if and to the extent that the foreign financial institution is entitled to a reduced rate of withholding under an applicable U.S. income tax treaty, even if the foreign financial institution would not have been otherwise subject to withholding on the payment under the normal nonresident withholding rules. Financial institutions in non-treaty countries would not be entitled any refund of the withheld taxes.

Conclusion

The intention of the Act is to make all foreign financial institutions report to the Internal Revenue Service (IRS) on U.S. account holders. If the foreign financial institution does not report then it will be subject to a 30-percent withholding tax on all U.S. source payments

About the Author

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