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Tax Transactions Update
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Foreign Account Tax Compliance Act of 2009: Information Reporting for US Client Accounts at Non-US Financial Institutions

On October 27, 2009, Senators Baucus and Kerry, together with Representatives Rangel and Neal, introduced the Foreign Account Tax Compliance Act of 2009 (the "Act"). The bill is the product of consultation between Congress and the US Treasury Department (Treasury) and is intended to curb the abuse of offshore bank and investment accounts by US taxpayers. As Congress considers legislation that increases government spending, the Act could be paired with that legislation as a spending offset because it is projected to generate $8 billion in new revenue for the Treasury over the next ten years. This increases the possibility that the Act could be approved by Congress quickly, potentially before the current session comes to an end later this year. Additionally, if the Act is brought up for consideration, it is possible that other members of Congress will seek to amend it, including possibly Senator Levin, who is the author of the Stop Tax Haven Abuse Act, which he first introduced in February 2007 and on which then-Senator Obama joined as a cosponsor.

New Withholding Tax and Information Reporting Regime for Certain Payments to Non-US Financial Institutions

The Act would create a new reporting regime that effectively requires full disclosure, on the part of a non-US financial institution, of a US person's account maintained at that non-US financial institution. This new reporting regime would be in addition to the current withholding tax regime applicable to US source income paid to non-US persons and the qualified intermediary program (QI program) that generally governs the obligations of non-US financial institutions under the current US withholding tax regime applicable to US source income paid to non-US and US persons.

To the extent that a non-US financial institution does not enter into an agreement with the Treasury or the Internal Revenue Service (IRS) to provide information regarding US persons, a withholding tax will be imposed at a 30 percent rate on all payments to the non-US financial institution of US source income and gross proceeds relating to assets that produce US source income (not merely those payments attributable to US persons or US beneficial owners). Dual withholding would not be required under either the provisions of this bill or the current withholding rules applicable to US source payments. Non-US persons that would otherwise be permitted to obtain tax treaty benefits with respect to a payment of US source income, however, would not be able to obtain their treaty-reduced rate of withholding tax to the extent that the withholding tax applies to the payment of US source income received by the non-US financial institution pursuant to this new withholding tax regime.

Information Exchange by Non-US Financial Institutions Would Eliminate Withholding Tax

As a preliminary matter, the Act would create a new chapter of the Internal Revenue Code that provides for the imposition of a 30 percent withholding tax either on any payment to a non-US financial institution of US source income or with respect to gross proceeds from the sale of property that produces US source dividends or interest (Withholdable Payments). Accordingly, this withholding tax would apply to all Withholdable Payments made to the non-US financial institution (including those on assets held for the institution's own account), not merely those Withholdable Payments attributable to a US person. This withholding tax could be avoided only if the financial institution enters into an agreement with Treasury or the IRS to provide information relating to

certain US persons that directly or indirectly maintain an account at such financial institution (Information Reporting Agreement).

The Information Reporting Agreement would require that the non-US financial institution (i) obtain information from each account owner to determine whether the account was a "United States account,"[1] (US Accounts); (ii) comply with verification and due diligence rules relating to the identification of US Accounts (these requirements will be specified by regulation , but it is expected that these rules will be based upon the know your customer (KYC) standards for identifying US persons, including indirect account holders, that are followed in the anti-money laundering (AML) context); (iii) make an annual report of information with respect to its US Accounts (these requirements also would be specified by regulation); (iv) comply with requests by the United States to provide additional information with respect to these US Accounts; and (v) obtain appropriate waivers of local privacy laws from the owner of US Accounts or, to the extent not provided, close the account. Under the Act, information must be reported regarding US Accounts maintained by financial institution affiliates (including controlled partnerships) of a non-US financial institution that has entered into an Information Reporting Agreement.

The legislation authorizes Treasury to terminate an Information Reporting Agreement, and thereby subject an institution to the 30 percent withholding tax, if a determination is made that the non-US financial institution is not in compliance with the agreement. It is unclear under what circumstances such a determination would be made (e.g., whether a technical default would result in such a determination or whether some type of gross noncompliance is required).

Non-US Financial Institutions May Elect to Undertake Information Reporting as if they were US Financial Institutions, Subject to Certain Modifications

As an alternative to the above information reporting requirements, non-US financial institutions could elect to comply with the information reporting obligations currently imposed on US financial institutions with respect to payments to US persons (i.e., reporting payments on Form 1099). In such case, an electing non-US financial institution would report payments to US Accounts as if the recipient of the payment were a US individual and the payment were considered made in the United States.

Alternative Information Reporting Procedures and Requirements Differ from Traditional Information Reporting Under the QI Agreement and Current US Information Rules

To the extent no election is made, the non-US financial institution would be obligated to provide certain identifying information regarding account holders that are specified US persons and substantial US owners of US owned foreign entities (e.g, name, address, taxpayer identification number). In addition, the non-US financial institution would be obligated to provide the account number, the account balance or value (determined pursuant to regulations issued by Treasury and the IRS) and the gross receipts and gross withdrawals or payments from the account (pursuant to rules to be determined by Treasury and the IRS). In effect, these rules would seem to require that the non-US financial institution provide the account statement relating to a US Account to the IRS.

Documentation Requirements for Certifying Non-US Status

Non-US financial institutions would be permitted to rely on certifications (e.g., possibly a suitably modified Form W-8BEN) supplied by the account holder to confirm that the account is not a US Account, provided that neither the non-US financial institution nor any affiliate knows or has reason to know that any information provided in the certification is incorrect. The Act does not indicate whether these certifications must be transmitted to, or reviewed by, the IRS. Presumably, the non-US financial institution would be expected to utilize AML procedures to ensure that the certification of non-US status is reliable.

Refund Procedure Limited to Amounts Beneficially Owned by the Non-US Financial Institution

The Act provides a refund procedure under which a non-US financial institution would be able to claim any applicable income tax treaty benefits to the extent the 30 percent withholding tax is applied to payments

beneficially owned by that financial institution. However, there would be no similar refund procedure available for non-US persons that are clients of a financial institution subject to the withholding tax. In other words, non-US persons that hold accounts at non-US financial institutions that have not entered into an Information Reporting Agreement will lose any reduced rate of withholding tax provided pursuant to an applicable income tax treaty.

It appears that one purpose of including this provision is to coerce non-US financial institutions to enter into Information Reporting Agreements with the United States by potentially subjecting those institutions to a competitive disadvantage compared to institutions that have entered into those agreements.

Effective Date

As proposed, the Act will become effective as of December 31, 2010. This is very ambitious in light of the steps that would have to be taken by Treasury, the IRS and the affected institutions by the effective date. By way of comparison, the withholding tax regulations that created the QI program were first announced in 1996 and ultimately did not take effect until 2001. Even then, the IRS faced a significant backlog in reviewing and approving various countries' KYC regimes and entering into QI agreements with non-US financial institutions.

Even assuming Treasury and the IRS are able to meet the effective date, non-US financial institutions will be hard-pressed to accomplish the necessary due diligence required by the Act to determine whether their population of existing accounts involve a US person as owner or beneficiary. Modifications of IT and other systems in order to produce information in a format consistent with the requirements of Information Reporting Agreement, alone, are likely to take several months to implement. Accordingly, it is anticipated that organizations representing the interests of non-US banks will, among other things, seek additional flexibility concerning the effective date of any new reporting requirements.

Endnote

[1] For this purpose, the term United States account generally means a deposit or custody account that is owned by individuals that are "specified US persons" or "United States owned foreign entities." The term "specified US persons" means all US persons other than certain identified persons, such as publicly traded corporations and tax exempt entities. The term "US owned foreign entities" means any non-US entity owned by one or more "substantial US owner." The term "substantial US owner" means (i) with respect a corporation, any specified US person that owns directly or indirectly more than 10% of the corporation (by vote or value), (ii) with respect to a partnership, any specified US person that owns directly or indirectly, more than 10% of the profits or capital interest in such partnership, and (iii) in the case of any trust, any specified US person that is treated as an owner of any portion of the trust under the grantor trust rules. A non-US financial institution may elect to exclude from treatment as a US Account any depository account owned by an individual located at the financial institution and its affiliates that has an aggregate value of less than $10,000 (or $50,000 for existing accounts).

For more information about the Foreign Account Tax Compliance Act of 2009, or any other matter raised in this Client Update, please contact any of the following lawyers.

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