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The American Assault on Tax Havens–Status Report

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Abstract

The White House, Internal Revenue Service (I.R.S.), U.S. Department of the Treasury (U.S. Treasury), and Department of Justice have mounted a crackdown on U.S. individuals and companies who improperly use foreign tax havens and bank secrecy jurisdictions to avoid tax. New procedures, legislation, international agreements, and enforcement initiatives have been adopted to deter the use of tax havens and bank secrecy jurisdictions. This U.S. effort is spearheaded by the 2010 Foreign Asset and Tax Compliance Act (FATCA), P.L. 111-147, which aims to force foreign financial institutions to report their U.S. account holders. This article will review FATCA and certain other U.S. initiatives, such as the expansion of the foreign bank and financial account reporting requirements. In addition, this article mentions certain other 2010 developments in U.S. cross-border tax enforcement.

I. FATCA Foreign Asset Reporting

FATCA enacted Section 6038D, which generally requires individuals holding "specified foreign financial assets" in excess of $50,000 during a year to report these assets with their Form 1040.[1] This reporting requirement takes effect with calendar year 2011 income tax returns (which are filed in 2012).[2] This requirement applies in addition to the requirement to file a Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR), with the U.S. Treasury.[3] Duplicate FBARs are not required to be filed with tax returns, and the section 6038D specified foreign financial asset returns are not to be filed with the FBAR unit.[4] These reporting requirements also apply, to the extent provided in

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1. I.R.C. § 6038D (West 2011).
2. *Id.*
3. 31 C.F.R. § 103.24 (2011); *see Report of Foreign Bank and Financial Accounts (FBAR)*, Internal Revenue Service (U.S.), Apr. 22, 2010, http://www.irs.gov/businesses/small/article/0,,id=148849,00.html.
4. I.R.C. § 6038D.

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Treasury Regulations, to U.S. entities formed or availed of for the purpose of investing in specified foreign financial assets.[5]

Specified financial assets include: (1) any account maintained by a foreign financial institution (FFI); and (2) any of the following assets that are not held in an account maintained by an FFI: (a) any stock or security issued by a foreign person (even stock in foreign hedge funds or equity funds for which FBAR reporting might not be required); (b) any financial instrument or contract held for investment where the issuer or counterparty is a foreign person; and (c) any interest in a foreign entity, whether or not that foreign entity owns foreign financial assets.[6]

The I.R.S. is authorized to make exceptions from the reporting requirements in order to avoid duplicative reporting.[7] For example, it may create exceptions with respect to passive foreign investment company (PFIC) and controlled foreign corporation stockownership reporting.

There is a $10,000 penalty for a failure to report that increases by $10,000 for each thirty-day period (or portion of such period), if the failure to file continues for more than ninety days after notification by the I.R.S.[8] The penalty will be waived if the failure is due to reasonable cause and not due to willful neglect, although foreign secrecy laws do not constitute reasonable cause for non-reporting.[9] If the I.R.S. discovers specified financial assets and the individual fails to produce sufficient information showing that the aggregate value of the individual's specified financial assets is no more than $50,000, then the $50,000 threshold is deemed met so that the reporting requirement and $10,000 penalty can apply.[10]

A forty percent penalty applies to any understatement attributable to any transaction involving an undisclosed financial asset.[11] The statute of limitations can be extended beyond three years for understatements triggered by omissions of more than $5,000 of gross income relating to specified financial assets or of required reports of specified financial assets.[12] The FATCA withholding provisions, discussed below, may be viewed as an attempt to enforce this foreign asset reporting by putting pressure on foreign intermediaries that invest in U.S. assets to disclose their U.S.-owned accounts.

II. FATCA Withholding

FATCA imposes thirty percent U.S. withholding on "withholdable payments" made to FFIs that fail to meet certain reporting and withholding requirements.[13] FATCA also imposes a thirty percent U.S. withholding tax on withholdable payments made to certain foreign entities that are not FFIs.[14] The withholding requirements generally commence

5. § 6038D(f).
6. § 6038D(b).
7. § 6038D(h)(1).
8. § 6038D(d)(1).
9. § 6038D(g).
10. § 6038D(e).
11. § 6662.
12. *See* § 6501; I.R.C. § 6038(d)(1).
13. § 1471.
14. § 1472.

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on January 1, 2013.[15] An I.R.S. official has reportedly concluded that "if [the] IRS does not collect 'a dollar of withholding tax,' but the measure helps to establish taxpayer trust in the fairness of the system, 'that will have satisfied a major goal.'"[16]

FFIs are defined in such a manner as to include foreign banks, foreign brokerage firms, foreign trust companies, foreign mutual funds, foreign hedge funds, foreign private equity funds, and other foreign funds engaged primarily in investing or trading in U.S. or foreign securities.[17] In I.R.S. Notice 2010-60,[18] however, the Service made exceptions from adverse FFI characterization for certain foreign companies, even though they may primarily be engaged in investing or trading in securities. Such non-FFIs include: foreign holding companies of a group of non-FFI companies (but private equity, venture capital, and similar funds that intend to hold their investment in their operating companies for a limited period of time are not excepted); foreign companies starting up a non-FFI business for their first twenty-four months after organizing; non-FFI foreign companies liquidating or reorganizing with the intent to restart a non-FFI business; and hedging and financing foreign subsidiaries of a corporate group primarily engaged in a non-FFI business that only do business with other members of that group.[19]

Also excepted from FFI characterization are foreign insurance or reinsurance companies that only offer policies with no cash value, and do not offer life insurance policies with cash surrender value or annuities.[20] FFIs organized under the laws of Puerto Rico, the U.S. Virgin Islands, and other U.S. territories are exempt from FFI characterization as payees but are generally withholding agents as payors.[21] Notice 2010-60 also indicates that certain small foreign family trusts or other small entities, all of whose owners supply information directly to the U.S. withholding agent, can avoid FFI characterization.[22] Notice 2010-60 requests further comments on whether there should be an exception from FFI characterization for foreign investment funds not marketed to U.S. persons.[23]

Foreign pension plans are exempted by Notice 2010-60 from FATCA withholding if: (i) they qualify as a retirement plan under the laws of the country where established; (ii) are sponsored by a foreign employer; and (iii) do "not allow U.S. participants or beneficiaries other than employees who worked for the foreign employer in the country in which such retirement plan is established during the time in which benefits accrued."[24] Notice 2010-60 does not exempt from FATCA withholding an FFI that receives withholdable payments through a U.S. branch.[25] Notice 2010-60 also does not exempt from FATCA withholding an FFI that is a U.S.-controlled foreign corporation.[26]

15. Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, § 501(d)(1), 124 Stat. 71 (2010).
16. Alison Bennett, *Tax Havens: Musher Says IRS Focused on Timelines, Burden in Implementing FATCA Provisions*, [2010] 79 Daily Tax Rep. (BNA) G-2 (Apr. 27, 2010).
17. § 1471(d)(4), (5).
18. I.R.S. Notice 2010-60, 2010-37 I.R.B. 329 § II.B.1.
19. *Id.*
20. *Id.* § II.B.2.
21. *Id.* § II.B.4.
22. *Id.* § II.B.3.
23. *Id.* § V.E.
24. *Id.* § II.C.
25. *Id.* § II.D.1.
26. *Id.* § II.D.2.

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"Withholdable payments" are generally defined to include U.S. source dividends, interest on obligations of U.S. corporate or non-corporate obligors (including bank deposit interest and portfolio interest), the gross selling price or proceeds of redemption of U.S. corporate stocks or obligations of U.S. obligors, and certain other U.S.-source investment income.[27] Thus, income otherwise exempt from U.S. tax under the Internal Revenue Code or a tax treaty, such as capital gains, portfolio interest, and bank deposit interest, and other items that are not income at all to either the FFI or its U.S. or foreign clients, such as the recovery of cost of a U.S. stock or U.S. bond that is received when the stock or bond is sold, may be subject to FFI withholding. With respect to U.S. source fixed, determinable, and periodic income paid to FFIs and non-FFI foreign entities, FATCA applies in addition to the pre-existing withholding rules, subject to future rules coordinating the various withholding regimes.[28] Under a special grandfather rule, payments on obligations issued before March 19, 2012, will not be withholdable payments subject to FATCA, even if those payments are made on or after the general January 1, 2013, FATCA effective date.[29] Also, payments made to a class of persons identified by the Treasury as posing a low risk of tax evasion will not be withholdable payments.[30]

An FFI can avoid the thirty percent FATCA withholding by agreeing with the I.R.S.: (1) to determine which, if any, of its accounts is a U.S. account; (2) to comply with any U.S. due diligence and verification requirements regarding possible U.S. accounts; (3) to report information about such U.S. accounts annually to the I.R.S.; (4) to withhold the thirty percent FATCA tax, or be withheld upon, on certain pass-through payments to other FFIs which do not enter into such an agreement with the I.R.S. or on payments to "recalcitrant" account holders who fail to supply information as to U.S. ownership; (5) to comply with any I.R.S. requests for additional information about U.S. accounts; and (6) if foreign law would prevent disclosure, to seek a waiver of the foreign law, and, if a waiver cannot be obtained, to close the account.[31] I.R.S. Notice 2010-60 outlines the expected reporting required by an FFI that seeks to avoid thirty percent FATCA withholding through an I.R.S. agreement.[32] The I.R.S. will publish a draft FFI Agreement.[33] Having a Qualified Intermediary (QI) agreement with the I.R.S., however, does not excuse an FFI from being subject to FATCA withholding. FATCA applies to payments to a QI FFI, in addition to the requirements imposed on the FFI under the QI agreement.[34]

An FFI can also avoid the FATCA thirty percent withholding if: (1) it complies with I.R.S. procedures designed to ensure that the FFI does not maintain U.S. accounts and meets such requirements as the I.R.S. may prescribe with respect to accounts of other FFIs;[35] (2) it is a member of a class of FFIs for which the I.R.S. makes an exception;[36] or (3) it has no withholdable payments because it invests only in non-U.S. assets.[37]

27. I.R.C. § 1473 (West 2011).
28. § 1474.
29. Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, § 501(d)(2), 124 Stat 71 (2010).
30. I.R.C. § 1471(f)(4).
31. § 1471(b)(1).
32. § 1471(c); *see* I.R.S. Notice 2010-60, 2010-37 I.R.B. 329.
33. I.R.S. Notice 2010-60, 2010-37 I.R.B. 329.
34. I.R.C. § 1471(c)(3).
35. § 1471(b)(2)(A).
36. § 1471(b)(2)(B).
37. § 1473(1).

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As noted, there is also a thirty percent U.S. withholding tax imposed by FATCA on withholdable payments made to certain foreign entities that are not FFIs.[38] The withholding of a thirty percent U.S. tax is avoided if the non-FFI foreign entity provides the withholding agent information on any "substantial United States owner."[39] The withholding on non-FFIs is excused for: publicly traded foreign corporations and their majority owned subsidiaries; entities formed under the laws of and exclusively owned by residents of a U.S. possession; foreign governments and central banks; international organizations; and others to be specified by regulations, even if they do not provide a statement that there are no substantial U.S. owners.[40]

The Treasury is to provide a mechanism for refunding over-withholding where the foreign entity discloses its U.S. owners or in certain cases involving treaties.[41]

FATCA withholding only applies to payments to entities, and has no application to amounts paid to individuals.[42] Only the pre-existing withholding rules apply to payments to individuals.

"U.S. accounts," which are the trigger for an FFI FATCA withholding, must be "financial accounts."[43] A "financial account" generally includes any depository account, any custodial account, and any non-publicly traded equity or debt interest in a financial institution.[44]

To be a "U.S. account," the FFI financial account must be held by one or more "specified United States persons" or foreign entities with "one or more substantial United States owners."[45] A specified U.S. person, whose account must be reported, is generally any U.S. person *other than*: (1) a publicly traded U.S. corporation and its majority owned subsidiaries; (2) a U.S. tax-exempt U.S. charity, U.S. pension plan or IRA; (3) a U.S. governmental entity or agency; (4) a U.S. bank, U.S. REIT, or U.S. mutual fund; or (5) a common trust fund, a CRAT or CRUT, or certain special classes of nonexempt trusts.[46] Certain individual accounts of less than $50,000 at a FFI may also be excluded.[47] But the I.R.S. may require balances across the FFI affiliated group to be aggregated to determine whether the $50,000 threshold is exceeded;[48] in that case, the cost of establishing affiliated-group-wide data collection programs to aggregate individual customer balances may dissuade FFI groups from seeking to apply this reporting exception.

A substantial U.S. owner of a foreign entity, the accounts of which will then be U.S. accounts, is generally any U.S. owner of an FFI that is primarily engaged in investing or trading in securities, a more than ten percent (by vote or value) U.S shareholder of a foreign corporation, a more than ten percent (profits or capital interest) U.S. partner of a foreign partnership, a U.S. beneficiary with a more than ten percent interest in a non-

38. *See supra* text accompanying note 13.
39. I.R.C. § 1472(b).
40. § 1472(c).
41. § 1474(b)(2).
42. *See* §§ 1471(d)(3), 1472(d).
43. § 1471(d)(1).
44. § 1471(d)(2).
45. § 1471(d)(1), (3).
46. § 1473(3).
47. § 1471(d)(1)(B)(ii).
48. *Id.*

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grantor foreign trust, or a U.S. owner of any portion of a grantor foreign trust.[49] Percentage ownership is indirect or direct, requiring a look-through, and therefore presents due diligence challenges, particularly when tiers of foreign entities are present or there is a significant turnover of investors.

As noted above, the I.R.S. will publish a draft FFI Agreement.[50] Notice 2010-60 has due diligence requirements that are to be applied by an FFI that executes an FFI Agreement with the I.R.S. to determine whether an account is a U.S. account.[51] Generally, more due diligence will be required for accounts opened after the execution of an FFI Agreement than those opened before the execution of an FFI Agreement, particularly accounts opened before the execution of the FFI Agreement that are not in electronically searchable form.[52] This is evidently a partial concession to comments by such FFIs as Germany's Allianz Insurance Company, which informed the Treasury that it has approximately thirty million pre-FATCA insureds, many of whose files do not contain non-U.S.-status due diligence data.[53]

For new entity accounts, FFIs must incorporate all knowledge obtained by local anti-money-laundering and know-your-customer rules in determining whether an account is a U.S. account.[54] Notice 2010-60 requests comments on a system whereby the I.R.S. can rely on certifications by FFI management or public accountants that the due diligence requirements have been met.[55]

Notice 2010-60 narrowly interprets the available FATCA grandfather rule that excuses withholding on payments made during and after 2013 on obligations issued before March 19, 2012.[56] That an account was opened before March 19, 2012, does not grandfather all payments to that account.[57] Payments on pre-March 19, 2012, accounts that can be withdrawn on demand are not grandfathered.[58] A pre-March 19, 2012, obligation that is materially modified on or after March 19, 2012, is no longer grandfathered.[59] Pre-March 19, 2012, royalty license agreements and other non-debt contractual obligations can qualify for the FATCA grandfather rule.[60] But U.S. stocks owned before March 19, 2012 are not grandfathered obligations.[61]

There are a number of broad economic issues raised by FATCA withholding. For example, will FFIs and other foreign investors be deterred from investing in the United States? In this regard, will other countries argue that, in view of FATCA, the I.R.S. should dismantle its QI program? The QI rules intentionally have the effect of preventing the I.R.S. from readily obtaining, and thus exchanging, information on the identity of

49. I.R.C. § 1473(2) (West 2010).
50. See *supra* text accompanying note 33.
51. I.R.S. Notice 2010-60, § III.B.
52. *Id.*
53. Hans Guenter Mayr, *Allianz SE Comments on FATCA Section of HIRE Act, Announcement 2010-22*, 10 TaxCore (BNA) No. 130, at 114 (July 9, 2010).
54. I.R.S. Notice 2010-60, 2010-37 I.R.B. 329, § III.B.2.b.
55. *Id.* § V.A.
56. *Id.* § I.
57. *Id.*
58. *Id.*
59. *Id.*
60. *Id.*
61. *Id.*

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foreign portfolio investors in the United States,[62] in complete opposition to FATCA, which requires disclosure to the I.R.S. of U.S. portfolio investors abroad. Dismantling the QI program could itself discourage foreign investment in the United States.

Other questions remain. What will the cost level be to satisfy the FATCA due diligence requirements to determine indirect or direct U.S. ownership? Will other countries adopt and harmonize FATCA-type due diligence obligations and reporting requirements? For example, will U.S. financial institutions that invest in European securities be required by European governments to identify and report to European tax authorities their European account holders? I.R.S. officials have stated that the Organization for Economic Co-operation and Development's (OECD) Tax Relief and Compliance Project is focusing on off-shore compliance, that other countries around the world are looking at what the United States is doing to implement FATCA, and that harmonization of reporting to ensure residence-based taxation is likely.[63]

Many FFIs have criticized FATCA because of perceived high compliance costs relative to the U.S. tax avoidance potential.[64] But groups besides FFIs, such as U.S. citizens living abroad, have also criticized FATCA.[65] U.S. citizens living abroad have argued that they may face account closures by foreign banks that are not large enough to comply with FATCA, but are too large to completely avoid U.S. investments.[66] Thus, some U.S. citizens living abroad may be forced to open accounts only at foreign banks that are smaller and do not hold U.S. portfolios.[67] Depending on the eventual FATCA exclusions for foreign insurance companies and policies, these individuals may face similar issues when buying such items as cash value insurance policies.[68] Some pension funds that are not excluded from FFI characterization may seek to deny U.S. citizens coverage or may no longer invest in U.S. stocks, U.S. securities, or other U.S.-based investments.[69] Most U.S. citizens abroad, even if they are not wealthy, will likely have much more than $50,000 in foreign financial assets. Thus, as a result, they will be pushed into the Section 6038D specified financial asset reporting.[70]

III. FBAR–Proposed Regulations

An FBAR (Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts) must be filed with the U.S. Treasury Department each year to report a U.S. person's financial interest in, or signature or other authority over, financial accounts maintained outside of the United States when the aggregate balance in the account or accounts exceeds $10,000

62. Treas. Reg. § 1.1441-1(e)(5) (as amended in 2007).
63. Alison Bennett, *International Taxes: OECD Shifting Focus to Residence-Based Tax, Looking at Reporting, Danilack Says*, [2010] 124 Daily Tax Rep. (BNA) G-3 (June 30, 2010).
64. *See e.g.*, Adrian Coles, *Building Societies Association Comments on IRS Notice 2010-60 on Foreign Account Tax Compliance Act*, 10 TaxCore (BNA) No. 220 (Nov. 17, 2010).
65. Marylouise Serrato & Jacqueline Bugnion, *American Citizens Abroad Comments on FATCA Section of HIRE Act, Announcement 2010-22*, 10 TaxCore (BNA) No. 130, at 113 (July 9, 2010).
66. *Id.*
67. *Id.*
68. *Id.*
69. *Id.*
70. *Id.*

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during the calendar year.[71] Questions have been raised as to the efficacy of these requirements after the District Court's 2010 decision in *United States v. Williams*.[72] There the Court held that the taxpayer checking the "No" box on the question as to ownership over a foreign account on the I.R.S. Form 1040 and pleading guilty to tax evasion were insufficient to establish an FBAR willfulness-based penalty, where the taxpayer reasonably believed that the I.R.S. already knew of the accounts.[73]

FinCEN issued proposed regulations in 2010 to modify the FBAR reporting rules.[74] But the proposed regulations do not address what the effective date will be of the new regulations if they become final.

The current regulations do not define who is a U.S. person for purposes of being required to file an FBAR. In regard to what individuals are U.S. persons, Internal Revenue Manual Section 4.26.16.3.1.1 instructs I.R.S. agents that the plain meaning of the term "resident," that is, someone who is living in the United States and not planning to leave the United States permanently, should be used for FBAR examination purposes. The proposed regulations would define an individual U.S. person required to file an FBAR as not only a U.S. citizen or generally a U.S. green card holder, but also a U.S. individual who is treated as income tax resident under the "substantial presence test" of the U.S. income tax law.[75] By contrast, foreign persons (including entities), even if they are engaged in business in the United States, need not file an FBAR.[76]

The proposed regulations also provide that reportable accounts include not only bank accounts and securities brokerage accounts, but also such items as insurance policies with a cash value, annuities, accounts with a commodities broker, and shares in a mutual fund.[77] The proposed regulations reserve giving guidance on private equity funds, venture capital funds, hedge funds, and other pooled investment vehicles not offered to the general public or not having regular redemptions at net asset value.[78] By contrast, investments in these items are covered by the FATCA foreign asset tax reporting requirements unless excepted by the I.R.S.[79] Similarly, I.R.S. Notice 2010-23, issued concurrently with the FBAR proposed regulations, provides that until further notice, no FBAR reporting is required for pre-2010 holdings of foreign hedge funds, foreign private equity funds, or other non-mutual-fund products.[80]

The proposed regulations treat a U.S. person as having a reportable financial interest if that person holds legal title for itself or as agent for another person or if another person holds legal title but is the taxpayer's agent.[81] A direct or indirect majority owner of a

71. 31 C.F.R. § 103.24, 103.27 (2011).
72. United States v. Williams, No. 1:09-CV-437, 2010 WL 3473311 (E.D. Va. Sept. 1, 2010).
73. *Id.*
74. Financial Crimes Enforcement Network; Amendment to the Bank Secrecy Act Regulations-Reports of Foreign Financial Accounts, 75 Fed. Reg. 8844 (Feb. 26, 2010).
75. Reports of Foreign Financial Accounts, 75 Fed. Reg. 8844 (proposed Feb. 26, 2010) (to be codified at 31 C.F.R. pt. 103).
76. *Id.*
77. *Id.*
78. *Id.*
79. *Id.*
80. I.R.S. Notice 2010-23, 2010-11 I.R.B. 441.
81. 75 Fed. Reg. 8844 (proposed Feb. 26, 2010) (to be codified at 31 C.F.R. pt. 103).

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corporation, partnership, or trust has a financial interest in the entity's foreign accounts.[82] A U.S. person who creates an entity to evade FBAR reporting is deemed to have a financial interest in any foreign account owned by the entity.[83] Tax-disregarded single member U.S. limited liability companies and U.S. grantor trusts are nevertheless subject to FBAR filing requirements.[84]

A U.S. person has signature authority only if the U.S. person, "alone or in conjunction with another" person, can control the disposition of assets in the financial account by written, oral, or e-mail instructions directed to the institution maintaining the account.[85] Officers and directors of publicly traded U.S. corporations and their foreign subsidiaries that file a consolidated FBAR with their parent, and officers and directors of certain regulated banks, broker-dealers, and investment advisers, need not file FBARs with respect to foreign accounts over which they have signature authority but no financial interest if certain requirements are met.[86] I.R.S. Notice 2010-23 generally extends the FBAR filing deadline for U.S. persons with signature authority, but no financial interest, in a foreign financial account to June 30, 2011.[87]

Under the proposed regulations, U.S. federal, state, and local entities are not required to file FBARs.[88] Participants in qualified retirement plans and IRA beneficiaries need not report foreign accounts over which they have no signature authority.[89] But U.S. custodians of IRAs with signature authority over foreign accounts and U.S. trustees of qualified plans, other than governmental plans, must report the foreign accounts of the IRA or plan.[90]

In 2010, FinCEN proposed regulations for an annual report by banks of the accountholder's U.S. tax identification number and account number for all accounts used to originate or receive cross-border electronic transfer of funds.[91] The Director of FinCEN said that "[b]y establishing a centralized database, this regulatory plan will greatly assist law enforcement in detecting and ferreting out . . . international tax evasion."[92]

IV. Other FATCA and non-FATCA Provisions

A. Withholding on Dividend-Equivalent Amounts

Beginning in September 2010, section 871(m), enacted by FATCA, imposed U.S. dividend withholding tax on swap payments to the extent they are directly or indirectly contingent upon, or determined by, U.S. corporate dividends on U.S. non-publicly traded

82. *Id.*
83. *Id.*
84. *Id.*; I.R.S. Notice 2010-60, 2010-37 I.R.B. 329, § III.B.
85. 75 Fed. Reg. 8844 (proposed Feb. 26, 2010) (to be codified at 31 C.F.R. pt. 103).
86. *Id.*
87. I.R.S. Notice 2010-23, 2010-11 I.R.B. 441.
88. 75 Fed. Reg. 8844 (proposed Feb. 26, 2010) (to be codified at 31 C.F.R. pt. 103).
89. *Id.*
90. *See* I.R.S. Notice 2010-60, 2010-37 I.R.B. 329, § III.B.
91. Reporting Related to Cross-border Electronic Transmittal of Funds, 75 Fed. Reg. 60,377 (proposed Sept. 30, 2010) (to be codified at 31 C.F.R. pt. 103).
92. Robert T. Zung & Aaron Lorenzo, *Information Reporting: FinCEN Proposes Requirement to Report Cross-Border Electronic Fund Transmittals*, [2010] 186 Daily Tax Rep. (BNA) G-3 (Sept. 28, 2010).

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stocks or on U.S. publicly-traded stocks where the underlying stock has been transferred or pledged as collateral between the parties.[93] Beginning on March 19, 2012, section 871(m) will impose U.S. dividend withholding tax on the dividend equivalent element of all notional principal contracts, including those involving publicly traded stocks not involving transfers or collateralization of the underlying stock, unless the contract is excepted by the Treasury.[94]

B. Expansion of U.S. Persons Treated as Grantor of Foreign Trusts

Under section 679(a), a U.S. transferor to a foreign trust is treated as the owner of the portion of the trust attributable to the transferred property if there is a U.S. beneficiary of any portion of the foreign trust.[95] FATCA expands the circumstances in which a foreign trust transferee will be viewed as having a U.S. beneficiary, thereby correspondingly expanding grantor trust treatment to the U.S. transferor.[96] FATCA treats a foreign trust as having a U.S. beneficiary if a U.S. beneficiary's interest in the trust is contingent on a future event.[97] A foreign trust is also treated as having a U.S. beneficiary if any person has the discretion to distribute to or for the benefit of a person, unless the trust identifies the class of permissible distributees and none of these persons are U.S. persons during the taxable year.[98] A trust is also treated as having a U.S. beneficiary if implementation of a letter of wishes or other arrangement would create a present or future U.S. beneficiary.[99]

New reporting requirements are imposed for U.S. transferors to foreign trusts. A U.S. transferor to a foreign trust is treated as a grantor unless the U.S. transferor satisfies I.R.S. reporting requirements and affirmatively demonstrates the absence of a present or contingent U.S. beneficiary.[100] The U.S. grantor of a foreign grantor trust must supply information directly to the I.R.S. as well as ensure that the foreign trust itself supplies information to owners and distributees.[101] There is a thirty-five percent penalty for failure to report transactions with foreign trusts without reasonable cause, with the minimum penalty generally being $10,000.[102]

C. Annual PFIC Reporting

Before FATCA, a U.S. person was generally not required to report ownership of PFIC shares if that U.S. person merely held those PFIC shares and did not dispose of or receive distributions from those PFIC shares during the year and no special PFIC elections were made.[103] Rather, I.R.S. Form 8621 (Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund) was generally required to be filed if there was

93. *See* I.R.S. Notice 2010-46, 1984-1 C.B.; I.R.C. § 871(m) (LexisNexis 2011).
94. Hiring Incentives to Restore Employment Act, H.R. 2847, 111th Cong. § 541(b) (2010).
95. I.R.C. § 679(a) (LexisNexis 2011).
96. *See id.*
97. § 679(c)(1).
98. § 679(c)(4).
99. § 679(c)(5).
100. § 679(d).
101. I.R.C. § 6048(b)(1) (LexisNexis 2011).
102. I.R.C. § 6677 (LexisNexis 2011).
103. I.R.C. § 1298, *amended by* 2010 Foreign Asset and Tax Compliance Act (FATCA), Pub. L. No. 111-147, § 501, 124 Stat. 71 (2010).

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a disposition of PFIC shares, a distribution from the PFIC was received, or certain PFIC elections were made.[104] Under FATCA, the I.R.S. may require U.S. owners of stock of a PFIC to file a return with respect to the PFIC, even if one of these events has not occurred.[105] I.R.S. Notice 2010-34[106] states that for individuals owning PFIC stock for a calendar year, the first new PFIC reports to identify PFICs owned during the 2011 year will be due no sooner than 2012.

D. Portfolio Interest Exemption Eliminated for Foreign-Targeted Bearer Bonds

For foreign-targeted bearer bonds issued on or after March 19, 2012, the U.S. issuer will no longer be entitled to a deduction for the interest, and the foreign bond owners will no longer qualify for the portfolio interest exemption.[107]

Clearstream Banking (Clearstream) acts as clearing agent for $12 trillion of bonds issued by U.S. corporations and others.[108] Clearstream uses a "dematerialized book-entry system," under which ownership of bearer bonds can only be transferred through Clearstream's records.[109] Clearstream has asked the I.R.S. to confirm that such registration of owners, coupled with certain I.R.S.-specified procedures to detect U.S. accounts, will permit foreign persons registered as owners with Clearstream to be viewed as receiving portfolio interest on or after March 19, 2012, even if they do not give Clearstream a W-8BEN.[110]

E. Education Jobs and Medicaid Assistance Act of 2010[111]—Changes to the Foreign Tax Credit

Public Law 111-226, which is not part of FATCA, makes a variety of changes to the foreign tax credit.[112] Among the changes is the creation of a separate foreign tax limitation applied to items resourced as foreign under U.S. income tax treaties, but lightly taxed by the treaty partner.[113] Further, the "hopscotch" rule is replaced with a "hypothetical distribution rule" in connection with determining the amount of foreign tax credits that are deemed paid when a high-taxed foreign subsidiary, in a tier of ownership below more lightly taxed foreign subsidiaries, triggers an income inclusion to its U.S. parent under Section 956 because of such reasons as the high-taxed foreign subsidiary having effectively

104. *Instructions for Form 8621*, Internal Revenue Service (U.S.), http://www.irs.gov/instructions/i8621/ch01.html (last visited Feb. 9, 2011).
105. 2010 Foreign Asset and Tax Compliance Act (FATCA), Pub. L. No. 111-147, § 501, 124 Stat. 71 (2010).
106. Notice 2010-34, 2010-1 C.B. 612.
107. I.R.C. §§ 163(f)(2), 871(h)(2) (LexisNexis 2011).
108. Clearstream Banking Comments on FATCA Section of HIRE Act, Announcement 2010-22, TaxCore Vol. 10, No. 137 (BNA) (July 20, 2010).
109. *Id.*
110. *Id.*
111. Pub. L. No. 111-226, 124 Stat. 2389 (2010).
112. *See generally id.*
113. I.R.C. § 904(d)(6) (LexisNexis 2010).

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repatriated its earnings and profits by means of loans to a U.S. parent or affiliate, or having its assets pledged to secure a loan to such U.S. related parties.[114]

F. Health Care and Education Affordability Reconciliation Act of 2010[115]—Codification of the Economic Substance Doctrine

This legislation provides that a transaction, to be respected for tax purposes, must change the taxpayer's economic position in a material way and that the taxpayer must have a substantial non-tax purpose for entering into the transaction.[116] A new twenty percent penalty, increased to forty percent if there is inadequate disclosure, applies to transactions lacking economic substance.[117] There is no reasonable cause exception, so, reliance on the opinion of counsel will not protect against the penalty.[118]

G. Administrative Initiatives to Promote Disclosure of Hidden U.S.-Owned Foreign Accounts

The I.R.S. has been reorganizing to better achieve tax compliance with respect to U.S.-owned foreign accounts.[119] In October of 2010, I.R.S. reorganized its Large and Mid-Size Business Division (LMSB) into the Large Business and International Division (LB&I).[120] About 875 specialists in international taxation are to be brought into the LB&I.[121] This restructuring is meant to improve identification and auditing of international issues, including issues relating to unreported income and transfer pricing issues, and also to aid in implementing FATCA.[122]

An FBAR twenty percent civil penalty voluntary disclosure program, which was adopted in the context of the Union Bank of Switzerland (UBS) litigation, ended in 2009 and resulted in approximately 15,000 taxpayers making voluntary disclosures of unreported foreign bank and financial accounts.[123] Another approximately 3,000 taxpayers made voluntary disclosures between November 2009 and December 2010 without a pre-established civil penalty structure.[124] In 2010, the United States settled summons litigation against UBS, pursuant to which approximately 4,450 names of U.S. account holders at

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114. I.R.C. § 960(c) (LexisNexis 2010); Lowell Yoder, *Section 956 Inclusions: New Limit on Foreign Taxes Deemed Paid*, [December 2010] Tax & Accounting (BNA) (Dec. 1, 2010).
115. Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (2010).
116. I.R.C. § 7701(o) (LexisNexis 2010), *enacted by* Pub. L. No. 111-152, § 1409 (2010); I.R.S. Notice 2010-62, 2010-40 I.R.B. 411.
117. I.R.C. § 6662(b)(6), (i) (LexisNexis 2010).
118. §§ 6664(c)(2), 6676(c).
119. Tamu N. Wright, *LMSB Restructure Will More Than Double Staff Size, Adds Transfer Pricing Director*, [2010] 149 Daily Tax Rep. (BNA) GG-1 (Aug. 5, 2010).
120. *Id.*
121. *Id.*
122. *Id.*
123. Alison Bennett, *IRS Plans to Offer New Voluntary Disclosure Program for Offshore Assets, Shulman Says*, [2010] 236 Daily Tax Rep. (BNA) G-3 (Dec. 10, 2010); *Statement from IRS Commissioner Doug Shulman on Offshore Income*, Internal Revenue Service (U.S.), Mar. 26, 2009, http://www.irs.gov/newsroom/article/0,,id=206014,00.html.
124. Bennett, *supra* note 123.

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UBS were to be delivered to the I.R.S.[125] In February of 2011, the I.R.S. announced another voluntary disclosure program, available through August 31, 2011, with a civil penalty generally somewhat more costly (involving an FBAR twenty-five percent civil penalty) than that of the 2009 program.[126]

On the bi-lateral and multi-lateral front, in 2010, bi-lateral tax information exchange agreements entered into force between the United States and the traditional tax havens and secrecy jurisdictions of Gibraltar, Liechtenstein, and Monaco.[127] In 2010, the United States, Denmark, Finland, Iceland, Italy, France, Mexico, Netherlands, Norway, Portugal, Slovenia, South Korea, Sweden, Ukraine, and the United Kingdom signed an update to the 1995 multi-party Convention on Mutual Administrative Assistance in Tax Matters (Convention).[128] The 2010 Convention provides for cross-border exchange of information without regard to supplying state tax interest or bank secrecy; multilateral simultaneous tax examinations; and cross-border assistance in tax collection, while imposing safeguards to protect the confidentiality of the information exchanged.[129] Moreover, non-OECD members, *e.g.*, developing countries, can become parties to the Convention.[130] The United States is active in the Joint International Tax Shelter Information Centre (JITSIC), whose membership includes the tax administrations of Australia, Canada, Japan, and the United Kingdom.[131] In 2010, I.R.S. Commissioner Shulman stated that the JITSIC will focus on combating the "use of offshore arrangements to avoid tax."[132]

H. Disclosure of Uncertain Tax Positions

In I.R.S. Announcement 2010-75, the I.R.S. released, for comment, a draft Uncertain Tax Positions Schedule UTP that would be required of C corporations, with assets of at least $100 million in 2010 (phasing down to $10 million in 2014), to file (with their Forms 1120) to report uncertain tax positions if they issue audited financial statements.[133] Transfer price uncertainties under Section 482, for which there is a significant financial accounting tax liability reserve, are specifically mentioned in Announcement 2010-75 as subject to disclosure.[134]

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125. *Id.*

126. *Second Special Voluntary Disclosure Initiative Opens; Those Hiding Assets Offshore Face Aug. 31 Deadline*, Feb. 8, 2011, http://www.irs.gov/newsroom/article/0,,id=235695,00.html.

127. Jason R. Connery, Steven R. Lainoff & Charles W. Cope, *Current Status of U.S. Tax Treaties and International Tax Agreements*, 39 Tax Mgmt Int'l J. (BNA) No. 790 (Dec. 10, 2010).

128. Rick Mitchell, *Fifteen Nations Sign OECD, Council of Europe Agreement on Cooperation in Tax Matters*, [2010] 102 Daily Tax Rep. (BNA) I-3 (May 28, 2010).

129. *Protocol to Convention on Mutual Administrative Assistance on Tax Matters*, [2010] 10 TaxCore (BNA) 102 (May 28, 2010).

130. *Id.*

131. Alison Bennett, *IRS Stressing Focus on Global Examinations, Seeks More Data on Taxpayers, KPMG Says*, [2010] 54 Daily Tax Rep. (BNA) G-4 (Mar. 23, 2010) [hereinafter *IRS Stressing Focus on Global Examinations*].

132. *IRS Commissioner Shulman June 8, 2010, Prepared Remarks for USCIB, BIAC Conference on OECD Issues*, 10 TaxCore (BNA) 109 (June 9, 2010).

133. I.R.S. Announcement 2010-75, 2010-41 I.R.B. 428.

134. *Id.*

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V. Fiscal Year 2011 Legislative Proposals

A. Proposals to Reduce Deferral Through the Use of Low-Tax Jurisdictions

One of the Obama Administration's (Administration) proposals would include deferring a deduction for interest expenses related to deferred income from foreign corporations.[135] Another would base the deemed paid foreign tax credit on the pooled weighted average foreign corporate tax rate of all foreign subsidiaries, thereby restricting the ability to use high-tax country dividends to shelter low-tax-country dividends from U.S. corporate income tax.[136] The Administration has also proposed denying a deduction to U.S. insurance companies for reinsurance premiums paid to foreign affiliate reinsurers to the extent that those premiums (less ceding commissions) exceed fifty percent of the direct insurance premiums of the U.S. payor and its U.S. affiliates for a line of business if the related foreign entity was not subject to U.S. income tax with respect to those premiums.[137]

B. Proposals to Address Transfer "Mispricing"

The Fiscal Year 2011 budget plan would add as items within the scope of Section 482 commensurate with income "super-royalty" provision: workforce in place, goodwill, and going concern value transferred by U.S. taxpayer to a new foreign corporation.[138] Multiple related intangibles could be valued by the I.R.S. on an aggregate basis to create a premium.[139] In addition, intangibles would be valued at their highest and best use.[140] If a U.S. person were to transfer intangibles to a low-tax foreign subsidiary in circumstances that evidence excessive income shifting, the foreign subsidiary's excessive return would be denied deferral and would not be able to be used to create foreign tax credit limitations to shelter the U.S. transferor's higher taxed foreign income.[141]

VI. U.S. Proposals and Initiatives Aimed at Foreign Persons

A. Preventing Foreign Persons from Avoiding U.S. Withholding Tax

The U.S. Treasury has been negotiating new limitations of benefits clauses to prevent treaty-shopping by foreign persons to obtain reduced U.S. tax withholding or exemptions from U.S. tax.[142] An example is the new treaty with Hungary signed in 2010.[143] The I.R.S. has also introduced a Tier I withholding tax initiative to audit companies for compliance with U.S. withholding rules, such as withholding upon fees paid to foreign persons

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135. *General Explanation of the Administration's Fiscal Year 2011 Revenue Proposals*, U.S. Dep't of the Treasury, 39-40 (2010), http://www.treasury.gov/resource-center/tax-policy/Documents/greenbk10.pdf.
136. *Id.* at 41.
137. *Id.* at 45.
138. *Id.* at 44.
139. *Id.*
140. *Id.*
141. *Id.* at 43.
142. *See* Alison Bennett, *United States Signs New Tax Treaties With Chile, Hungary in Two Ceremonies*, 23 Daily Tax Rep. (BNA) GG-1 (Feb. 5, 2010) [hereinafter *United States Signs New Tax Treaties*].
143. *Id.*

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for services performed in the United States.[144] Such withholding rules also include Section 861(a)(9), enacted in 2010, which provides that fees for guarantees paid by a U.S. borrower to a foreign guarantor are treated as U.S. source income for U.S. withholding tax purposes.[145]

B. Preventing Foreign Persons from Hiding Income in the United States

The U.S. Treasury's expansion of tax information exchange agreements gives foreign countries more of a right to obtain information on their taxpayers.[146] Senate Bill 569, the proposed "Incorporation Transparency and Law Enforcement Assistance Act," would, effective in 2012, require all U.S. states to obtain a list of the beneficial owners of limited liability corporations (LLCs) and corporations formed under their laws.[147] Various countries have designated certain U.S. states as tax-haven or secrecy jurisdictions or certain U.S. entities, such as Delaware LLCs, as tax-haven entities.[148]

144. *IRS Stressing Focus on Global Examinations*, *supra* note 131.
145. *Id.*
146. *See United States Signs New Tax Treaties*, *supra* note 142.
147. Incorporation Transparency and Law Enforcement Assistance Act, S. 569, 111th Cong. (2009).
148. *See*, *e.g.*, Ed Taylor, *Brazil's Tax Department Releases New List Of Tax Havens and Privileged Tax Regimes*, 115 Daily Tax Rep. (BNA) I-2 (June 17, 2010).

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