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Foreign Account Tax Compliance Act of 2009 – United States to Financial Institutions: Cooperate with Anti-Tax Evasion Efforts or Else

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On October 27, 2009, Senator Max Baucus (D-Montana) and Representative Charles Rangel (D-New York), chairmen of the Congressional tax writing committees, introduced the Foreign Account Tax Compliance Act of 2009 (the "Bill") in the U.S. Congress. A statement released by the House Ways and Means Committee indicates that the Bill "is intended to clamp down on tax evasion and improve taxpayer compliance by giving the IRS new administrative tools to detect, deter and discourage offshore tax abuses." If enacted in its current form, the Bill would, among other things, impose a 30% tax on payments made to foreign financial institutions, unless they comply with disclosure and certification requirements relating to their U.S. account holders, and to foreign non-financial institutions in certain circumstances.[1] Both President Barack Obama and Treasury Secretary Timothy Geithner issued statements giving their unqualified support for the Bill.

Impact on Foreign Financial Institutions

The Bill would introduce a 30% withholding tax on any "withholdable payment" made to a foreign "financial institution" (whether or not beneficially owned by such institution), unless the foreign financial institution agrees, pursuant to an agreement entered into with the U.S. Treasury, to provide information (including U.S. accountholder identification information and annual account activity information) with respect to each "financial account" held by "specified U.S. persons" and "U.S.-owned foreign entities." The new disclosure requirements would be in addition to requirements imposed by a "Qualified

Intermediary" agreement.

The term "financial institution" would include banks, brokers and investment funds, including private equity funds and hedge funds. A "withholdable payment" generally would include any payment of interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income from sources within the United States.[2] It also includes gross proceeds from the sale of property that is of a type which can produce U.S.-source dividend or interest, such as stock or debt issued by domestic corporations. A "financial account" would include bank accounts, brokerage accounts and other custodial accounts. The term "specified U.S. person" would be any U.S. person other than certain categories of entities such as publicly-traded corporations and their affiliates, banks, mutual funds, real estate investment trusts and charitable trusts. A "U.S.-owned foreign entity" for this purpose would be any entity that has one or more "substantial U.S. owners," which generally means (i) in the case of a corporation, if a specified U.S. person, directly or indirectly, owns more than 10% of the stock, by vote or value, (ii) in the case of a partnership, if a specified U.S. person, directly or indirectly, owns more than 10% of the profits or capital interests, or (iii) in the case of a trust, if a specified U.S. person is treated as an owner of any portion of the trust under the grantor trust rules.

Impact on Foreign Non-Financial Institutions

The Bill would also introduce a 30% withholding tax on any withholdable payment made to a non-financial foreign entity, unless the non-financial foreign entity provides the withholding agent with either (i) a certification that it does not have a substantial U.S. owner or (ii) the name, address, and taxpayer identification number of each substantial U.S. owner. This provision would not apply to payments made to a publicly-traded non-financial foreign entity, or any of its affiliates.

Treaty Relief, Credits and Refunds

If the beneficial owner of a payment is entitled to treaty benefits, the withholding tax rate imposed on any withholdable payment may be reduced or eliminated by the provisions of an applicable tax treaty and such beneficial owner would be entitled to a partial or full refund or credit. In addition, even if a treaty is not available, the beneficial owner of a withholdable payment on which the 30% tax is withheld may otherwise be entitled to a full refund or credit of the tax (*e.g.*, because payments are eligible for the portfolio interest exemption or represent gross proceeds from the sale of a capital asset). In such a case, a non-U.S. person would have to file a U.S. tax return to obtain a full or partial refund or credit. Similarly, a U.S. person with a foreign bank account on which it receives payments that are withheld on, presumably would have to claim a refund or credit on its U.S. tax return.

Effective Date

These provisions generally would apply to payments made after December 31, 2010. However, the provisions would not apply to payments made on debt obligations outstanding on the date of first committee action in the United States Congress if such obligations are in bearer form or if the terms of such obligations (on the issue date of the obligations) include a gross-up provision (providing for the payment of additional amounts in respect of taxes) that would be triggered as a result of the enactment of the Bill.

Footnotes

[1] Please see our prior client alert addressing the Bill's proposed repeal of the U.S. bearer debt exception at http://www.mofo.com/news/updates/files/16103.html.

[2] Thus, for example, the provision presumably would not apply to payments on "notional principal contracts" because, under current law, such payments are foreign source if made to a foreign person.