



TO: CLIENTS, EMPLOYEES, AND FRIENDS OF DOEREN MAYHEW **DATE:** 3/24/2010

FROM: DOEREN MAYHEW TAX DEPARTMENT

SUBJECT: ANTI-ABUSE AND OTHER FOREIGN PROVISIONS IN THE HIRE ACT

The President recently signed into law the “Hiring Incentives to Restore Employment Act of 2010” (the HIRE Act, P. L. 111-47, 03/18/2010). The HIRE Act includes a comprehensive set of measures to reduce offshore noncompliance by giving the IRS new administrative tools to detect, deter, and discourage offshore tax abuses, as well as a three-year delay (through 2020) of implementation of worldwide allocation of interest – the liberalized rule for allocating interest expense between U.S. sources and foreign sources for purposes of determining a taxpayer’s foreign tax credit limitation. An overview of these provisions follows.

Increased Disclosure of Beneficial Owners

Reporting on certain foreign bank accounts. The Act imposes a 30% withholding tax on certain income from U.S. financial assets held by a foreign institution 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 gross withdrawals/payments from such account. Foreign financial institutions would also be required to agree to disclose and report on foreign entities that have substantial U.S. owners. Congress expects that foreign financial institutions will comply with these disclosure and reporting requirements in order to avoid paying this withholding tax. These provisions are effective generally for payments made after 2012.

Reporting on owners of foreign corporations, foreign partnerships, and foreign trusts. The Act requires foreign entities to provide withholding agents with the name, address, and tax identification number of any U.S. individual that is a substantial owner of the foreign entity. Withholding agents are to report this information to the U.S. Treasury Department. The Act exempts publicly-held and certain other foreign corporations from these reporting requirements and provides the Treasury Department with the regulatory authority to exclude other recipients that pose a low risk of tax evasion. Any withholding agent making a withholdable payment to a foreign entity that does not comply with these disclosure and reporting requirements is required to withhold tax at a rate of 30%. These provisions are effective generally for payments made after 2012.

Extending bearer bond tax sanction to bearer bonds designed for foreign markets. Bearer bonds (i.e., bonds that do not have an official record of ownership) allow individuals seeking to evade taxes with the ability to invest anonymously. Recognizing the potential for U.S. individuals to take advantage of bearer bonds to avoid U.S. taxes, Congress took a number of steps in the 1980’s to eliminate bearer bonds in the U.S. First, they prevented the U.S. government from issuing bearer bonds that would be marketed to U.S. investors. Second, they imposed sanctions on issuers of bearer bonds that could be purchased by U.S. investors. The Act extends many of these sanctions to bearer bonds that are marketed to foreign investors and prevents the U.S. government from issuing any bearer bonds. These provisions apply to debt obligations issued after March 18, 2012.

Foreign financial asset reporting

Disclosure of information with respect to foreign financial assets. The new law requires individuals to report offshore accounts and other foreign financial assets with values of \$50,000 or more on their tax returns. Individuals who fail to make the required disclosures are subject to a penalty of \$10,000 for the tax year; an additional penalty can apply if Treasury notifies an individual by mail of the failure to disclose and the failure to disclose continues. These provisions apply for tax years beginning after March 18, 2010.

Penalties for underpayments attributable to undisclosed foreign financial assets. For tax years beginning after March 18, 2010, the Act imposes a penalty equal to 40% of the amount of any understatement that is attributable to an undisclosed foreign financial asset (i.e., any foreign financial asset that a taxpayer is required to disclose and fails to disclose on an information return).

New 6-year limitations period. For returns filed after March 18, 2010, as well as for any other return for which the assessment period has not yet expired as of March 18, 2010, the Act imposes a new six-year limitations period for omissions of items from a tax return that exceed \$5,000 and are attributable to one or more reportable foreign assets. The Act also clarifies that the statute of limitations does not begin to run until the taxpayer files the information return disclosing the taxpayer's reportable foreign assets.

Other Disclosure Provisions

New reporting rule for PFICs. Effective on March 18, 2010, activities with respect to passive foreign investment companies (PFICs) are subject to a new reporting rule. Unless otherwise provided by IRS, each U.S. person who is a shareholder of a PFIC must file an annual information return containing such information as IRS may require. A person that meets this new reporting requirement could, however, also have to meet the new reporting rule requiring disclosure of information with respect to foreign financial assets (see above). It is anticipated that IRS will exercise its regulatory authority to avoid duplicative reporting.

Electronic filing. For returns the due date for which (determined without regard to extensions) is after March 18, 2010, the Act creates an exception to the general annual 250 returns threshold for electronic filing: IRS will be permitted to issue regs requiring filing on magnetic media for any return filed by a financial institution with respect to any taxes withheld by it for which it is personally liable. Thus, IRS will be authorized to require a financial institution to electronically file returns with respect to any taxes withheld by the financial institution even though the financial institution files less than 250 returns during the year.

Provisions Related to Foreign Trusts

Clarifications with respect to foreign trusts. Under present law, a U.S. person is treated as the owner of the property transferred to a foreign trust if the trust has a U.S. beneficiary. Under current Treasury regulations, a foreign trust is treated as having a U.S. beneficiary if any current, future or contingent beneficiary of the trust is a U.S. person. Notwithstanding this requirement, some taxpayers have taken positions that are contrary to this regulation. In order to enhance compliance with this regulation, the Act codifies this regulation into the statute. This provision is effective on March 18, 2010. The Act also clarifies that a foreign trust will be treated as having a U.S. beneficiary if (1) any person has discretion to determine the beneficiaries of the trust unless the terms of the trust specifically identify the class of beneficiaries and none of those beneficiaries are U.S. persons or (2) any written oral or other agreement could result in a beneficiary of the trust being a U.S. person. As a final clarification, the Act clarifies that the use of any trust property will be treated as a payment from the trust in the amount of the fair market value of such use.

Presumption with respect to transfers to foreign trusts. For transfers of property after March 18, 2010, the Act provides that if a U.S. person directly or indirectly transfers property to a foreign trust (other than a trust established for deferred compensation or a charitable trust) IRS may treat the trust as having a U.S. beneficiary unless such person can demonstrate to the satisfaction of IRS that under the terms of the trust, (1) no part of the trust may be paid or accumulated during the year for the benefit of a U.S. person, (2) that if the trust were terminated during the year, no part of the trust could be paid to a U.S. person (3) and that such person provides any additional information as IRS may require with respect to such transfer.

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Minimum penalty with respect to failure to report on certain foreign trusts. Under pre-Act law, a taxpayer that fails to file an information return with respect to certain transactions involving foreign trusts (e.g., the creation of a foreign trust, the transfer of money or property to a foreign trust, or the death of a U.S. owner of a foreign trust) is subject to a penalty of 35% of the amount required to be disclosed on such return. If IRS uncovers the existence of an undisclosed foreign trust but is unable to determine the amount required to be disclosed on such return, it is unable to impose a penalty. The Act strengthens this penalty by imposing a minimum penalty of \$10,000 on any such failure to file. This provision applies to notices and returns required to be filed after December 31, 2009. Notwithstanding this minimum penalty, in no event may the penalties imposed on taxpayers for failing to file an information return with respect to a foreign trust exceed the amount required to be disclosed on the return.

Dividend Equivalent Payments

Dividend equivalents treated as dividends. For payments made on or after September 14, 2010, the Act treats a dividend equivalent as a dividend from U.S. sources for certain purposes, including the U.S. withholding tax rules applicable to foreign persons. A dividend equivalent is 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. or any payment made under a specified notional principal contract that directly or indirectly is contingent upon, or determined by reference to, the payment of a dividend from sources within the U.S. A dividend equivalent also includes any other payment that IRS determines is substantially similar to a payment described in the preceding sentence. Under this rule, for example, IRS may conclude that payments under certain forward contracts or other financial contracts that reference stock of U.S. corporations are dividend equivalents.

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