

## The 2010 'FATCA' Legislation

On March 18, 2010, President Obama signed into law the Hiring Incentives to Restore Employment Act (the "HIRE" Act) intending to boost private sector hiring in 2010, principally through payroll forgiveness for Social Security taxes paid on certain new hires and a tax credit for retaining such new hires for at least one year thereafter. While providing incentives for new hiring, the estimated \$18 billion cost of the HIRE Act is by no means insubstantial. Congress and the President believe that these costs will be offset, at least in part, through increased taxation, information reporting and enforcement in the area of offshore accounts and foreign trusts under the 'offset provisions' of HIRE known as the Foreign Account Tax Compliance Act (FATCA or informally FATCA). This legislation already has impacted many taxpayers, worldwide.

### Foreign Asset Reporting

Individuals with an interest in a "foreign financial asset" will be required to attach to their individual *income tax return* (as distinguished from the technically non-tax FBAR reporting), for tax years beginning in 2010, certain information about the foreign financial asset if the aggregate value of all such specified foreign financial assets equals at least \$50,000.

A "foreign financial asset" includes (i) any financial accounts at foreign financial institutions; (ii) to the extent not held in an account at a financial institution, foreign issued stock or securities, interests in a foreign investment fund or derivatives with a foreign counterparty; and (iii) any interest in a foreign entity.

The information that must be provided to the Internal Revenue Service includes (i) the name of the foreign financial institution maintaining the account, (ii) the account number, and (iii) the maximum value of the account during the tax year. Failure to make the required disclosure will subject the account holder to a \$10,000 penalty. Moreover, a 40% penalty will apply to any actual underpayment attributable to an undisclosed foreign financial asset. In addition, the statute of limitations period has been extended to six years for assessments relating to a "significant omission" of income from foreign assets. A significant omission is an omission that exceeds the lesser of 25% of the amount of gross income stated in the return, or \$5,000. And though very similar, and no doubt there will be lots of duplication, this reporting is *in addition* to the FBAR reporting.

### Foreign Trusts

Under long-standing law, a foreign trust created by a United States transferor, for the benefit of one or more United States beneficiaries, is treated as a grantor trust, and thus will be subject to taxation by the United States on the trust's worldwide income.

The HIRE Act (i) "clarifies," but more honestly expands, the circumstances when a foreign trust will be treated as having one or more United States beneficiaries (for example, even when the interest of a United States person is contingent on a future event), (ii) provides special rules requiring certain trust provisions, and that discretionary distributions be limited to non-United States persons, if the trust is to be treated as a foreign non-grantor trust, and (iii) presumes that a foreign trust has United States beneficiaries unless the United States transferor both submits as yet undetermined information to the Secretary of the Treasury, and demonstrates that the trust has no United States beneficiaries. This last bit ostensibly will require a filing by many foreign trusts.

In addition, the Act provides that, upon enactment, any annual uncompensated use of foreign trust property by a United States grantor, United States beneficiary or any United States person related to such grantor or beneficiary will be subject to tax, as a distribution to such grantor or beneficiary of the fair market rental value of such property. This provision will result in many individuals newly having to file a Form 3520 to report such deemed distributions. Finally, United States owners of foreign trusts will be subject to new reporting requirements and increased penalties for failing to properly report (now equal to the greater of \$10,000 and 35% of the value of the trust).

### Passive Foreign Investment Companies

United States persons who are shareholders of a passive foreign investment company (commonly known as a "PFIC") will now have augmented annual reporting to the Internal Revenue Service, containing such information "...as the Internal Revenue Service may require." It is currently unknown as to what PFIC

reporting will be required under this provision, which is in addition to extensive PFIC reporting already imposed under the Code.

### **Financial Institution Reporting**

Nipping on the heels of the UBS matter, FATCA includes provisions intended to effectively end financial privacy in all foreign jurisdictions.

Under FATCA, all United States "withholding agents" must withhold 30% of certain payments to a foreign financial institution unless that foreign financial institution has signed an agreement to comply with reporting requirements in FATCA, relating to accounts held by or for the benefit of any United States persons. Specifically, to avoid being subject to this withholding the foreign financial institution must agree, among other things (i) to comply with verification and due diligence procedures with respect to accounts held by United States persons or United States-owned foreign entities, (ii) to itself withhold 30% on certain pass-through payments to U.S. account holders, and to either (iii) obtain waivers from its U.S. account holders of the protection of foreign secrecy laws or, absent receipt of a waiver within a reasonable time, close the account.

Foreign financial institutions agreeing to the new rules will be required to report the name, address and taxpayer identification number (SSN, EIN or TIN) of each United States account holder, as well as the account number, account balance, and gross receipts and withdrawals or payments from the account. In the case of any United States-owned foreign entity, the institution will also be required to report the name, address and taxpayer identification number of each substantial (generally 10% or greater) United States owner.

As a result of the foregoing, United States taxpayers will no longer have financial privacy abroad (as some would say, will not "be able to hide behind bank secrecy laws"), at least in most foreign jurisdictions. A potentially interesting exception will apply in the case of financial institutions in the U.S. possessions, such as Puerto Rico, as the rules generally will not apply to institutions organized under the laws of those jurisdictions.

### **Effects**

Because many foreign financial institutions do not have the wherewithal to accept FATCA, hosts of Americans are being run out of foreign banks and other financial institutions, and not just the few outright, brazen evaders of U.S. taxes, but all American citizens and non-citizen green card holders (such as those who live and work abroad) with foreign accounts...ironically, even employees of the U.S. government. Some large, or entrepreneurial, banks abroad are actually entering the "U.S. compliant bank" business, giving e.g. Americans resident abroad access to banking services they are now losing at others. However, many of these institutions are only offering private banking services (e.g. trusts) and require substantial minimum deposits. There is a severe shortage of retail banking available, and it is not any easier if the institution is a foreign branch of a U.S. bank (such as Citibank)...the FATCA still applies.

Non-resident non-U.S. citizens that otherwise would contemplate obtaining U.S. residency (either under a non-immigrant visa or a 'green card') must consider the full impact of such status, even more now than previously. Once the status obtains, FATCA will apply and the immigrant or U.S. beneficiary of a foreign benefactor must not rely upon financial privacy laws.

In light of the treatment they are receiving both by the U.S. government and by the foreign banks, many American citizens and green card holders residing abroad, and even U.S. citizens and residents that live 'stateside,' are considering expatriation (renouncing U.S. citizenship or their green cards). There is anecdotal evidence of year-long waiting lists at certain U.S. embassies and consulates for appointments to file renunciation paperwork.

U.S. taxpayers with undisclosed foreign interests who have not yet come forward under the 'voluntary compliance initiative' should give serious consideration to doing so now, lest the Internal Revenue Service find them first.

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