

ALERT: March 29, 2010

**Foreign Account Tax Compliance Act of 2009
Provisions Incorporated in Legislation Signed into
Law on March 18, 2010**

The Hiring Incentives to Restore Employment (HIRE) Act (Pub. L. No. 111-14) was signed into law on March 18, 2010. The centerpiece of the Act is the creation of tax breaks for businesses hiring new workers and extending higher expensing limits for small businesses that make capital investments. To pay for these tax breaks, however, the Act incorporates provisions of the Foreign Account Tax Compliance Act of 2009, which has far-reaching implications for foreign financial institutions that may have U.S. clients. A summary of some of the provisions that we believe would be of interest to our individual clients and their advisors is set forth below:

A. Withholding Tax Provisions

There are withholding taxes to enforce new reporting requirements on specified foreign accounts owned by specified U.S. persons or by U.S.-owned foreign entities.

Every foreign financial institution is encouraged to enter into an agreement with the United States that would require it to:

- Obtain information regarding each holder of each account to determine if the account is a “U.S. account”;
- Comply with verification and due diligence procedures set by the United States;
- For every U.S. account, annually report to the IRS information regarding account holder, balances, income and withdrawals;
- Withhold 30 percent on all payments to “recalcitrant account holders” and to other foreign financial institutions that have not entered into such an agreement;
- Provide any other information regarding the account requested by the United States and;
- Insist that the owners of U.S. accounts waive local bank secrecy laws, and close the accounts of those who refuse to do so.

Those foreign financial institutions that refuse to enter into such an agreement are subject to withholding of 30 percent on all payments to them of U.S. source dividends, interest and similar investment income, and on the gross proceeds of all sales of U.S. securities and other assets that produce interest or dividends.



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- For this purpose, “U.S. accounts” are accounts maintained by “specified U.S. persons” or U.S.-owned foreign entities. The latter includes foreign corporations and partnerships that are more than 10 percent owned by specified U.S. persons; grantor trusts with U.S. persons as grantors; and non-grantor trusts in which a specified U.S. person holds, directly or indirectly, more than 10 percent of the beneficial interest. Among others, “a specified U.S. person” includes a U.S. natural person, a U.S. corporation (other than a publicly held corporation) and a U.S. partnership.
- “Recalcitrant account holders” are account holders who refuse to provide information to allow the institution to determine whether the account is a U.S. account.
- For this purpose, “financial accounts” include:
 - Depository accounts
 - Custodial accounts
 - Equity or debt interests in a financial institution itself, other than interests that are regularly traded on an established securities market.

These rules are in addition to the existing Qualified Intermediary rules and are effective for payments made after December 31, 2012.

B. Foreign Trust Provisions

The provisions regarding foreign trusts have been amended to broaden the U.S. grantor trust rules as applied to a U.S. grantor of a foreign trust, tax U.S. beneficiaries on uncompensated use of trust property, and tighten the foreign trust reporting rules applicable to U.S. grantors and beneficiaries alike.

- The U.S. Internal Revenue Code (the Code) is now reconciled with Treasury regulations, which provide that a foreign trust created by a U.S. person is deemed to have a U.S. beneficiary unless for that taxable year there is a specified class among whom distributions may be made, none of whom is a U.S. person. There is now a rebuttable presumption that every foreign trust created by a U.S. person has U.S. beneficiaries. There is now a requirement that a U.S. grantor provide information requested by the IRS with respect to the foreign trust, in addition to ensuring the foreign trust files an annual information report.
- There is a new rule that treats the use of real or tangible property held in a foreign trust as a trust distribution to a U.S. beneficiary, U.S. grantor or related person if fair market rent is not paid.
- There is now a minimum penalty of \$10,000 for failure to report transfers to, or distributions from, foreign trusts, and a maximum penalty that could be greater than the value of the transfer or distribution.

These rules are effective on the date of enactment and for transfers made or uses of property after the date of enactment, or taxable years beginning after the date of enactment, as the case may be.

C. Other Provisions of Interest

- There is a new disclosure requirement imposed on U.S. persons with respect to “specified foreign financial assets” that exceed

\$50,000; this is in addition to existing Foreign Bank and Financial Account (FBAR) filing requirements. “Specified foreign financial assets” include foreign depository or custodial accounts, foreign stock or securities, financial instruments or contracts issued by or having a counterparty who is not a U.S. person, and any interest in a foreign entity.

- There is a new accuracy-related penalty for underpayment of taxes attributable to “undisclosed foreign financial assets,” and the statute of limitations has been extended to six years in certain cases. An “undisclosed foreign financial asset” is one that is subject to certain information requirements specified in the Code and for which the required information is not provided.
- A U.S. shareholder with an interest in a Passive Foreign Investment Company (PFIC) must now file an annual information return, regardless of whether a taxable event has taken place in that year.

These rules are effective for taxable years beginning after the date of enactment, except for the PFIC reporting which is effective on the date of enactment.

Bar Admissions: New Jersey^{NJ} New York^{NY}

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