Excerpt from eBook

The IRS and Offshore Tax Evasion - U.S. Foreign Grantor Trusts

FATCA Summary

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Chapter 12 - FATCA Summary

On March 18, 2010, President Obama signed the Hiring Incentives to Restore Employment ("HIRE") Act (P.L. 111-147) (The "Act"), which included the Foreign Account Tax Compliance Act containing new foreign account tax compliance rules.

Under the Act, new reporting and disclosure requirements for foreign assets was phased in between 2010 – 2014:

1. Foreign Institutional Reporting: Foreign Institutions have new reporting and withholding obligations for accounts held by U.S. Persons (generally effective after 12/31/12, commencing 1/1/13).

2. Foreign Financial Assets ($50,000): Individuals with an interest in a "Foreign Financial Asset" have new disclosure requirements. If foreign financial assets are valued in excess of $50,000, the U.S. Taxpayer must attach certain information to their income tax returns for tax years beginning after March 18, 2010. (U.S. Taxpayers are not required to disclose interests that are held in a custodial account with a U.S. financial institution).

The penalty is substantial ($10,000, plus additional amounts for continued failures, up to a maximum of $50,000 for each applicable tax period). The penalty may be waived if the individual can establish that the failure was due to reasonable cause and not willful neglect.

3. 40% Penalty: A 40% accuracy-related penalty is imposed for underpayment of tax that is attributable to an undisclosed foreign financial asset understatement. Applicable assets are those subject to mandatory information reporting when the disclosure requirements were not met. The penalties are effective for tax years beginning after March 18, 2010.

4. 6-Year Statute of Limitations: Statute of limitations re: omission of income in connection with foreign assets: The statute of limitations for assessments of tax is extended to six (6) years if there is an omission of gross income in excess of $5,000 attributable to the foreign financial asset. The six-year statute of limitations is effective for tax returns filed after March 18, 2010, as well as for any other tax return for which the assessment period has not yet expired as of March 18, 2010.

5. Passive Foreign Investment Companies: The Act imposes an information disclosure requirement on U.S. Persons who are PFIC shareholders. A PFIC is any foreign corporation if:

a. 75% or more of the gross income of the corporation for the taxable year is passive income; or

b. The average percentage of assets held by such corporation during a taxable year which produce passive income or which are held for the production of passive income are at least 50%.

6. Foreign Trusts with U.S. Beneficiaries: The Act clarifies if a foreign trust is treated as having a U.S. Beneficiary, an amount accumulated is treated as accumulated for the U.S. Person's benefit even if that Person's trust interest is contingent.

The Act clarifies that the discretion to identify beneficiaries may cause the trust to be treated as having a U.S. Beneficiary. This provision is effective after March 18, 2010.

7. Rebuttable Presumption/Foreign Trust – U.S. Beneficiary: The Act creates a rebuttable presumption that a foreign trust has a U.S. Beneficiary if a U.S. Person directly or indirectly transfers property to a foreign trust (unless the transferor provides satisfactory information to the contrary to the IRS). This provision is effective for property transfers after March 18, 2010.

8. Uncompensated Use of the Foreign Trust Property: The Act provides that the uncompensated use of the foreign trust property by a U.S. Grantor, a U.S. Beneficiary (or a U.S. Person, related to either of them), is treated as a distribution by the trust. The use of the trust property is treated as a distribution to the extent of the fair market value of the property's use to the U.S. Grantor/U.S. Beneficiary, unless the fair market value of that use is paid to the trust.

The loan of cash or marketable securities by a foreign trust, or the use of any other property of the trust, to or by any U.S. Person is also treated as paid or accumulated for the benefit of the U.S. Person. This provision applies to loans made and uses of property after March 18, 2010.

9. Reporting Requirements, U.S. Owners of Foreign Trusts: This provision requires any U.S. Person treated as the owner of any portion of a foreign trust to submit IRS-required information and insure that the trust files a return on its activities and provides such information to its owners and distributees.

This new requirement imposed on U.S. Persons treated as owners is in addition to the current requirement that such U.S. Persons are responsible for insuring that the foreign trust complies with its own reporting obligations. This provision is effective for taxable years beginning after March 18, 2010.

10. Minimum Penalty re: Failure to Report Certain Foreign Trusts: This provision increases the minimum penalty for failure to provide timely and complete disclosure on foreign trusts to the greater of $10,000 or 35% of the amount that should have been reported.

In the case of failure to properly disclose by the U.S. Owner of a foreign trust of the year-end value, the minimum penalty would be the greater of $10,000 or 5% of the amount that should have been reported. This provision is effective for notices and returns required to be filed after December 31, 2009.

Foreign Financial Assets

U.S. Taxpayers who hold any interests in specified foreign financial assets during the tax year must attach their tax returns for the year certain information with respect to each asset if the aggregate value of all assets exceeds $50,000. An individual who fails to furnish the required information is subject to a penalty of $10,000. An additional penalty may apply if the failure continues for more than 90 days after a notification by the IRS to a maximum of $50,000. The penalty may be avoided if the Taxpayer shows a reasonable cause for the failure to comply.

The Joint Committee on Taxation, Technical Explanation of the Hiring Incentives to Restore Employment Act (JCX-4-10) clarifies that although the nature of the information required to be disclosed is similar to the information disclosed on an FBAR, it is not identical.

For example, a beneficiary of a foreign trust who is not within the scope of the FBAR reporting requirements because his interest in the trust is less than 50%, may still be required to disclose the interest with his tax return if the $50,000 value threshold is met. In addition, this provision is not intended as a substitute for compliance with the FBAR reporting requirements, which remain unchanged.

For purposes of IRC Code §6038(D) as added by the HIRE Act, a specified foreign financial asset includes:

1. Any depository, custodial, or other financial account maintained by a foreign financial institution, and

2. Any of the following assets that are not held in an account maintained by a financial institution:
a. Any stock or security issued by a person other than a U.S. Person
b. Any financial instrument or contract held for investment that has an issuer or counterparty other than a U.S. Person, and
c. Any interest in a foreign entity (IRC §6038(D)(b) as added by the 2010 HIRE Act).

The information required to be disclosed with respect to any asset must include the maximum value of the asset during the tax year (IRC §6038(D)(c) as added by the 2010 HIRE Act).

For a financial account, the Taxpayer must disclose the name and address of the financial institution in which the account is maintained and the number of the account.

In the case of any stock or security, the disclosed information must include the name and address of the issuer and such other information as is necessary to identify the class or issue of which the stock or security is a part.

In the case of any instrument, contract, or interest, a Taxpayer must provide any information necessary to identify the instrument, contract, or interest along with the names and addresses of all issuers and counterparties with respect to the instrument, contract, or interest.

Under these rules, a U.S. Taxpayer is not required to disclose interests held in a custodial account with a U.S. financial institution. In addition, the U.S. Taxpayer is not required to identify separately any stock, security instrument, contract, or interest in a disclosed foreign financial account.

An individual who fails to furnish the required information with respect to any tax year at the prescribed time and in the prescribed manner is subject to a penalty of $10,000 (IRC §6038(D)(d) as added by the 2010 HIRE Act). If the failure to disclose the required information continues for more than 90 days after the day on which the notice was mailed (from the Secretary of Treasury), the individual is subject to an additional penalty of $10,000 for each 30-day period (or a fraction thereof) with the maximum penalty not to exceed $50,000.

In addition to the $10,000 penalty (up to $50,000) under IRC §6038(D) a 40% accuracy-related penalty is imposed on any understatement of tax attributable to a transaction involving an undisclosed foreign financial asset.

The statute of limitations for omission of gross income attributable to foreign financial assets (omission of gross income in excess of $5,000 attributable to a foreign financial asset), is extended to six years.

The IRC §6038(D) penalties are not imposed on any individual who can show that the failure is due to reasonable cause and not willful neglect. (IRC §6038D(g), as added by the 2010 HIRE Act.)

The information disclosure with respect to foreign financial assets supplements the FBAR reporting regime. The HIRE Act broadens reporting requirements and extends the rules to ownership of foreign assets such as foreign stocks, securities, interests in foreign companies not covered by the FBAR reporting. The threshold reporting requirement amount for FBARs ($10,000) is increased to $50,000. While the FBAR reporting covers those having signatory or other authority, the new reporting regime focuses on ownership

IRS Form 8938: Statement of Specified Foreign Financial Assets

“FATCA” Tax Reporting

Under the Foreign Account Tax Compliance Act (“FATCA”) for tax years beginning after March, 18, 2010, specified persons (i.e. U.S. Citizens, resident aliens), who have an ownership interest in specified foreign financial assets (i.e. foreign financial accounts, foreign stock, any interest in a foreign entity) must file Form 8938 (attached to their form 1040 tax return) if the value of the foreign financial assets exceeds applicable “reporting threshold”.

The value of a specified foreign financial asset, for Form 8938 reporting purposes is the asset’s fair market value.

For Individuals: more than $50,000 on the last day of the tax year, more than $75,000 at any time during the tax year. If living abroad; $200,000 on the last day of the tax year or more than $300,000 at any time during the tax year.

For Married Taxpayers: more than $100,000 on the last day of the tax year, more than $150,000 at any time during the tax year, if living abroad: $400,000 on the last day of the tax year, or more than $600,000 at any time during the tax year.

The IRS anticipates issuing regulations that will require domestic entity to file Form 8938, if it holds specified foreign financial assets whose value exceeds the applicable reporting threshold. Until the IRS issues such regulation, only individuals must file Form 8938.

Foreign Trusts
The value of an interest in a foreign trust, during the tax year, (if taxpayer doesn’t know its fair market value is the Maximum Value of the interest in the foreign trust calculated as the sum of the following amounts:

1. The value of all of the cash (or other property) distributed during the tax year from the trust to the beneficiary, plus

2. The value (using the IRC§7520 Valuation Tables) to receive mandatory distributions as of the last day of the tax year;

Foreign Grantor Trusts
A U.S. Taxpayer, who is the owner of a foreign grantor trust, does not have to report specified financial assets, held by the trust if:

1. The US Taxpayer reports the trust on a timely filed form 3520 for the same tax year;

2. The trust timely files Form 3520-A (Annual Information Return of Foreign Trust with a U.S. owner) for the same tax year;

3. Taxpayer identified on form 8938 how many of these forms they filed.

Specified Foreign Financial Assets

Foreign financial accounts include any depository (or custodial) account maintained by a foreign financial institution, any equity or debt interest in a foreign financial institution including any financial account maintained by a financial institution organized under the laws of a U.S. possession (America Samoa, Guam, The Northern Mariana Islands, Puerto Rico or the U.S. Virgin Islands)

A foreign financial institution is any financial institution that is not a U.S. entity, and satisfies one of the following conditions:

1. It accepts deposits;

2. It holds financial assets for the account of others;

3. It is engaged in the business of investing or trading in securities, partnership interests, or commodities;

4. It includes investment vehicles such as foreign mutual funds, hedge fund and private equity funds.

Interests in Specified Foreign Financial Assets

A U.S. Taxpayer:

1. Has an interest in a specified financial asset if any income, gains, losses, deductions, credits, gross proceeds, or distribution from asset dispositions is required to be reported on U.S. income tax returns;

2. Who is the owner of a disregarded entity, has an interest in any specified foreign financial assets owned by the disregarded entity;

3. Who has an interest in a financial account that holds specified foreign financial assets, do not have to report the assets held in the account;

4. Does not own an interest in any specified foreign financial asset held by a partnership, corporation or estate, as a result of their status as a partner, shareholder or beneficiary;

5. Who is the owner, under the grantor trust rules of any part of a trust, has an interest in any specified foreign financial asset held by that part of the trust;

6. Does not have an interest in a foreign trust or a foreign estate specified foreign financial asset, unless they know (or have reason to know) of the interest. If they receive a distribution from the foreign trust or foreign estate, they are considered to know of the interest.

Exceptions to Tax Reporting (Form 8938)
U.S. Taxpayers do not have to report a specified foreign financial asset on Form 8938:

1. If the financial account is maintained by a U.S. payer which includes: a U.S. financial institution, a domestic branch of a foreign bank or insurance company, a foreign branch or subsidiary of a U.S. financial institution;

2. If the U.S. Taxpayer reports the specified foreign financial asset on timely filed IRS forms:
a. Form 3520: Annual Return to Report Transactions with Foreign Trusts and Receipt of certain foreign Gifts
b. Form 5471: Information Return of U.S. Persons with Respect to Certain Foreign Corporations
c. Form 8865: Return of U.S. Persons with Respect to Certain Foreign Partnerships

Civil Penalties (Form 8938)

1. Failure to File Penalty: A penalty of $10,000 for each 30 day period not filed, (within 90 days after the IRS notifies of the failure to file) after the 90 day period has expired, up to $50,000 maximum penalty.

2. Accuracy-Related Penalty: A 40% penalty on a tax underpayment as a result of an undisclosed specified foreign financial asset.

3. Fraud: A 75% penalty on a tax underpayment, due to fraud.

Criminal Penalties (Form 8938)

Criminal penalties may be imposed for:
1. Failure to file Form 8938;
2. Underpayment of tax;
3. Failure to report asset.

Statute of Limitations

1. For failure to file Form 8938, failure to report a specified foreign financial asset, the statute of limitations remains open until 3 year after the date Form 8938 is filed.

2. For failure to include in gross income, an amount relating to one or more specified foreign financial assets, and the amount omitted in more than $5,000, any tax owed for the tax year, can be assessed at any time within 6 years after the tax return is filed.

Foreign Financial Institutions

U.S. Source Income (U.S. Accounts)
Under the new law with respect to each U.S. account (any financial account held by one or more specified U.S. persons or U.S. owned foreign entities (IRC §1471(d)(1)(A)), the foreign financial institution must provide information about account gross receipts and withdrawals.

U.S.-Source investment income is subject to U.S. information reporting and tax withholding.

Every person engaged in a trade or business in the United States must file with the IRS a Form 1099 information return for payments totaling at least $600 that it makes to a U.S. Person in the course of its trade or business (IRC §6041).

To avoid 28% back-up tax withholding (IRC §3406), a U.S. Person must furnish the payor with Form W-9 establishing that the payee is a U.S. Person (T.R. §32.3406(d)-1 and T.R. §32.3406(h)-3).

The combination of Form 1099 tax reporting and 28% back-up tax withholding is intended to ensure that U.S. Persons pay tax on investment income.

U.S. source income amounts, paid to foreign persons, are exempt from Form 1099 information reporting because they are subject to non-resident withholding rules.

A non-resident investor who seeks withholding tax relief for U.S. source investment income must provide certification on the appropriate IRS Form W-8 to the withholding agent to establish foreign status and eligibility for an exemption or reduced tax rate.

A withholding agent making payments of U.S. source amounts to a foreign person is required to report the payments, including any U.S. tax withheld, to the IRS on Forms 1042 and 1042-S by March 15th of the year following the year that the payment is made (T.R. §1.1461-1(b) and (c)). If the withholding agent withholds more than is required, the payee may file a claim for refund.

A non-financial foreign entity that is a beneficial owner of a withholdable payment must certify that it has no substantial U.S. owners or provide identifying information for each substantial U.S. owner.

Withholding Agents

The Foreign Account Tax Compliance Act (The "Act") expands withholding rules and additional reporting requirements for foreign financial institutions and non-financial foreign entities.

Under U.S. tax law, a withholding agent must deduct or withhold a tax equal to 30% on any withholdable payment (e.g., interest, dividends, rents, salaries, wages, premiums, annuities, compensations, and other fixed or determinable annual or periodical gains, profits and income from sources within the United States) made to a foreign financial institution or to a non-financial foreign entity (unless specific reporting requirements are met).

For each U.S. account maintained by the foreign financial institution, the institution must provide identifying information for each account holder that is a specified U.S. Person or substantial U.S. owner, the account number, the account balance, and gross receipts and withdrawals from the account.

A non-financial foreign entity that is a beneficial owner of a withholdable payment must certify that it has no substantial U.S. owners or provide identifying information for each substantial U.S. owner.

Every person required to deduct or withhold any tax to enforce reporting on certain foreign accounts is liable for the tax and is indemnified against claims and demands of anyone for the amount of the payments. (IRC §1474(a), as added by the 2010 HIRE Act.)

Six-Year Statute of Limitations

Under the new law, the statute of limitations is extended to six years if there is an omission of gross income in excess of $5,000 and the omitted gross income is attributable to a foreign financial asset.

Taxes are generally required to be assessed within three years after a Taxpayer's return was filed, whether or not it was timely filed. A special rule extends the three-year limitation period in the case where there is a substantial omission of income.

If a Taxpayer omits substantial income on a return, any tax with respect to that return may be assessed and collected within six years of the date on which the return was filed.

In the case of income taxes, there is a substantial omission of income if the Taxpayer omits from gross income an amount that was properly includible in gross income and that is in excess of 25% of the amount stated on the return.

The state of limitations period will be suspended if the Taxpayer failed to timely provide information with respect to foreign financial assets required to be reported. The limitation period will not begin to run until the information required has been furnished to the IRS.

The new six-year statute of limitations applies not only to returns filed after March 18, 2010 on which the Taxpayer fails to report income in excess of $5,000 attributable to foreign financial assets, but also to returns filed on or before the date for which the statute of limitations is still open on March 18, 2010 (Act §513(d) of the HIRE Act [PL 111-147]).

For example, a 2006 tax return (filed in 2007), on which the Taxpayer failed to report more than $5,000 of income attributable to a foreign financial asset and which is otherwise subject to the three-year limitations period, will be subject to the new six-year statute of limitations.

HIRE Foreign Account Tax Compliance: 40% Penalty

The HIRE Act gives the IRS assessment and collection remedies unavailable with respect to the FBAR penalty.

A 40% accuracy-related penalty is imposed for underpayment of tax attributable to transactions involving undisclosed foreign financial assets. Undisclosed foreign financial assets include foreign financial assets that are subject to information reporting but the required information was not provided by the Taxpayer.

The 40% accuracy-related penalty is imposed for underpayment of tax that is attributable to an undisclosed foreign financial asset understatement (IRC §6662(b)(7) and (j) as added by the HIRE Act 2010). An undisclosed foreign financial asset understatement for any tax year is the portion of the understatement for the year that is attributable to any transaction involving an undisclosed foreign financial asset.

In contrast to the FBAR penalty, which is limited to collection through the U.S. Financial Management System (which collects non-tax debts for the government), the HIRE Act penalties give the IRS the ability to assess and collect these new penalties through its administrative powers (including tax levy and tax lien).

The new penalties under the HIRE Act are for the understatement of tax and impose a lesser burden of proof and threshold for imposition of the penalty than the willful FBAR penalty.

Penalty for Failure to Report

The minimum amount of penalty for failure to report information or file returns for foreign trusts is increased to $10,000.

If any notice or return required to be filed under IRC §6048 is not filed on or before the due date, or does not include all the information that is required, or includes incorrect information, then the person required to file such notice or return must pay a penalty equal to the greater of:
1. $10,000, or
2. 35% of the gross reportable amount (5% for U.S. Persons treated as owners of the trust) (IRC §6677(a), as amended by the 2010 HIRE Act).

Prior to these revisions, the penalty for failure to provide the required information or file a return with respect to certain foreign trusts was 35% of the gross reportable amount (5% for U.S. Persons treated as owners of the trust).

With the new minimum amount, the IRS will be able to impose a $10,000 penalty even when there is not enough information to determine the gross reportable amount.

The maximum amount of the penalty has changed. The penalty for failure to report information or file a return with respect to certain foreign trusts cannot exceed the gross reportable amount (IRC §6677(a)).

To the extent that the aggregate amount of penalties exceeds the gross reportable amount, the IRS must refund the excess to the Taxpayer (IRC §6677(a), as amended by the 2010 HIRE Act).

Uncompensated Use of Foreign Trust Property

The uncompensated use of foreign trust property by a U.S. Grantor, a U.S. Beneficiary, or a U.S. Person related to either of them is treated as a distribution by the trust for non-grantor trust income tax purposes (which also includes the loan of cash or marketable securities by a foreign trust or the use of any other property of the trust).

The distribution treatment of foreign trust transaction has been expanded to include the uncompensated use of property by certain U.S. Persons. The treatment of foreign trusts as having U.S. beneficiaries for grantor trust purposes has been expanded to include loans of cash or marketable securities or the use of any other trust property to or by a U.S. Person.

If a foreign trust permits the use of any trust property by a U.S. Grantor, a U.S. Beneficiary, or any U.S. Person related to either of them, the fair market value of the use of such property is treated as a distribution by the trust to the Grantor or Beneficiary (IRC §643(i)(1), as amended by the 2010 HIRE Act).

This treatment does not apply to the extent that the trust is paid the fair market value of such use within a reasonable time (IRC §643(i)(2)(E), as added the 2010 HIRE Act). If distribution treatment does apply to the use of trust property, the subsequent return of such property is disregarded for federal tax purposes (IRC §643(i)(3), as amended by the 2010 HIRE Act).

Foreign Trusts Treated as Having U.S. Beneficiaries

For purposes of treating a foreign trust as a grantor trust, there is a rebuttable presumption that the trust has a U.S. beneficiary if a U.S. Person transfers property to the trust. An amount is treated as accumulated for a U.S. Person even if that person has a contingent interest in the trust.

A foreign trust is treated as having a U.S. beneficiary if any person has discretion to make trust distributions, (unless none of the recipients are U.S. Persons). An amount will be treated as accumulated for the benefit of a U.S. Person even if that person's interest in the trust is contingent on a future event (IRC §679(c)(1) as amended by the 2010 HIRE Act).

If any person has the discretion (by authority given in the trust agreement, by a power of appointment or otherwise, of making a distribution from the trust to or for the benefit of any person), the trust will be treated as having a beneficiary who is a U.S. Person, unless the trust terms specifically identify the class of person to whom such distribution may be made and none of those persons are U.S. Persons during the tax year (IRC §679(c)(4) as added by the 2010 HIRE Act).

If any U.S. Person who directly or indirectly transfers property to the trust is directly or indirectly involved in any agreement or understanding that may result in trust income or corpus being paid or accumulated to or for the benefit of a U.S. Person, that agreement or understanding will be treated as a term of the trust (IRC §679(c)(5) as added by the 2010 HIRE Act). The agreement or understanding may be written, oral or otherwise.

The provision creating a rebuttable presumption allowing the IRS to treat a foreign trust as having a U.S. beneficiary if a U.S. person directly or indirectly transfers property to the trust applies to transfers of property after March 18, 2010. (Act Section 532(b) 2010 HIRE Act.)

Reporting Requirements for U.S. Persons Treated as Owners of a Foreign Trust

A U.S. Person who is treated as the owner of any portion of a foreign trust under the grantor trust rules, must submit any information required by the IRS with respect to the foreign trust (in addition to the current requirement that such U.S. Persons are responsible for insuring that a foreign trust complies with his own reporting obligations) (see IRC§6048(b)(1), as amended by the 2010 HIRE Act). This requirement to supply information about the trust applies to tax years beginning after March 18, 2010 (Act §534(b) of the 2010 HIRE Act).

The current reporting obligations of the foreign trust include making a return for the year and providing certain information to each U.S. Person who is treated as the owner of any portion of the trust, or who receives a direct or indirect distribution from the trust (IRC §6048(b)(1)(A) and (B)).

FATCA/Foreign Financial Institutions

The task of gathering the information will be borne by the banks and financial institutions who are seeking to pass the cost of FATCA compliance on to their customers. The U.S. and the respective countries will focus on tax transparency and seek to find out where these taxpayers are hiding their unreported money.

FATCA contains two principal operative provisions, one applying to “Foreign Financial Institutions” (“FFIs”) and the other to all other foreign entities receiving payments from U.S. sources, either on their own behalf or acting as an intermediary. FFIs and other foreign entities that receive payments from U.S. sources under the provisions of FATCA (signed into law March 2010, under the “HIRE Act”) are being compelled to promote compliance with U.S. law requiring the U.S. persons to report income from non-U.S. accounts.

“Foreign Financial Institutions” are defined to include any entity not resident in a U.S. state or possession that:

1. Accepts deposits in the ordinary course of a banking or similar business;

2. Engages in the business of holding financial assets for the account of others; or

3. Engages primarily in the business of investing, re-investing or trading in securities, partnership interests, commodities or any interests in securities, partnerships or commodities.

Foreign Financial Institutions – U.S. Tax Withholding

Any “withholdable payment” by a U.S. withholding agent to any FFI would be subject to 30% tax withholding unless the FFI enters into a reporting agreement with the IRS.

“Withholdable payments” include:

1. U.S. source investment income;

2. U.S. source proceeds from the sale of any property “of a type which can produce interest or dividends”;

3. While gains from the sale of property are generally not includable in U.S. income, for non-residents FATCA subjects sale proceeds to withholding.

FFIs may avoid U.S. tax withholding if they execute an IRS agreement, under which they would be required to:

1. Obtain information regarding each holder of each account maintained by the FFI to determine which accounts are U.S. accounts and comply with IRS' verification and due diligence procedures;

2. Annually report information with respect to any U.S. account held at the FFI;

3. Deduct and withhold 30% of any "pass thru payment" to a 'recalcitrant account holder' or FFI not subject to an agreement (or elect to be withheld upon);

4. Comply with IRS information requests;

5. If under FFI's domestic law, the FFI would be prohibited from reporting the required interaction, the FFI must obtain a waiver of such prohibition or lose the account.

FFIs that are subject to an agreement and are required to report the name, address and TIN of account holders include:

1. Any specified U.S. person included in the account (i.e. any U.S. resident with the exception of publicly-traded corporations, banks, R.E.I.T.s and RICs).

2. A "substantial U.S. owner" (i.e. any person owning more than a 10% interest in any entity) or in case of payees primarily in the business of trading, anyone who owns any interest in the entity, including a profits-only interest.

Non-FFIs

A payee of U.S. source income who is a non-FFI is not permitted to enter into an IRS non-withholding agreement.

A withholding agent is required to withhold 30% of any withholdable payment to a non-FFI, regardless of whether the payee is the beneficial owner of the payment.

To avoid withholding, the payee would either have to:

1. Certify that the beneficial owner of any payment have no "substantial U.S. owners", or
2. Provide the name, address and TIN of each beneficial owner.

3. Report to the IRS all payee information received.

Exceptions to withholding:
1. Beneficial owners that are publicly traded;
2. Certain members of affiliated groups;
3. Residents of U.S. possessions.

The withholding agent would have to withhold if the agent has any reason to know any payee certifications or representations are false.

FATCA Effective Dates

Most FATCA requirements would apply to payments made after 12/31/12.

On 4/8/11, the IRS issued FATCA guidance instructing FFIs on the steps required for them to identify U.S. accounts among their existing account holders.

The 4/8/11 notice includes:

1. "A private banking test" for private bankers to attempt to find U.S. connections among account holders.

2. Details on the definition of pass-through payments.

3. Provides for a certification process for "deemed compliant" FFIs.

4. Provides that FFIs have to report only year-end balances to the IRS, and does not have to report basis on investment transactions.

In IRS Notice 2011-76, the IRS provided a new timeline whereby FFIs have until 6/30/13 to enter into a FATCA agreement with the IRS, and they will not be required to report on U.S. account holders until 2014.

On 2/8/12 the IRS issued additional FATCA guidance, including an agreement among the U.S., France, Germany, Italy, Spain, Switzerland and the UK to cooperate on implementing FATCA and arranging an automatic bilateral information exchange with the U.S. through the existing treaty structure.

The information sharing arrangement takes one of two forms:
1. FFI to U.S. government direct, or
2. FFI to foreign government and then to U.S. government.

FATCA Information Disclosure

U.S. taxpayers (individuals, not corporations, partnerships, or limited liability companies) are required to attach Form 8938: Statement of Specified Foreign Financial Assets to their Form 1040 tax returns if the aggregate value of such assets is greater than $50,000.

Specified Foreign Financial Assets include: depository or custodial accounts at FFIs, stocks or securities issued by foreign persons, a financial instrument or contract held for investment issued by a foreign country or party and any interest in a foreign entity.

The civil penalty for failure to supply this information is $10,000 with an additional $10,000 penalty up to a maximum of $50,000, after notice from the IRS (IRC Sec. 6038D(g).

Any understatement of tax attributable to an undisclosed foreign asset is subject to a 40% penalty (IRC Sec. 6662(j)).

Statute of Limitations

FATCA (IRC Sec. 6501(c)(8)(e) extends from three years to six years the period of assessment for understatements attributable to failure to report foreign accounts on the date such information is actually provided to the IRS.

When a taxpayer fails to report certain foreign asset information, the statute is tolled for a period including the taxpayer’s non-compliance plus three years; the extended statute applies to the taxpayer’s entire tax return, not just to foreign assets. This provision is effective for any year open on the date of enactment (March 2010) and to returns filed after enactment.

FATCA Foreign Trusts

FATCA clarifies foreign trust reporting as follows:

1. An amount is treated as accumulated for the benefit of a U.S. beneficiary of a foreign grantor trust even if the U.S. beneficiary’s interests are contingent on a future event (IRC Sec. 679(c)(10).

2. If any person, such as a trustee or protector, has the power to add beneficiaries, the trust shall be considered to have U.S. beneficiaries unless a specific list is provided and no beneficiary is a U.S. person (IRC Sec. 679(c)(4).

3. Any agreement or understanding, such as a letter of wishes, may result in a U.S. person benefiting from the trust, and will be considered a trust term (IRC Sec. 679(c)(5).

4. It imposes new reporting requirements on any U.S. person treated as an owner of any portion of a foreign trust and creates a presumption that a foreign trust has a U.S. beneficiary, unless the beneficiary submits information that no part of the income or corpus of the trust may be paid or accumulated for the benefit of a U.S. person, and if the trust were terminated during the taxable year, no part of the income or corpus could be paid for the benefit of a U.S. person (IRC Sec. 679(d)).

5. Cash and securities, if provided or loaned to a beneficiary, are considered distributions, the fair market value of any use of property owned by the trust, such as real estate, is treated as a trust distribution (IRC Sec. 643(i)).