

**Foreign Account Tax
and Compliance
Aspects of the Newly
Enacted “Hiring
Incentives to Restore
Employment” Act of
2010**

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CAVEAT

The information contained herein is provided for informational purposes only and is not intended to constitute the rendition of legal advice. No person should act upon this information without obtaining the opinion of United States legal counsel specializing in the area of international taxation.

Foreign Account Tax and Compliance Aspects of the Newly Enacted “Hiring Incentives to Restore Employment” Act of 2010

- **INCREASED DISCLOSURE OF BENEFICIAL OWNERS**
- **FOREIGN FINANCIAL ASSET REPORTING**
- **ENHANCED FOREIGN INVESTMENT COMPANY REPORTING**
- **PROVISIONS RELATED TO FOREIGN TRUSTS**
- **DIVIDEND EQUIVALENT PAYMENTS**
- **THE FOREIGN TRUST AUDIT**

Resident/Nonresident Domiciliary/Nondomiciliary

- RESIDENT
- DOMICILIARY



Why is he frowning?

- NONRESIDENT
- NONDOMICILIARY



Why is he smiling?

INCREASED DISCLOSURE OF BENEFICIAL OWNERS

Enforcement of Reporting Requirements

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

Reporting on Payments to Foreign Financial Institutions

- Thirty percent (30%) withholding tax will apply to income from U.S. financial assets held by a foreign financial institution unless the institution agrees to disclose the identity of U.S. account holders and to report annually on the account balance, gross receipts and gross withdrawals/payments from such accounts (generally effective for payments made after December 31, 2012).

Definitions

- United States Account
- Financial Account
- United States Owned Foreign Entity
- Foreign Financial Institution
- Recalcitrant Account Holder
- Passthru Payment

Reporting on Payments to Foreign Financial Institutions (Cont'd)

- As an alternative foreign financial institutions may make an election to report as if such financial institution were a U.S. person.
- These disclosure and reporting requirements apply in addition to any requirements imposed under the Qualified Intermediary program.

Reporting on Owners of Nonfinancial Foreign Entities

- The Act requires foreign entities to provide withholding agents with either a certification that the foreign entity does not have a substantial U.S. owner or the name, address and tax identification number of each substantial U.S. owner.
- 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 thirty percent (30%). Effective for payments made by December 31, 2012.

Changes in Bearer Bond Provisions

- Extend bearer bond tax penalties to such bonds marketed to offshore investors
- Foreign targeted obligations of the U.S. Treasury must be in registered form
- Repeal of treatment as portfolio interest

FOREIGN FINANCIAL ASSET REPORTING

Disclosure of Information With Respect to Foreign Financial Assets

- The Act requires any individual who holds more than \$50,000 (in the aggregate) in “specified foreign financial assets” to report information about them on a statement attached to the individual’s annual income tax return.
- Failures to comply with this requirement are subject to a penalty of \$10,000, and higher penalties (up to \$50,000) are imposed if the failure is not remedied within 90 days following notification from the Internal Revenue Service.

Penalties for Underpayments Attributable to Undisclosed Foreign Financial Assets

- The Act imposes a penalty equal to forty percent (40%) of the amount of any understatement of tax that is attributable to any transaction involving 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).

Modification of statute of limitations for significant underreporting of income in connection with foreign assets.

- The Act extends the six-year statute of limitations for omissions that exceed \$5,000 and are attributable to one or more specified foreign financial assets.
- The Act 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.

ENHANCED FOREIGN INVESTMENT COMPANY PROVISIONS

Passive Foreign Investment Company Reporting

- Under prior law, a shareholder of a passive foreign investment company (a "PFIC") was not required to file an information return with the Internal Revenue Service unless the shareholder recognized gain on the sale of PFIC stock, received a distribution from a PFIC or made reportable election.
- The Act requires each person who is a shareholder of a passive foreign investment company to file an annual report containing such information as the Secretary may require.
- Pursuant to Notice 2010-34, this new annual reporting requirement shall be effective for all tax years beginning on or after March 18, 2010.

PROVISIONS RELATED TO FOREIGN TRUSTS

Income Taxation of Trusts and Beneficiaries

- Grantor Trust
 - Person treated as owner of assets is treated as earning all current income (grantor trust does not have accumulated income)
- Non-Grantor Trust
 - Trust is separate taxable entity; beneficiaries are taxed on receipt of distributions of income and income required to be distributed (whether or not actually distributed)
- Foreign vs. Domestic
 - Accumulation Distributions from foreign trust subject to throwback rules – United States income tax and interest charge
 - Accumulated income loses character
- Controlled Foreign Corporations (“CFCs”) and Passive Foreign Investment Companies (“PFICs”)

Accounting Issues

- Trust's/Company's Year-end
- Cash basis versus accrual basis
- Historic cost, date of purchase and date of sale for assets sold
- Unrealized gain (loss) included in income statement
- Fair market value vs. historic cost balance sheet
- U.S. historic cost
- Accrued interest on bonds at time of purchase and sale
- PFIC income and gain
- Currency gain(loss)
- Currency conversion

Presumption with respect to transfers to foreign trusts

- Presumption that foreign trust has a U.S. beneficiary.
- Uncompensated Use of Trust Property Treated as a Distribution
- Reporting Requirement of United States Owners of Foreign Trusts

Minimum penalty with respect to failure to report on certain foreign trusts

- Increase of the minimum penalty with respect to failure to report on certain foreign trusts
- Amendment to the maximum penalty with respect to failure to report on certain foreign trusts

DIVIDEND EQUIVALENT PAYMENTS

Treatment of Dividend Equivalent Payments Received by Foreign Corporations in the Same Manner as Dividends

- Under prior law, dividend payments made to foreign investors were subject to withholding tax at a rate of thirty percent (30%) unless otherwise reduced by an applicable tax treaty.
- In order to avoid this withholding tax, foreign investors have entered into derivative transactions that provide them with dividend equivalent payments that are not subject to withholding.
- 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 United States 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 United States.

THE FOREIGN TRUST AUDIT

The Foreign Trust Audit

- A Trustee of a foreign trust should consider engaging our law firm to conduct an audit of the foreign trust if: (1) the settlor or a beneficiary of such trust is or becomes a United States taxpayer; or (2) such trust invests in United States situs property.
- The foreign trust audit will help the foreign trustee identify the United States tax and reporting issues that arise when the settlor or a beneficiary of such trust is becomes a United States taxpayer and/or in connection with an investment in United States situs property.
- If necessary, planning can take place to structure the funding of the foreign trust and the manner of structuring the investment holdings of the foreign trust to maximize its United States tax efficiency.

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