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Tax Letter

Continuation of the HIRE Act (also known as the Job Bill)

The HIRE Act (H.R. 2847) was passed by the House on 6-18-09, and by the Senate on 11-5-09. It was signed by Obama into law (Public Law No. 111-147) on 3-18-2010. The **HIRE Act**, also known as the **JOB Bill**, consisted of about 48 pages of written material. The portion devoted to hiring and job creation was only less than 8 pages. The balance of the material was primarily designed for actions to enhance the Highway Trust Fund, certain Public Transportation Programs, etc., **most importantly**, to increase tax and to attack everything related to "**Foreign**" .

Last month's tax letter we concentrated our attention to the name sake of this law – the HIRE Act or the Job Bill. In this letter, we will discuss the important points of the "Foreign" portion of the Bill.

I. Reporting of Foreign Accounts, Interest in Foreign Financial Assets.

(a) Before the new law: every U.S. person having financial interest in, or signature authority over any foreign bank accounts, foreign securities accounts, or other foreign financial accounts, and the aggregate amount exceeded $10,000, must make a report to the Department of Treasury on Form TD 90-22.1. Failure to report will subject the U.S. person to civil penalties up to 50% of the highest value in the account or the asset. Failure to include income, such as interest, dividend, gain and/or rent, generated from these foreign accounts and/or assets, penalties plus interest will be assessed by the IRS according to the tax code.

(b) Under the new law: in addition to the old provisions, effective 1/1/2011, any individual with an interest in one or more "specified foreign financial assets" during any time of a taxable year **must** attach a **disclosure statement** to their income tax return (i.e. Form 1040) for any taxable year when the aggregated value of all "specified foreign financial assets" exceed $50,000. Failure to provide complete information as required in a statement attached to their income tax returns will allow the IRS to automatically presume that the aggregated value exceed $50,000 and subject the taxpayer to heavy penalties (IRC Sec. 6038D).

"Specific foreign financial assets" are: (1) depository or custodial accounts at any foreign financial institutions, and (2) the amount not held in accounts at a financial institution, such as (a) stocks or securities issued by foreign persons, (b) any other financial instruments or contracts held for investment which were issued by non U.S. person(s), and (c) any interest in a foreign entity. (IRC Sec. 6038D)

II. Foreign Entity Withholding and Reporting:

(a) Before the new law: only foreign persons receiving US source "**FDAP**" income are required to be withheld by the payors (generally 30% which can be reduced to 15% or even zero based on tax treaties with the United States). "**FDAP**" income are **F**ixed, **D**eterminable, **A**nnually or **P**eriodically payable income, such as interest, dividend, etc.

However, interest on money deposited in banks, portfolio interest and capital gain on sales of properties including stocks are statutorily exempt from withholding requirement. Furthermore, the foreign recipients can prepared and provide Form W-8 to the US payor (sometimes referred to as withholding agent) to establish eligibility for an exemption from withholding or qualification for reduced withholding rate.

Annually, on or before March 15 of the following year, all payors (withholding agents) must prepare and file Form 1042 and/or 1042-S to the IRS to report all payment from US source to any foreign persons, whether the payments were subject to withholding or not.

(b) Under the new law: at least 4 new sections of the code were created and added to the Internal Revenue Code (IRC). They are IRC sections 1471 through 1474. These 4 sections are added to specifically target US citizens and US persons:

(i) Effective 1/1/2013, any US payor (withholding agent) must deduct and withhold 30% of any withholdable payment made to a **foreign financial entity.** To avoid this withholding requirement, the foreign financial entity must enter into an agreement with the IRS which stipulate that the foreign financial entity will report and disclose to the IRS information regarding accounts directly or beneficially owned by US persons. Annually report to the IRS information about the accounts, including names and identifying numbers of the US owners, account balances, gross deposits to and withdrawals from the accounts, etc. US person can be any US individual or any entity other than corporations whose stocks are regularly, publically traded on one of the established markets.

(ii) Effective 1/1/2013, any US payor (withholding agent) must deduct and withhold 30% of withholdable payment made to a **foreign non financial entity** having **s**ubstantial US owners or US beneficial owners**.** According to current standard, substantial US ownership could be one or more US persons holding, individually or collectively, 10% or more of the ownerships interest and/or voting power of the foreign non financial entity. Withholding could be avoided if the foreign non financial entity having substantial US ownership filed and reported to the IRS the name, address and taxpayer identification number of each US owners. Ownership could be indirectly and/or beneficially.

(iii) Withholdable Payments are defined as payments other than (1) US source FDAP income, (2) proceed from sales of properties that produce interest and dividend income, and (3) interest on money deposited with a foreign branch of a US commercial bank which could be considered as non US source income.

Further, withholding will not apply to any payment to an entity beneficially owned by a publicly traded corporation, foreign government and their political subdivisions, international organization such as Red Cross, etc., and any persons or entities specifically identified by the IRS.

C. Foreign Trusts:

(a) Before the new law: under current Treasury regulations, a US person transferring money and/or property to a foreign trust having one or more US beneficiaries is treated as the owner of the money or property so transferred. Further, a foreign trust is treated as having a US beneficiary, if any current beneficiary, future and/or contingent beneficiary of the foreign trust is or will be a US person. Any foreign trust having US beneficiary must annually file an information return disclosing any transaction involving the creation of the foreign trust, the transfer of money or property to and/or from a foreign trust, and the death of a US beneficiary or US owner of the foreign trust. Penalty for failure to file such an information return is 35% of the amount required to be disclosed on such a return.

(b) Under the new law: to enhance enforcement of the reporting requirement, effective immediately the new law codified the Treasury regulations into Statutory Law. The new law also clarifies that a foreign trust will be treated as having one or more US beneficiaries 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 are US persons, or (2) any written, orally or other agreement which could result in a beneficiary of the trust being a US person. In addition, the new law further stated that any use of any trust property will be treated as a payment from the trust to the user of the property in the amount of the fair market value of such use.

The new law established a minimum $10,000 penalty for failure to file the required information return, if for whatever reason, the 35% penalty for failure to file could not be determined by the IRS.

D. Other Disclosure and Reporting Requirement:

(a) Effective immediately, activities with respect to PFIC (Passive Foreign Investment Company) are subject to a new reporting rule. Unless otherwise exempted, each US person who is a shareholder of a PFIC must file an annual information return containing all the required information to the IRS. A specific form for this purpose **may be** designed and made available by the IRS.

A PFIC is defined as any foreign corporation that derives at least 75% of its total gross income from passive investments, or at least 50% of its total assets are held for the production of passive income (IRC Sec. 1297).

In addition to the above described information return, a US person who is required to attached a disclosure statement to their income tax returns, i.e. Form 1040, must also attach such disclosure statement. The above information return is not a substitute of the required disclosure statement.

(b) Effective 180 days after the enactment date, all “dividend equivalents” will be treated as dividends subject to withholding and reporting rules. A “dividend equivalent” is any substitute payment made pursuant to a security lending, sale-repurchase transaction or under a specified notional principal contract that, directly or indirectly, is contingent upon or determined by reference to the payment of dividend from sources within the US. Accordingly, the IRS may conclude that payments under certain forward contracts or financial contracts that reference to stocks of US corporations are “dividend equivalents”.

Any questions and follow-up discussions, please give us a call at 415-381-0681 or visit us at our web site: chochan.com.

Sincerely

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