Tax Extenders Bill Would Implement New Withholding and Information Reporting Requirements for Foreign Financial Institutions

On December 9, 2009, the House passed H.R. 4213, the "Tax Extenders Act of 2009" ("Extenders Act"). The Extenders Act would extend, for 1 year, forty-nine tax provisions currently scheduled to expire at the end of 2009, including the section 199 research credit, the active financing exception to Subpart F, and the Subpart F look-through rule (section 954(c)(6)). To offset the $31 billion cost of extending the forty-nine tax provisions, the Extenders Act would tax carried interests as ordinary income and create new information reporting and withholding requirements for payments to foreign financial institutions. The Obama Administration has stated that it "strongly supports" passage of the Extenders Act, "commend[ing] the House for paying for this job-creating legislation in a fiscally-responsible manner that is consistent with other legislative priorities including health care. The legislation would fulfill the Administration's commitment to crack down on overseas tax havens and put a stop to billions of dollars worth of tax abuse and would end the special preferential tax treatment for carried interest income." The carried interest offset in the Extenders Act is likely to face considerable opposition in the Senate.

The information reporting and withholding provisions in the Extenders Act are modified versions of those included in the "Foreign Account Tax Compliance Act of 2009" ("FATCA"), which was introduced October 27, 2009 by Senate Finance Chairman Baucus (D-MT), Senate Finance member John Kerry (D-MA), Ways & Means Chairman Rangel, and Ways & Means Select Revenue Subcommittee Chairman Richard Neal (D-MA). The modifications appear intended to address several of the concerns expressed by the financial industry regarding the effective date of several FATCA provisions and the anticipated compliance burden of those provisions. Several of the most significant information reporting and withholding provisions of the Extenders Act, as well as the differences the Extenders Act and FATCA, are summarized below.

The Extenders Act would require 30% withholding on payments of U.S. source interest, dividends, salaries, wages, premiums, and certain other amounts, notably including gross proceeds from the sale of securities that could produce U.S. source interest or dividends, to a "foreign financial institution," unless the foreign financial institution entered into an agreement with the Internal Revenue Service ("IRS") to obtain and report certain information regarding its U.S. account holders.

The information reporting and withholding provisions of the Extenders Act would apply to banks as well as investment vehicles, hedge funds, and private equity funds. The term "financial institution" is defined in the Act as entity that (1) accepts deposits in the ordinary course of a banking or similar business, (2) is engaged in the business of holding financial assets for the account of others, or (3) is engaged (or holds itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interest in such securities, partnership interests, or commodities. The Joint Tax Committee ("JCT") explanation of the Extenders Act also states that "It is anticipated that the Secretary may prescribe special rules addressing the circumstances in which certain categories of companies, such as insurance companies, are financial institutions, or the circumstances in which certain

accounts or policies, such as policies written by insurance companies, are financial accounts or United States accounts for these purposes."

To avoid 30% withholding, a foreign financial institution would be required to enter into an agreement with the IRS under which the institution agrees to:

- Obtain information from each accountholder "as is necessary" to determine which, if any, of such accounts are U.S. accounts;

- Comply with such verification and due diligence procedures "as the [IRS] may require" with respect to the identification of U.S. accounts;

- Comply "with requests by the [IRS] for additional information" with respect to any U.S. account maintained by such institution;

- In any case in which any foreign law would (but for a specified waiver) prevent the reporting of certain required information, (i) attempt to obtain a valid and effective waiver of such law from each account holder of such account, and (ii) if a waiver is not obtained, close the account; and

- In the case of any U.S. account maintained by such institution, to report on an annual basis (at such time and in such manner as the IRS may provide) certain information, including the name, address, and tax identification number of each U.S. account holder, the account number, the account balance or value, and the gross receipts and gross withdrawals or payments from the account.

According to the JCT explanation of the Extenders Act, "[t]he Secretary may use existing know-your-customer, anti-money laundering, anti-corruption, and other regulatory requirements as a basis in crafting due diligence and verification procedures in jurisdictions where those requirements provide reasonable assurance that the foreign financial institution is in compliance [with the information reporting rules]." Accordingly, under the Extenders Act information reporting and withholding provisions, existing procedures and requirements could be adequate to satisfy the due diligence and verification requirements. In contrast, the JCT explanation of FATCA suggested that additional procedures would need to be undertaken: "Due diligence could include procedures required by the foreign financial institution to ensure compliance with the agreement. Verification could include independent review procedures to ensure a foreign financial institution's compliance with its obligations under this provision."

The Extenders Act also would require foreign financial institutions to withhold 30% of any "passthru payment" (a withholdable payment or a payment attributable to a withholdable payment) to an account holder who has failed to comply with requests for information or has failed to provide a waiver allowing the reporting of information (a "recalcitrant account holder") or another foreign financial institution that has not entered into an agreement with the IRS (a "nonparticipating financial institution"). A foreign financial institution may, however, elect to be subject to withholding on payments received (rather than to withhold on payments made) to the extent a payment is allocable to accounts held by recalcitrant account holders or nonparticipating financial institutions.

Unlike FATCA, the Extenders Act provides that a foreign financial institution may be deemed by the IRS to meet the information reporting requirements described above if the financial institution meets certain requirements and follows certain procedures to be prescribed by the IRS. According to the JCT explanation of the Extenders Act, "it is anticipated that the Secretary may provide rules that would permit certain classes of widely held collective investment vehicles to be deemed to meet the requirements of this provision."

Under the Extenders Act, the new information reporting and withholding requirements described above would be effective for payments made after December 31, 2012. Under FATCA, the requirements would have applied to payments made after December 31, 2010.

The Extenders Act includes several other modified FATCA provisions in addition to the information reporting and withholding requirements described above, including:

- Repeal of foreign-targeted exceptions to registered bond requirements, which would take effect two years after the bill is enacted (rather than 180 days after enactment, as in FATCA);
- Required disclosure of information with respect to foreign financial accounts and certain other foreign investments on what is now being colloquially referred to as the "Title 26 FBAR;"
- Additional PFIC reporting requirements;
- Presumptions that certain foreign trusts have U.S. beneficiaries;
- Additional foreign trust reporting requirements; and
- Treatment of "substitute dividends" and "dividend equivalent" payments received by foreign persons as dividends from sources within the United States.