SUTHERLAND

LEGAL ALERT

March 18, 2010

FATCA Proposed Legislation Enacted as Part of HIRE Act

On March 18, 2010, the President signed into law the Hiring Incentives for Restoring Employment Act (H.R. 2847) ("HIRE Act"), which incorporated the anti-avoidance revenue provisions previously contained in the proposed Foreign Account Tax Compliance Act ("FATCA"). While the goal of the FATCA provisions in the HIRE Act is to prevent U.S. persons from hiding their identities behind foreign corporations, trusts, foundations, and other types of foreign entities, those provisions potentially will have a far-reaching effect on both U.S. payors and the foreign recipients of covered amounts. (For prior discussions of the FATCA provisions, see the following Sutherland Legal Alerts: December 11, 2009; November 10, 2009.)

Generally, the FATCA provisions of the HIRE Act will require 30% withholding on payments of specified amounts made to certain foreign entities if the owners of "United States accounts" in such entities are not identified by the foreign entities. The HIRE Act, like the proposed FATCA legislation, also generally repeals the exceptions to the registration requirement for bearer bonds, which means that interest paid on bearer bonds issued after the effective date generally will not be deductible by the issuer and will be subject to a 30% withholding tax unless the recipient can qualify for an exemption other than the portfolio interest exemption (*e.g.*, treaty benefits).

Mechanically, the final FATCA provisions work in the same manner as the proposed legislation, although some changes were made in the legislative process. The legislation as enacted will apply only to payments made after December 31, 2012, and a new grandfather provision exempts payments made on, or proceeds from the disposition of, obligations that are "outstanding" two years after the date of enactment. However, the Joint Committee Staff Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3310 (Feb. 23, 2010) ("JCTE") states that the IRS may provide guidance on the application of the material modification rules under section 1001 of the Code in determining whether an obligation is considered to be outstanding on the date that is two years after enactment. It is likely that these special rules will limit what is considered to be outstanding for purposes of the FATCA provisions.

The most significant unanswered question under the enacted FATCA rules is the scope of the definitions of the terms "foreign financial institution," "non-financial foreign entity," and "U.S. account," as discussed in our prior Legal Alerts. In this regard, the legislative history of FATCA indicates that the definition of a "foreign financial institution" is to be broadly applied. It is not clear, however, how that definition will be applied to foreign insurance companies. According to the JCTE, regulations may be provided that will address the circumstances in which insurance companies will constitute financial institutions or in which certain insurance contracts or policies, such as annuities or life insurance contracts with cash value, will be considered "U.S. accounts" for purposes of the FATCA rules. Although compelling arguments can be made that most foreign insurance companies should not be considered "foreign financial institutions" under the statutory definition, and that annuity and insurance contracts should not be treated as "U.S. accounts" under the FATCA rules, such outcomes are by no means clear. (Indeed, we note that the proposed Foreign Bank and Financial Account ("FBAR") regulations would treat annuities and life insurance contracts with cash value as financial accounts for FBAR purposes. *See* Prop. Reg. §31.103.24(c)(3) (Feb. 26, 2010).)

With respect to the repeal of the bearer bond exception, a new provision provides relief for obligations issued under a "dematerialized" registry system or other book system that is specified by the Secretary of the Treasury. In Notice 2006-99, 2006-2 C.B. 907, the IRS concluded that a "dematerialized" bond that can be held and transferred only through a book entry system is in "registered form" when a holder may obtain a physical certificate in bearer form only if the clearing organization that maintains the book entry system goes out of business without a successor. Thus, these bonds are not subject to the repeal of the bearer bond exception under the HIRE Act.

The HIRE Act provides that the repeal of the bearer bond requirements is effective two years from March 18, 2010, the date of enactment. Previous versions of FATCA contained effective dates of 90 and 180 days after enactment, so the two-year provision provides some relief for issuers.

The IRS and Treasury have publicly stated that they already have assembled their teams to draft the guidance under FATCA. According to Steven A. Musher, IRS Associate Chief Counsel (International), in remarks to the ABA Taxation Section in January 2010, the government will begin a consultation process similar to that used for the development of the section 1441 regulations. The IRS and Treasury held many consultations with stakeholders (including foreign banks) during that process. Musher stated that he expects that an evolutionary and transitional set of rules will be provided. It is possible that consideration will be given to applying the existing presumption rules under section 1441 to permit foreign entities to determine the identities of their account holders. Not surprisingly, Musher added that he anticipates a different standard for new accounts than for existing accounts, but increasing the requirements for existing accounts over time.

Text of Legislation: click
Joint Committee on Taxation – Technical Explanation: click

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If you have any questions about this development, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

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