



Proposed US *Stop Tax Haven Abuse Act* Requires Disclosure of Interests held in Non-US Financial Accounts

Introduction

On March 2, 2009, Senator Carl Levin (D-MI) introduced the Stop Tax Haven Abuse Act of 2009 (the "Bill"). On March 3, 2009, over 40 Representatives, led by Rep. Lloyd Doggett (D-TX) and Rep. Rosa DeLauro (D-CT) introduced a companion bill in the House of Representatives that mirrors the Senate bill. A similar bill was introduced in the Senate in 2007 (cosponsored by then Senator Barack Obama), but was not acted upon. The Bill, like its 2007 predecessor, contains numerous provisions generally intended to prevent US taxpayers from holding assets in accounts of financial institutions located in so-called tax havens without disclosing the existence of those accounts to the Internal Revenue Service, as well as certain other provisions intended to address perceived abuses of offshore tax planning.

Some of the more noteworthy provisions of the Bill are intended to grant special powers to the Secretary of the Treasury (the "Secretary") effectively to cut off a foreign financial institution's access to the US financial system if the Secretary determines that such financial institution or the jurisdiction of such financial institution is impeding US tax enforcement. Further, the Bill would impose requirements on US financial institutions and certain non-US financial institutions to report to the Internal Revenue Service a transaction in which such a financial institution either establishes US accounts on behalf of non-US entities (that such financial institutions have reason to know are beneficially owned by US persons) or sets up non-US accounts or entities on behalf of their US clients. Penalties would be imposed on withholding agents and financial institutions that fail to properly file such returns.

In addition, the Bill contains two important additions to its predecessor which, if enacted, would significantly affect hedge funds, CDO and CLO vehicles, many other businesses operated through non-US entities and investors in those entities. These provisions would (1) cause certain non-US corporations that are managed and controlled from within the US to be treated as domestic corporations for US income tax purposes, causing them to become subject to US corporate income tax, and (2) require withholding on payments to non-US persons of dividend equivalent amounts and substituted dividends with respect to the stock of US corporations. A third addition would require US persons to report to the IRS a variety of relationships they have with a passive foreign investment corporation ("PFIC").

Highlights from the Bill

Secretary of the Treasury Special Powers.

Currently, Section 5318A of Title 31 provides special powers to the Secretary to penalize (1) jurisdictions outside the US, (2) financial institutions operated outside the US and (3) transactions involving a jurisdiction outside the US (a "Jurisdiction, Financial Institution or Transaction") that the Secretary determines are facilitating money laundering transactions. The Bill would expand Section 5318A by granting to the Secretary additional powers under such section to penalize Jurisdictions and Financial Institutions that the Secretary determines to be impeding US tax enforcement. The Bill provides that the

White & Case offers unparalleled assistance in resolving complex and unprecedented legal issues. Our more than 100 dedicated tax lawyers, working from offices worldwide, combine their in-depth knowledge to help clients manage the tax aspects of their most ambitious and difficult undertakings. Diverse companies look to us for guidance through the tax laws of many countries as well as the intricacies of cross-border tax issues.

Our tax work is integrated with that of White & Case's other practice areas to produce seamless service. By engaging our tax services, clients benefit from the Firm's legal and business experience, extensive global reach and in-depth local knowledge.

White & Case offers clients the most innovative and effective tax-related legal advice available and provides comprehensive, efficient solutions. Preeminent in their areas of focus, our lawyers assist clients on a broad range of matters including cross-border transactions and multinational tax planning, and resolving domestic and international tax controversies.

Should you have any questions or comments, please contact:

John Lillis, Partner
+1 212 819 8512
jllillis@whitecase.com

Jeremy Naylor, Partner
+1 212 819 8760
jnaylor@whitecase.com

White & Case
1155 Avenue of the Americas
New York, NY 10036
United States
+ 1 212 819 8200

Tax Client Alert

Secretary, consulting with the Secretary of State and Attorney General, would have the authority to determine that a Jurisdiction, Financial Institution or Transaction was of primary money laundering concern or involved in an effort to impede US tax enforcement. Upon such a determination, the Secretary would be entitled to require US financial institutions that have correspondent accounts for a Financial Institution to provide information on the Financial Institution's customers. Alternatively, the Secretary could prohibit or impose conditions upon opening or maintaining a correspondent or payable-through account in the US on behalf of such Jurisdiction or Financial Institution. The Bill would further provide the Secretary with an additional remedy with respect to both money laundering and tax enforcement concerns. The Bill authorizes the Secretary to instruct US financial institutions not to authorize or accept credit card transactions involving a Jurisdiction or Financial Institution determined to be of primary money laundering concern or impeding US tax enforcement.

Reporting US Beneficial Owners of Foreign Owned Financial Accounts.

The Bill would require additional filings from withholding agents and financial institutions in relation to US persons with possible ties to a statutorily defined tax haven jurisdiction.

The Bill provides an initial list of 34 such countries, including Bermuda, the Cayman Islands, the BVI, the Channel Islands, Luxembourg, Cyprus, Malta and Switzerland, although the Secretary would be authorized under the Bill to add or delete countries from such list. Under the Bill, a person required to report and withhold US taxes (a "withholding agent") would be required to report additional information to the Internal Revenue Service with respect to payments of US source income to a non-US entity if the withholding agent determines, based on information available to the withholding agent, that a US person has a beneficial interest in the non-US payee entity. The withholding agent would be required to include on the report to the Internal Revenue Service the name, address and taxpayer identification number of the US beneficial owner.

In addition, if a financial institution opens a bank, brokerage or other financial account in a listed tax haven jurisdiction or forms or acquires an entity in any such tax haven jurisdiction, in each case,

on behalf of a US person, such financial institution would be required to file a return reporting such transaction and including the name, address, and taxpayer identification number of the US person, as well as other information with respect to the transaction. The Bill also would impose new penalties on any failure to file a return required by these provisions. There would be a US\$50 penalty for each information return not properly filed, capped at US\$100,000 in total penalty fees. For each payee statement that is not properly filed, there would be a US\$50 penalty, also capped at US\$100,000 (but if the failure to file the return was determined to be due to intentional disregard, the penalty would be the greater of US\$100 or ten percent of the aggregate amount of items required to be reported, with no cap on the amount of penalties that would be required to be paid). Banks could face daily penalties equal to the lesser of US\$1million or one percent of the bank's total assets if the bank knowingly failed to file a required return. Securities firms could be required to pay penalties as high as the greater of US\$500,000 or the gross amount of pecuniary gain resulting from the failure to file the return.

Treating Non-US Corporations as Domestic Corporations.

Under the Bill, a non-US corporation that is managed and controlled from within the US would be taxed as a domestic corporation if either the stock is regularly traded on an established securities market or the corporation holds gross assets (including assets that it manages for investors) worth US\$50 million or more.

The Bill would set forth two tests to determine whether the non-US corporation is managed and controlled from within the US. The first test looks at the geographical location of the corporation's executive officers and senior management. If substantially all the executive officers and senior management who have the day-to-day responsibility for making management decisions are located primarily within the US, then the non-US corporation is considered managed from within the US. The Bill further states that any employees who make day-to-day decisions that would normally be made by executive officers or senior management will be considered to be executive officers or senior management for the purpose of determining if the corporation is managed from within the US. The second test would treat a non-US corporation as a domestic corporation if that non-US corporation's assets consist

Tax Client Alert

primarily of assets being managed on behalf of investors and the decisions about how to invest the assets are made in the US. The Treasury Department has broad regulatory authority to provide further guidance as to what would cause a non-US company to be considered managed from within the US.

Recognizing that, as phrased, the foregoing text could treat substantially all subsidiaries of US groups as domestic corporations, the Bill would provide that controlled foreign corporations that are subsidiaries of US domestic groups are not treated as domestic corporations under this provision. However, the US parent would be required to have substantial assets (other than cash, cash equivalents and stock of foreign subsidiaries) held for use in the active conduct of a US trade or business.

If a corporation whose stock is not regularly traded on an established securities market was previously treated as a domestic corporation under this provision of the Bill, and has gross assets that have dropped below the US\$50 million level (and the value of the gross assets is expected to remain below that level), then the non-US corporation would be able to seek a waiver from the Secretary that would relieve the non-US corporation of its classification as a domestic corporation. It is unclear how beneficial such a savings provision may prove to be in its actual application.

If the Bill is enacted into law in its current form, this provision would cause many, if not most, non-US investment funds that are managed and controlled within the US to be subject to US corporate income tax on their net income. The Bill provides that the provision relating to the treatment of a non-US corporation as a domestic corporation will be effective for the taxable year that begins after the second anniversary of the Bill's enactment. Thus, if the Bill is enacted in its current form, non-US corporations would have an opportunity to restructure or alter their methods of operation prior to the effective date.

Closing of Dividend Withholding Tax "Loophole"

The Bill would also impose withholding tax on payments of dividend equivalent amounts and substituted dividends with

respect to shares of US corporations. The Bill targets transactions in which a non-US investor owning stock of a US corporation would enter into a notional principal contract or secured lending transaction with a financial institution or hedge fund, pursuant to which the financial institution or hedge fund would make a payment equivalent to the amount of a dividend paid on the stock (often referred to as a "dividend equivalent" or "substituted dividend"). Under current law, such payments arguably would not be subject to the 30 percent withholding tax that a dividend payment to a non-US investor would normally bear. The Bill would eliminate the ability to avoid withholding tax on these payments by considering all dividend equivalents and substituted dividends with respect to US stock to be dividends for US tax purposes, subject to US withholding tax.

Reporting Information Related to PFICs.

The Bill would require a US person to report to the IRS information with respect to PFICs if such US person is a shareholder of such PFIC, has directly or indirectly formed such PFIC, has transferred assets to such PFIC, is a beneficiary of such PFIC, has a beneficial interest in such PFIC, or has received money or property or the use of either from such PFIC. The scope of this provision is given no clear definition. If the Bill were to move forward with this provision, it is hoped that clarity would be provided on the scope of this provision.

Looking Forward

The Bill, if adopted, would have a substantial impact on the tax planning of affected entities. This legislation is in its early stages, and it is very uncertain whether the provisions described above will ultimately be enacted into law. However, late on March 3, 2009, in testimony before Congress, Treasury Secretary Timothy Geithner strongly endorsed the Bill. Sen. Baucus (D-MT), chairman of the Senate Finance Committee, has announced that he will introduce a separate bill that will focus on additional tax reporting requirements in order to identify US persons who may be using tax haven jurisdictions to avoid US taxation. We will continue to monitor the progress of Senator Levin's Bill and any bill that Senator Baucus may introduce on this subject.

White & Case

White & Case is a leading global law firm with more than 2,400 lawyers in 34 offices in 23 countries. Among the first US-based law firms to establish a truly global presence, we provide counsel and representation in virtually every area of law that affects cross-border business. Our clients value both the breadth of our global network and depth of our US, English and local law capabilities in each of our regions and rely on us for their complex cross-border transactions, arbitration and litigation provided by our global practices. Whether in established or emerging markets, the hallmark of White & Case is our complete dedication to meeting the business priorities and legal needs of our clients.

Our approach is based on listening to our clients' needs, taking the time to understand their business and responding with effective strategies and solutions, no matter how big the opportunity or formidable the challenge. With new technologies, globalization, consolidation and other forces continuously changing how business gets done, we help our clients evaluate the risks and rewards of ventures designed to advance their interests.

We work with the world's most established and respected companies, including two thirds of the *Global Fortune 100* and half of the *Fortune 500*, as well as with start-up visionaries, governments and state-owned entities.

White & Case has no responsibility for any websites other than its own, and does not endorse the information, content, presentation or accuracy, or make any warranty, express or implied, regarding any other website.

This Alert is prepared for the general information of our clients and other interested persons. It should not be acted upon in any specific situation without appropriate legal advice, and is protected by copyright. Material appearing herein may be reproduced or translated with appropriate credit.

Pursuant to Internal Revenue Service Circular 230, we hereby inform you that any advice set forth herein with respect to US federal tax issues was not intended or written by White & Case to be used and cannot be used, by you or any taxpayer, for the purpose of avoiding any penalties that may be imposed on you or any other person under the Internal Revenue Code.

In this document, White & Case means the international legal practice comprising White & Case LLP; a New York State registered limited liability partnership, White & Case LLP, a limited liability partnership incorporated under English law and all other affiliated partnerships, corporations and undertakings.