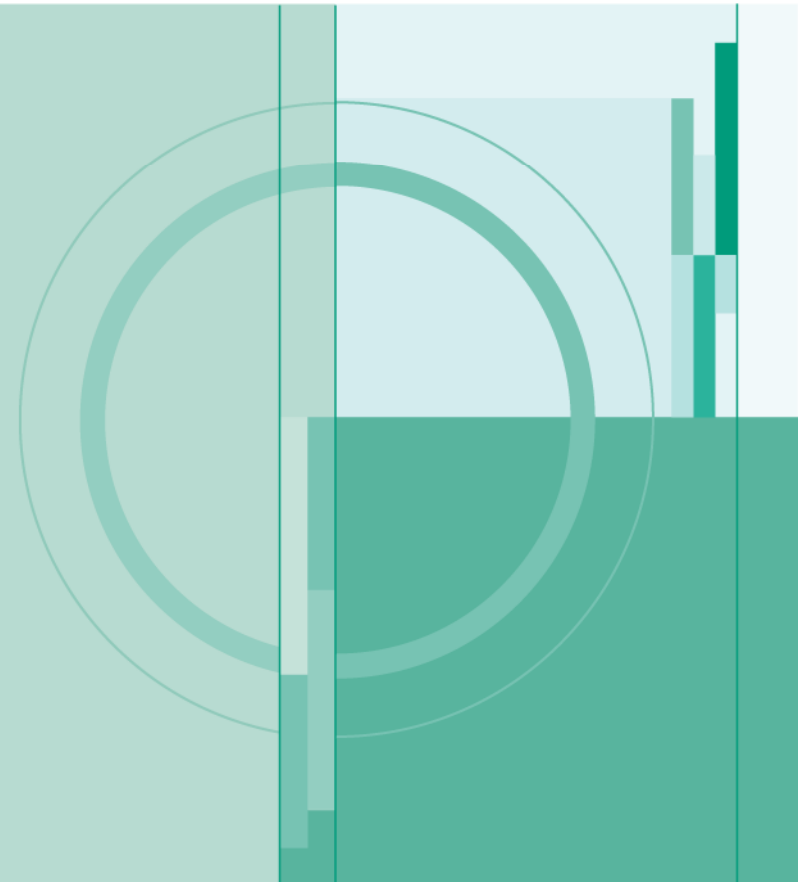


Transnational Taxation Network
International Tax Reform and Anti-Tax Haven Legislation
What are the Implications?
May 18, 2009



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Agenda

1. Anti-Tax Haven Legislation
2. Administration's Revenue Proposals

Stop Tax Haven Abuse Legislation

- President's Budget (February 26, 2009):
 - \$210 Billion --international enforcement, reform deferral, and other tax reform policies
- Senator Levin introduced March 2, 2009 directed at tax reform and tax haven abuse
 - Co-Sponsored with Senator Obama in 2007
- Revised drafted authored by Senator Baucus on March 11

Title I – Deterring the Use of Tax Havens for Tax Evasion

- Sec. 101. Establishing presumptions for entities and transactions involving off-shore secrecy jurisdictions.
- Sec. 102. Authorizing special measures against foreign jurisdictions, financial institutions, and others that impede United States tax enforcement.
- Sec.103. Treatment of foreign corporations managed and controlled in the United States as domestic corporations.
- Sec. 104. Allow more time for investigations involving offshore secrecy jurisdictions.
- Sec. 105. Reporting United States beneficial owners of foreign owned financial accounts.
- Sec. 106. Preventing misuse of foreign trusts for tax evasion.
- Sec. 107. Limitation on legal opinion protection from penalties with respect to transactions involving offshore secrecy jurisdictions.
- Sec. 108. Closing the offshore dividend tax loophole.
- Sec. 109. Reporting of activities with respect to passive foreign investment companies.

Title II – Other Measures to Combat Tax Haven and Tax Shelter Abuses

- Sec. 201. Penalty for failing to disclose offshore holdings.
- Sec. 202. Deadline for anti-money laundering rule for hedge funds and private equity funds.
- Sec. 203. Anti-money laundering requirements for formation agents.
- Sec. 204. Strengthening summons in cases involving off shore secrecy jurisdictions.
- Sec. 205. Improving enforcement of foreign financial account reporting.

Title III – Combating Tax Shelter Promoters

- Sec. 301. Penalty for promoting abusive tax shelters.
- Sec. 302. Penalty for aiding and abetting the understatement of tax liability.
- Sec. 303. Tax planning inventions not patentable.
- Sec. 304. Prohibited fee arrangement.
- Sec. 305. Preventing tax shelter activities by financial institutions.
- Sec. 306. Information sharing for enforcement purposes.
- Sec. 307. Disclosure of information to Congress.
- Sec. 308. Tax opinion standards for tax practitioners.
- Sec. 309. Denial of deduction for certain fines, penalties, and other amounts.

Title IV – Requiring Economic Substance

- Sec. 401. Clarification of economic substance doctrine.
- Sec. 402. Penalty for understatements attributable to transactions lacking economic substance, etc.
- Sec. 403. Denial of deduction for interest on underpayments attributable to non-economic substance transactions.

Section 103. Deny Tax Benefits for Foreign Corporations Managed and Controlled in the U.S.

Background

- Presently under section 7874 certain expatriated domestic partnerships and corporations are treated as U.S. corporations if assets are moved offshore.
- Foreign corporations are only taxed on income that is effectively connected to the U.S.
- This provisions would treat certain foreign companies that are managed and controlled outside the U.S. as U.S. corporations.
- Ugland House

Section 103 applies where:

- The corporation is not otherwise treated as a domestic corporation, but it is managed and controlled in the U.S. and
- the stock of such corporation is regularly traded on an established securities market, or
- the aggregate gross assets of such corporation (or any predecessor thereof), including assets under management for investors, whether held directly or indirectly, at any time during the taxable year or any preceding taxable year is \$50,000,000 or more.

Section 103. Deny Tax Benefits for Foreign Corporations Managed and Controlled in the U.S. (continued)

Management and Control

- The Secretary shall prescribe regulations for purposes of determining cases in which the “management and control of a corporation” is to be treated as occurring primarily within the United States.

Executive Officers and Senior Management

- The management and control of a corporation shall be treated as occurring primarily within the United States if substantially all of the executive officers and senior management of the corporation who exercise day-to-day responsibility for making decisions involving strategic, financial, and operational policies of the corporation are located primarily within the United States, and
- Individuals who are not executive officers and senior management of the corporation (including individuals who are officers or employees of other corporations in the same chain of corporations as the corporation) shall be treated as executive officers and senior management if such individuals exercise the day-to day responsibilities of the corporation.

Section 103. Deny Tax Benefits for Foreign Corporations Managed and Controlled in the U.S. (continued)

Corporations Holding Primarily Investment Assets

- Management and control of a corporation shall be treated as occurring primarily within the United States if - -
 - "(i) the assets of such corporation (directly or indirectly) consist primarily of assets being managed on behalf of investors, and
 - "(ii) decisions about how to invest the assets are made in the United States."

Exception from Gross Assets Test

- The provisions shall not apply to a corporation which is a controlled foreign corporation and which is a member of an affiliated group the common parent of which --
 - (i) is a domestic corporation (determined without regard to this subsection), and
 - (ii) has substantial assets (other than cash and cash equivalents and other than stock of foreign subsidiaries) held for use in the active conduct of a trade or business in the United States.

Effective Date

- The amendments shall apply to taxable years beginning on or after the date which is 2 years after the date of the enactment of this Act.

Section 108. Treatment of Dividend Equivalents and Substitute Dividend Payments

Background

- Hearings during 2008 focused on perceived withholding tax abuses.
- Current rules source payments on a notional principal contract to residence of a recipient.
- Dividend equivalents are sourced like the underlying stock, but in Notice 97-66 the IRS severely but the scope of the provision by addressing foreign to foreign securities loans (no withholding tax in foreign to foreign securities loans, even if no withholding tax is actually collected).

Proposed Provision

- The term “dividend” shall include dividend equivalents and substitute dividends,
- A dividend equivalent with respect to the stock of one or more domestic corporations shall be treated as sourced within the United States, and
- A substitute dividend payment shall be sourced in the same manner as a dividend distribution with respect to the transferred security to which the substitute dividend relates.

Section 108. Treatment of Dividend Equivalents and Substitute Dividend Payments (continued)

Dividend Equivalent

- “Dividend equivalent” includes any payment that is made pursuant to a notional principal contract and is contingent upon, or is referenced to, the payment of a dividend on stock or the payment of a dividend on property that is substantially similar or related to stock (determined in a manner similar to the manner under section 246(c)(4)(C)).

Notional Principal Contract

- The term 'notional principal contract' means a financial instrument that provides for the payment of amounts by 1 party to another at specified intervals calculated by reference to a specified index upon a notional principal amount in exchange for specified consideration or a promise to pay similar amounts.

Section 108. Treatment of Dividend Equivalents and Substitute Dividend Payments (continued)

Substitute Dividend

- The term “substitute dividend” means a payment, made to the transferor of a security in a securities lending transaction or a sale-repurchase transaction, of an amount equivalent to a dividend distribution which the owner of the transferred security is entitled to receive during the term of the transaction.

Coordination with Treaties

- The meaning of the term “dividend” in any income tax convention shall be construed to include dividend equivalents and substitute dividends in accordance with this section.

Effective Date

- The amendments shall apply to payments made on or after the date that is 90 days after the date of the enactment of this Act.

Section 101. Presumptions Pertaining to Entities and Transactions Involving “Offshore Secrecy Jurisdictions”

The bill would establish three evidentiary presumptions that could be used in a civil tax enforcement proceeding:

- a presumption that a U.S. taxpayer who "formed, transferred assets to, was a beneficiary of, or received money or property" from an offshore entity, such as a trust or corporation, is in control of that entity;
- a presumption that funds or other property received from offshore are taxable income, and that funds or other property transferred offshore have not yet been taxed; and
- a presumption that a financial account controlled by a U.S. taxpayer in a foreign country contains enough money to trigger an existing statutory reporting threshold and allow the IRS to assert the minimum penalty for nondisclosure of the account by the taxpayer.

Effective Date

- The amendments made by this section shall take effect on the date of the enactment of this Act.

Section 101. Presumptions Pertaining to Entities and Transactions Involving “Offshore Secrecy Jurisdictions” (continued)

INITIAL LIST OF OFFSHORE SECRECY JURISDICTIONS.

- (i) Anguilla.
- (ii) Antigua and Barbuda.
- (iii) Aruba.
- (iv) Bahamas.
- (v) Barbados.
- (vi) Belize.
- (vii) Bermuda.
- (viii) British Virgin Islands.
- (ix) Cayman Islands.
- (x) Cook Islands.
- (xi) Costa Rica.
- (xii) Cyprus.

Section 101. Presumptions Pertaining to Entities and Transactions Involving “Offshore Secrecy Jurisdictions” (continued)

INITIAL LIST OF OFFSHORE SECRECY JURISDICTIONS (continued)

(xv) Grenada.

(xvi) Guernsey/Sark/Alderney.

(xvii) Hong Kong.

(xviii) Isle of Man.

(xix) Jersey.

(xx) Latvia.

(xxi) Liechtenstein.

(xxii) Luxembourg.

(xxiii) Malta.

(xxiv) Nauru.

(xxv) Netherlands Antilles.

(xxvi) Panama.

Section 101. Presumptions Pertaining to Entities and Transactions Involving “Offshore Secrecy Jurisdictions” (continued)

INITIAL LIST OF OFFSHORE SECRECY JURISDICTIONS. (continued)

(xxvii) Samoa.

(xxviii) St. Kitts and Nevis.

(xxix) St. Lucia.

(xxx) St. Vincent and the Grenadines.

(xxxi) Singapore.

(xxxii) Switzerland.

Senator Baucus-Draft Response to Levin Bill

- Requiring entities transferring funds offshore (other than on behalf of publicly traded companies) to report to the IRS the amount, destination, and account information of funds transferred;
- Extending the statute of limitations from three years to six years for tax returns that report, or should have reported, certain international transactions;
- Requiring the foreign bank account report (FBAR) form to be filed with the tax return;
- Requiring preparers to ask a series of due diligence questions to determine whether an FBAR should be filed;

Senator Baucus-Draft Response to Levin Bill (cont'd)

- Enhancing the foreign trust failure-to-file penalty, particularly when the corpus of the trust is unknown, by establishing a \$10,000 minimum penalty;
- Expanding the types of property considered to be a distribution from foreign trusts (for example, artwork and jewelry);
- Doubling applicable fines and penalties on underpayments attributable to some offshore transactions; and
- Modifying a provision in the Heroes Earnings Assistance and Relief Tax Act of 2008 (P.L. 110-245) that requires offshore entities that hire workers to perform services under a U.S. government contract to be treated as American employers by establishing a rule that 100 hours of service a month constitutes an employee.

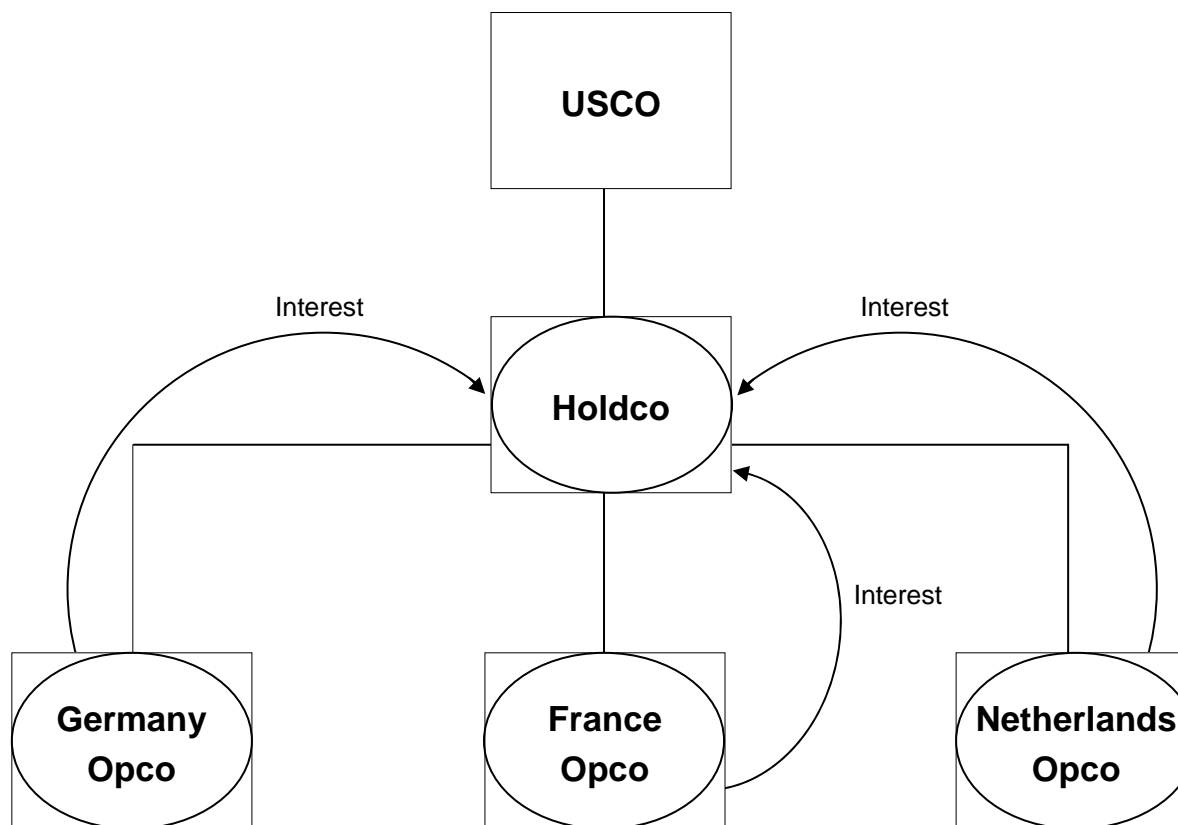
Administration's Revenue Proposals-International Tax System Reform

- Reform Business Entity Classification Rules for Foreign Entities
 - Under the proposal, a foreign eligible entity may be treated as a disregarded entity only if the single owner of the foreign eligible entity is created or organized in, or under the law of, the foreign country in, or under the law of, which the foreign eligible entity is created or organized
- Defer Deduction of Expenses, Except R&E Expenses, Related to Deferred Income
 - The proposal would defer a deduction for expenses (other than research and experimentation expenditures) of a U.S. person that are properly allocated and apportioned to foreign-source income to the extent the foreign-source income associated with the expenses is not currently subject to U.S. tax.
- Reform Foreign Tax Credit: Determine the Foreign Tax Credit on a Pooling Basis
 - Under the proposal, a U.S. taxpayer would determine its deemed paid foreign tax credit on a consolidated basis by determining the aggregate foreign taxes and earnings and profits of all of the foreign subsidiaries with respect to which the U.S. taxpayer can claim a deemed paid foreign tax credit (including lower tier subsidiaries described section 902(b)).

Administration's Revenue Proposals-International Tax System Reform (continued)

- Limit Earnings Stripping by Expatriated Entities
 - The proposal would revise section 163(j) to tighten the limitation on the deductibility of interest paid by an expatriated entity to related persons. The current law debt-to-equity safe harbor would be eliminated.
- Prevent Repatriation of Earnings in Certain Cross-Border Reorganizations
 - The proposal would repeal the boot-within-gain limitation of current law in the case of any reorganization in which the acquiring corporation is foreign and the shareholder's exchange has the effect of the distribution of a dividend, as determined under section 356(a)(2).
- Repeal 80/20 Company Rules
 - Dividends and interest paid by a domestic corporation are generally U.S.-source income to the recipient and are generally subject to gross basis withholding tax if paid to a foreign person. The proposal would repeal the 80/20 company provisions under current law.

Reform Check-the-Box Rules



Defer Deductions Related to Foreign Deferred Income

Step One

- Determine Deductions Related to Foreign Income.

Step Two

- Allocate Deductions to Remitted and Retained Foreign Source Income.

Example

- Foreign Related Expenses \$20
- CFC Has \$100 of Earnings and Profits
- Remits Dividend of \$50
- Expenses Allowed: $= \$50/\$100 \text{ times } \$20 = \10

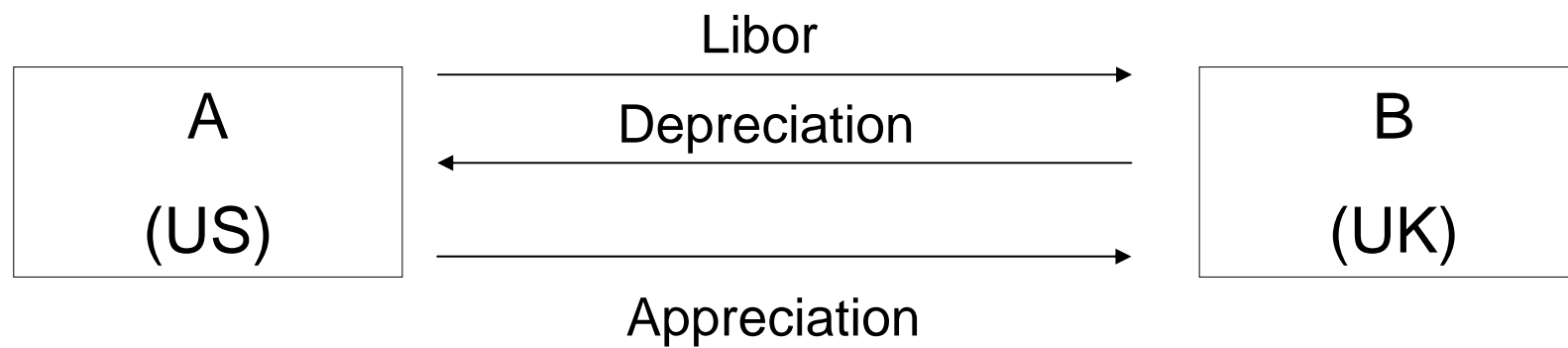
Administration's Revenue Proposals-International Tax System Reform (continued)

- Reform Foreign Tax Credit: Determine the Foreign Tax Credit on a Pooling Basis
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- Reform Foreign Tax Credit: Prevent Splitting of Foreign Income and Foreign Taxes
 - The proposal would adopt a matching rule to prevent the separation of creditable foreign taxes from the associated foreign income.
- Limit Shifting of Income Through Intangible Property Transfers
 - To prevent inappropriate shifting of income outside the United States, the proposal would clarify the definition of intangible property for purposes of sections 367(d) and 482 to include workforce in place, goodwill and going concern value.

Administration's Revenue Proposals-International Tax System Reform (continued)

- Prevent the Avoidance of Dividend Withholding Taxes
 - In order to address the avoidance of U.S. withholding tax through the use of securities lending transactions, the Treasury Department plans to revoke Notice 97-66 and issue guidance that eliminates the benefits of such transactions but minimizes over-withholding. Further, income earned by foreign persons with respect to equity swaps that reference U.S. equities would be treated as U.S.-source to the extent that the income is attributable to (or calculated by reference to) dividends paid by a domestic corporation.
- Modify the Tax Rules for Dual Capacity Taxpayers
 - In the case of a dual-capacity taxpayer, the proposal would treat a foreign levy that would otherwise qualify as an income tax or in lieu of tax as a creditable tax only if the foreign country generally imposes an income tax.

Equity Swap



- Classification
- Withholding Issues

Administration's Proposals

Treasury will revoke Notice 97-66

Withholding will apply on equity swaps involving U.S. corporations, except where:

- the terms of the equity swap do not require the foreign person to post more than 20% of the value of the underlying stock as collateral;
- the terms of the equity swap do not include any provision addressing the hedge position of the counterparty to the transaction;
- the underlying stock is publicly traded and the notional amount of the swap represents less than 5% of the total public float of that class of stock and less than 20% of the 30-day average daily trading volume;
- the foreign person does not sell the stock to the counterparty at the inception of the contract, or buy the stock from the counterparty at the termination of the contract;
- the prices of the equity that are used to measure the parties' entitlements or obligations are based on an objectively observable price; and
- the swap has a term of at least 90 days.

The Treasury Department would be given regulatory authority to provide additional exceptions to implement the purpose of the rule.

The proposal would be effective for payments made after December 31, 2010.

Administration's Revenue Proposals—Tax Haven Proposals (continued)

- Require Greater Reporting by Qualified Intermediaries Regarding U.S. Account Holders
 - Under the proposal, no foreign financial institution would qualify as a QI unless it identifies all of its account holders that are U.S. persons.
- Require Withholding on Payments of FDAP Income Made Through Nonqualified Intermediaries.
 - Any withholding agent making a payment of FDAP income to a nonqualified intermediary would be required to treat the payment as made to an unknown foreign person (and therefore to withhold tax at a rate of 30 percent).

Administration's Revenue Proposals—Tax Haven Proposals (continued)

- Require Withholding on Gross Proceeds Paid to Certain Nonqualified Intermediaries
 - Under the proposal, a withholding agent would be required to withhold tax at a rate of 20 percent on gross proceeds from the sale of any security of a type that would be reported to a U.S. non-exempt payee, when paid by the withholding agent to a nonqualified intermediary that is located in a jurisdiction with which the United States does not have a comprehensive income tax treaty that includes a satisfactory exchange of information program.
- Require Reporting of Certain Transfers of Money or Property to Foreign Financial Accounts
 - Any U.S. financial intermediary and any qualified intermediary that transfers money or property with a value of more than \$10,000 to a foreign bank, brokerage, or other financial account on behalf of a U.S. person (or on behalf of any entity of which a U.S. person owns, actually or constructively, more than 50 percent of the ownership interest) would be required to file an information return regarding such transfer.

Administration's Revenue Proposals—Tax Haven Proposals (continued)

- Require Disclosure of FBAR Accounts to be Filed with Tax Return
 - Individual taxpayers required to file an FBAR would be required to disclose certain information on their income tax returns
- Require Third-Party Information Reporting Regarding the Transfer of Assets to Foreign Financial Accounts and the Establishment of Foreign Financial Accounts
 - Any U.S. person, or any qualified intermediary, that forms or acquires a foreign entity on behalf of a U.S. individual (or on behalf of any entity of which the individual owns, actually or constructively, more than 50 percent of the ownership interest) would be required to file an information return with the IRS regarding the foreign entity that is formed or acquired.
- Require Third-Party Information Reporting Regarding the Establishment of Offshore Entities
 - Any U.S. person, or any qualified intermediary, that forms or acquires a foreign entity on behalf of a U.S. individual (or on behalf of any entity of which the individual owns, actually or constructively, more than 50 percent of the ownership interest) would be required to file an information return with the IRS regarding the foreign entity that is formed or acquired.

Administration's Revenue Proposals—Tax Haven Proposals (continued)

- Negative Presumption for Foreign Accounts with Respect to Which an FBAR has not Been Filed
 - A rebuttable evidentiary presumption would be applicable in a civil administrative or judicial proceeding providing that any foreign bank, brokerage, or other financial account in which a citizen or resident of the United States, or a person in and doing business in the United States, has a financial interest in or signature or other authority over the account contains enough funds to require that an FBAR be filed.
- Negative Presumption Regarding Failure to File an FBAR for Accounts with Nonqualified Intermediaries
 - A rebuttable evidentiary presumption would be applicable in a civil administrative or judicial proceeding providing that failure to file an FBAR with respect to any foreign bank, brokerage, or other financial account held with a nonqualified intermediary is willful if the account has a balance of greater than \$200,000 at any point during the calendar year.

Administration's Revenue Proposals—Tax Haven Proposals (continued)

- Negative Presumption Regarding Withholding on FDAP Payments to Certain Foreign Entities
 - Any withholding agent making a payment of FDAP income to a foreign entity would be required to treat the payment as made to an unknown person (and therefore subject to 30 percent gross-basis withholding tax), unless the foreign entity provides documentation of the entity's beneficial owners.
- Extend Statute of Limitations for Certain Reportable Cross-Border Transactions and Foreign Entities
 - The proposal would extend the period during which the statute of limitations provided by section 6501(c)(8) does not expire to six years after the taxpayer furnishes the information required to be reported.

Administration's Revenue Proposals—Tax Haven Proposals (continued)

- Double Accuracy-Related Penalties on Understatements Involving Undisclosed Foreign Accounts
 - The 20-percent accuracy-related penalty imposed on (i) substantial understatements of income tax, (ii) understatements resulting from negligence or disregard of rules or regulations, or (iii) a reportable transaction understatement, would be doubled to 40 percent when the understatement arises from a transaction involving a foreign account that the taxpayer failed to disclose properly under the proposed requirement that taxpayers disclose FBAR-related information on their income tax returns.
- Improve the Foreign Trust Reporting Penalty
 - The penalty provision would be amended to impose an initial penalty of the greater of \$10,000 or 35 percent of the gross reportable amount (if the gross reportable amount is known).