JONES WALKER

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ANALYSIS OF S. 1346, THE STOP TAX HAVEN ABUSE ACT

INTRODUCTION:

On July 11, 2011, Senator Carl Levin (D-MI), along with five of his Senate colleagues, introduced S.1346, the Stop Tax Haven Abuse Act, which was referred to the Senate Finance Committee. The bill amends a number of existing laws, including the Internal Revenue Code of 1986, the U.S.A. Patriot Act of 2001, the Foreign Account Tax Compliance Act (FATCA), and the Securities Acts of 1933 and 1934. Each of these proposed amendments has the stated purpose of curtailing the use of offshore jurisdictions by U.S. individuals and entities for banking and other purposes in order to increase the collection of U.S. income taxes by individuals and businesses that are currently, or under this legislation would be deemed to be subject to the U.S. income tax system. S.1346 is the most recent effort on the part of Senator Levin and others in Congress to advance legislative proposals that would help eliminate the so-called "U.S. tax gap." One point to keep in mind when evaluating the prospects of all or part of this legislation becoming the law of the land is that several related proposals advanced by Senator Levin recently became law as part of the Hire Act (P.L. 111-147). The commission formed to address the federal debt will also be making recommendations.

As the following title by title detailed analysis of the legislation demonstrates, domestic and foreign financial institutions, certain businesses with a U.S. presence, and tax practitioners would be affected by S. 1346 should it become law.

TITLE I: DETERRING THE USE OF TAX HAVENS FOR TAX EVASION

SEC. 101. Authorizing Special Measures Against Foreign Jurisdictions, Financial Institutions and Others that Impede United States Tax Enforcement

Section 101 amends 31 U.S.C. 5318A (section 311(a) of the U.S.A. Patriot Act, as amended) relating to so-called special measures the Secretary of the Treasury may require domestic financial institutions and domestic financial agencies to take if the Secretary finds any jurisdiction, financial institution, transaction, or type of account outside of the United States to be of primary money laundering concern by:

- Expanding the basis for the Secretary to require a special measure be undertaken if the jurisdiction, institution, transaction or type of account "is impeding U.S. tax enforcement".
- Expanding subsection (b)(5) to include the prohibition or conditions on certain payment cards in addition to the existing authority to require prohibition or conditions on certain correspondent and payable-thru accounts.
- Expanding subsection (c)(2)(A) relating to jurisdictional factors the Secretary shall consider in whether to make a finding under this section, to add (1) "tax, corporate, trust or financial secrecy regulating advantages" offered by that jurisdiction or financial institutions in the jurisdiction, (2) international tax enforcement to items to be reviewed as to the substance and quality of the laws of that jurisdiction, (3) tax haven to how a jurisdiction is characterized by credible international or multilateral organizations, and (4) whether the U.S. has a tax treaty or tax information agreement with the jurisdiction in question as additional considerations.

SEC. 102. Strengthening The Foreign Account Tax Compliance Act (FATCA)

Section 102(a) amends 26 U.S.C. 1298 to strengthen FATCA by clarifying when foreign financial institutions and U.S. persons must report foreign financial accounts to the Internal Revenue Service ("IRS"). Specifically, the reporting requirements with respect to passive foreign investment companies ("PFICs") are extended to any foreign financial institution or U.S. person who directly or indirectly forms, transfers assets to, is a beneficiary of, has a beneficial interest in, or receives money or property thereof from a PFIC. Section 102(b) amends section 26 U.S.C. 6011(e) to extend FATCA reporting requirements to certain entities that are engaged in the business of derivatives, including a futures or forward contract swap, or option, and any interest in such securities, partnership interests, commodities, or derivatives.

Section 102(g)(1)(A) also establishes a presumption that amounts received from or transferred, directly or indirectly, to a non-FATCA account is income to the recipient and is previously unreported income by the transferor. The provision also establishes a presumption of control and beneficial ownership of United States persons who, directly or indirectly, form, transfer assets to, or is a beneficiary of a non-FATCA account –

(1) Amends section 26 U.S.C. 7701(a) to define a "Non-FATCA institution"

(2) Amends section 21 of the Securities Exchange Act of 1934 (15 U.S.C. 78) by adding a new subsection that:

- For purposes of any civil judicial or administrative proceeding under this title (of the 1934 Act) creates a rebuttable presumption that a U.S. person who directly or indirectly, formed, transferred assets to, was a beneficiary of, had a beneficial interest in, or received money or property or the use thereof from an entity, including a trust, corporation, limited liability company, partnership, or foundation that holds an account, or has assets, in a non-FATCA institution exercised control over said activity. This new provision does not apply to any entity with shares regularly traded on an established securities market.
- For purposes of any civil and judicial administrative proceeding under this title (of the 1934 Act), creates a rebuttable presumption that any U.S. person who directly or indirectly exercised control over any entity, including a trust, corporation, limited liability company, partnership, or foundation is presumed to have beneficial ownership over such entity of such securities as normally held by such entity. This new provision does not apply to any entity with shares regularly traded on an established securities market.
- Also amends 31 U.S.C. 5314, relating to records and reports on foreign financial transactions, to add a rebuttable presumption that any account with a non-FATCA institution (as defined in 7701(a)(51) of the Internal Revenue Code of 1986) contains funds sufficient to require a report described by regulations under this section.
- Requires the Secretary of the Treasury and the Chairman of the SEC to adopt regulations and other guidance to implement the amendments made by this subsection.

SEC. 103. Treatment of Foreign Corporations Managed and Controlled in the United States as Domestic Corporations

Section 103 amends section 26 U.S.C. 7701 to provide that foreign corporations that are publicly traded or have gross assets of $50 million or more are treated as domestic corporations for income tax purposes if they are managed and controlled primarily within the United States.

SEC. 104. Reporting United States Beneficial Owners of Foreign Owned Financial Accounts

Section 104 amends subpart B of part III of subchapter A of chapter 61 of title 26 of the U.S.C. by adding sections 6056 C and D that:

- Requires withholding agents that have control, receipt, custody, disposal, or payment of any U.S. source income of a foreign person or entity (other than a publicly traded entity) to file information returns where it determines that a U.S. person has a beneficial interest in the foreign person and entity. A withholding agent required to make the return is to furnish the U.S. beneficial owner with a statement setting forth the information set forth in such return.
- Requires any financial institution directly or indirectly opening a bank, brokerage or other financial account on behalf of a foreign entity in a non-FATCA institution at the direction or on behalf of a U.S. person to file an information return identifying the U.S. person, the non-FATCA institution, and information regarding the account. The financial institution filing the information return must notify the U.S. person of the filing of the information return.
- Section 104 also amends section 12 U.S.C. 93(b)(1), relating to bank penalties, and 15 U.S.C 78u(d)(3)(A), relating to securities firm penalties, to include violations of new section 26 U.S.C. 6045-D.

SEC. 105. Credit Default Swap Payments Made From the United States to Persons Offshore

Section 105 amends the sourcing rules under sections 26 U.S.C. 871 (a)(1) and 881(a) with respect to credit default swap payments in that they are treated as sourced from the location of the payor.

SEC. 106. Tax on Income of Controlled Foreign Corporations Deposited in Financial Accounts Located in the United States

Section 106 amends section 26 U.S.C. 952(a) to provide that any property of a controlled foreign corporation that is deposited and maintained, directly or indirectly, in a financial account located in the United States is to be treated as a constructive distribution to United States shareholders of such controlled foreign corporation.

TITLE II: OTHER MEASURES TO COMBAT TAX HAVEN AND TAX SHELTER ABUSES

SEC. 201. Country-By-Country Reporting

Section 201 adds a new subsection (r) to section B of the Securities Exchange Act of 1934 (15 U.S.C. 78m) entitled "Disclosure of Financial Performance on a Country-By-Country Basis". This new subsection defines the terms "issuer group", "country of operation," and "world-wide allocation" and requires the Commission to issue rules that require each

issuer to include in an annual report filed with the Commission information indicative of financial performance on a country-by-country basis during the covered period, including:

(A) a list of each country of operation;

(B) the world-wide allocation of group members;

(C) the financial performance of each member of the issuer group in each country of operation, without exception, including, and set forth according to –

(i) total number of employees physically working in the country of operation;

(ii) total sales by the member of the issuer group to third parties;

(iii) total sales by the member of the issuer group to other members of the issuer group and total sales to each such member;

(iv) total purchases by the member of the issuer group from third parties;

(v) total purchases by the member of the issuer group from other members of the issuer group and total purchases from each such member;

(vi) total financing payments made by the member of the issuer group to third parties;

(vii) total financing payments made by the member of the issuer group to other members of the issuer group and total financing payments made to each such member;

(viii) pre-tax gross revenues of the member of the issuer group;

(ix) pre-tax net revenues of the member of the issuer group; and

(x) such other financial information as the Commission may determine is indicative of the financial performance of the issuer;

(D) the tax paid by each member of the issuer group in each country of operation, without exception, including, and set forth according to –

(i) total Federal, regional, local, and other tax assessed against each member of the issuer group with respect to each country of operation during the covered period;

(ii) after taking into account any tax deductions, tax credits, tax forgiveness, or other tax benefits or waivers, total amount of tax paid from the treasury of the member of the issuer group to the government of each country of operation during the covered period; and

(iii) such other financial information as the Commission may determine is necessary or appropriate to inform the public of the tax obligations of and payments by each member of the issuer group; and

(E) such other financial information as the Commission may determine is necessary or appropriate in the public interest or for the protection of investors.

Section 201 also requires the Commission to issue a proposed rule to carry out this section not later than 180 days after the date of enactment, and a final rule not later than 270 days after the date of enactment, to carry out this section. In issuing these rules the Commission:

- Shall consult with the Secretary of the Treasury and the Commissioner of the Internal Revenue Service and, to the extent practicable and in furtherance of its obligation to protect investors, shall issue rules that support Federal efforts to reduce offshore tax evasion and abuses.
- Shall require that the information recorded by issuers in their annual reports be submitted in an interactive data format.
- May allow issuers to provide the financial information required under section 13(r) of the Securities Exchange Act of 1934, as added by this section, to be aggregated at the level of each country of operation instead of with respect to each member of the issuer group individually.

SEC. 202. Penalty for Failing to Disclose Offshore Holdings

Section 202 amends section 21(d)(3)(B) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)(3)(B)), relating to the amount of civil penalty the SEC may seek in federal district court against any person who has violated any provision of chapter 2B, the rules or regulations thereunder, or a cease and desist order entered by the Commission pursuant to section 78u-3 of this title, by adding a fourth tier of not to exceed $1,000,000 if the violation is the subject of an action by the Commission under section 21(d)(3)(A) involving "…a knowing failure to disclose any holding or transaction involving equity or debt instruments of an issuer and known by such person to involve a foreign entity, including any trust, corporation, limited liability company, partnership, or foundation that is directly or indirectly controlled by such person, and which would have been otherwise subject to disclosure by such person under this title".

Section 202(b) of this section amends section 20(d)(2) of the Securities Act of 1933 (15 U.S.C. 77t(d)(2)) by adding the same Fourth Tier penalty provision as added to the 1934 Securities Act by subsection (a) of this section for such violation described in 20(d)(1) of the 1933 Act.

Section 202(c) of this section amends section 9(d)(2) of the Investment Act of 1940 (15 U.S.C. 80a–9(d)(2)) by adding the same Fourth Tier penalty provision as added to the 1934 Securities Act by subsection (a) of this section.

Section 202(d) of this section amends section 203(i)(2) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3(i)(2)) by adding the same Fourth Tier penalty provision as added to the 1934 Securities Act by subsection (a) of this section.

SEC. 203 Deadline for Anti-Money Laundering Rule for Hedge Funds and Private Equity Funds

This section requires the Secretary of the Treasury, in consultation with the Chairman of the SEC and the Chairman of the EFTC to, within 90 days after the date of enactment, publish a proposed rule and, within 180 days publish a final rule, requiring unregistered investment companies, including large hedge funds or private equity funds, to stabilize anti-money laundering programs and submit suspicious activity reports under subsection (g) and (h) of section 5318 of title 31 U.S.C.

The section also sets forth the contents to be included in this rule and provides definitions of the terms "investment company", "issuer", and "unregistered investment company".

SEC. 204. Anti-Money Laundering Requirements for Formation Agents

Section 204 amends 5312(a)(2) of title 31 U.S.C., relating to definitions of entities which are required to have anti-money laundering programs, by adding persons engaged in the business of forming new corporations, limited liability companies, partnerships, trusts, or other legal entities.

It also requires the Secretary of the Treasury, in consultation with the Attorney General of the U.S., the Secretary of Homeland Security, and the Commissioner of the Internal Revenue Service, to prescribe a proposed rule not later than 120 days after the date of enactment of the Act, and a final rule not later than 270 days after such date of enactment, requiring persons described in new section 5312(a)(2)(Z) of title 31 U.S.C. to establish anti-money laundering programs under subsections (g) and (h) of section 5318 of that title.

The section directs the Secretary to exclude any government agency and any attorney or law firm that uses a paid formation agent operating within the U.S. to form such corporations or other entities.

SEC. 205. Strengthening John Doe Summons Proceedings

Section 205 amends 26 U.S.C. 7609 to provide that where a particular person or ascertainable group or class of persons have financial accounts in or transactions relating to a non-FATCA institution that for purposes of determining whether a John Doe summons should be issued there shall be a presumption that there is a reasonable basis for believing that such group or class of persons may fail or may have failed to comply with provisions of internal revenue law. The provision also allows the IRS to issue a summons to a class of persons that relate to a long-term project approved and overseen by a court.

SEC. 206. Improving Enforcement of Foreign Financial Account Reporting

Section 206 amends 26 U.S.C. 6103(b) to clarify that the civil and criminal enforcement divisions of the IRS may use Suspicious Activity Reports in their investigations. The provision also allows the IRS to use tax return information to evaluate foreign financial account reports and also simplifies the calculation of foreign financial account penalties by having them based on the highest balance in the account during the reporting period to which the violation relates.

Section 206 also amends section 5321(a)(5)(D)(ii) of title 31 U.S.C., relating to foreign financial agency transaction violations, to change the part of the reasonable cause exception from "the balance in the account at the time the transaction was reported" to "the highest balance in the account during the reporting period to which the violation relates".

The section amends section 5319 of title 31 U.S.C. to include the civil and criminal enforcement divisions of the Internal Revenue Service among those agencies set forth in such section which may review a report filed under this subchapter.

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. Prohibited Fee Arrangement

Sections 301, 302 and 303 amend 26 U.S.C. 6700 and 6701 to increase penalties up to a maximum fine of 150 percent of gross income derived from promoting or aiding and abetting abusive tax shelters, as well as 150 percent of fees which are based upon tax savings attributable to abusive tax shelters.

SEC. 304. Preventing Tax Shelter Activities By Financial Institutions

Section 304 mandates that each of the Federal banking agencies and the Securities and Exchange Commission consult with the Internal Revenue Service to develop examination techniques to detect violations pertaining to the abuse of tax shelters by depository institutions, brokers, dealers, and investment advisors. In the case where an examination reveals a potential violation, the examining agency is mandated to promptly notify the Internal Revenue Service of such potential violation.

SEC. 305. Information Sharing for Enforcement Purposes

Section 305 amends 26 U.S.C. 6103(h) to provide that upon receipt by the Secretary of the Treasury of a written request meeting the specified requirements from the Securities and Exchange Commission, an appropriate Federal banking agency, or the Public Company Accounting Oversight Board, a return or return information shall be disclosed to such requestor’s officers and employees who are personally and directly engaged in an investigation, examination, or proceeding by such requestor to evaluate, determine, penalize, or deter conduct by a financial institution, issuer, or public accounting firm, or associated person, in connection with a potential or actual violation of section 6700 (promotion of abusive tax shelters), 6701 (aiding and abetting understatement of tax liability), or activities related to promoting or facilitating inappropriate tax avoidance or tax evasion.

SEC. 306. Disclosure of Information to Congress

Section 306 expands the exception to the prohibition on the disclosure of information by tax return preparers to include disclosure pursuant to:

(i) The order of any Federal, State, or local court of record.

(ii) A subpoena issued by a Federal or State grand jury.

(iii) An administrative order, summons, or subpoena which is issued in the performance of its duties by —

(I) any Federal agency, including Congress or any committee or subcommittee thereof, or

(II) any State agency, body, or commission charged under the laws of the State or a political subdivision of the State with the licensing, registration, or regulation of tax return preparers.

The section also requires disclosure of information to Congress related to an Internal Revenue Service determination of the tax-exempt status of an organization.

SEC. 307. Tax Opinion Standards for Tax Practitioners

Section 307 revises 31 U.S.C. 330(a) to direct the Secretary of the Treasury to impose standards applicable to the rendering of written advice with respect to any listed transaction or any entity, plan, arrangement, or other transaction which has a potential for tax avoidance or evasion. Such standards shall address, but not be limited to, the following issues:

(1) Independence of the practitioners issuing such written advice from persons promoting, -marketing, or recommending the subject to the advice.

(2) Collaboration among practitioners, or between a practitioner and other party, which could result in such collaborating parties having a joint financial interest in the subject of the advice.

(3) Avoidance of conflicts of interest which would impair auditor independence.

(4) For written advice issued by a firm, standards for reviewing the advice and ensuring the consensus support of the firm for positions taken.

(5) Reliance on reasonable factual representations by the taxpayer and other parties.

(6) Appropriateness of the fees charged by the practitioner for the written advice.

(7) Preventing practitioners and firms from aiding or abetting the understatement of tax liability by clients.

(8) Banning the promotion of potentially abusive or illegal tax shelters.

—Arnold I Havens and Alex P. Trostorff

Remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. For further information regarding these issues, contact:

William M. Backstrom, Jr.
Jones Walker
201 St. Charles Avenue
New Orleans, LA 70170-5100
504.582.8228 *tel*
504.589.8228 *fax*
bbackstrom@joneswalker.com

John J. Jaskot
Jones Walker
499 S Capitol St SW
Washington D.C. 2003
202.203.1014 *tel*
202.203.0000 *fax*
jjaskot@joneswalker.com

Tax & Estates Attorneys

Jesse R. Adams, III
William M. Backstrom, Jr.
Edward B. Benjamin, Jr.
Brandon Kelly Black
John C. Blackman, IV
Timothy P. Brechtel
Adam G. Brimer
Andre B. Burvant
Melissa A. Campbell
Ricardo X. Carlo
Robert R. Casey
Susan K. Chambers
David F. Edwards
Janice Martin Foster
Kathryn Scioneaux Friel
John W. Gant, Jr.
Leon Gary, Jr.
Genevieve M. Hartel
Miriam Wogan Henry
Jonathan R. Katz
Brooke L. Longon
Matthew A. Mantle
B. Michael Mauldin
Louis S. Nunes, III
Rudolph R. Ramelli
Coleman Douglas Ridley, Jr.
Kimberly Lewis Robinson
Kelly C. Simoneaux
Hope M. Spencer
Alex P. Trostroff
Edward Dirk Wegmann
B. Trevor Wilson

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