
General Explanations
of the
Administration's Fiscal Year 2010
Revenue Proposals



Department of the Treasury
May 2009

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¹ The Administration’s primary policy proposals reflect changes from a tax baseline that modifies current law by “patching” the alternative minimum tax, freezing the estate tax, and making permanent a number of the tax cuts enacted in 2001 and 2003. The baseline changes to current law are described in the Appendix. In some cases, the policy descriptions in the body of this report make note of the baseline (e.g., descriptions of upper-income tax provisions), but elsewhere the baseline is implicit.

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Combat Under-Reporting of Income Through Use of Accounts and Entities in Offshore Jurisdictions

The Administration is concerned about the use of offshore accounts and entities by certain U.S. and foreign persons to evade U.S. tax. To reduce such evasion, the Administration is proposing a series of measures to strengthen the information reporting and withholding systems that support U.S. taxation of income earned or held through offshore accounts or entities.

The qualified intermediary (QI) program is intended to bring foreign financial institutions more directly into the U.S. information reporting and withholding tax system, thereby helping to ensure that foreign persons are subject to the proper U.S. withholding tax. Strengthening the withholding and reporting rules under which QIs operate with respect to U.S. and foreign persons while creating incentives for more foreign financial institutions to become QIs will help to ensure that U.S. persons are properly paying tax in connection with foreign income and accounts and that proper withholding tax applies with respect to foreign persons.

REQUIRE GREATER REPORTING BY QUALIFIED INTERMEDIARIES REGARDING U.S. ACCOUNT HOLDERS

Current Law

A withholding agent generally must withhold tax at a rate of 30 percent from the gross amount of all U.S.-source fixed or determinable annual or periodical gains, profits, or income (FDAP income) of a nonresident alien individual or foreign entity. A payor is generally required to withhold tax at a rate of 28 percent on a reportable payment made to a U.S. non-exempt recipient if the payee fails to provide a taxpayer identification number or fails to certify, when required, that the payee is not subject to backup withholding, or the payor is notified by the IRS or a broker that the payee is subject to backup withholding.

Treasury regulations address certification, documentation, withholding, and reporting of payments to U.S. and foreign persons through foreign financial institutions. Foreign financial institutions may contract with the IRS to operate according to a set of withholding and reporting rules under the so-called “qualified intermediary” (QI) program. QIs agree to collect identifying documentation from their customers, file withholding tax returns and information returns, and submit to periodic audits performed by external auditors supervised by IRS examiners. QIs may furnish a withholding certificate to a withholding agent in lieu of transmitting to the withholding agent documentation for persons for whom the QI receives the payment and, in the case of U.S. non-exempt recipients, assumes primary Form 1099 reporting and backup withholding responsibility.

QIs need not assume primary Form 1099 reporting and backup withholding responsibility. If a QI nevertheless assumes primary Form 1099 reporting and backup withholding responsibility with respect to accounts held by U.S. persons, such reporting may be limited to certain income earned through those accounts. Further, a QI that assumes primary Form 1099 reporting and backup withholding responsibility with respect to U.S. persons is not required to assume that responsibility for all accounts. Moreover, in the case of financial institutions that are part of a

controlled group, one member of the controlled group may contract to be a QI while other members of the controlled group do not, and thus accounts and clients may be divided between commonly-controlled QI and non-QI institutions.

Reasons for Change

Strengthening the withholding and reporting rules under which QIs operate with respect to U.S. persons while creating incentives for the use of QIs would help to ensure that U.S. persons are properly paying tax on income earned through foreign accounts and that proper withholding tax applies with respect to foreign persons. In order to facilitate operation of this strengthened QI program, a list of QIs must be made publicly available.

Proposal

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. A QI would be required to report all reportable payments (for this purpose, treating the QI as a U.S. payor) received on behalf of all U.S. account holders. Thus, a QI would file Form 1099s with respect to payments to those U.S. account holders as though the QI were a U.S. financial institution. The Treasury Department would be authorized to issue regulations to implement the purposes of this proposal, including authority to require that for any financial institution to be a QI, commonly-controlled foreign financial institutions must meet certain reporting obligations with respect to account holders or that a financial institution may be a QI only if all commonly-controlled financial institutions are also QIs, and including authority to provide that for any financial institution to be a QI it must collect information indicating the beneficial owners of foreign entity account holders and specifically report if a U.S. person is a beneficial owner. The proposal would also clarify that under section 6103 of the Code the IRS may publish the list of QIs.

The proposal would be effective beginning after December 31 of the year of enactment.

REQUIRE WITHHOLDING ON PAYMENTS OF FDAP INCOME MADE THROUGH NONQUALIFIED INTERMEDIARIES

Current Law

In general, payments of U.S.-source fixed or determinable annual or periodical gains, profits, or income (FDAP income) to nonresident alien individuals and foreign entities are subject to withholding tax at a rate of 30 percent. This 30-percent withholding tax may be reduced or eliminated pursuant to certain statutory provisions or pursuant to the terms of a tax treaty.

To determine whether the recipient of a payment is exempt from withholding tax or eligible for a reduced rate, withholding agents generally must rely on beneficial ownership documentation provided by the payee certifying that the payee is entitled to an exemption from withholding tax or a reduced rate of withholding tax under a Code provision or relevant tax treaty. In general, withholding agents are entitled to rely on the self-certification they receive absent actual knowledge or reason to know that the information provided is incorrect or unreliable. In the case of payments made through an intermediary, the intermediary generally provides to the withholding agent the appropriate documentation on behalf of the payment's beneficial owners.

Reasons for Change

The Administration is concerned that some persons that are not entitled to an exemption from withholding tax or a reduced rate of withholding tax may attempt to avoid U.S. tax by arranging to receive payments through foreign intermediaries that are not qualified intermediaries (nonqualified intermediaries). The proposal would discourage U.S. and foreign persons from attempting to avoid U.S. tax or to obtain a lower rate of withholding tax by providing incorrect self-certification or otherwise relying on the lack of information reporting associated with using nonqualified intermediaries. The proposal would also encourage use of the strengthened qualified intermediary system, by requiring withholding of tax on payments made through nonqualified intermediaries.

Proposal

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). The Treasury Department would receive regulatory authority to provide exceptions, including exceptions for payments collected by nonqualified intermediaries for foreign government, central bank, foreign pension fund, and foreign insurance company payees, and other similar investors, and for payments that the Treasury Department concludes present a low risk of tax evasion. The rules will be designed so as not to disrupt ordinary and customary market transactions. Foreign persons that are subject to over-withholding as a result of this proposal would be permitted to apply for a refund of any excess tax withheld.

The proposal would be effective for payments made after December 31 of the year of enactment.

REQUIRE WITHHOLDING ON GROSS PROCEEDS PAID TO CERTAIN NONQUALIFIED INTERMEDIARIES

Current Law

Brokers are generally required to withhold tax at a rate of 28 percent on certain reportable payments made to a U.S. non-exempt recipient if the payee fails to provide a taxpayer identification number or fails to certify that the payee is not subject to backup withholding, or the payor is notified by the IRS or a broker that the payee is subject to backup withholding. Reportable payments include the gross proceeds from certain transactions effected by brokers for their customers. A broker is exempt from reporting a payment (and thus backup withholding) where the broker can, prior to payment, associate the payment with documentation upon which it can rely to either treat the customer as a foreign beneficial owner, or treat the payment as made or presumed to be made to a foreign payee. With respect to payments through foreign intermediaries that are not qualified intermediaries (nonqualified intermediaries), brokers may rely on the beneficial owner's self-certification of non-U.S. status passed on by the nonqualified intermediary to determine whether certain third-party information reporting, and therefore backup withholding, may be required.

A withholding agent generally must withhold tax at a rate of 30 percent from the gross amount of all U.S.-source fixed or determinable annual or periodical gains, profits, or income (FDAP income) of a nonresident alien individual or foreign entity. FDAP income includes interest and dividends, but generally does not include gross proceeds or gains from sales. A foreign payee may claim a refund of any overpayment of tax which is withheld at source.

Reasons for Change

U.S. persons seeking to evade U.S. tax may arrange to receive payments, with respect to which gross proceeds would otherwise be reported, through nonqualified intermediaries and certify that they qualify as foreign persons. A broker making a payment through a nonqualified intermediary is unlikely to be in a position to verify whether self-certification regarding foreign status is accurate. The proposal would discourage U.S. persons from attempting to evade U.S. tax by providing incorrect self-certification or otherwise relying on the lack of information reporting associated with using nonqualified intermediaries. The proposal would also encourage use of the strengthened qualified intermediary system by requiring withholding on gross proceeds on the sale of securities held through nonqualified intermediaries.

Proposal

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. The Treasury Department would receive regulatory authority to provide exceptions, including exceptions for payments collected by nonqualified intermediaries for foreign government, central bank, foreign pension fund, and

foreign insurance company payees, and other similar investors; payments to nonqualified intermediaries located in jurisdictions with which the United States has a tax information exchange agreement; and payments that the Treasury Department concludes present a low risk of tax evasion. The rules will be designed so as not to disrupt ordinary and customary market transactions. Nonqualified intermediaries would be eligible to claim a refund on behalf of their direct account holders for any taxable year in which they identified all of their direct account holders that are U.S. persons and reported all reportable payments received on behalf of U.S. account holders. Foreign persons that are subject to withholding tax in excess of their income tax liability as a result of this proposal, and on whose behalf a refund claim is not made by a nonqualified intermediary, would be permitted to apply for a refund of any tax withheld.

The proposal would be effective for payments made after December 31 of the year of enactment.

REQUIRE REPORTING OF CERTAIN TRANSFERS OF MONEY OR PROPERTY TO FOREIGN FINANCIAL ACCOUNTS

Current Law

United States persons must disclose whether, at any time during the preceding year, they had an interest in, or signature or other authority over, financial accounts in a foreign country, if the aggregate value of these accounts exceeds \$10,000. United States persons must also report certain information with respect to certain foreign business entities that they control. Under Treasury regulations, a U.S. person controls a foreign corporation for this purpose if the person owns, actually or constructively, more than 50 percent of the corporation's stock, by vote or by value. Current law does not contain a provision that generally requires reporting of transfers of money or property to, or receipt of money or property from, a foreign bank, brokerage, or other financial account by U.S. individuals.

Reason for Change

The Administration is concerned about the use of foreign accounts by U.S. citizens and residents to evade U.S. tax. To reduce such evasion, the Administration proposes to increase information reporting requirements with respect to transfers to and from certain foreign accounts.

Proposal

A U.S. individual would be required to report, on the individual's income tax return, any transfer of money or property made to, or receipt of money or property from, any foreign bank, brokerage, or other financial account by the individual, or by any entity of which the individual owns, actually or constructively, more than 50 percent of the ownership interest. Transfers to accounts held at qualified intermediaries and receipts from accounts held by U.S. persons at qualified intermediaries would not be required to be reported. In addition, individuals would be exempt from the reporting requirement if the cumulative amount or value of transfers and the cumulative amount or value of receipts that would otherwise be reportable on the individual's income tax return for a given year were each less than \$10,000. Failure to report a covered transfer would result in the imposition of a penalty equal to the lesser of \$10,000 per reportable transfer or 10 percent of the cumulative amount or value of the unreported covered transfers. No penalty would be imposed for a failure to report due to reasonable cause. The Treasury Department would receive regulatory authority to issue rules to prevent abuse of the reporting exemptions and to provide exceptions to the reporting requirement, such as an exception for arm's-length payments in the ordinary course of business for services or tangible property.

The proposal would be effective for transfers made after December 31 of the year of enactment.

REQUIRE DISCLOSURE OF FBAR ACCOUNTS TO BE FILED WITH TAX RETURN

Current Law

Individual taxpayers currently must indicate on their income tax returns whether they had an interest in or signature or other authority over a financial account in a foreign country during the year to which the tax return relates. If a taxpayer has a foreign account, the tax return refers the taxpayer to the Report of Foreign Bank and Financial Accounts, Form TD F 90-22.1 (FBAR). The FBAR requires a citizen, resident, or person in and doing business in the United States to disclose whether, at any time during the preceding year, that person had an interest in, or signature authority over, financial accounts, if the aggregate value of these accounts exceeds \$10,000. The FBAR further requires the person to disclose certain information regarding the foreign account, including the account number, financial institution, and maximum value during the year. The FBAR is not required to be filed until June 30 of the year following the calendar year to which it relates. The FBAR is filed with the Treasury Department generally and not directly with the IRS.

Reasons for Change

Disclosure of more detailed information regarding foreign accounts on the income tax return itself would assist the IRS in identifying and investigating instances where taxpayers have used foreign accounts to evade U.S. taxes. Further, associating the FBAR disclosure requirements with a taxpayer's obligation to file an income tax return would improve awareness and compliance with the FBAR disclosure obligations and improve the IRS's ability to review FBAR compliance.

Proposal

Individual taxpayers required to file an FBAR would be required to disclose certain information on their income tax returns. The information would be disclosed on a schedule that would be considered part of the individual's income tax return. The schedule would be consistent with the information disclosure obligations of the FBAR itself, and would require the taxpayer to provide information such as the account number, financial institution, and maximum value during the year. The disclosures would be required when the income tax return is due, even if Title 31 does not require the FBAR to be filed until a later date.

The tax return disclosure would not replace or mitigate the individual's obligation to separately file an FBAR with the Treasury Department as required under Title 31. The penalties imposed under Title 31 for failing to file an FBAR would continue to apply to a failure to file an FBAR as required under Title 31. Failure to disclose the foreign accounts with the income tax return would not be subject to the Title 31 penalties, although it could give rise to penalties and other consequences imposed under the Code, including extension of the statute of limitations.

The proposal would be effective for taxable years beginning after December 31 of the year of enactment.

REQUIRE THIRD-PARTY INFORMATION REPORTING REGARDING THE TRANSFER OF ASSETS TO FOREIGN FINANCIAL ACCOUNTS AND THE ESTABLISHMENT OF FOREIGN FINANCIAL ACCOUNTS

Current Law

United States persons must disclose whether, at any time during the preceding year, they had an interest in, or signature or other authority over, financial accounts in a foreign country, if the aggregate value of these accounts exceeds \$10,000. Current law does not generally require third-party information reporting to the IRS with regard to the transfer of money or property to, or receipt of money or property from, a foreign bank, brokerage, or other financial account on behalf of a U.S. person, or with regard to the establishment of a foreign bank, brokerage, or other financial account on behalf of a U.S. person.

Reasons for Change

The Administration is concerned that U.S. persons are failing to comply with the requirement to report certain foreign financial accounts. Establishing a third-party reporting requirement with respect to transfers to foreign financial accounts, receipts from such accounts, and the establishment of such accounts would lead to greater disclosure of foreign financial accounts, and consequently would discourage the evasion of U.S. taxation. These third-party reporting requirements complement taxpayer reporting requirements.

Proposal

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. Any U.S. financial intermediary and any qualified intermediary that receives a transfer of money or property with a value of more than \$10,000 from 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. Any U.S. financial intermediary and any qualified intermediary that opens 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 with the IRS regarding such account, including reporting any amounts of money or property transferred by the financial intermediary to such account. Exceptions to the reporting requirement would be provided for 1) accounts opened and amounts transferred to, from, or on behalf of, publicly traded companies and their subsidiaries, 2) accounts opened at and transfers made to qualified intermediaries 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) or 3) transfers received by or 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) from accounts held by a U.S. person at a qualified

intermediary. The Treasury Department would receive regulatory authority to provide additional exceptions to the reporting requirement, to require that certain additional information be reported, and to permit U.S. financial intermediaries and qualified intermediaries to report additional transfers of money or property to a foreign bank, brokerage, or other financial account on behalf of a U.S. person (or on behalf of an entity of which the U.S. person owns, actually or constructively, more than 50 percent of the ownership interest).

The proposal would be effective for amounts transferred and accounts opened beginning after December 31 of the year of enactment.

REQUIRE THIRD-PARTY INFORMATION REPORTING REGARDING THE ESTABLISHMENT OF OFFSHORE ENTITIES

Current Law

United States persons must report certain information with respect to certain foreign business entities that they control. Current law does not generally require third-party information reporting in connection with the acquisition or formation of a foreign business entity on behalf of a U.S. individual. Current law does not require withholding agents to ascertain the ownership of foreign payees that may be entities with respect to which U.S. persons have a U.S. reporting or income tax obligation.

Reasons for Change

Because no information is reported to the IRS by third parties with respect to the formation of foreign business entities, the IRS cannot readily ascertain whether U.S. individuals are complying with their reporting obligations in regard of foreign business entities that they control. Requiring third-party reporting, and providing for additional information collection by withholding agents, would supplement the reporting requirements of current law and help the IRS to enforce U.S. tax law and reduce tax evasion through the use of foreign entities.

Proposal

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. The Treasury Department would receive regulatory authority to determine the information to be reported and to provide exceptions to the reporting requirement. In addition, the Treasury Department would receive regulatory authority to require, as necessary, withholding agents to collect additional information to determine whether a U.S. person is the beneficial owner of a foreign entity and specifically report if a U.S. person is a beneficial owner.

The proposal would be effective for entities formed or acquired after December 31 of the year of enactment.

NEGATIVE PRESUMPTION FOR FOREIGN ACCOUNTS WITH RESPECT TO WHICH AN FBAR HAS NOT BEEN FILED

Current Law

A citizen or resident of the United States, or a person in and doing business in the United States, who has a financial interest in, or signature or other authority over, financial accounts in a foreign country must file a Report of Foreign Bank and Financial Accounts (FBAR) if the aggregate value of these accounts exceeds \$10,000 at any time during the preceding year. The civil penalty for failing to disclose a foreign financial account on an FBAR will not exceed \$10,000 absent a willful violation. The penalty may not be imposed if the violation was due to reasonable cause and the balance in the account was properly reported. For willful violations, the maximum civil penalty is the greater of \$100,000 or 50 percent of the balance in the account at the time of the violation. The criminal penalties for willfully failing to report a foreign bank account include a maximum fine of \$250,000, a maximum term of imprisonment of five years, or both, with higher penalties if the defendant violates any other U.S. law, or if the violation was part of a pattern of any illegal activity involving more than \$100,000 in a 12-month period. Civil and criminal penalties may be imposed together.

Reasons for Change

The Administration is concerned that U.S. persons are failing to comply with FBAR filing obligations. Under current law, the civil penalty provisions associated with the requirement to file an FBAR may be difficult to apply in cases where the IRS is aware of the existence of unreported foreign financial accounts but cannot ascertain without documentation from the foreign financial institution whether those accounts contain more than \$10,000. Imposing a rebuttable evidentiary presumption would encourage voluntary disclosure of account information and assist the IRS in its enforcement efforts with respect to undisclosed foreign financial accounts.

Proposal

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. An exception would apply for accounts held through a qualified intermediary. The Treasury Department would receive regulatory authority to provide additional exceptions. The rebuttable evidentiary presumption would not apply in criminal proceedings.

The proposal would be effective for FBARs due to be filed beginning after the date of enactment.

NEGATIVE PRESUMPTION REGARDING FAILURE TO FILE AN FBAR FOR ACCOUNTS WITH NONQUALIFIED INTERMEDIARIES

Current Law

A citizen or resident of the United States, or a person in and doing business in the United States, who has a financial interest in, or signature or other authority over, financial accounts in a foreign country must file a Report of Foreign Bank and Financial Accounts (FBAR) if the aggregate value of these accounts exceeds \$10,000 at any time during the preceding year. The civil penalty for failing to disclose a foreign financial account on an FBAR will not exceed \$10,000 absent a willful violation. The penalty may not be imposed if the violation was due to reasonable cause and the balance in the account was properly reported. For willful violations, the maximum civil penalty is the greater of \$100,000 or 50 percent of the balance in the account at the time of the violation. The criminal penalties for willfully failing to report a foreign bank account include a maximum fine of \$250,000, a maximum term of imprisonment of five years, or both, with higher penalties if the defendant violates any other U.S. law, or if the violation was part of a pattern of any illegal activity involving more than \$100,000 in a 12-month period. Civil and criminal penalties may be imposed together.

Reasons for Change

The Administration is concerned that U.S. persons are failing to comply with FBAR filing obligations. Although qualified intermediaries must perform certain information reporting with respect to U.S. accountholders, foreign intermediaries that are not qualified intermediaries (nonqualified intermediaries) do not perform such information reporting. As a result, the ability of the IRS to discover unreported accounts and enforce compliance with respect to those accounts is limited. Imposing a rebuttable evidentiary presumption with respect to accounts held with nonqualified intermediaries would encourage voluntary disclosure of account information and assist the IRS in its enforcement efforts with respect to undisclosed foreign financial accounts.

Proposal

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. The evidentiary presumption would not apply to accounts in which the person has signature or other authority by virtue of being an officer or employee of a corporation, but otherwise has no more than a de minimis financial interest in that corporation. The Treasury Department would receive regulatory authority to provide additional exceptions to the evidentiary presumption. The evidentiary presumption would not apply in criminal proceedings.

The proposal would be effective for FBARs due to be filed beginning after the date of enactment.

NEGATIVE PRESUMPTION REGARDING WITHHOLDING ON FDAP PAYMENTS TO CERTAIN FOREIGN ENTITIES

Current Law

In general, payments of U.S.-source fixed or determinable annual or periodical gains, profits, or income (FDAP income) to nonresident alien individuals and foreign entities are subject to withholding tax at a rate of 30 percent. This 30 percent withholding tax may be reduced or eliminated pursuant to certain statutory provisions or pursuant to the terms of a tax treaty.

To determine whether the recipient of a payment is exempt from withholding tax or eligible for a reduced rate, withholding agents generally must rely on beneficial ownership documentation provided by the payee certifying that the payee is entitled to an exemption from withholding tax or a reduced rate of withholding tax under a Code provision or relevant tax treaty. In general, withholding agents are entitled to rely on the self-certification they receive absent actual knowledge or reason to know that the information provided is incorrect or unreliable. In the case of payments made through an intermediary, the intermediary generally provides to the withholding agent the appropriate documentation on behalf of the payment's beneficial owners.

Reasons for Change

Persons that are not entitled to an exemption from withholding tax or a reduced rate of withholding tax may arrange to receive payments through entities that appear to qualify for an exemption or a reduced rate. A withholding agent making a payment to such an entity is unlikely to be in a position to determine whether the entity's self-certification regarding its qualification is accurate.

Proposal

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. Exceptions would be provided for payments to publicly traded companies and their subsidiaries, foreign governments, and pension funds. In addition, the Treasury Department would receive regulatory authority to provide additional exceptions for payments to entities engaged in the active conduct of a trade or business in their country of residence, charities, widely-held investment vehicles, entities that enter into an agreement with the IRS to collect documentation for all owners and report all U.S. non-exempt owners to the IRS, and for any other payment that the Treasury Department concludes presents a low risk of tax evasion.

The proposal would be effective for payments made after December 31 of the year of enactment.

EXTEND STATUTE OF LIMITATIONS FOR CERTAIN REPORTABLE CROSS-BORDER TRANSACTIONS AND FOREIGN ENTITIES

Current Law

In general, additional Federal tax liabilities in the form of tax, interest, penalties, and additions to tax must be assessed by the IRS within three years after the date a return is filed. If an assessment is not made within the required time period, the additional liabilities generally cannot be assessed or collected at any future time. Section 6501(c)(8) of the Code provides an exception to this general statute of limitations with respect to any tax relating to any event or period for which certain information returns are required with respect to certain foreign transfers, foreign entities, and foreign-owned entities. In these cases, the statute of limitations does not expire until three years after the taxpayer furnishes the information required to be reported.

Section 6038A of the Code requires certain foreign-owned domestic corporations to file information returns containing specified information with respect to related-party transactions, and to maintain such records as may be appropriate to determine the correct treatment of such transactions. Failure to file the required information returns triggers the section 6501(c)(8) extension of the statute of limitations.

Reasons for Change

Compliance with reporting and recordkeeping obligations is essential in order to enable the IRS to enforce the tax laws. The three-year period provided by section 6501(c)(8) does not always allow sufficient time for the IRS to determine a taxpayer's tax liability. Furthermore, the information returns to which section 6501(c)(8) applies do not include some of the information returns the IRS requires in order to enforce the tax law with respect to foreign entities and accounts, including certain newly proposed information returns. The generally applicable three-year statute of limitations also does not always allow sufficient time for the IRS to determine a taxpayer's tax liability if a violation of record maintenance obligations under section 6038A has occurred.

Proposal

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. The information returns with respect to which section 6501(c)(8) applies would be broadened to include the information returns filed by qualifying electing funds pursuant to regulations under section 1295(b) of the Code, the proposed tax return disclosure of FBAR information, and the information returns proposed to be required of U.S. individuals with respect to certain transfers of money or property to and receipts from certain foreign bank, brokerage, or other financial accounts. The extended statute of limitations provided by section 6501(c)(8) would also apply in the case of failure to furnish information or maintain records as required by section 6038A(a). The section 6501(c)(8) exception to the general statute of limitations would be made applicable to the entire income tax return. The Treasury Department would receive regulatory authority to provide exceptions to these rules.

The proposal would be effective for returns due to be filed after the date of enactment.

DOUBLE ACCURACY-RELATED PENALTIES ON UNDERSTATEMENTS INVOLVING UNDISCLOSED FOREIGN ACCOUNTS

Current Law

Current law imposes a 20-percent accuracy-related penalty on (i) a substantial understatement of income tax, (ii) an understatement resulting from negligence or disregard of rules or regulations, and (iii) an understatement related to a reportable transaction. The 20-percent accuracy-related penalty increases to 30 percent in the case of an understatement from a reportable transaction that was not properly disclosed. The accuracy-related penalty is not imposed when the taxpayer demonstrates “reasonable cause” for the position and acted in good faith. In the case of a reportable transaction, the reasonable cause exception to the imposition of penalties only applies if the taxpayer disclosed the reportable transaction as required by law and certain other requirements are met.

Individual taxpayers must indicate on their income tax returns whether they had an interest in or signature or other authority over a financial account in a foreign country during the year to which the tax return relates. If the taxpayer had a foreign financial account, the income tax return instructs the taxpayer to refer to the Report of Foreign Bank and Financial Accounts (FBAR), which requires the taxpayer to disclose information regarding certain foreign accounts.

Reason for Change

United States persons may seek to evade U.S. tax liability by transferring assets to foreign accounts. Increasing the penalties on understatements from transactions that involve undisclosed foreign accounts would encourage proper disclosure of such accounts and deter the use of foreign accounts to evade U.S. tax liability.

Proposal

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. In addition, in the case of a reportable transaction understatement, the reasonable cause exception would not be available with respect to this increased penalty.

The proposal would be effective for taxable years beginning after December 31 of the year of enactment.

IMPROVE THE FOREIGN TRUST REPORTING PENALTY

Current Law

Certain information must be reported to the IRS with respect to certain foreign trusts. A civil penalty applies to persons who fail to file a timely return as required or who file an incomplete or incorrect return. Generally, the penalty is equal to 35 percent of the “gross reportable amount,” which is defined as the gross value of property involved in a reportable event such as a gratuitous transfer to the trust, the gross value of the portion of the trust’s assets at the close of the year that is treated as owned by a United States person, or the gross amount of distributions received from the trust. In the case of a failure to report that continues for more than 90 days after the IRS mails notice of such failure, the penalty (in addition to the 35 percent penalty) is \$10,000 for each 30-day period (or fraction thereof) during which the failure continues. The total penalty with respect to any failure may not exceed the gross reportable amount.

Reasons for Change

In many instances, the IRS obtains information relating to the creation of a foreign trust from third parties, or the IRS discovers funding of a foreign trust from public records. Without the cooperation of persons actually involved with the trust, however, it is often difficult for the IRS to determine the gross reportable amount. If the IRS cannot determine the gross reportable amount, the IRS may not be able to assess the penalties, including the \$10,000 penalty for continued failure to report. The current penalty regime therefore may create an incentive for persons subject to the reporting requirement not to report or cooperate with the IRS in the hope that the IRS will not be able to determine the gross reportable amount, which is essential to presenting a prima facie case sufficient to meet the Code section 7491(c) burden of production to support the penalty.

Proposal

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). The additional \$10,000 penalty for continued failure to report would remain unchanged. Thus, even if the gross reportable amount is not known, the IRS may impose a \$10,000 penalty on a person who fails to report timely or correctly as required, and may impose a \$10,000 penalty for each 30-day period (or fraction thereof) that the failure to report continues. If the person subsequently provides enough information for the IRS to determine the gross reportable amount, the total penalties would be capped at that amount and any excess penalty already paid would be refunded. Accordingly, a person can stop the compounding of penalties by cooperating with the IRS so that it can determine the gross reportable amount.

The proposal would be effective for information reports required to be filed after December 31 of the year of enactment.