
General Explanations
of the
Administration's Fiscal Year 2011
Revenue Proposals



Department of the Treasury
February 2010

General Explanations of the Administration's Fiscal Year 2011 Revenue Proposals



Department of the Treasury
February 2010

This document is available in Adobe Acrobat format on the Internet at:

<http://www.treas.gov/offices/tax-policy/library/greenbk10.pdf>

The free Adobe Acrobat Reader is available at: <http://get.adobe.com/reader>

Combat Under-Reporting of Income on Accounts and Entities in Offshore Jurisdictions	51
<i>Require Increased Reporting on Certain Foreign Accounts</i>	51
<i>Require Increased Reporting with Respect to Certain Recipients of FDAP Income or Gross Proceeds</i>	54
<i>Repeal Certain Foreign Exceptions to Registered Bond Requirements</i>	56
<i>Require Disclosure of Foreign Financial Assets to Be Filed with Tax Return</i>	58
<i>Impose Penalties for Underpayments Attributable to Undisclosed Foreign Financial Assets</i>	60
<i>Extend Statute of Limitations for Significant Omission of Income Attributable to Foreign Financial Assets</i> .	61
<i>Require Reporting of Certain Transfers of Assets to or from Foreign Financial Accounts</i>	62
<i>Require Third-Party Information Reporting Regarding the Transfer of Assets to or from Foreign</i> <i>Financial Accounts and the Establishment of Foreign Financial Accounts</i>	63
<i>Permit the Secretary to Require Electronic Filing by Financial Institutions of Certain Withholding Tax</i> <i>Returns</i>	65
<i>Establish Presumption of U.S. Beneficiary in Case of Transfers to Foreign Trusts by a U.S. Person</i>	66
<i>Treat Certain Uncompensated Uses of Foreign Trust Property as a Distribution to U.S. Grantor or</i> <i>Beneficiary</i>	67
<i>Improve Foreign Trust Reporting Penalty</i>	68
Reform Treatment of Insurance Companies and Products.....	69
<i>Modify Rules that Apply to Sales of Life Insurance Contracts</i>	69
<i>Modify Dividends-Received Deduction for Life Insurance Company Separate Accounts</i>	70
<i>Expand Pro Rata Interest Expense Disallowance for Corporate-Owned Life Insurance (COLI)</i>	72
<i>Permit Partial Annuitization of a Nonqualified Annuity Contract</i>	74
ELIMINATE FOSSIL FUEL TAX PREFERENCES.....	75
Eliminate Oil and Gas Company Preferences.....	75
<i>Repeal Enhanced Oil Recovery Credit</i>	75
<i>Repeal Credit for Oil and Gas Produced from Marginal Wells</i>	76
<i>Repeal Expensing of Intangible Drilling Costs</i>	77
<i>Repeal Deduction for Tertiary Injectants</i>	79
<i>Repeal Exemption to Passive Loss Limitation for Working Interests in Oil and Gas Properties</i>	80
<i>Repeal Percentage Depletion for Oil and Natural Gas Wells</i>	81
<i>Repeal Domestic Manufacturing Deduction for Oil and Gas Production</i>	83
<i>Increase Geological and Geophysical Amortization Period for Independent Producers to Seven Years</i>	84
Eliminate Coal Preferences.....	85
<i>Repeal Expensing of Exploration and Development Costs</i>	85
<i>Repeal Percentage Depletion for Hard Mineral Fossil Fuels</i>	87
<i>Repeal Capital Gains Treatment of Certain Royalties</i>	89
<i>Repeal Domestic Manufacturing Deduction for Coal and Other Hard Mineral Fossil Fuels</i>	90
ADDITIONAL REVENUE CHANGES	91
<i>Tax Carried (Profits) Interests as Ordinary Income</i>	91
<i>Modify the Cellulosic Biofuel Producer Credit</i>	93
<i>Eliminate the Advanced Earned Income Tax Credit</i>	94
<i>Deny Deduction for Punitive Damages</i>	95
<i>Repeal Lower-of-Cost-or-Market Inventory Accounting Method</i>	96
REDUCE THE TAX GAP AND MAKE REFORMS	97
Expand Information Reporting	97
<i>Require Information Reporting on Payments to Corporations</i>	97
<i>Require Information Reporting for Rental Property Expense Payments</i>	98
<i>Require Information Reporting for Private Separate Accounts of Life Insurance Companies</i>	99
<i>Require a Certified Taxpayer Identification Number from Contractors and Allow Certain Withholding</i>	100
<i>Require Increased Information Reporting for Certain Government Payments for Property and Services</i>	101
<i>Increase Information Return Penalties</i>	102
Improve Compliance by Business	103
<i>Require Greater Electronic Filing of Returns</i>	103
<i>Implement Standards Clarifying when Employee Leasing Companies Can Be Held Liable for their</i> <i>Clients' Federal Employment Taxes</i>	105

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

For too long, some Americans have evaded their taxpaying responsibilities by hiding unreported income in a foreign bank account, trust, or corporation. 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.

REQUIRE INCREASED REPORTING ON CERTAIN FOREIGN ACCOUNTS

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. This 30-percent withholding tax may be reduced or eliminated pursuant to certain statutory provisions or pursuant to the terms of a tax treaty. 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.

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.

Treasury regulations specifically address certification, documentation, withholding, and reporting of payments to U.S. and foreign persons through foreign financial institutions (FFIs). FFIs 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, may assume primary Form 1099 reporting and backup withholding responsibility.

If a QI 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.

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.

Reasons for Change

Strengthening the withholding and reporting rules under which FFIs operate with respect to U.S. persons will 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 reporting and withholding program, a list of compliant FFIs must be made publicly available.

Proposal

Under the proposal, a withholding agent would withhold tax at a rate of 30 percent on payments to a FFI (including certain entities engaged primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interests in the foregoing) of U.S.-source FDAP income and gross proceeds from the sale of any property of a type which can produce U.S.-source interest or dividends, unless the FFI has entered into an agreement with the IRS. The agreement would require the FFI to identify accounts (including debt and equity securities issued by the FFI that are not regularly traded on an established securities market) held at such FFI or at an FFI in the same expanded affiliated group by specified U.S. persons or by foreign entities in which a specified United States person owns, directly or indirectly, an interest of more than 10 percent (a United States owned foreign entity). The FFI would be required to report the name, address, and taxpayer identification number (TIN) of the U.S. account holder (or each substantial U.S. owner of the United States owned foreign entity account holder), the account balance or value, and the gross receipts and gross withdrawals or payments from the account. Instead of reporting the account balance and the gross receipts and gross withdrawals or payments from the account, a FFI may elect to report such information as such FFI would be required to report under sections 6041, 6042, 6045, and 6049 if such FFI were a United States

person and each holder of such accounts that is a specified United States person or a United States owned foreign entity were a natural person and citizen of the United States.

This proposal would not apply to a payment if the beneficial owner is a foreign government, an international organization, a foreign central bank, or any other class of persons that the Treasury Department concludes presents a low risk of tax evasion. The Treasury Department would be authorized to issue regulations to implement the purposes of this proposal. The rules would be designed so as not to disrupt ordinary and customary market transactions. Foreign beneficial owners of payments (other than FFIs that do not qualify for the benefits of an income tax treaty with the United States) that are subject to withholding tax in excess of their income tax liability as a result of this proposal would be permitted to apply for a refund of any excess tax withheld.

The proposal would be effective beginning after December 31, 2012.

REQUIRE INCREASED REPORTING WITH RESPECT TO CERTAIN RECIPIENTS OF FDAP INCOME OR GROSS PROCEEDS

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.

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 (TIN) 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.

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 (other than foreign financial institutions) 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 U.S.-source FDAP income and gross proceeds from the sale of any property of a type which can produce U.S.-source interest or dividends to a foreign entity (other than a foreign financial institution) would be required to withhold a tax of 30 percent, unless the foreign entity certifies that no U.S. person owns, directly or indirectly, an

interest of more than 10 percent or the foreign entity provides the name, address, and TIN of each such substantial U.S. owner, and the withholding agent does not know or have reason to know that any information provided is incorrect. Exceptions would be provided for payments to publicly traded companies and their subsidiaries, foreign governments, international organizations, foreign central banks, any entity that is organized under the laws of a possession of the United States and that is wholly owned by one or more bona fide residents of such possession, and other classes of person identified by the Secretary, or any class of payment identified by the Secretary, as posing a low risk of tax evasion.

The proposal would be effective for payments made after December 31, 2012.

REPEAL CERTAIN FOREIGN EXCEPTIONS TO REGISTERED BOND REQUIREMENTS

Current Law

In general, a taxpayer may deduct all interest paid or accrued within the taxable year on indebtedness. For registration-required obligations, a deduction for interest is allowed only if the obligation is in registered form. Generally, an obligation is treated as issued in registered form if the issuer or its agent maintains a registration of the identity of the owner of the obligation and the obligation can be transferred only through this registration system.

In addition to the denial of an interest deduction, an excise tax is imposed on the issuer of any registration-required obligation that is not in registered form. The excise tax is equal to one percent of the principal amount of the obligation multiplied by the number of calendar years (or portions thereof) during the period beginning on the date of issuance of the obligation and ending on the date of maturity.

Moreover, any gain realized by the beneficial owner of a registration-required obligation that is not in registered form on the sale or other disposition of the obligation is treated as ordinary income (rather than capital gain), unless the issuer of the obligation was subject to the excise tax described above. Finally, deductions for losses realized by beneficial owners of registration-required obligations that are not in registered form are disallowed.

A foreign targeted obligation is excluded from the definition of a registration-required obligation.

Payments of "portfolio interest" are generally exempt from U.S. withholding tax to a nonresident alien or foreign corporation from sources within the United States. Interest on an obligation that is not in registered form may qualify as portfolio interest if the obligation meets the foreign targeting requirements of section 163(f) (2) (B).

Under title 31 of the United States Code, every "registration-required obligation" of the U.S. government must be in registered form, unless it is foreign targeted.

Reasons for Change

Bonds that are not in registered form may allow persons seeking to evade U.S. taxes the ability to invest in such obligations anonymously. Eliminating the foreign-targeted exceptions to the registration requirements will help to ensure that the owners of such obligations are properly identified and that income from such obligations is properly reported.

Proposal

The proposal would repeal the foreign targeted obligation exception to the denial of a deduction for interest on bonds not in registered form. Thus, under the proposal, a deduction for interest would be disallowed with respect to any registration-required obligation not issued in registered form. Under the proposal, a dematerialized book entry system or other book entry system

specified by the Secretary would be treated as a book entry system for purposes of determining whether an obligation is in registered form.

Further, under the proposal, the foreign targeted obligation exception would not be available with respect to the ordinary income treatment of any gain realized by the beneficial owner of a registration-required obligation that is not in registered form on the sale or other disposition of the obligation. Similarly, the foreign targeted obligation exception would not be available with respect to the present law rule disallowing deductions for losses realized by a beneficial owner of a registration-required obligation that is not in registered form. The proposal would include a conforming change to title 31 of the United States Code that repeals the foreign targeted exception to the definition of a registration-required obligation.

Finally, under the proposal interest paid on bonds that are not issued in registered form would not be treated as portfolio interest. Under the proposal, interest would qualify as portfolio interest only if it is paid on an obligation that is issued in registered form and for which the beneficial owner has provided the withholding agent with a statement certifying that the beneficial owner is not a United States person, unless the Secretary determines that such a statement is not necessary.

The provision would be effective for obligations issued after the date which is two years after the date of enactment.

REQUIRE DISCLOSURE OF FOREIGN FINANCIAL ASSETS TO BE FILED WITH TAX RETURN

Current Law

United States persons must file certain information reports with respect to certain interests in foreign entities. Upon the formation, acquisition or ongoing ownership of certain foreign corporations, certain U.S. persons must file an information return providing information about foreign corporations in which they hold an interest. Similarly, certain U.S. persons must file information returns with respect to certain interests in a controlled foreign partnership, with respect to certain foreign trusts, and with respect to foreign disregarded entities. In addition, a U.S. person that capitalizes a foreign entity generally must file an information return regarding the transaction.

Under current law, taxpayers generally 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 the taxpayer 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 financial assets on the income tax return would assist the IRS in identifying and investigating instances where taxpayers have used foreign financial assets to evade U.S. taxes.

Proposal

Any U.S. individual who holds an interest in a foreign financial account, an interest in a foreign entity or any financial instrument or contract held for investment and issued by a foreign person would be required to file an information return if the aggregate value of all such assets exceeds \$50,000. The information return would set forth the name and address of the financial institution that maintains such account or the issuer of the instrument, and the maximum value of the asset during the year. The disclosure would be included as part of the tax return for the taxpayer. Penalties for failing to report the foreign financial asset would be consistent with current penalties under current law for failing to disclose an interest in a foreign entity, such that a failure to report the required information would result in a penalty of \$10,000, unless the failure is shown to be due to reasonable cause and not willful neglect. The Secretary would be given regulatory authority to apply the proposal to certain domestic entities formed or availed of for purposes of holding foreign financial assets, and to coordinate the proposal with other information returns required under the Code.

A rebuttable evidentiary presumption would be applicable in a civil administrative or judicial proceeding providing that, if it is established that the individual had an interest in an undisclosed foreign financial asset, then the aggregate value of all foreign financial assets in which a U.S. individual has an interest will be presumed to exceed \$50,000. The rebuttable evidentiary presumption would not apply in criminal proceedings.

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 the date of enactment.

IMPOSE PENALTIES FOR UNDERPAYMENTS ATTRIBUTABLE TO UNDISCLOSED FOREIGN FINANCIAL ASSETS

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.

Under present law, failure to comply with the various information reporting requirements generally does not, in itself, determine the amount of the penalty imposed on an underpayment of tax.

Reasons for Change

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

Proposal

In addition to the circumstances identified under current law, the 20-percent accuracy-related penalty would apply to any understatement attributable to undisclosed foreign financial assets. In addition, the proposal would double the 20-percent accuracy-related penalty to 40 percent in the case of such foreign financial asset understatements. Undisclosed foreign financial assets would be foreign financial assets that the taxpayer failed to disclose properly under section 6038, 6038B, 6046A, 6048, or the proposed requirement that taxpayers disclose foreign financial assets. As under current law, the penalty would not be imposed when the understatement is due to reasonable cause.

The proposal would be effective for taxable years beginning after the date of enactment.

EXTEND STATUTE OF LIMITATIONS FOR SIGNIFICANT OMISSION OF INCOME ATTRIBUTABLE TO FOREIGN FINANCIAL ASSETS

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.

A special rule is provided where there is a substantial omission of income. If a taxpayer omits substantial gross income on a return, any tax with respect to that return may be assessed and collected within six years of the date on which the return was filed. In the case of income taxes, a substantial omission means at least 25 percent of the amount that was properly includible in gross income; for estate and gift taxes, a substantial omission means 25 percent of a gross estate or total gifts.

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 where the taxpayer has omitted income and failed to disclose foreign assets.

Proposal

Under the proposal, if the taxpayer omits from gross income more than \$5,000 that is attributable to one or more foreign financial assets required to be disclosed under the proposal to require disclosure of foreign financial assets (without regard to the \$50,000 threshold), the statute of limitation would be extended to six years after the required return was filed. In addition, the tolling of the statute of limitations under section 6501(c) (8) would apply to failures to file the reports that would be required under the proposal to require reporting of foreign financial assets.

The proposal would be effective for income tax returns due to be filed after the date of enactment, and returns filed on or before such date if the statute of limitations with respect to such return has not expired as of the date of enactment.

REQUIRE REPORTING OF CERTAIN TRANSFERS OF ASSETS TO OR FROM 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.

Reasons 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. Additionally, any entity of which a U.S. individual owns, directly or indirectly, more than 25 percent of the ownership interest would be required to report 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 entity. Such an entity would also be required to report the name, address, and taxpayer identification number of any U.S. individual who owns more than 25 percent of the ownership interest in the entity. This reporting requirement would not apply if the cumulative amount or value of transfers, and the cumulative amount or value of receipts that would otherwise be reportable for a given year were each less than \$50,000. The Treasury Department would receive regulatory authority to require the reporting of additional information, including classifying transfers and receipts as for investment or for arm's-length payments in the ordinary course of business for services or tangible property, or such other categories as the Secretary may prescribe. 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.

The proposal would be effective for transfers made after December 31, 2012.

REQUIRE THIRD-PARTY INFORMATION REPORTING REGARDING THE TRANSFER OF ASSETS TO OR FROM 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 institution that during the year transfers to, or receives from, a foreign bank, brokerage, or other financial account money or property with an aggregate value of more than \$50,000 on behalf of a U.S. individual, or on behalf of any entity of which a U.S. individual owns, directly or indirectly, more than 25 percent of the ownership interest, would be required to file an information return regarding such transfer or receipt (including, in the case of a transfer by an entity, the name, address, and taxpayer identification number (TIN) of any U.S. individual who owns more than 25 percent of the ownership interest in such entity). Any U.S. financial institution that opens a foreign bank, brokerage, or other financial account on behalf of a U.S. individual, or on behalf of any entity of which a U.S. individual owns, directly or indirectly, more than 25 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 institution to, or received by it from, such account.

In addition to filing an information return with the Internal Revenue Service, the U.S. financial institution would be required to send a copy of such return to the U.S. individual, or entity, as to which the return is made.

Reporting would not be required where the U.S. financial institution determined the entity making or receiving the transfer was: a publicly traded corporation, or a subsidiary thereof; an organization exempt from tax under section 501; an individual retirement plan; the United States or any wholly owned agency or instrumentality thereof; any State, the District of Columbia, any possession of the United States, any political subdivision of any of the foregoing, or any wholly

owned agency or instrumentality of any one or more of the foregoing; any bank (as defined in section 581); any real estate investment trust (as defined in section 856); any regulated investment company (as defined in section 851); any common trust fund (as defined in section 584(a)); any trust which is exempt from tax under section 664(c) or is described in section 4947(a)(1); or an entity engaged in an active trade or business (other than the business of investing or similar activities).

Failure to file a required information return or to provide a copy of such return to the U.S. individual would result in the imposition of a penalty of \$50 with respect to each such failure. In the case of a failure to file due to intentional disregard, the penalty would be the greater of \$100 or 5 percent of the amount of the items required to be reported. No penalty would be imposed for a failure to report due to reasonable cause.

The Treasury Department would receive regulatory authority to provide additional exceptions (including where the Secretary determines that the reporting would be duplicative of other reporting requirements), to limit the types of transfers subject to the reporting requirement, to require that certain additional information be reported, and to permit U.S. financial institutions to report additional transfers of money or property to, or from, a foreign bank, brokerage, or other financial account on behalf of a U.S. individual (or on behalf of an entity of which the U.S. individual owns, actually or constructively, more than 25 percent of the ownership interest).

The proposal would be effective for amounts transferred and accounts opened beginning after December 31, 2012.

PERMIT THE SECRETARY TO REQUIRE ELECTRONIC FILING BY FINANCIAL INSTITUTIONS OF CERTAIN WITHHOLDING TAX RETURNS

Current Law

Every withholding agent must file an annual return with the IRS on Form 1042, reporting all taxes withheld during the preceding year and remitting taxes still owing for such preceding year. A withholding agent also must file an information return on Form 1042-S, providing all items of income specified in section 1441(b) paid during the previous year to foreign persons.

Reasons for Change

The Secretary's authority to require returns electronically is limited to persons required to file at least 250 returns during the year. Electronic filing reduces errors on the required returns and facilitates compliance and enforcement measures by the IRS.

Proposal

The proposal would permit the Treasury Department to issue regulations requiring electronic filing for any return filed by a financial institution with respect to any taxes withheld by the financial institution, regardless of the general 250 return threshold.

The proposal would apply to returns the due date for which (determined without regard to extensions) is after the date of enactment.

ESTABLISH PRESUMPTION OF U.S. BENEFICIARY IN CASE OF TRANSFERS TO FOREIGN TRUSTS BY A U.S. PERSON

Current Law

A U.S. person that directly or indirectly transfers property to a foreign trust is generally treated as the owner of the portion of the trust attributable to that property for any year in which there is a U.S. beneficiary of any portion of the trust. A trust is treated as having a U.S. beneficiary for a taxable year unless under the terms of the trust, no part of the income or corpus of the trust may be paid or accumulated during the taxable year to or for the benefit of any U.S. person, and if the trust were terminated at any time during the taxable year, no part of the income or corpus of the trust could be paid to or for the benefit of a U.S. person.

Reasons for Change

In the absence of adequate information reporting, it is difficult for the IRS to determine whether a trust has a U.S. beneficiary. A presumption that a foreign trust receiving a transfer of property from a U.S. person has a U.S. beneficiary unless the transferor provides sufficient information with respect to the existence of U.S. beneficiaries will improve the ability of the IRS to enforce U.S. tax rules applicable to foreign trusts.

Proposal

Under the proposal, if a U.S. person directly or indirectly transfers property to a foreign trust (other than certain deferred compensation and charitable trusts), the trust would be presumed to have a U.S. beneficiary for purposes of the grantor trust rules unless the U.S. transferor files an information return with the IRS and demonstrates that (1) under the terms of the trust, no part of the income or corpus of the trust may be paid or accumulated during the taxable year to or for the benefit of any U.S. person, and (2) if the trust were terminated at any time during the taxable year, no part of the income or corpus of the trust could be paid to or for the benefit of any U.S. person. The proposal would also make certain clarifications of existing rules applicable to foreign trusts with U.S. grantors and beneficiaries.

This proposal would be effective for transfers of property made after the date of enactment.

TREAT CERTAIN UNCOMPENSATED USES OF FOREIGN TRUST PROPERTY AS A DISTRIBUTION TO U.S. GRANTOR OR BENEFICIARY

Current Law

In general, if a foreign trust makes a loan of cash or marketable securities directly or indirectly to any grantor or beneficiary of the trust who is a U.S. person, or to any U.S. person related to such grantor or beneficiary, the amount of the loan is treated as a distribution by the foreign trust to the grantor or beneficiary. In addition, the trust is not treated as a simple trust for the year of the distribution. The grantor trust rules do not currently treat a U.S. person receiving an uncompensated loan of cash or marketable securities, or the uncompensated use of trust property, as a U.S. beneficiary.

Reasons for Change

The administration is concerned that foreign trusts may permit the uncompensated use of trust property by U.S. persons without treating the value of the use as a trust distribution, and without treating the recipient as a U.S. beneficiary for purposes of the grantor trust rules.

Proposal

Under the proposal, if a foreign trust permits the use of trust property other than cash or marketable securities by a U.S. grantor or beneficiary (or a related U.S. person), the fair market value of the use of such property would be treated as a distribution to the U.S. grantor or beneficiary, except to the extent that the trust is paid the fair market value of such use within a reasonable period of time. In addition, for purposes of the grantor trust rules, a loan of cash or marketable securities or the use of other property of a foreign trust would be treated as paid or accumulated for the benefit of a U.S. person, except to the extent that the U.S. person repays the loan at market rates (or pays the fair market value of the use) within a reasonable period of time.

This proposal would be effective for loans made, and uses of property, after the date of enactment.

IMPROVE 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.