They say the sequel is always worse than the original. The latest incarnation of US legislation targeting offshore financial centres proves that adage true, and this time the bill appears to have the support of the Obama administration.

Senator Carl Levin reintroduced the Stop Tax Haven Abuse Act (the ‘STHAA’) Monday, pledging to clamp down on ‘tax havens’ which, according to Levin, are ‘engaged in economic warfare against the United States, and honest, hardworking Americans’.

US Treasury Secretary Timothy Geithner said the Obama administration will ‘fully support’ the STHAA. This comment was made Tuesday in a hearing before the House Committee on Ways and Means on the 2010 budget overview. This statement is a break from the silence on the legislation that has emanated from the White House since Obama’s inauguration. Estimates predict that the STHAA will generate $100 billion per year in tax revenues – an amount that the Administration could sorely use to offset deepening deficit projections.

The announcement is the latest in a series of high-profile statements by leaders in the US and Europe calling for heightened international scrutiny of offshore jurisdictions. Last week, Gordon Brown asked for the members of the G20 to take ‘definitive action’ against tax havens during their meeting in London on 2 April.

The STHAA creates a broad blacklist of 34 ‘Offshore Secrecy Jurisdictions’ (‘OSJs’) including the Channel Islands, the Isle of Man, Switzerland, the Cayman Islands, the British Virgin Islands, Bermuda, the Bahamas, Costa Rica, Belize, Hong Kong and Singapore, among others.

While many headlines have been made over the possibility of the US creating a jurisdictional ‘blacklist’, a number of key provisions of the STHAA are not linked to the blacklist. The significance of such a list, if any, varies with each provision. For example any US financial institution opening offshore accounts or creating offshore entities for US persons would be required to report that fact to the IRS. Further, certain non-US companies would become subject to US taxation if they are deemed to be ‘managed and controlled’ from the US. This latter provision is, in part, targeted at hedge fund managers and other investment managers.

Only time will tell how the sequel ends.

Overview

The 84-page bill includes dozens of proposals ranging from broadened investigative powers for the IRS to increased disclosure of certain offshore accounts. The provisions are outlined below.

**Presumption of control of offshore entities**

The STHAA would create certain rebuttable evidentiary presumptions against US taxpayers dealing with offshore secrecy jurisdictions:

1. A US taxpayer who formed, funded or benefited from an entity in an OSJ is in control of that entity.
2. Funds received from an OSJ entity are fully taxable and funds transferred to an OSJ have not yet been taxed.
3. A ‘financial account’ in an OSJ is subject to existing Foreign Bank Account Form (T.D. F 90-22.1) reporting requirements.

Importantly, these rebuttable presumptions would apply only in civil or administrative enforcement proceedings to collect tax (or in connection with certain securities law proceedings) and would not affect a taxpayer’s reporting obligations on a tax return (or SEC filing).

**Enhanced US tax enforcement**

The legislation would allow the Treasury to impose sanctions and penalties granted under the Patriot Act on foreign jurisdictions or financial institutions that are ‘impeding US tax enforcement.’ These penalties include the ability to prohibit the use of credit cards issued by a sanctioned bank in the US.
US ‘management and control’ rules for non-US companies and fund managers

Certain non-US companies would be subject to US income and gains taxation where management and control occurs primarily in the US. This generally would apply to any publicly traded company or any company with over $50 million of gross assets. Regulations are to be issued deeming US management and control to exist where the corporate assets are primarily being managed for the benefit of investors and ‘decisions about how to invest the assets are made in the United States’.

The provision would appear to simultaneously focus on businesses incorporated outside the US but managing their business activities from the US and fund and investment management businesses with key decision-makers living in the US.

This provision was not included in the 2007 STHAA proposal and would apply to non-US companies regardless of whether they were based in an OSJ.

Extension of time for offshore audits

The legislation would extend from three to six years the amount of time the IRS has to complete an audit and assess a tax on transactions involving an OSJ. This extension will help combat the perceived sluggishness of certain offshore jurisdictions in dealing with IRS audits.

Increased disclosure of offshore accounts and entities

The STHAA would require financial institutions opening accounts in the name of an offshore entity to report that account to the US where the financial institution knows under its ‘known your customer’ rules that a US taxpayer is the ‘beneficial owner’ of the offshore entity. This rule would apply to both US financial institutions opening accounts for offshore entities and to non-US financial institutions participating in the Qualified Intermediary (‘QI’) program.

The bill also would require any US financial institution that directly or indirectly establishes a non-US account or entity for a US taxpayer to report that transaction to the IRS. Generally speaking, existing rules already require the US taxpayer to himself report the transaction to the IRS, but this proposal would create a parallel obligation on the institution itself.

Foreign trust treatment

The STHAA would treat any US person who benefits from a foreign trust as a trust beneficiary, even if not named as such in the trust document. Future or contingent US beneficiaries of a foreign trust would be treated as current beneficiaries. Loans of trust assets or property, such as jewellery or real estate, would be treated as trust distributions and, thus, become potentially taxable. In addition, there are provisions which attribute certain protector and protector-like powers to the grantor – this could in some circumstances result in grantors becoming taxable trust income and gains.

This section would apply to all relevant non-US trusts regardless of whether they were affiliated with an OSJ.

Legal opinions

Under current law, ‘more likely than not’ legal opinions issued to a taxpayer can prevent the IRS from imposing certain penalty charges should they ultimately prevail in challenging a transaction. The STHAA would eliminate the ability for taxpayers to rely on legal opinions removing penalty charges in connection with transactions (any part of which) involves an OSJ unless the Treasury issues regulations exempting either (i) opinions reaching a much higher ‘should’ level of confidence (at least 70% to 75%) or (ii) certain opinions not viewed as presenting the potential for abuse (e.g. corporate reorganizations).

Dividend tax loophole

The legislation would treat all US corporate dividend-based payments to non-US persons as taxable income subject to withholding and is focused at non-US investors currently utilizing certain structured finance arrangements to eliminate US withholding tax on US dividends.

This provision was not included in the 2007 STHAA proposal.

PFICs

The STHAA would increase disclosure obligations in connection with Passive Foreign Investment Companies, so called ‘PFICs’, by requiring reporting from any US person who directly or indirectly causes a PFIC to be formed or who transferred assets to or received assets from a PFIC. This would be in addition to the existing reporting obligations imposed on direct or indirect US owners of PFICs.

This provision was not included in the 2007 STHAA proposal.

Additional Provisions

In addition to the foregoing proposals, the STHAA also would create additional penalties for failures to make required securities disclosures; require anti-money laundering programs for hedge funds and company formation agents; make technical improvements to the IRS John Doe summons capabilities; make certain refinements to the FBAR rules; strengthen tax shelter penalties; prohibit tax shelter patents; create a set of integrated rules preventing tax practitioners from charging fees calculated according to projected or actual tax savings; authorise the Treasury to disclose certain taxpayer information to other governmental agencies including the SEC; increase the Circular 230 obligations on tax practitioners issuing opinion letters; and codify the economic substance doctrine.
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