Fields of Dreams? - President Obama's US budget proposal, tax havens and private clients

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President Obama has announced a new US international tax proposal, entitled 'Levelling the Playing Field: Curbing Tax Havens and Removing Tax Incentives for Shifting Jobs Overseas', focusing on corporations and high net worth individuals currently utilising what the Administration terms 'indefensible tax breaks and loopholes.' The sweeping proposal seeks to raise $210 billion over 10 years and will fundamentally alter the geography of US international taxation. This summary outlines the application of the proposed disclosure and enforcement measures to private clients and the financial intermediaries through whom they invest.

Blacklists

The Obama Administration's proposal combines elements of several other international tax proposals introduced earlier this year, including the Stop Tax Haven Abuse Act ('STHAA') that was re-introduced in March by Senator Carl Levin. Unlike the STHAA, Obama's proposal does not create a jurisdictional 'tax haven' blacklist. Instead a number of blacklist-like provisions would target financial institutions that refuse to sign up to a modified 'Qualified Intermediary' (QI) regime that addresses when, how and to what extent they must provide information about their customers to the IRS.

Summary

The Obama Administration's full budget proposal will be unveiled later this month and is expected to include further international tax reform measures. The current proposal focuses on disclosure and enforcement measures in large part by modifying the QI rules to require financial institutions doing business with 'US customers' to become 'Qualified Intermediaries' and share information about those US customers to the same extent as required of US institutions. In exchange for sharing information about their US customers, financial institutions participating in the QI regime are not required to turn over the names of their non-US customers to the IRS. Relevant institutions not becoming QIs would be presumed to be facilitating tax evasion and withholding tax would be imposed on payments to their customers.

More specifically, investors choosing to utilise financial institutions that do not opt in to the new QI regime would be subject to

(i) withholding tax at 20% to 30% rates on payments from US financial institutions to such non-QI institutions – in order to receive a refund the investor would have to identify himself to the IRS and demonstrate his entitlement; and
(ii) a rebuttable presumption that a Report of Foreign Bank and Financial Account Form TD F 90-22.1 (the so called 'FBAR' form) must be filed for any bank, brokerage or other financial account held by a US person at a non-QI institution. Any failure to meet any such deemed FBAR filing requirement would itself be deemed 'wilful' where the account balance exceeded $200,000 at any point in the year. Under current law 'wilful' FBAR filing violations can be subject to civil penalties on the greater of $100,000 or 50% of the account balance. Criminal penalties also can apply.

Under the current QI rules, non-US financial institutions are not required to disclose to the IRS the names of US customers where such persons invest via certain non-US entities, including corporations and certain trust and foundation structures. The administration's proposal would require information about such US customers be reported to the IRS, though no details have yet been provided.
Financial institutions also would be required to report certain transactions establishing non-US business entities and certain transfers to and from non-US financial accounts on behalf of US taxpayers. US taxpayers would themselves be required to report transfers of money or property to or from non-QI institutions.
Further, QI status would be denied to certain financial institutions where other commonly controlled entities in their group opted not to qualify for QI status. According to the Obama Administration this provision is intended to prevent firms from shifting US investors to affiliated entities opting not to participate in the QI program.
From a collection and enforcement perspective, the Administration's proposal also would:

(i) double certain penalties for US taxpayers failing to make required disclosures of non-US financial accounts – this presumably refers to the aforementioned FBAR reporting requirement, though no further details are available at this time;
(ii) extend the general statute of limitations from three years to six years in connection with international tax enforcement matters (this period only begins to run after taxpayers have submitted their required information); and
(iii) hire almost 800 new IRS employees to be devoted to international enforcement.

Conclusion

President Obama's announcement continues the worldwide trend of stricter collection and enforcement measures for individuals with

investments outside of their home jurisdiction and signals the President's willingness to put legislative muscle behind the April G20 summit commitments to 'deploy sanctions to protect our public finances and financial systems'. If enacted, the provisions would go a long way towards requiring all financial institutions desiring access to US investment markets to provide the IRS with information about their US clients regardless of whether or not and to what extent such institutions might otherwise be or not be required to turn over information about their clients under any applicable income tax treaty or information sharing agreement.

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