



Authors

Charles Kolstad
ckolstad@Venable.com
310.229.9954

Rory Cohen
rmcohen@Venable.com
212.370.6253

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HIRE Act Takes a Higher Toll on Foreign Entities

The Hiring Incentives to Restore Employment (HIRE) Act of 2010 imposes significant new burdens on foreign financial institutions and other foreign investors with US investments. These new rules will affect every foreign entity which receives payments of US source income – they will have to determine whether to comply with the new reporting requirements or pay a 30% withholding tax. The withholding tax provisions of the HIRE Act will likely override existing provisions of US income tax treaties, resulting in the imposition of a 30% withholding tax in many situations.

The HIRE Act continues the trend of focusing on foreign financial accounts owned by US taxpayers by seeking to impose significant new information gathering obligations on foreign entities to identify US account holders. Depending on how the Secretary acts to implement the provisions of the HIRE Act, many foreign entities may choose to no longer invest in US stock or securities.

Payments to Foreign Financial Institutions

Under new Section 1471, a withholding agent will be required to withhold US tax at the rate of 30% on a withholdable payment to a foreign financial institution unless certain information reporting requirements are met with respect to that payment.

In order to avoid the new withholding tax, the foreign financial institution must have an agreement in place with the IRS defining procedures to identify, and provide substantial information regarding, US account holders. The foreign financial institution must agree to (1) obtain information from each holder of each account to determine whether the accounts are US accounts, (2) comply with any verification and due diligence requirements the Secretary may require with respect to the identification of US accounts, (3) report to the IRS on an annual basis, (4) deduct and withhold a payment of 30% on any passthru payments made to a recalcitrant account holder or another foreign financial institution which does not also meet these requirements, (5) comply with requests from the Secretary for additional information with respect to any US account, and (6) obtain a waiver from the account holder if any foreign privacy or other law would otherwise prevent the disclosure of the above information.

If a foreign financial institution has one or more US accounts, and has entered in an agreement with the Secretary, then the institution must provide the following information annually to the IRS:

- name, address, and TIN of each account holder who is a specified US person or of each substantial US owner of a US owned foreign entity;
- the account number;
- the account balance or value;
- the gross receipts and gross withdrawals and payments from the account, except as provided for by the Secretary.

The requirement to provide information as to the gross receipts and gross withdrawals and payments will probably make it necessary for many institutions to develop computer programs specifically to comply with these new US reporting requirements.

The Secretary is authorized to treat a foreign financial institution as satisfying the HIRE Act reporting requirements if the institution confirms that it does not maintain US accounts, and meets other requirements regarding accounts maintained with that institution by other foreign financial institutions. In that case, the 30% withholding tax would not apply to withholdable payments to foreign financial institutions.

Payments to Non-financial Foreign Entities

Similar withholding tax provisions under new Section 1472 apply to withholdable payments made to a non-financial foreign entity. Withholding can be avoided if (1) the beneficial owner provides either a certification that the non-financial foreign entity has no substantial US owners, or the name, address and TIN of each substantial US owner, (2) the withholding agent does not know or have reason to know that any information under (1) is incorrect, and (3) the withholding agent reports the information to the IRS in the manner outlined by the Secretary.

Effective Date

The above new rules will apply to payments made after December 31, 2012. There is an exception for certain grandfathered obligations which are outstanding 2 years after the date of enactment of the HIRE Act.

Request for Comments

In Announcement 2010-22, the Treasury Department and the IRS requested comments from the public regarding guidance projects that should be undertaken by them, as well as issues that arise with respect to the interpretation and implementation of the HIRE Act provisions. While we believe that the bulk of the comments which will be sent to the Treasury and IRS will be from foreign financial institutions, foreign businesses subject to the other reporting requirements of the HIRE Act should also consider sending appropriate comments reflecting their concerns and implementation burdens.

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