

LEGAL ALERT

House of Representatives Passes Tax Extenders Act of 2009 Includes New Taxes on Fund Managers and Anti-Tax Haven Measures

On December 9th, the House of Representatives passed H.R. 4213, the “Tax Extenders Act of 2009,” which extends for one year certain expiring tax cuts. The continued tax cuts will be paid in part by imposing new taxes on investment fund managers and tightening measures on overseas tax avoidance schemes.

Under the Tax Extenders Act of 2009, “carried interest”—the share of profits that investment fund managers are allocated, sometimes called “incentive allocation” or “performance allocation”—will be taxed at ordinary income tax rates. The payment for carried interest will also be considered self-employment income subject to the 2.9% Medicare tax and, subject to customary limitations, 12.4% Social Security tax. If the bill is enacted, these provisions would be effective for tax years ending after 2009. It should be noted that Senator Max Baucus (D-Mont.), the Finance Committee Chairman, has commented that these changes affecting the carried interest currently does not have the votes needed to pass in the Senate.

The bill also includes a provision that would impose a 30% withholding tax on payments to accounts owned by U.S. persons in foreign financial institutions, unless those institutions acknowledge such accounts to the IRS and disclose account ownership, amounts, and fund transfers. Similar rules apply to payments of U.S. source income made to certain foreign entities having U.S. owners. Additionally, tax advisers who help set up offshore accounts would be required to disclose their activities or pay a penalty. The bill also mandates electronic reporting of information reports regarding withholding on transfers to foreign accounts to enable the IRS to better match reports to tax returns. Moreover, the legislation treats certain “dividend equivalent” payments as dividends for tax purposes. This would generally subject to U.S. tax certain notional principal contract (swap) payments and other substitute payments that are economically similar to dividends but currently avoid U.S. tax. The bill also gives the Internal Revenue Service authority to require annual information reporting by U.S. shareholders of a passive foreign investment company.

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