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January 2010

Tax Talk 2010 ©

US Tax Law Developments

IRS Voluntary Disclosure: UBS and Beyond

As many of you surely read about in the international press, a combined governmental effort last year -- by both the U. S. Dept. of Justice and the IRS -- began targeting account holders of Swiss bank UBS who had previously failed to disclose their foreign accounts or related income on U.S. tax returns. The sweeping assault on offshore account holders was prompted by the U.S. authorities' pressure on UBS to turn over the names of 4,450 American clients…which the bank eventually wound up doing, along with paying a $780 million fine while also admitting to criminal wrongdoing.

For those U.S. persons who had never reported their foreign accounts or income – either from UBS or any other overseas bank – the IRS provided a clear ultimatum: come clean under the Voluntary Disclosure Program, which offered reduced penalties for amended returns and FBAR (Foreign Bank Account Reporting) forms filed before the October 15, 2009 deadline, or else risk steep penalties that would, in many cases, wipe out everything in the offshore account.

In November 2009, the IRS proudly announced that as many as 14,700 persons had signed up for the amnesty program. For those who did not disclose in time, the IRS has not yet indicated whether the program would be offered again in the future; rather, they have ensured that additional agents would be hired to fully investigate the overseas income and assets of U.S. taxpayers.

As always, we strongly urge all of our clients to report all foreign-source income on their annual U.S. tax returns, and to report all foreign bank accounts on Form TD F 90.22-1, which is due on June 30th of each year.

Currently, there is <u>no U.S. Estate Tax</u> in 2010…and then?

For some, this may sound too good to be true. For others (especially estate planners), this may cause a year-long headache. In any case, as of the printing of this newsletter (late January 2010), there is currently no U.S. Estate Tax on the estates of decedents dying in 2010.

The reason for this estate tax anomaly dates back to 2001, when Congress passed the *Economic Growth and Tax Relief Reconciliation Act of 2001*, which made sweeping changes to U.S. tax legislation, including higher exemptions and lower tax rates for estate and gifts. The provisions of the 2001 Act were set to expire by December 31, 2009. However, as Congress failed to vote in new legislation prior to the year-end, there is currently a "black hole" whereby the estate tax (but not the gift tax, which is still in place) does not in fact exist in 2010. Starting January 1, 2011, estate tax legislation will revert back to rules which existed prior to the 2001 Act.

Before getting any dangerous ideas, note that it is fairly certain Congress will enact new estate tax legislation prior to year-end, and that such legislation will be retroactive to the beginning of 2010. In all likelihood, the new laws will reflect those outlined in the *Permanent Estate Tax Relief for Families, Farmers and Small Businesses Bill of 2009*, which passed the House late in 2009 and is currently sitting in the Senate. Among the bill's estate tax measures are a permanent exclusion set at $3.5 million for unmarried persons ($7 million for married couples), and a top estate tax rate capped at 45 percent.

In the meantime, there will be no U.S. estate tax (the French estate tax, of course, is still in place) for 2010. Although this sounds like unprecedented relief, keep in mind that in light of the absence of an estate tax, assets passing to descendants in 2010 will receive a "carryover basis," which can result in a much higher capital gains tax when such assets are eventually sold.

Homebuyer Credit expanded through April 2010

In order to help keep the U.S. housing market afloat, Congress has extended the Homebuyer Credit via *The Worker, Homeownership, and Business Act of 2009*, which was voted in last November.

While the original credit was only available for first-time homebuyers within certain income limits, the new credit is available for both first-time and other homebuyers, with higher phase-out thresholds than before. The credit is set at $8,000 for first-time purchases, and $6,500 for other purchases made by long-term residents who have occupied the same household for five out of the last eight years.

Both credits are available for purchases of homes <u>within the U.S. only</u> that cost $800,000 or less, and that are made before April 30, 2010.

Haiti Relief Donations

The IRS recently announced that donations made to charities providing earthquake relief to Haiti will be eligible for deduction on 2009 tax returns if they are made before March 1, 2010. Only cash contributions will qualify, though "cash" includes donations made by text message, check, credit or debit card.

Note that as a general rule, charitable contributions are taken as Itemized Deductions on Schedule A, and subject to certain phase-out limits for higher income taxpayers. For a list of qualifying charities, please visit the IRS website here: http://www.irs.gov/charities/

Additional U.S. Tax Measures

Further U.S. tax relief – totaling a whopping $280 billion -- for lower and middle-income households was set forth in last February's *American Recovery and Reinvestment Act of 2009*, many of whose provisions will affect 2009 and 2010 returns:

- An Alternative Minimum Tax (AMT) “patch” was extended for 2009, raising the exemption amounts above which households are subject to AMT. The 2009 amounts are: $46,700 for singles and heads of households, $70,950 for joint filers and surviving spouses.

- Individuals on fixed incomes (mainly Social Security recipients) will receive a one-time $250 recovery payment. The check should have already been sent by the U.S. Treasury and received by qualifying individuals in 2009.

- The Making Work Pay credit will allow a credit against income tax, equal to the lesser of 6.2% of earned income or $400 ($800 for married filing jointly). The credit is only available when Modified Adjusted Gross Income (MAGI) does not exceed $75,000 ($150,000 for married couples filing jointly). The credit applies for both 2009 and 2010 returns

- Up to $2,400 in unemployment compensation and benefits are excluded from 2009 taxable income.

- Distributions from Qualified Tuition Programs (known as “529 plans”) will be exempt from taxation if used to pay for a beneficiary’s computer, computer technology and internet access. The exemption is available in both 2009 and 2010.

French Tax Law Developments

France cracks down on tax havens

Following in the wake of the IRS’ recent attack on UBS clients, the French fiscal authorities began cracking down last year on international tax fraud with the aid of a reportedly stolen list of 3,000 account holders of HSBC Switzerland. A special office was opened at the Ministry of Finances for taxpayers wishing to voluntary disclose their offshore accounts and income, who would in turn receive amnesty on penalties and interest, depending on the circumstances and “good faith” of the individual.

While the special tax fraud office was officially closed as of December 31, 2009, French taxpayers can continue to disclose offshore accounts and income to their local *Centre des impôts* (CDI), though future policy has not yet been outlined to explain how penalties and interest charges will be handled.

Loi de finances pour 2010 and *Loi de finances rectificative pour 2009*

The 2010 Finance Law and 2009 Rectified Finance Law offer little in terms of incentives for individual taxpayers. The two major reforms, which sparked controversy when introduced in late 2009, will primarily hit businesses: The suppression of the *Taxe profesionnelle* (a fixed annual tax on both business entities and self-employed persons), will take effect as of January 1, 2010. Meanwhile, the much-debated *“Taxe carbone”* on greenhouse gas emissions was rejected by the *Conseil constitutionnel* at the close of 2009, and is currently being watered down into a regime that will mostly penalize corporations who fail to abide by EU environmental standards. Below is a brief summary of provisions affecting individuals:

- Individual income tax brackets and estate/gift tax brackets have been raised by 0,4%, while the threshold for paying the Wealth Tax (ISF) is still fixed at €790,000 for 2010.

- Starting in 2011, the *bouclier fiscal* calculation will include an add-back for abatements on dividends and for capital losses carried forward from previous years.

- The tax exemption for voluntary retirement severance has been suppressed, while 50% of social security disability pay received for work-related accidents will now be taxed.

- Starting on January 1, 2010 maximum threshold for *niches fiscales* (tax shelters) is reduced to €20,000, plus 8% of taxable income, starting on January 1, 2010.

- The option for voluntary tax withholding on dividends is extended until June 15, 2010.

US-France Treaty Update

For the second time in a few years, the 1994 U.S.-France Income Tax Treaty has been modified, this time by the 2009 Protocol, which was ratified in late 2009 and will take effect starting January 1, 2010.

The 2009 Protocol makes significant changes with regards to tax withholding rates on dividends, providing for a 0% rate in the case of cross-border payments made by certain controlling corporate shareholders and pension funds. A 0% withholding rate is also now available for cross-border royalty payments, whereas a 5% rate previously applied.

Other changes in the 2009 Protocol include a substantially modified Limitation of Benefits clause, a Mandatory Arbitration clause in the case of Competent Authority disputes, and new residency tests with regards to fiscally transparent entities.

Finally, the 2009 Protocol corrects a snafu in the previous 2004 Protocol, and once again offers an exemption -- available prior to tax year 2007 -- from U.S. income tax on French social security pensions received by U.S. citizens residing in France. For 2007 and 2008, this exemption was only available to U.S. persons residing in the U.S., while for 2010 onwards it will also be available for U.S. citizens residing in France.

Thus, beginning with tax year 2010, U.S. citizens living in France who receive French pensions “under the social security legislation or similar legislation” will no longer have to report such pension income on their U.S. income tax returns!

****************Wishing you all a safe and happy 2010********************

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