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Reporting Obligations Imposed by FATCA on Foreign Retirement Plans And U.S. Participants in Such Plans

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INTRODUCTION

The Foreign Account Tax Compliance Act (FATCA) was enacted in March 2010 with the primary goal of preventing tax evasion by U.S. persons who hold accounts in ''foreign financial institutions'' (FFIs) and fail to pay U.S. income tax on income earned in those accounts. FATCA, as broadly understood, has two main prongs: one requires reporting by FFIs and the other requires reporting by U.S. persons. FATCA is part of a focus on offshore accounts that has also seen the Internal Revenue Service (IRS) introduce offshore voluntary disclosure programs.

REPORTING BY FFIs IN GENERAL

FATCA requires FFIs to actively review customer accounts to identify those held by U.S. persons and report the accounts to the IRS or to the tax authorities in the FFI's jurisdiction. The approach of enlisting FFIs is relatively novel as it is specifically directed at entities that are generally not even subject to U.S. jurisdiction. However, the threat of a punitive withholding tax on income earned from certain U.S. financial assets provides a substantial incentive to comply with FATCA registration and diligence requirements.

The new 30% withholding tax specifically applies to ''withholdable payments''[1] made to FFIs that do not register for FATCA purposes. A withholdable payment includes: (1) any payment of U.S.-source fixed or determinable annual or periodical (FDAP) income; and (2) any gross proceeds from the sale or other disposition (occurring after December 31, 2016) of any property of a type that can produce interest or dividends that are U.S.-source FDAP income. U.S.-source FDAP income includes, among other items, interest, dividends, and rents (other than income effectively connected with a U.S. trade or business).

An FFI is any foreign entity that falls within one or more of the categories described below:

- accepts deposits in the ordinary course of a banking or similar business, such as savings banks, commercial banks, savings and loan associations, thrifts, credit unions, building societies, and other cooperative banking institutions;
- holds financial assets for the account of others as a substantial portion of its business, such as brokers, dealers, clearing organizations, trust companies, custodian banks, and entities acting as custodians with respect to assets of employee benefit plans, pension plans, and insurance companies with cash value insurance policies;

[1] Reg. §1.1473-1(a)(1). All section (''§'') references are to the U.S. Internal Revenue Code of 1986, as amended, or the regulations thereunder.

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- is engaged or holds itself out as being engaged primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interest in securities, including a futures or forward contract or option, such as mutual funds, funds of funds, exchange-traded funds, hedge funds, private equity and venture capital funds, other managed funds, commodity pools, foundations, and other investment vehicles;
- insurance companies that make payments with respect to certain contracts that are treated as financial accounts.

REPORTING BY FOREIGN RETIREMENT PLANS

Given the broad definition of FFI, foreign retirement plans that are funded and hold investment assets are at risk of being characterized as FFIs. In addition, if captive insurance entities have been established to hold financial assets, such assets may also implicate the FFI definition. The drafters of the FATCA regulations clearly contemplated that foreign retirement plans would initially be classified as FFIs, but provided the following six exemptions:

1. ''Broad participation'' retirement plans: plans that are established to provide retirement income (or death/disability benefits) to plan participants. In order to qualify for the broad participation exemption a foreign retirement plan must meet a series of requirements, including the following:

   a. the plan has more than one beneficiary and one beneficiary does not have more than 5% of the plan assets;

   b. the plan is subject to government regulation in the jurisdiction in which the plan is established;

   c. the plan provides annual reporting information about its participants to the local tax authorities in the jurisdiction in which the plan is established; and

   d. the plan meets one of the following:

      i. the fund receives at least 50% of its total contributions from the sponsoring employers;

      ii. the distributions or withdrawals from the plan are allowed only upon retirement, death, or disability, or penalties apply to distributions or withdrawals not made upon retirement, death, or disability;

      iii. the plan is generally exempt from taxation on its investment income under the laws of the relevant jurisdiction in which the plan is established;

      iv. contributions by employees are limited to earned income or may not exceed $50,000 annually.

2. ''Narrow participation'' retirement plans. Like the broad participation exemption above, the narrow participation exemption applies to foreign retirement plans that are designed to provide only retirement, disability, or death benefits to its beneficiaries. In order to qualify for this exemption a foreign retirement plan must meet the following requirements:

   a. the plan has fewer than 50 participants;

   b. the plan is sponsored by one or more employers that are not investment entities or passive non-financial foreign entities;

   c. employee and employer contributions to the plan are limited to earned income and the employee's compensation;

   d. nonresident participants of the jurisdiction in which the plan is established are not entitled to more than 20% of the plan's assets;

   e. the plan is subject to regulation in the jurisdiction in which it has been established; and

   f. the plan is required to report information about its participants to the relevant jurisdiction's tax authorities.

3. Retirement programs covered by a tax treaty. This exemption applies to a fund that is generally exempt from taxation on U.S.-source income under a tax treaty with the United States. The specific retirement plan must meet all the conditions prescribed under the tax treaty for the tax relief.

4. Retirement plans similar to a U.S. qualified plan. There is an exemption for a foreign retirement plan that meets the conditions of §401(a) and qualifies for tax-favored status.

5. Investment vehicles exclusively for retirement funds. This exemption applies to a fund that is established only to earn income for other exempt retirement funds.

6. Tax-favored retirement and savings accounts. This exemption applies to an account that is registered or regulated under the laws of the local country and is a tax-favored plan in that country.

In many cases, the above exemptions are helpful and the foreign retirement plan can clearly qualify for one of the above exemptions and simply indicate such

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status on the new Form W-8BENE. However, in practice, it has been seen that plans may not strictly meet the above exemptions due to missing one or more of the stated requirements. For example, a foreign jurisdiction may not require any sort of annual reporting by the plan. In general, any foreign retirement plan should be reviewed in light of the FATCA requirements to determine whether exemptions are available. An initial list of questions is included in Exhibit A. Note that whether a U.S. person participates in the plan is not a relevant factor.

In addition to the exemptions provided by the FATCA regulations, there may be additional exemptions useful for retirement plans in an intergovernmental agreement (IGA), which is an agreement between the United States and a foreign country relating to the implementation of FATCA. For example, the IGA with the United Kingdom provides an exemption for certain U.K. tax-approved retirement plans and U.K. tax-approved equity compensation plans so that the plan balances and equity awards are not treated as financial accounts for purposes of the FATCA rules, including the participant reporting discussed in the next section.

Exhibit B sets out the current list of IGAs by Model type. Most of the IGAs are classified as a Model 1 type, which provides that FFIs report the relevant information to the tax authorities in their own jurisdiction, which then exchange the information with the IRS. Model 2-type agreements provide for direct reporting to the IRS by FFIs.

The challenge remains that, if no exemption is ultimately available, the registration process for FATCA is generally not appropriate for retirement plans because it was designed for financial institutions and the requirements specifically focus on review of customer accounts.

FATCA withholding became effective on July 1, 2014, with certain transitional exemptions. In addition, given the substantial burdens raised by the FATCA review and registration process, the IRS announced in Notice 2014-33 that it will treat calendar years 2014 and 2015 as a transition period for purposes of enforcing and administering implementation of FATCA. As such, entities will not be subject to withholding tax liabilities or penalties for failing to withhold in 2014 or 2015, provided they make a good faith effort during that period to comply with FATCA's requirements.

REPORTING BY U.S. INDIVIDUALS IN GENERAL

The second prong of FATCA, contained in §6038D, requires U.S. individuals annually to report to the IRS information about foreign financial assets that exceed certain thresholds. This reporting requirement became effective with 2011 tax return filings. Temporary regulations issued in December 2011 under §6038D require ''specified individuals'' annually to file a statement with their income tax returns to report interests in ''specified foreign financial assets'' on IRS Form 8938 if the aggregate value of those assets exceeds certain thresholds for a year (stated below). An individual who is not required to file a U.S. income tax return for a year (such as certain bona fide residents of certain U.S. possessions and certain nonresident aliens) is not required to file a Form 8938 for that year.

This reporting requirement is completely independent of the foreign bank account (FBAR) requirements, which have been in effect for a number of years. The penalties for non-compliance are substantial. Failure to timely file a Form 8938 subjects an individual to a penalty of $10,000, which can be increased up to $50,000 for each failure. The penalty can be waived by the IRS if the individual is able to show that the failure is due to reasonable cause and not willful neglect. Other penalties include an increased accuracy-related penalty of up to 40%, an extended statute of limitations, and an extended period for assessing penalties.

The thresholds for filing vary based on whether the individual lives in the United States or outside the United States and the individual's tax return filing status. The thresholds that trigger the requirement to file Form 8938 are as follows:

Filing Status	**Individual Living**	**Aggregate Value of Specified Non-U.S. Assets Exceeds:**	
		On Last Day of Year	**At Any Time During Year**
Single or Married Filing Separate Return	In U.S.	$50,000	$75,000
Married Filing Joint Return	In U.S.	$100,000	$150,000

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Filing Status	Individual Living	Aggregate Value of Specified Non-U.S. Assets Exceeds:	
Single or Married Filing Separate Return	Outside U.S.	$200,000	$300,000
Married Filing Joint Return	Outside U.S.	$400,000	$600,000

An individual is considered to be living outside the United States for this purpose if he or she meets the requirements to claim the foreign earned income exclusion under §911.

Specified foreign financial assets fall into two broad categories: (1) financial accounts maintained by a foreign financial institution; and (2) foreign financial assets held outside of a U.S. or foreign financial account, such as stocks, securities, debt instruments, financial instruments or contracts issued by a foreign person or that have a foreign counterparty, and interests in a foreign entity.

A financial account maintained by a foreign financial institution includes any of the following accounts with a foreign person: a depository bank account, account with a broker dealer, custodial account, account with a clearing organization, account with a trust company, shares in a mutual fund, interest in a hedge fund, private equity fund, venture capital fund, real estate fund, or other managed funds, and certain insurance contracts. A financial account maintained by a U.S. branch of a foreign bank or foreign insurance company, or such an account maintained by a foreign subsidiary of a U.S. financial institution, is not subject to FATCA reporting. Foreign assets, such as stock in a foreign entity, held in a U.S. financial account, such as a U.S. brokerage account, need not be reported. While there is no guidance on whether options and equity awards over a foreign entity's stock that are administered by a U.S. financial institution are subject to FATCA reporting, the exception from FATCA reporting available to financial accounts maintained by U.S. financial institutions might be interpreted to provide a basis for not having to report equity awards administered by a U.S. financial institution.

Foreign financial assets held outside of a U.S. or foreign financial account that are required to be reported on Form 8938, or counted toward the thresholds for reporting on Form 8938, include stock or securities issued by a foreign corporation, a capital or profits interest in a foreign partnership, indebtedness issued by a foreign person, and an option to acquire any of the preceding. Stock purchase rights, stock options, restricted stock awards, restricted stock units, stock appreciation rights, and performance shares issued by a foreign entity to U.S. taxpayer employees, consultants, and directors are clearly subject to FATCA reporting if the equity awards, when aggregated with other foreign assets owned by the taxpayer, exceed the reporting thresholds and they are not held in a U.S. financial institution account. There is no guidance as to whether unvested awards must be reported. However, the guidance might be reasonably interpreted to treat such unvested awards as having a zero value.

Assets not subject to FATCA reporting include assets held in a U.S. financial account or an account of a foreign subsidiary of a U.S. financial institution, assets held in a financial account maintained by a U.S. branch of a foreign bank or insurance company, certain assets reported to the IRS on other IRS tax forms (other than assets listed in FBAR reports), and an interest in a social security, social insurance, or other similar program of a foreign government.

The value of a specified foreign financial asset must be determined both for purposes of determining whether the aggregate value of assets exceeds the reporting thresholds (based on the asset value on the last day of a taxable year or at any time during a year) and for purposes of reporting the maximum value of an asset as required by Form 8938. The value of an asset for both of these purposes generally is the asset's fair market value. The maximum value is the asset's highest fair market value during the taxable year, except as noted below, and must be converted into U.S. dollars on Form 8938. Fair market value may be determined from publicly available reliable financial information sources or from other verifiable sources. Third-party appraisals are not required if there is no information from reliable financial information sources or other verifiable sources. How to report stock options and other forms of equity held by employees and others is not addressed. There is also no guidance as to whether adjustments should be made for unvested awards and how to value stock that is not publicly traded.

An individual may rely on periodic account statements for the taxable year to report a financial account's maximum value, unless the individual knows or has reason to know that the statements do not reflect a reasonable estimate of the maximum account value during the taxable year, for example, because the value of the account has changed significantly. For assets not held in a foreign or U.S. financial account, such as employer stock held in book entry form, an employee may assume that the fair market value of

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the stock on the last day of the year is the maximum value unless an employee actually knows, or has reason to know, that the value of the stock on the last day of the year does not reflect a reasonable estimate of maximum value, for example, because the value of the stock has changed significantly.

REPORTING BY U.S. PARTICIPANTS IN FOREIGN RETIREMENT PLANS

Every U.S. citizen, U.S. resident (a green card holder or individual who satisfies the substantial presence test), and nonresident alien who has elected to be taxed as a U.S. resident who participates in an equity, incentive compensation, pension, deferred compensation, or other compensation plan sponsored or granted by a foreign employer, or by a foreign parent or holding company, needs to closely review the FATCA reporting rules for individuals.

Surprisingly, the regulations take the position that an employee's interest in a foreign pension plan or a foreign deferred compensation arrangement is subject to FATCA reporting, perhaps as a form of investment contract. (Under such a broad interpretation, it is possible that other types of compensation arrangements, such as incentive arrangements sponsored by a foreign entity, especially those that involve deferred payments, might be subject to FATCA reporting.) The regulations provide an exemption for reporting for individuals who maintain an interest in a Canadian Registered Retirement Plan and report such an interest on IRS Form 8891. However, there is no clear exemption for most other foreign retirement plans.

In the case of an interest in a foreign pension plan or a foreign deferred compensation arrangement, if an individual does not know or have reason to know the fair market value of the benefit, an individual may report only the fair market value of any currency or other property distributed to the individual during the year. If there were no distributions during the year, no amount would need to be reported for that year. For example, if an individual who participates in a foreign defined benefit pension plan is provided only with the amount of an anticipated monthly benefit payable at retirement age (and not the present value of the benefit), and the individual does not receive a distribution during the year, the individual may treat the pension benefit as having a zero value for that year. However, in the case of a foreign defined contribution plan or cash balance type plan where values are more readily available, the account balance or lump sum value might need to be reported, even if no distribution is made during the year. For certain mobile employees with significant foreign pension benefits, the value of foreign pension benefits alone may trigger FATCA reporting.

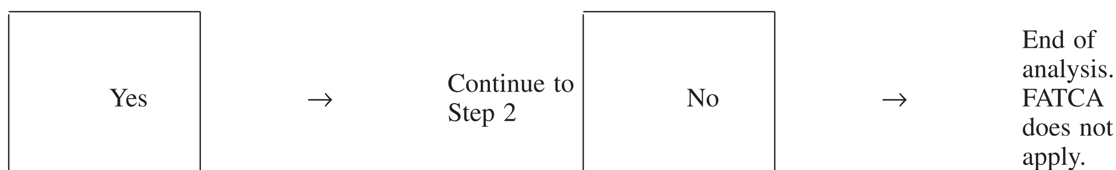
SUMMARY

FATCA presents significant compliance issues for both sponsors of funded plans outside of the United States as well as U.S. individuals who participate in them.

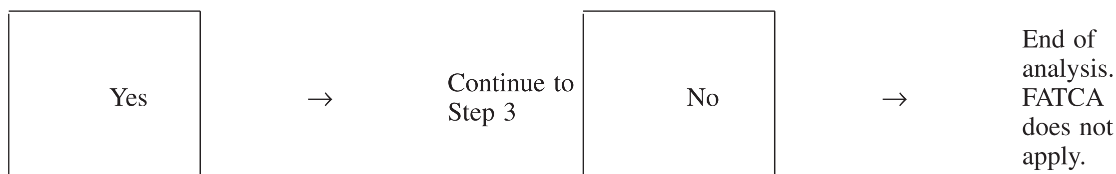
EXHIBIT A

Steps for Evaluating:

1. Determine whether the plan is funded. In other words, are there actual investment assets set aside in an entity or trust to fund the eventual payments under the plan? (Contributions to government or industry funds should be answered "No.")



2. Does the funding vehicle (entity or trust) invest in U.S. investments?[2]



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[2] U.S. investments refer to investments in shares or debt issued by companies organized under the laws of the U.S., or debt issued by the U.S. government, etc.

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3. If the foreign plan is funded and holds U.S. investments, then the related funding entity/vehicle is likely subject to the FATCA reporting requirements unless an exemption under FATCA or under an intergovernmental agreement (IGA) applies.
4. Determine whether an exemption under FATCA applies:
    a. ''Broad participation'' retirement plans.
    b. ''Narrow participation'' retirement plans.
    c. Retirement program covered by a tax treaty.
    d. Retirement funds similar to a U.S. qualified plan.
    e. Investment vehicle exclusively for retirement funds.
    f. Tax-favored retirement and savings accounts.
5. Determine whether an exemption under the applicable IGA is available.
6. Consider whether to register the plan for FATCA purposes.

EXHIBIT B [3]

Jurisdictions that have signed agreements:

Model 1 IGA	**Model 2 IGA**
Australia (4-28-2014)	Austria (4-29-2014)
Belgium (4-23-2014)	Bermuda (12-19-2013)
British Virgin Islands (6-30-2014)	Chile (3-5-2014)
Canada (2-5-2014)	Japan (6-11-2013)
Cayman Islands (11-29-2013)	Switzerland (2-14-2013)
Costa Rica (11-26-2013)	
Denmark (11-19-2012)	
Estonia (4-11-2014)	
Finland (3-5-2014)	
France (11-14-2013)	
Germany (5-31-2013)	
Gibraltar (5-8-2014)	
Guernsey (12-13-2013)	
Hungary (2-4-2014)	
Honduras (3-31-2014)	
Ireland (1-23-2013)	
Isle of Man (12-13-2013)	
Israel (6-30-2014)	
Italy (1-10-2014)	
Jamaica (5-2-2014)	
Jersey (12-13-2013)	
Latvia (6-27-2014)	
Liechtenstein (5-19-2014)	

[3] Lists prepared on July 18, 2014.

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Model 1 IGA	Model 2 IGA
Luxembourg (3-28-2014)	
Malta (12-16-2013)	
Mauritius (12-27-2013)	
Mexico (4-9-2014)	
Netherlands (12-18-2013)	
New Zealand (6-12-2014)	
Norway (4-15-2013)	
South Africa (6-9-2014)	
Spain (5-14-2013)	
Slovenia (6-2-2014)	
United Kingdom (9-12-2012)	

Jurisdictions that have reached agreements in substance and have consented to being included on this list (beginning on the date indicated in parentheses):

Model 1 IGA	Model 2 IGA
Algeria (6-30-2014)	Armenia (5-8-2014)
Anguilla (6-30-2014)	Hong Kong (5-9-2014)
Antigua and Barbuda (6-3-2014)	Iraq (6-30-2014)
Azerbaijan (5-16-2014)	Nicaragua (6-30-2014)
Bahamas (4-17-2014)	Moldova (6-30-2014)
Bahrain (6-30-2014)	Paraguay (6-6-2014)
Barbados (5-27-2014)	San Marino (6-30-2014)
Belarus (6-6-2014)	Taiwan (6-23-2014)
Brazil (4-2-2014)	
Bulgaria (4-23-2014)	
Cabo Verde (6-30-2014)	
China (6-26-2014)	
Colombia (4-23-2014)	
Croatia (4-2-2014)	
Curacao (4-30-2014)	
Czech Republic (4-2-2014)	
Cyprus (4-22-2014)	
Dominica (6-19-2014)	
Dominican Republic (6-30-2014)	
Georgia (6-12-2014)	

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Model 1 IGA	Model 2 IGA
Greenland (6-29-2014)	
Grenada (6-16-2014)	
Guyana (6-24-2014)	
Haiti (6-30-2014)	
India (4-11-2014)	
Indonesia (5-4-2014)	
Kosovo (4-2-2014)	
Kuwait (5-1-2014)	
Lithuania (4-2-2014)	
Malaysia (6-30-2014)	
Montenegro (6-30-2014)	
Panama (5-1-2014)	
Peru (5-1-2014)	
Poland (4-2-2014)	
Portugal (4-2-2014)	
Qatar (4-2-2014)	
Romania (4-2-2014)	
St. Kitts and Nevis (6-4-2014)	
St. Lucia (6-12-2014)	
St. Vincent and the Grenadines (6-2-2014)	
Saudi Arabia (6-24-2014)	
Serbia (6-30-2014)	
Seychelles (5-28-2014)	
Singapore (5-5-2014)	
Slovak Republic (4-11-2014)	
South Korea (4-2-2014)	
Sweden (4-24-2014)	
Thailand (6-24-2014)	
Turkey (6-3-2014)	
Turkmenistan (6-3-2014)	
Turks and Caicos Islands (5-12-2014)	
Ukraine (6-26-2014)	
United Arab Emirates (5-21-2014)	
Uzbekistan (6-30-2014)	

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Model 1 IGA	Model 2 IGA

Model 1 requires reporting to local tax authorities and subsequent information exchange with the IRS.

Model 2 allows direct reporting to the IRS.

For the most current information, please see: http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA-Archive.aspx.

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