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US Taxpayers Participating in Non-US Retirement Plans: When is There an FBAR or FATCA Reporting Obligation?

It is common in multinational corporations with mobile employees to have US taxpayers, either US citizens abroad or resident aliens in the US, participating in non-US retirement plans. Those non-US retirement plans, in turn, might be "corresponding plans" under US tax treaties or might be one of the innumerable other types of retirement plans or individual retirement savings arrangements available in other countries. This article highlights the issues US taxpayers participating in such non-US retirement plans should be aware of regarding their reporting obligations to the Internal Revenue Service (IRS) and US Treasury Department under two recent complimentary - but separate - efforts of the US government to have US taxpayers disclose non-US accounts (typically referred to by the IRS as foreign accounts), the Report of Foreign Bank and Financial Accounts ("FBAR") and the Foreign Account Tax Compliance Act ("FATCA"). Although some guidance has been issued on retirement plans under those provisions, the application to retirement plans is still somewhat vague, and there remain a number of important issues for US taxpayers who work in the US or abroad and participate in non-US retirement plan(s). Due to the complexity of these rules, the substantial penalties associated with noncompliance for the participant and the reputational risk for the employer, counsel for multinational corporations have an interest in helping to ensure compliance by executives.

FBAR

An FBAR, designated as Treasury Department Form TD F90-22.1, must be filed by "each United States person who has a financial interest in or signature or other authority over any foreign accounts, including bank, securities, or other types of financial accounts, in a foreign country, if the aggregate value of these financial accounts exceeds $10,000 at any time during the calendar year." The civil penalties for a failure to file FBAR can range from $500 per violation up to the greater of $100,000 or 50 percent of the account balance, and in some circumstances, criminal penalties may apply. The term "United States person" is broadly defined for FBAR purposes to include US citizens, US residents, entities, including but not limited to, corporations, partnerships, or limited liability companies created or organized in the United States or under the laws of the United States and trusts or estates formed under the laws of the United States. US residents includes individuals who are resident aliens under Section 7701(b) of the Internal Revenue Code (i.e., generally, individuals who (i) are lawfully admitted for residence in the United States, (ii) meet the substantial presence test (have been present in the US for at least 31 days during the calendar year and 183 days during the current year and two previous years), or (iii) elect to be treated as a resident alien).

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What is a foreign account under FBAR?

To trigger an FBAR filing requirement, an account must be located outside of the United States. For FBAR purposes, the United States is defined to include Puerto Rico and certain other US territories. In addition, the account must be one of the following types of financial accounts:

- any bank, securities, securities derivatives or other financial account (which includes an account that is an insurance or annuity policy with a cash value);
- any savings, demand, deposit, time deposit, or other account (including debit card and prepaid credit card accounts) maintained with a financial institution or other person engaged in the business of a financial institution; or
- any account in which the assets are held in a commingled fund and the account owner holds an equity interest in the fund (including mutual funds).

Persons with foreign financial accounts that have an aggregate value of $10,000 or less in the calendar year need not file FBAR. For purposes of applying this filing threshold, one should determine the maximum value of each account, as it appears on account statements (or if no statements are provided, at any time in the calendar year), in a calendar year, converted to US dollars using the foreign exchange rates available at the end of the year. Although the final FBAR regulations (as discussed below) are generally applicable to FBAR filings that relate to the 2010 calendar year, IRS Notice 2010-23 (which supplemented IRS Notice 2009-62) provided administrative relief to persons with no financial interest in a foreign financial account but with signature or other authority over such account, who were required to file FBAR for calendar years 2009 and earlier. Notice 2010-23 extended such persons' FBAR filing requirements until June 30, 2011.

What is a "financial interest" in a foreign account?

A person has a "financial interest" in an account where that person is the owner of record or holds legal title to that account, regardless of whether the account is maintained for his or her own benefit. A financial interest may arise by virtue of a person's role as agent, nominee, attorney, or in some other capacity with respect to a financial account on behalf of a US person. A 50 percent interest in a corporation, partnership or trust that holds legal title to or is the owner of record for a foreign financial account also qualifies as a "financial interest" in such account.

What is "signature authority" over an account?

"Signature authority" over an account exists where a person can control the disposition of money or other property by delivery of a document containing his or her signature (or his or her signature and that of one or more other person) to the bank or other person with whom the account is maintained. Similarly, a person will have "other authority" where that person can exercise power over an account by communicating oral instructions to the bank or person with whom the account is maintained.

As noted above, because more than one person may have a financial interest in or signature or other authority over a foreign financial account, multiple FBAR filings may have to be made for the same account. In some instances, persons required to report 25 or more foreign financial accounts need not provide information regarding every account, provided they retain detailed records about the accounts for five years.

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Recent FBAR Regulations

On February 24, 2011, the Financial Crimes Enforcement Network ("FinCEN") issued final FBAR regulations (the "final rule") which clarified many issues, but left certain other items open, including the treatment of non-US retirement plans.

First, the preamble to the final rule clarifies that a US person will not have to file FBAR with respect to a custody account held outside of the US if the US person cannot "directly access" the foreign holdings in that account (for example, there is an intermediary manager or custodian who has the direct access). Because this clarification narrows the definition of "foreign financial account," it is relevant both to persons who may have a "financial interest" in the account and to those who may have "signature or other authority over" the account.

In addition, the final rule includes an exemption providing that participants in, and beneficiaries of, plans meeting the requirements of Internal Revenue Code sections 401(a), 403(a), 403(b) – and owners and beneficiaries of individual retirement accounts under Internal Revenue Code sections 408 and 408A – are not required to file FBAR with respect to a foreign financial account held by or on behalf of the plan or IRA. However, this exemption for US retirement plans implies by omission that there is no such exemption for foreign retirement plans or a distinction between defined contribution or defined benefit plans – the treatment of such retirement plans must presumably be arrived at by applying the other standards.

FBAR penalties

The IRS has discretion to impose penalties for failure to file FBAR, incorrect FBAR filings, and a failure to maintain appropriate records. Civil penalties range from $500 per violation up to the greater of $100,000 or 50 percent of the account balance, and criminal penalties may also be imposed in circumstances where there is a willful failure to file FBAR, to retain records of an account or knowingly and willfully filing a false FBAR. The maximum penalty for non-willful violations is $10,000 and there is no penalty in the case of a violation that the IRS determines was due to reasonable cause.

Applying FBAR to a non-US Retirement Plan

The issue with respect to when participation by a US person in a non-US retirement plan may have to report their benefit under the plan as such a "foreign account" appears to hinge primarily on whether it meets one of those two criteria - whether the person has a "financial interest" in or "signature authority" over the account. Issues of interpretation arise, however, because of a lack of clarity as to how those definitions, more designed to describe typical bank accounts and investments, apply to the ways in which different types of retirement plans and trusts are structured.

This would entail applying a number of questions to the person's participation in a non-US retirement plan to determine whether the participant has either a "financial interest" in or "signature authority" over the account:

1. If the assets are held in a trust, does the participant hold a 50 percent or greater interest in the trust? If so, then it is possible that the participant has a "financial interest" in such account. Many participants in broad-based retirement plans appear to have taken the position that if they are only one participant in a

retirement plan and trust with a large number of other participants, they do not have a "financial interest" in the trust and the retirement benefit does not have to be reported. The Treasury has not issued clear guidance on this, however. In addition, because in other countries, the assets of the plan for a participant may be held in individual accounts or schemes, or individual insurance or annuity contracts, it is possible that the individual participant would be viewed as holding a 100% interest in that account. Again, the Treasury has issued no guidance on that, though we would note that US individual retirement accounts (IRAs) are expressly excluded from filing.

2. Does the participant have "signature authority" over the retirement account? Can the participant control the disposition of the retirement benefit by delivery of a document containing his or her signature (or his or her signature and that of one or more other person) to the bank or other person with whom the account is maintained, or by oral communication? Does it matter whether the participant is eligible to take a retirement distribution or not (for example, where distributions are not allowed until termination of employment or attainment of retirement age)?

3. Alternatively, is it possible the US person cannot "directly access" the non-US retirement benefit? For example, there may be an intermediary manager or custodian who has the direct access. If the US person has to go through the employer or plan administrator to access his or her retirement account, is that sufficient to not have a "financial interest" or "signature authority"? The Treasury, again, has not directly answered that question.

In addition to these FBAR questions and uncertainties, another reporting scheme, the Foreign Account Tax Compliance Act, or FATCA, raises similar questions of when non-US retirement plan interests have to be disclosed for its purposes. The IRS approach to FATCA may shed some light on how non-US retirement plans should be reported under FBAR.

FATCA

FATCA added a new section 6038D to the Internal Revenue Code which generally requires that US taxpayers holding foreign financial assets with an aggregate value in excess of $50,000 (in some cases higher) must report those assets on their US tax return, effective for taxable years beginning after March 18, 2010. FATCA also imposes a regime of withholding on certain US-source income paid to foreign financial institutions (FFIs) that do not comply with reporting of accounts held by those FFIs or withholding on certain of their distributions. The extent to which non-US retirement plans may be exempt from such FFI status is the subject of complex recently proposed regulations, but those FFI exemptions will not apply for purposes of the individual filing obligation. In this article, we focus on the individual reporting obligation.

<u>How is individual reporting done under FATCA</u>?

On December 19, 2011, the Department of Treasury and the IRS released temporary and proposed regulations under Section 6038D, and the new Form 8938 (Statement of Specified Foreign Financial Assets). Individuals must attach the new Form 8938 to their tax returns (beginning with their 2011 tax returns) in order to comply with FATCA's reporting requirements. It is important to note that complying with FATCA's reporting requirement will not relieve an individual of the responsibility to file FBAR, if the FBAR is otherwise required to be filed. The obligations are independent.

An individual is required to file Form 8938 if he or she is a specified individual, holds interest in a specified foreign financial asset and meets the applicable filing threshold. If an individual is not required to file a US income tax return, then he or she is also exempt from filing a Form 8938, irrespective of whether he or she meets the filing thresholds.

Who is a specified individual under FATCA?

Specified individuals include (i) US citizens, (ii) resident aliens of the US for any part of a year, (iii) nonresident aliens who make an election to be treated as resident aliens for purposes of filing a joint income tax return, and (iv) nonresident aliens who are bona fide residents of American Samoa or Puerto Rico.

What is a "specified foreign financial asset" for purposes of FATCA?

Section 6038D(b) defines the term “specified foreign financial asset” as any financial account maintained by a "foreign financial institution", and any of the following assets which are not held in an account maintained by a financial institution:

- any stock or security issued by a person other than a United States person,
- any financial instrument or contract held for investment that has an issuer or counterparty which is other than a United States person, and
- any interest in a foreign entity.

A financial account includes any depository account maintained by a financial institution, any custodial account maintained by a financial institution, any equity or debt interest in a financial institution (other than interests which are regularly traded on an established securities market), and cash value insurance and annuity contracts (not including insurance contracts that provide pure insurance protection such as term life, disability, health and property and casualty insurance contracts). The term foreign financial institution includes any financial institution which is a foreign entity (i.e., any entity which is not a United States person), however, it does not include a financial institution which is organized under the laws of any possession of the United States.

Financial institution means any entity that (i) accepts deposits in the ordinary course of a banking or similar business, (ii) as a substantial portion of its business, holds financial assets for the account of others, or (iii) is engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interest (including a futures or forward contract or option) in such securities, partnership interests, or commodities.

Examples of other specified foreign financial assets include the following, if they are held for investment and not held in a financial account:

- Stock issued by a foreign corporation.
- Capital or profits interest in a foreign partnership.
- A note, bond, debenture, or other form of indebtedness issued by a foreign person.
- An interest in a foreign trust or foreign estate.
- An interest rate swap, currency swap, basis swap, interest rate cap, interest rate floor, commodity swap, equity swap, equity index swap, credit default swap, or similar agreement with a foreign counterparty.
- An option or other derivative instrument with respect to any of the above or with respect to any currency or commodity that is entered into with a foreign counterparty or issuer.

However, the temporary and proposed regulations also provide that a Form 8938 does not have to be filed for an account if it has been reported on a Form 8891, "U.S. Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans" (though the value is included in determining the total value of assets for Form 8938 filing threshold purposes), and that an interest in a social security, social insurance, or other similar program of a foreign government is not a specified foreign financial asset.

FATCA Filing Thresholds

Section 6038D(a) requires that any individual who, during any taxable year, holds any interest in a "specified foreign financial asset", must attach a Form 8938 to their income tax return for that year if the aggregate value of all such assets exceeds $50,000 (or such higher amount as the IRS as the Secretary may prescribe). The temporary (TD 9567) and proposed (REG-130302-10) IRS regulations and the instructions to the Form 8938 provide the different reporting thresholds which are based on the individual's filing status and whether the individual resides in the United States.

Unmarried taxpayers and married taxpayers who file separate income tax returns and live in the United States, are required to file a Form 8938 with their tax return if the total value of their specified foreign financial assets is more than $50,000 on the last day of the their tax year or more than $75,000 at any time during their tax year. Married taxpayers who file a joint income tax return and live in the United States are required to file a Form 8938 if the total value of their specified foreign financial assets is more than $100,000 on the last day of their tax year or more than $150,000 at any time during their tax year.

The reporting threshold is significantly higher for taxpayers living abroad. An individual is considered a taxpayer living abroad if the individual is a US citizen whose tax home is in a foreign country and he or she is either a bona fide resident of a foreign country or countries for an uninterrupted period that includes the entire tax year, or if the taxpayer is a US citizen or resident, who during a period of 12 consecutive months ending in their tax year, is physically present in a foreign country or countries at least 330 days.

Taxpayers who live abroad and file a joint income tax return, are required to file a Form 8938 if the total value of their specified foreign financial assets exceeds $400,000 on the last day of the tax year or $600,000 at any time during the year. These thresholds apply even if only one spouse resides abroad. Taxpayers who live abroad and do not file a joint income tax return, are required to file a Form 8938 if the total value of their specified foreign financial assets exceeds $200,000 on the last day of the tax year or $300,000 at any time during the year.

If a taxpayer's specified foreign financial assets are denominated in a foreign currency during the tax year, then the value of the asset must be determined in the foreign currency and then converted to US dollars. In most cases, taxpayers must use the US Treasury Department's Financial Management Service foreign currency exchange rate for purchasing US dollars. If this is not available, taxpayers can use another publicly available foreign currency exchange rate for purchasing US dollars and disclose this on the Form 8938. Taxpayers should use the currency exchange rate on the last day of the tax year to calculate the value of their specified foreign financial assets, even if taxpayers sold or otherwise disposed of their specified foreign financial assets before the last day of the tax year.

FATCA Penalties

Substantial penalties are imposed under Section 6038D(d) for a failure to disclose the requisite financial information under FATCA. Specifically, if any individual fails to furnish the information required by FATCA, the individual is subject to a $10,000 penalty. In addition, if the failure to file Form 8938 continues for more than 90 days after the day on which the IRS notifies the individual of the failure, the individual is subject to an additional penalty of $10,000 for each 30-day period (or fraction thereof) during which the failure continues after the expiration of the 90-day period, subject to a maximum penalty of $50,000.

It is important to note that, unlike the obligation to file FBAR, which arises under the Bank Secrecy Act, the obligation to file Form 8938 arises under the Internal Revenue Code. Therefore, the IRS has the authority to enforce civil penalties for a failure to file a Form 8938 and the collection and enforcement provisions of the Internal Revenue Code are available to the IRS.

Reporting Value of Foreign Pension and Deferred Compensation Plans

The Instructions to the Form 8938 require taxpayers to report their interests in foreign pension and deferred compensation plans at the fair market value of their beneficial interest as of the last day of the tax year. If a taxpayer does not know or have reason to know (based on readily accessible information) the fair market value of his or her interest a foreign pension and/or deferred compensation plan, then the value to be included in determining the total value of his or her specified foreign financial assets during the tax year is the fair market value of the cash and other property distributed determined on the last day of the tax year. If the taxpayer received no distributions during the tax year and does not know or have reason to know (based on readily accessible information) the fair market value of his or her interest in a foreign pension and/or deferred compensation plan, then the taxpayer must still report the interest in the plan on the Form 8938, but may use a value of zero for the interest. (Recently added Q&As on the IRS website indicate that in that circumstance, though, the value of zero can be used for determining the reporting threshold.)

Open Questions for US Taxpayers

The guidance by FinCEN and the IRS leaves many questions unanswered for US taxpayers who participate in an employer's non-US retirement plans. For FBAR purposes, US participation in non-US plans may not necessarily require an FBAR filing, but the details of each plan must be examined, and instances where there are individual accounts or contracts, or where the participant can obtain a distribution upon request, should probably be examined most closely.

In the case of FATCA, the current instructions to Form 8938 indicate that retirement accounts will have to be disclosed. Specifically, the instructions to Form 8938 provide that a taxpayer's interest in a foreign pension plan or foreign deferred compensation plan must be reported in Part II of the Form 8938 (which lists other foreign assets). The dollar threshold for filing under FATCA is generally much higher than filing under FBAR, but where the value of the retirement plan interest is not known, the instructions to the FATCA form would suggest filing under FATCA anyway.

An additional question may arise if the individual is clearly required to disclose foreign retirement plan participation under one of the two regimes, FBAR or FATCA, but the answer is less clear under the other, and whether it may be advisable to disclose under both rules anyway despite their separate criteria.

The FBAR and FATCA rules are complicated and there are substantial penalties for noncompliance. US taxpayers and their employers sponsoring non-US plans should be aware of these rules and make sure they have consulted with their tax advisor and/or legal counsel to ensure they have satisfied their FBAR and FATCA reporting obligations. There are, however, significant issues which are not addressed in the current IRS and FinCEN guidance. We are hopeful that FinCEN and the IRS will be issuing additional guidance in the coming years to address these unanswered questions, particularly if taxpayers actively seek such guidance.

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