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FATCA Reporting by U.S. Persons of Participation in Foreign Retirement Plans and Deferred Compensation—New Rules for the 2011 Tax Year

BY DAVID W. POWELL

The Foreign Account Tax Compliance Act, known as FATCA, passed as part of the Hiring Incentives to Restore Employment (HIRE) Act in 2010,[1] contains two major parts. One calls for reporting of U.S. taxpayer accounts by certain foreign financial institutions, or FFIs, and a 30 percent withholding on most U.S. investment income paid to the FFI if it does not comply. This part of the rule for FFIs is generally being implemented in 2013 through 2015.

The other major part of FATCA requires reporting of foreign accounts by individual U.S. persons, generally beginning with the 2011 tax year. Such reporting involves a requirement to file new IRS Form 8938, which accompanies the individual's U.S. tax return, usually one of the 1040 series, and which is due at the same time (i.e., April 17 (in 2012), plus extensions).[2] For purposes of the Form 8938, non-U.S. pensions and deferred compensation, whether funded or not, and including equity-based compensation and stock options, may be treated as a foreign account subject to reporting. Many issues remain as to when and how such benefits may be subject to reporting. This article examines those issues under the current law.

It should be observed at the outset that this is an evolving area. We are at the beginning of the Internal Revenue Service guidance process, with more guidance expected in the future. Currently, for the individual reporting aspect of FATCA, there are both temporary regulations and proposed regulations. Most of the content of the temporary regulations is incorporated in the proposed regulations, but with additional provisions, primarily for looking through to the holdings of certain passive entities, only proposed.[3] In addition, the Treasury Department is reported to be in discussion with various foreign governments as to ways to simplify reporting under FATCA, though it is unclear whether this will affect the individual reporting obligation, as opposed to reporting by FFIs, which is the larger global concern.[4]

Who Must File a Form 8938?

The requirement to file Form 8938 is sourced in tax code Section 6038D. The requirement applies to ''specified individuals,'' which includes U.S. citizens, resident aliens of the United States (as determined under Section 7701(b) and the regulations thereunder), and nonresident aliens who have elected under tax code Section 6013(g) or (h) to be taxed as a U.S. resident. A resident alien who elects to be taxed as a resident of a foreign country pursuant to a U.S. income tax treaty's residency tie breaker rules will still be treated as a specified individual for purposes of Form 8938.[5]

[1] Pub. L. No. 111–147. The relevant FATCA provisions are in Sections 501 through 513 of the act and the principal provision for additional individual reporting is found in new Internal Revenue Code (''code'') Section 6038D.

[2] See Form 8938 and Instructions.

[3] The temporary regulations are Temp. Treas. Reg. § 1.6038D-1T through 8T, T.D. 9567, Internal Revenue Bulletin 2012-8 (Feb. 21, 2012), and the proposed regulations can be found as REG-130302-10 in the same Bulletin.

[4] See ''Joint Statement from the United States, France, Germany, Italy, Spain, and the United Kingdom Regarding an Intergovernmental Approach to Improving International Tax Compliance and Implementing FATCA,'' a press release on the U.S. Treasury Department website (http://www.treasury.gov).

[5] Temp. Treas. Reg. § 1.6038D-1T(a)(2) and the preamble thereto. Currently, an additional category of filers referred to as ''specified domestic entities'' is reserved under the regulations. The proposed regulations would add such specified domestic entities, generally passive look-through entities, to the list of specified persons required to file, effective after 2011. See the proposed regulations referred to in footnote 3.

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A specified person is not required to file Form 8938 if such person is not required to file an annual return with IRS. Consequently, a bona fide resident of a U.S. territory has a filing requirement only if he or she is required to file a U.S. federal income tax return for the taxable year. This generally means that bona fide residents of the U.S. Virgin Islands, Guam, and the Northern Mariana Islands who are not required to file a federal income tax return, provided they correctly report and pay tax on their worldwide income to their U.S. territory taxing authority, do not need to file Form 8938. Further, bona fide residents of Puerto Rico and American Samoa, who generally are not required to file a federal income tax return with IRS unless they have income from sources from outside the relevant U.S. territory, will not have to file a Form 8938 unless they have such income and file a U.S. federal income tax return.[6]

What Are the Reporting Thresholds?

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 their tax year or more than $75,000 at any time during their tax year.[7] For married taxpayers who file a joint income tax return and live in the United States, those thresholds are doubled to $100,000 and $150,000, respectively.

The reporting thresholds are significantly higher for taxpayers living abroad. An individual is considered a taxpayer living abroad if the individual is a U.S. 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 U.S. 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. For those taxpayers who live abroad, the thresholds are essentially quadrupled — $200,000/$300,000 if they do not file a joint return, and $400,000/$600,000 if they file a joint return. These higher thresholds apply even if only one spouse resides abroad.[8]

If a taxpayer's specified foreign financial assets are denominated in a foreign currency during the tax year, then the value of the assets must be determined in the foreign currency and then converted to U.S. dollars. In most cases, taxpayers must use the U.S. Treasury Department's Financial Management Service foreign currency exchange rate for purchasing U.S. dollars. If this is not available, taxpayers can use another publicly available foreign currency exchange rate for purchasing U.S. 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.[9]

[6] Temp. Treas. Reg. § 1.6038D-1T(a)(2) and the preamble thereto.

[7] All values are in U.S. dollars.

[8] Temp. Treas. Reg. § 1.6038D-2T(a) and the preamble thereto.

[9] Temp. Treas. Reg. § 1.6038D-5T and the preamble thereto. See also the Instructions to Form 8938.

What Retirement Plans Must Be Reported?

Foreign financial accounts are, of course, the main emphasis of the FATCA reporting regime. If any assets are held in a financial account, then a separate analysis is needed to determine whether the financial account is held by a U.S. financial institution, a U.S. payer, or by a foreign financial institution.[10]

Under the temporary regulations and IRS guidance, other ''specified foreign financial assets'' are also reportable when held for investment not held in an account maintained by a financial institution. This term broadly includes:

- stock or securities issued by a person other than a U.S. person;
- a financial instrument or contract that has an issuer or counterparty that is other than a U.S. person;
- an interest in a foreign entity;
- a note, bond, debenture, or other form of indebtedness issued by a foreign person;
- an interest in a foreign trust; or
- any option or other derivative instrument with respect to any of these items that is entered into with a foreign counterparty or issuer,[11] as well as foreign retirement or deferred compensation plans.[12]

Thus, foreign company stock options, nonqualified deferred compensation plans, and even bonus plans, at least to the extent they defer compensation, are potentially reportable if they meet the dollar thresholds. Life insurance that does not have a cash value does not have to be reported.[13]

Foreign equivalents to U.S. Social Security are not reportable,[14] but it may be necessary to closely examine any given country's arrangements. Some countries may have, in addition to something clearly akin to U.S. Social Security, other more independently administered national plans with mandatory participation where the answer may not be as clear. For countries that have entered into a Social Security Totalization Agreement with the United States, it would appear to be relevant whether or not the benefit in question is treated as comparable to U.S. Social Security for the purposes of that agreement.[15]

What Deferred Compensation Plans Must Be Reported?

The temporary regulations do not currently distinguish between vested and nonvested interests in stock

[10] Temp. Treas. Reg. § 1.6038D-3T(a) and the preamble thereto.

[11] Temp. Treas. Reg. § 1.6038D-3T(b)(1), (c), and (d) and the preamble thereto. See also the Instructions to Form 8938 and ''Basic Questions and Answers on Form 8938 (posted Feb. 29, 2012)'' on the IRS website (http://www.irs.gov).

[12] Temp. Treas. Reg. § 1.6038D-5T(f)(3) and the preamble thereto. See also the Instructions to Form 8938. Note that such interests are presumably to be reported because they are considered to be financial instruments or contracts ''held for investment'' under Temp. Treas. Reg. § 1.6038D-3T(b)(1).

[13] See ''Basic Questions and Answers on Form 8938 (posted Feb. 29, 2012)'' on the IRS website (http://www.irs.gov).

[14] See the Preamble to Temp. Treas. Reg. § 1.6038D-3T.

[15] International Social Security Agreements can be found on the Social Security Administration website (http://www.ssa.gov).

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or retirement plans or deferred compensation, or between funded and unfunded deferred compensation. Presumably, these could all be considered financial instruments or contracts with a foreign issuer or counterparty.

A particular area that is not clear is what constitutes ''deferred compensation'' for purposes of the temporary regulations and Form 8938. It is not defined in the temporary regulations. One possibility is that IRS may eventually apply an analysis similar to the tax code Section 409A definitions relating to deferred compensation.[16]

What About Equity-Based Compensation?

As noted, the temporary regulations indicate that stock and securities issued by a foreign issuer and held by the individual (i.e., outside of a financial account) are generally reportable, subject to the dollar threshold. Note, however, that if the stock is held in a financial account, then reporting depends upon whether it is held in a U.S. or foreign financial account (If an asset is held in a financial account maintained by a foreign financial institution, that asset is part of the value of the foreign account—it is not required to be reported on Form 8938 separately from the reported financial account in which the asset is held). There are also exceptions for financial accounts maintained by a U.S. payer as defined in § 1.6049-5, a definition that includes branches of U.S. corporations as well as controlled foreign corporations.[17] There can in some cases be a question of who the issuer of equity-based compensation is, but there is not currently an exception just because the equity on which the compensation may be based is a stock traded on a U.S. exchange. In the case of an American Depositary Receipt (ADR), the U.S. depositary would appear to be the issuer; while that is not entirely clear, in many cases ADRs will presumably be held in financial accounts maintained with U.S. financial institutions and thus not be reportable on Form 8938 in any event.[18] In the case of stock options, warranties, and other interests derived from equity, in addition to the question of who the issuer is, there may also be a question of whether it is ''held'' in a financial account. It is understood that, based upon the facts of each individual case, administration of equity-based compensation by a financial institution may rise to the level of being treated as ''held'' in an account of such institution.

Valuation for Reporting Purposes

The Instructions to the Form 8938 require taxpayers to report their interests in foreign pension and deferred compensation plans at their fair market value 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 in 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, determined on the last day of the tax year, of the distributions from the plan for 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.[19] Some important areas not clearly addressed in the current guidance include whether the extent to which property is vested should be taken into account and how to value stock options. It is understood that, for the immediate future, IRS is principally interested in foreign accounts being identified on the Form 8938, as opposed to specific valuation methods.

Penalties for Failure to File Form 8938

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 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. The penalties may be waived for reasonable cause. 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 IRS.[20]

Relationship of FATCA to FBAR

FATCA's Form 8938 and the Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR), are completely separate, with different rules for who must file and what is reported. They are even overseen by different agencies, IRS for FATCA and the Financial Crimes Enforcement Network (FinCEN) for FBAR.

To trigger an FBAR filing requirement, the U.S. person must have a financial interest in or signature authority over an account located outside of the United States. For FBAR purposes, the United States is defined to include Puerto Rico and certain other U.S. 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

[16] See, e.g., the definitions of ''nonqualified deferred compensation'' and ''deferral of compensation'' in Treas. Reg. § 1.409A-1(a) and (b). It is understood that IRS is interested in receiving comments on this issue.

[17] Temp. Treas. Reg. § 1.6038D-3T(a)(3)(i) and the preamble thereto.

[18] See, e.g., Rev. Rul. 72-271 (holding for purposes of the foreign tax credit of code Section 901 and U.S. tax treaties that ''a holder of an ADR will be treated ... as if he held the underlying corporation's stock directly'').

[19] Temp. Treas. Reg. § 1.6038D-5T(a) and the preamble thereto and the Instructions to Form 8938.

[20] Temp. Treas. Reg. § 1.6038D-8T and the preamble thereto and the Instructions to Form 8938.

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).[21]

Persons with non-U.S. financial accounts that have an aggregate value of $10,000 or less in the calendar year need not file FBAR.[22]

A person has a ''financial interest'' in an account when 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 U.S. person.[23] 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.[24]

''Signature authority'' over an account exists when 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'' when that person can exercise power over an account by communicating oral instructions to the bank or person with whom the account is maintained.[25]

However, a U.S. person will not have to file FBAR with respect to a custody account held outside of the United States if the U.S. person cannot ''directly access'' the holdings in that account (for example, if there is an intermediary manager or custodian who has the direct access).[26]

For a foreign retirement plan, for example, the U.S. person might consider whether the assets are held in a trust in which the U.S. person holds a 50 percent or greater interest, such as an individual pension arrangement. The U.S. person might also consider whether as a participant he or she has ''signature authority'' over the retirement account, possibly, or whether they can ''directly access'' the non-U.S. retirement benefit.

Conclusion

Reporting guidance by IRS (and FinCEN in the case of FBAR) leaves many questions unanswered for U.S. taxpayers who participate in an employer's non-U.S. retirement plans. The details of each plan must be examined. Under FBAR, instances in which there are individual accounts or contracts, or when the participant can obtain a distribution upon request, should probably be examined most closely. Under FATCA, important questions include whether there is a plan of deferred compensation, whether an asset is held in a ''financial account'' or not, and who the ''issuer'' is. In both areas, valuation questions arise.

The FBAR and FATCA rules are complicated and there are substantial penalties for noncompliance. U.S. taxpayers and their employers sponsoring non-U.S. plans should be aware of these rules and consult with their tax adviser and/or legal counsel to ensure they have satisfied their reporting obligations. In the case of non-U.S. plan administrators, they should be prepared to provide information for FATCA reporting to U.S. participants who may ask for it, including valuation information. There are, however, significant issues that are not addressed in the current guidance. For this reason, U.S. participants and non-U.S. plan sponsors may also wish to consider seeking guidance from IRS on these unanswered questions.

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[21] 31 C.F.R. § 1010.350; see also Instructions to Form TD F 90-22.1.

[22] 31 C.F.R. § 1010.306(c).

[23] 31 C.F.R. § 1010.350(e).

[24] 31 C.F.R. § 1010.350(e)(2)(iv).

[25] 31 C.F.R. § 1010.350(a) and (f).

[26] See the preamble to 31 C.F.R. § 1010.350.

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