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## Non-US Pension Fund Exemptions under the Final FATCA Regulations

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On January 17, 2013, the US Internal Revenue Service (IRS) and Treasury Department issued final regulations under the Foreign Account Tax Compliance Act (FATCA), replacing the proposed regulations issued in February, 2012.

FATCA is the controversial US legislation enacted in 2010 as part of comprehensive efforts by the US administration to crack down on concealed financial accounts owned by US taxpayers outside the US. Under the Act, Foreign Financial Institutions (FFIs) are subject to US reporting requirements and are subject to the imposition of a 30% tax withholding on most types of investment income for failure to comply.

The principal issue for non-US retirement plans has been that the definition of FFI includes any non-US entity that holds financial assets for the account of others as a substantial portion of its business – a definition the US interprets to include retirement plans. Both as proposed and now final, the FATCA regulations contain certain specific exemptions for certain types of retirement plans as well as for some retirement accounts and other types of savings accounts. Generally, the final regulations provide a number of helpful expansions and clarifications to the retirement plan and account exemptions as originally proposed. This article will review the final exemptions, point out some of the changes from the proposed regulations, and note some remaining issues and points to watch out for.

### **The Retirement Savings Account Exemption: Not a "Financial Account"**

The proposed regulations had exempted certain retirement savings accounts from being considered a "financial account". The result of such an exemption was that an FFI's duties with respect to information on financial accounts did not apply to such retirement savings accounts. The FFI holding the account was not itself exempt from FATCA, however, and would otherwise have to comply, satisfy an exemption, be covered by an Intergovernmental Agreement (IGA) between the US Treasury and its home country revenue agency, or face potential FATCA withholding.

Under the final regulations, an exemption from the definition of "financial account" applies to a retirement or pension account that satisfies the following conditions under the laws of the jurisdiction where the account is maintained:

1. The account is subject to regulation as a personal retirement account or is part of a registered or regulated retirement or pension plan for the provision of retirement or pension benefits (including disability or death benefits);

2. The account is "tax-favored", which means that: (a) contributions to the account that would otherwise be subject to tax under such laws are deductible or excluded from the gross income of the account holder or taxed at a reduced rate; or (b) taxation of investment income from the account is deferred or taxed at a reduced rate.
3. Annual information reporting is required to the relevant tax authorities with respect to the account;
4. Withdrawals from the account are conditioned on reaching a specified retirement age, disability, or death, or penalties apply to withdrawals made before such specified events; and
5. Either (a) annual contributions are limited to USD 50,000 or less, or (b) there is a maximum lifetime contribution limit to the account of USD 1,000,000 or less.

### **Non-Retirement Savings Accounts (i.e., Accounts for Other Types of Benefits)**

In addition, the final regulation modifies another exemption for non-retirement savings accounts to indicate that it can provide an exemption for certain accounts used for other types of benefits.

Under the final regulation, certain non-retirement savings accounts (which does not include insurance or annuity contracts) are also exempt from the definition of "financial account" if they satisfy the following conditions under the laws of the jurisdiction where the account is maintained:

1. The account is subject to regulation as a savings vehicle for purposes other than for retirement;
2. The account is "tax-favored" (as described above for retirement savings accounts);
3. Withdrawals from the account are conditioned on meeting specific criteria related to the purpose of the savings account (for example, the provision of educational or medical benefits), or penalties apply to withdrawals made before such criteria are met; and
4. Annual contributions are limited to USD 50,000 or less;

### **Rollovers to Retirement or Non-Retirement Savings Accounts**

Retirement savings accounts and non-retirement savings accounts may receive assets or funds transferred from one or more of the same types of exempt financial accounts or from one or more retirement or pension funds that are treated as exempt beneficial owners as described below.

### **Retirement Plans Exemptions: "Exempt Beneficial Owners"**

In an effort to streamline and simplify the rules, exemptions affecting both defined contribution plans and defined benefit pension plans have been combined and placed into categories. Those familiar with the proposed regulations will recall that there were various exemptions for certain defined contribution plans where the participant was essentially considered the beneficial owner of the fund, which were treated as "deemed compliant FFIs" under one portion of the regulation, namely Treas. Reg. §1.1471-5(f). Defined benefit plans, on the other hand, were generally considered the beneficial owner of the investments and plans covered by tax treaties were exempt under another provision, Treas. Reg. §1.1471-6(f), as "exempt beneficial owners".

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The final regulations remove this distinction based on whether the plan or the participant is the beneficial owner and combine these categories under Treas. Reg. §1.1471-6(f) as exempt beneficial owners in 6 different categories, as follows:

1. Treaty-qualified retirement fund. A retirement fund will be exempt if the fund is established in a country with which the US has an income tax treaty in force, the fund is entitled to benefits under such treaty on income that it derives from sources within the US (or would be entitled to such benefits if it derived any such income) as a resident of the other country that satisfies any applicable limitation on benefits requirement, and the fund is operated principally to administer or provide pension or retirement benefits;

*Example of the Tax Treaty Exemption:* FP, a foreign pension fund established in Country X, is generally exempt from income taxation in Country X, and is operated principally to provide retirement benefits in such country. The US-Country X income tax treaty is identical in all material respects to the 2006 U.S. model income tax convention. FP is a resident of Country X under Article 4(2)(a) and a qualified person under Article 22(2)(d) of the US-Country X income tax treaty. Therefore, FP is a pension fund treated as an exempt beneficial owner under the tax treaty exemption.

2. "Broad participation" retirement fund. An exemption is provided to a fund that is established to provide retirement, disability, or death benefits, or any combination thereof, to beneficiaries that are current or former employees (or persons designated by such employees) of one or more employers in consideration for services rendered, provided that the fund --
  - a. Does not have a single beneficiary with a right to more than 5% of the fund's assets;
  - b. Is subject to government regulation and provides annual information reporting about its beneficiaries to the relevant tax authorities in the country in which the fund is established or operates; and
  - c. Satisfies one or more of the following requirements --
    - i. The fund is generally exempt from tax on investment income under the laws of the country in which it is established or operates due to its status as a retirement or pension plan;
    - ii. The fund receives at least 50 percent of its total contributions (other than transfers of assets from a retirement savings account described above or from other retirement funds treated as exempt beneficial owners under the retirement fund exemption) from the sponsoring employers;
    - iii. Distributions or withdrawals from the fund are allowed only upon the occurrence of specified events related to retirement, disability, or death (except rollover distributions to retirement and pension accounts or other retirement funds treated as exempt beneficial owners), or penalties apply to distributions or withdrawals made before such specified events; or
    - iv. Contributions (other than certain permitted make-up contributions) by employees to the fund are limited by reference to earned income of the employee or may not exceed \$50,000 annually.

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3. "Narrow participation" retirement funds. A fund is exempt if it is established to provide retirement, disability, or death benefits to beneficiaries that are current or former employees (or persons designated by such employees) of one or more employers in consideration for prior services rendered, provided that --
  - a. The fund has fewer than 50 participants;
  - b. The fund is sponsored by one or more employers that are not investment entities or passive non-financial foreign entities (NFFEs);
  - c. Employee and employer contributions to the fund (other than transfers of assets from a retirement savings account described above or from other retirement funds treated as exempt beneficial owners under the retirement fund exemption) are limited by reference to earned income and compensation of the employee, respectively;
  - d. Participants that are not residents of the country in which the fund is established or operated are not entitled to more than 20% of the fund's assets; and
  - e. The fund is subject to government regulation and provides annual information reporting about its beneficiaries to the relevant tax authorities in the country in which the fund is established or operates.
4. Fund formed pursuant to a plan similar to a section 401(a) plan. A fund is exempt if it is formed pursuant to a pension plan that would meet the requirements of section 401(a), other than the requirement that the plan be funded by a trust created or organized in the United States.
5. Investment vehicles exclusively for retirement funds. A fund is exempt if it is established exclusively to earn income for the benefit of one or more retirement funds covered by the exemptions described above in (1) through (5) of this section or retirement savings accounts described above.
6. Pension fund of governmental and international organization employers. An exemption is provided for a fund established and sponsored by an exempt beneficial owner which is a foreign government, a political subdivision or wholly owned agency or instrumentality of a foreign government, an international organization or wholly owned agency or instrumentality of an international organization, a non-US government central bank, or a government of a US territory to provide retirement, disability or death benefits to beneficiaries or participants that are current or former employees of the exempt beneficial owner (or persons designated by such employees), or that are not current or former employees, but the benefits provided to such beneficiaries or participants are in consideration of personal services performed for the exempt beneficial owner.

### **Retirement Fund Exemption Changes from the Proposed Regulation**

In a change from the proposed regulations, the final regulations treat a fund entitled to benefits under an income tax treaty and operated principally to administer or provide pension or retirement benefits as an exempt beneficial owner regardless of whether the fund is generally exempt from taxation in the country in which it is organized.

In addition, many plans would have failed to qualify under a rule provided in the proposed regulations requiring that all contributions to a plan, except for rollover contributions from other retirement funds, come from employer or employee contributions. Instead, the final regulations provide alternative requirements, including annual information reporting, strict limitations on withdrawals or distributions from the fund, or penalties for early distributions. Further, because certain types of mandatory governmental plans might have failed the requirement in the proposed regulations that contributions be solely from employer or employee contributions, a special exemption was added for non-US governmental plans. In response to comments, the final regulations provide that the provision of certain disability and death benefits should not disqualify a retirement fund from being an exempt beneficial owner if it would otherwise qualify. The final regulations also added a new category for funds formed pursuant to pension plans that would meet the requirements of section 401(a), other than the requirement that the plan be funded by a trust created or organized in the United States.

### **Annuitized Benefits**

The final regulations add an exemption that a financial account does not include a non-investment linked, non-transferable immediate annuity purchased by the accountholder in connection with an exempt retirement or pension account.

### **Interaction with IGAs**

If a country has entered into an IGA with the US, the plans listed in Annex II to the IGA will be treated as exempt from FATCA without regard to whether the account or fund satisfies the exemptions of the final regulations. The final regulations do not appear to address whether, in the case of a rollover or transfer from an account or fund exempt under an IGA, but which would not be an exempt retirement savings account or exempt beneficial owner under the final regulations, to a fund or account in a country without an IGA, the exemption for the recipient account or fund will be affected by the rollover or transfer.

### **Claiming an Exemption**

Claiming the retirement fund withholding exemptions will likely be done using a Form W-8BENE to be provided to the US payor. The IRS had previously issued a draft version of the form, and has announced that it intends to issue a revised draft taking into account the final regulations. One thing to look for in that revised draft is what documentation will be needed to provide evidence of a fund's exemption. Retirement savings accounts have not been included on that form. An FFI holding a retirement savings account presumably must look for its own exemption or be subject to FATCA.

### **Individual FATCA Reporting Unaffected**

Certain US individual taxpayers holding foreign financial assets (including interests in non-US retirement plans and deferred compensation) with aggregate value in excess of 50,000 USD (higher thresholds can apply depending on the circumstances) must report those assets on their US income tax return using Form 8938 effective beginning with the 2011 tax year (returns filed on or by 17 April 2012, plus extensions). The exemptions in these final regulations do not apply for purposes of such individual reporting.

## **Conclusion**

The final regulations provide welcome clarification to many of the questions left by the proposed regulation, and many retirement accounts and funds, including investment funds holding plan assets, should be exempt as a result. Non-US plan sponsors will want to review the final regulations and consider IGAs as they are issued to determine whether all of their plans will meet the exemptions or whether they will have any exposure to FATCA tax withholding in 2014. And with additional forms, guidance and IGAs expected to be issued by the IRS in the coming years, plan sponsors should also monitor for new developments.

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