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IRS Instructions to Form 8938, Reporting of Foreign Accounts, Clarify Reporting Rules and Provide Relief for Failure to Report Certain Foreign Retirement Plans and Accounts for 2014 and Earlier Years

Background – Since 2011, under the Foreign Account Tax Compliance Act, or “FATCA”, individual US taxpayers have been required to annually report ownership of foreign deferred compensation over certain threshold amounts on an information return, Form 8938. This is often referred to as “individual-level FATCA”. Separately, FATCA imposes 30% tax withholding on US source dividends, interest, royalties and certain other types of income known as “fixed or determinable annual or periodic” income or “FDAP” paid to foreign persons unless certain exemptions are met, and also requires foreign financial institutions to perform due diligence on certain financial accounts in order to claim an exemption from such withholding as a “participating foreign financial institution” or PFFI. This is known as “entity-level FATCA”.

IRS regulations on entity-level FATCA and specific FATCA agreements between the US and foreign jurisdictions (“Intergovernmental Agreements” or “IGAs”) have included certain exemptions for retirement funds from entity-level FATCA, either as exempt funds or as accounts not treated as financial accounts. In our view, it has always been relatively clear that the exemptions for entity-level FATCA withholding did not apply to individual-level FATCA information reporting. In December of 2014, the IRS issued final regulations under Code section 6038D, the regulations governing Form 8938, that expressly so state. (A prior Groom alert on those final 6038D regulations can be found on http://www.groom.com/media/publication/1512_Final_IRS_Regulations_Clarity_Some_Questions_on_Individual_FATCA_Report.pdf.) On March 10, 2015, the IRS incorporated that express provision from the regulation in the instructions to Form 8938. Fortunately, it also has granted relief if an individual failed to report certain exempt plans for years beginning on or before December 12, 2014, which for most individuals will be the 2014 tax year and earlier years back to 2011.

What the New Instructions Do – In these new instructions, the IRS states that, for taxable years beginning on or before December 12, 2014, if the jurisdiction in which a financial account is maintained has an IGA in effect, or is treated as having a Model 1 IGA or Model 2 IGA in effect, on or before the last day of the taxpayer's taxable year, retirement and pension accounts, non-retirement savings accounts, and accounts satisfying conditions similar to those described in Treas. Reg. section 1.1471-5(b)(2)(i) that are excluded from the definition of financial account in such IGA are not required to be reported on Form 8938.

However, the IRS instructions explicitly also warn that, for taxable years beginning after December 12, 2014, the final section 6038D regulations provide that, in addition to retirement and pension accounts and non-retirement savings accounts described in §1.1471-5(b)(2)(i), any retirement and pension accounts, non-retirement savings accounts, and accounts satisfying conditions similar to those described in §1.1471-5(b)(2)(i) that are excluded from the definition of financial account in an applicable Model 1 IGA or Model 2 IGA nevertheless **must be reported by the taxpayer on Form 8938**. Thus, such entity-level exempt plans and accounts must be reported for individual-level FATCA purposes on the Form 8938 for 2015 and going forward – without regard to whether the plan or account is maintained in a jurisdiction with an IGA. In other words, just because a non-US account is not an “account” for entity-level FATCA due diligence purposes does not mean it is not an account for individual-level reporting on the Form 8938.

Notably, the exemptions under IGAs for retirement funds and certain accounts generally include those plans and accounts that are broad-based, tax-advantaged and regulated by the local jurisdiction, similar to US qualified plans, IRAs and HSAs. Such exemptions also apply only to countries with IGAs or which are treated as having an IGA pending finalization of the IGA. Thus, this relief will not cover most nonqualified plans or plans in non-IGA countries in any event. Taxpayers will need to consider carefully whether this relief may apply to their own foreign plan participation or accounts.

Key Takeaways – The new instructions provide good news for taxpayers who may have failed to list on their Form 8938 plans or deferred compensation accounts that are exempt from entity level FATCA withholding or from the definition of financial account. They also provide a clear warning that such accounts (and all other foreign deferred compensation accounts), may be subject to reporting on the Form 8938 beginning with the 2015 tax year, subject to non-filing penalties of \$10,000 to \$50,000 per return, where the filing thresholds are met.