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It's 2015, Are Your Plans Ready for FATCA?

Much has been written on the potential impact of the Foreign Account Tax Compliance Act (FATCA) on non-US retirement funds and the need for those funds to prepare to avoid the adverse consequence of 30% FATCA withholding. Now that it is mid-2015, it is worthwhile focusing on the upcoming deadlines, and what plan sponsors need to do to prepare.

When will withholding on US-source dividends and interest payments to non-US retirement funds begin?

Depending on the US withholding agent, it may have already begun. Generally, withholding on fixed and determinable annual and periodic payments (FDAP) began as early as July 1, 2014. However, withholding agents are subject to a "reasonable efforts" period to comply with their due diligence and withholding obligations until the end of 2015 under IRS Notice 2014-33. Many withholding agents have been in the process of seeking W-8 series and W-9 forms from their payees, US and non-US, particularly on existing accounts, and so if uncertain that the payee is foreign or not exempt, those agents may not yet have begun withholding on those payees. However, unless the reasonable efforts period is extended, non-US retirement funds that have not sought to confirm their exemptions with applicable withholding agents may yet see withholding on FDAP beginning in 2016. Because a US withholding agent can be liable for amounts that it fails to withhold under FATCA, there is an incentive for them to withhold if there is any doubt as to whether the payee is exempt.

What if a non-US retirement fund is in an IGA jurisdiction?

Intergovernmental Agreements or IGAs between the US and other countries re-define the obligations of Participating Foreign Financial Institutions (PFFIs) generally so that they can be recognized as exempt from FATCA themselves by reporting account information to their own government, which will exchange it with the US, rather than directly with the US Treasury. IGAs can also vary the dates by which the FATCA rules may apply. The US-Sweden IGA, for example, generally provides that information may begin to be exchanged between the US and Sweden as early as September, 2015, and that financial institutions in Sweden are to have completed their due diligence on preexisting entity accounts with an account balance or value that exceeds USD 250,000 as of June 30, 2014, by June 30, 2016.

It may be advisable for a non-US retirement fund dealing with financial institutions in its home country to make certain that it is properly classified by those financial entities so that it will be treated as exempt, or at least not as a US entity or "recalcitrant" accountholder, so that payments to the fund from those entities will not be withheld on. (IGAs also often suspend passthru withholding by FFIs on recalcitrant accountholders in that jurisdiction.) The non-US retirement fund will still have to act to claim any IGA exemption from withholding by a US withholding agent as explained below, but the IGAs in many instances expand the available exemptions for retirement funds from withholding as "exempt beneficial owners".

How does a retirement fund claim a FATCA withholding exemption?

Exemptions from FATCA withholding for non-US retirement funds are not self-executing. An exemption must be claimed, and the applicable form is W-8BEN-E, signed by an authorized person and filed with the US withholding agent, not the IRS. A Form W-8BEN-E remains valid for the period starting on the date the form is signed and ending on the last day of the third succeeding calendar year, unless a change in circumstances makes any information on the form incorrect. There are other W-8 series forms for other types of non-US persons and entities. If a fund is a US person, the proper form is W-9. Some non-US retirement funds might plausibly check several of the available exemption boxes on the W-8BEN-E. A particular fund should consult with its tax or legal advisor as to which is the proper box to check.

What if I believe a particular retirement fund should be exempt, but it does not seem to completely satisfy the FATCA regulation exemptions?

The FATCA regulation exemptions for non-US retirement funds are not always clear (see here for a summary: http://www.groom.com/resources-744.html). For example, there is concern about how much reporting is required by a non-US retirement fund to its local regulator to be able to meet the requirement that it "provides annual information reporting about its beneficiaries to the relevant tax authorities in the country in which the fund is established or operates". Where such uncertainty exists, the plan sponsor might consider making comments to the US Treasury, or where there is an IGA or one is being developed, consult with their home country regulator to have that specific type of plan expressly listed in the IGA as a class of "exempt beneficial owners". We also note that many Third Country National or International Pension Plans that are funded do not meet an exemption and may not be intended to be exempt.

What can be done if withholding occurs anyway even though I believe the retirement fund should be exempt?

The FATCA tax is a withholding tax, and should be recoverable if the retirement fund was exempt or a mistake occurred. Current IRS guidance under the preexisting general foreign withholding tax rules provides that erroneous withholding may be corrected using one of two methods if the error is caught and corrected before the withholding is reported to the IRS and the taxpayer on the applicable IRS reporting form (generally, no later than March 15 of the year following the year of withholding). In that case, the withholding agent may either adjust the amount of the tax pursuant to a "reimbursement" procedure or a "set-off" procedure, both as described in Treasury Regulations.

However, in the event that an adjustment for overwithholding is not made within the deadline for the reimbursement or set-off procedures, relief generally must be sought by requesting a tax refund or credit from the IRS. The tax credit or refund is claimed by filing the appropriate tax return.

When do plan participants and beneficiaries who are US persons (if the plan is not exempt) begin to be reported by Foreign Financial Institutions to the IRS?

When a retirement fund is not exempt, such as with certain funded Third Country National plans, reporting of US plan participants and beneficiaries by Participating Foreign Financial Institutions (PFFIs) has already begun. By March 31, 2015, the first reporting by PFFIs of accounts of US persons for 2014 began to be made to the US Treasury. Depending on IGA provisions and the size of the account, other non-exempt participant and beneficiary accounts may begin to be reported as the due diligence compliance dates for PFFIs are met.

What will happen to those US participants if their non-US deferred compensation plan benefits or accounts are reported?

If a US taxpayer has not properly reported their non-US deferred compensation on a Form 8938 (or, in some cases, FinCEN 114, Report of Foreign Bank and Financial Accounts, for FBAR), they may be subject to additional income tax and penalties.

All of our non-US retirement fund assets are held by insurance companies or other foreign financial institutions. Do I need to do anything?

If retirement funds are held by a Foreign Financial Institution (FFI) that is also a Participating Foreign Financial Institution (PFFI) that has registered with the US Treasury (so as not to be subject to withholding when that PFFI receives withholdable payments from US sources), that PFFI will be expected to perform some due diligence to identify certain accountholders. Some retirement funds are excluded from the definition of "account", but for many customers, the PFFI will need to perform due diligence do determine whether the customer is a US person or not or an exempt account or not. If the PFFI makes such information requests and the retirement fund fails to adequately respond, the PFFI may need to resort to "passthru withholding" on "recalcitrant" accountholders beginning in 2015 or 2016 depending on the type of account, subject to further guidance and any applicable Intergovernmental Agreement (IGA) . Retirement fund fiduciaries may find it advisable to make inquiries of its financial service providers to make certain they are on top of these matters and have such information they need to ensure that the retirement fund customer is not adversely affected.

What is this I hear about UK FATCA?

Tax authorities in other countries have begun to see some utility in the kind of reporting enforcement for which the US Treasury is blazing the trail. (As the HMRC itself has said, "The UK was quick to see the potential that this provides to embed a new international standard in the exchange of information based around the FATCA model.") For example, the UK has been putting into place its own foreign reporting regime, Automatic Exchange of Information Agreements, also known as UK FATCA, beginning with the 2014 UK tax year. Under these agreements, reporting financial institutions or "RFIs" are required to provide tax information on their UK taxpayer accountholders to the local Tax Information Authority or "TIA" which is then exchanged with HM Revenue and Customs.

Generally, RFIs will provide information on UK reportable accounts annually, including, for each reportable account, personal details such as name, address, date of birth and tax numbers/UK National Insurance Number, account balances and number, and total gross amount paid or credited to the UK accountholder where the RFI is obligor or debtor. The UK requires RFIs to earmark these reportable accounts and conduct ongoing due diligence. Retirement funds, including US retirement funds, with accounts in tax authorities with UK FATCA agreements, may be required by RFIs to provide information on their tax residence and status.

Is that all? What is this about European FATCA?

That is what is known as the OECD Common Reporting Standards ("CRS"). By September 2017, tax authorities in over 50 jurisdictions are expected to be entitled to information on accounts that individuals or entities hold in a "reportable jurisdiction". A reportable jurisdiction will be one that has a multilateral or bilateral Competent Authority Agreement with the other jurisdictions to provide information under CRS and that is on the OECD's list of such jurisdictions. CRS is similar to UK FATCA in terms of account due diligence and reporting requirements, and unlike US FATCA, does not impose a withholding tax regime. Reportable information will be the same as UK FATCA above, with the addition of place of birth. Generally, RFIs will be required to document all accountholders existing on December 31, 2015, with the exception of entities with account balances of USD 250,000 or less. There is no de minimis exception for individual accountholders. At some point, retirement funds may well be asked to provide information for CRS purposes as well.

Conclusion

US FATCA is just in the middle of being rolled out, and UK and EU FATCA are following close behind. Plan sponsors and retirement fund managers should stay aware of how their retirement funds are complying with the requirements and work with their tax counsel to keep a close eye on future guidance in the area.