



The Foreign Account Tax Compliance Act (FATCA) and its Tax and Reporting Impact on Non-US Pension Plans

Presentation to the OECD
Working Party on Private Pensions
November 28, 2011

David W. Powell
Groom Law Group, Chartered
Washington, DC USA



Overview

- FATCA will require, beginning in 2013, foreign financial institutions to enter into agreements to provide annual information to the US Treasury and IRS, or be subject to 30% withholding on many sources of income paid from the US beginning in 2014
- Foreign retirement plans are expected to be exempt, but the exemption is expected to include specific requirements to prevent abuse.
 - Early guidance indicated several exemption criteria which would fail to exempt a number of foreign retirement plans.
 - Certain foreign retirement plans may have to self-identify to be exempt.
- Currently, Treasury and IRS are expected to issue regulations with the details of the exemptions before the end of 2011.



Background of FATCA

- The Foreign Account Tax Compliance Act (FATCA) was enacted in 2010 as part of the Hiring Incentives to Restore Employment (HIRE) Act.
 - Sections 1471-1474 of the Internal Revenue Code.
- Individual tax consequences:
 - US taxpayers holding foreign financial assets with aggregate value in excess of 50k USD must report those assets on their US tax return, effective for taxable years beginning after IRS forms are finalized.* Substantial penalties are imposed for failures.
 - * *Source: IRS Notice 2011-55*
- For Foreign Financial Institutions (FFIs), new reporting requirements and imposition of tax withholding for failure to comply.



What is a Foreign Financial Institution?

- “Foreign Financial Institution” means any non-US entity that
 - Accepts deposits in the ordinary course of a banking or similar business,
 - Holds financial assets for the account of others as a substantial portion of its business, or
 - 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.
- Currently, non-US entities such as banks, broker/dealers, insurance companies, hedge funds, securitization vehicles, and private equity funds will be considered FFIs.
- **This definition is broad enough to include a retirement plan.**
 - *Source: IRS Notice 2010-60*



Reporting by Foreign Financial Institutions

- FFIs must to report directly to the IRS information concerning financial accounts held by US taxpayers, or by foreign entities in which US taxpayers hold a substantial ownership interest.
- To comply with these new reporting requirements, an FFI will have to enter into a special agreement with the IRS by June 30, 2013. Under such an agreement a "participating" FFI will be obligated to:
 - Undertake specified identification and due diligence procedures with respect to its accountholders;
 - Report annually to the IRS its accountholders who are US persons or foreign entities with substantial US ownership; and
 - Withhold and pay over to the IRS a percentage of any "pass-thru" payments of US source income, as well as gross proceeds from the sale of securities that generate US source income, made to
 - Non-participating FFIs,
 - Individual accountholders failing to provide sufficient information to determine whether or not they are a US person, or
 - Foreign entity accountholders failing to provide sufficient information about the identity of its substantial US owners.



What reporting does a participating FFI have to do?

- FFIs that enter into an FFI participation agreement with the IRS will need to report the following information on their US accounts:
 - The name, address, and Taxpayer Identification Number (TIN) of each account holder which is a specified US person and, in the case of any account holder which is a US-owned foreign entity, the name, address, and TIN of each substantial US owner of such entity;
 - The account number;
 - The account balance or value at year end; and
 - Gross dividends, interest and other income paid or credited to the account.
- Alternatively, an FFI may make an election to provide full IRS Form 1099 reporting on each account holder that is a specified US person or US-owned foreign entity as if the holder of the account were a natural person and citizen of the US.



Timeline for implementing FATCA

- IRS will begin accepting FFI applications through an electronic submissions process no later than January 1, 2013.
- An FFI must enter an agreement with the IRS by June 30, 2013, to ensure that it will be identified as a participating FFI in sufficient time to allow withholding agents to refrain from withholding beginning on January 1, 2014.
- Due diligence requirements for identifying new and pre-existing US accounts (including certain high-risk accounts) will begin in 2013.
- Reporting requirements will begin in 2014.
- Withholding on US source dividends and interest paid to non-participating FFIs will begin on Jan. 1, 2014.
- Withholding on all other withholdable payments, e.g., passthru payments, will be fully phased in on Jan. 1, 2015.
 - *Source: IRS Notice 2011-53.*



Tax withholding consequence of being a non-participating FFI that is not exempt

- Any US person making a payment of US source income to a non-participating FFI must generally withhold tax of 30% on US source "fixed or determinable annual or periodical" (FDAP) gross income distributed to the foreign person.
- Withholdable payments include:
 - Any payment of interest, dividends, rents, royalties, salaries, wages, annuities, licensing fees and other FDAP income, gains, and profits if such payment is from sources within the United States.
 - Any gross proceeds from the sale or disposition of US property of a type that can produce interest or dividends.
 - Grandfather for certain non-equity instruments with a definite term held on March 18, 2012
 - Interest paid by foreign branches of US banks.
- Income effectively connected with a United States business is generally exempt from withholding under FATCA.
- A participating FFI must itself withhold and pay over to IRS withholding on certain "pass-thru" payments that would have been withheld on had the FFI been non-participating, e.g., payments passed through by the participating FFI to a non-participating FFI or a recalcitrant account holder.



Impact of tax treaty with the US on FATCA compliance

- The fact that a country has entered into a double taxation relief treaty or an Exchange of Information treaty with the US does not exempt entities in that jurisdiction from having to comply with the FATCA provisions.
- If a tax treaty with the US would provide a lower level of withholding, the FFI can apply for a refund.
- Exchange of Information treaties will be used when the governments are seeking information about specific taxpayers.



What foreign retirement plans will be exempt?

- IRS has authority to exempt classes of persons identified as posing a low risk of tax evasion.
- IRS notice in 2010 stated that "Treasury and the IRS intend to issue guidance providing that certain foreign retirement plans pose a low risk of tax evasion ..., and therefore payments beneficially owned by such retirement plans will be exempt...."
- Treasury and IRS anticipate that a foreign retirement plan will be exempt only if the retirement plan:
 - qualifies as a retirement plan under the law of the country in which it is established,
 - is sponsored by a foreign employer, and
 - does not allow US participants or beneficiaries other than employees that worked for the foreign employer in the country in which such retirement plan is established during the period in which benefits accrued.
- Comments were requested on the definition and on how a plan could appropriately identify or document itself to a withholding agent, and whether other categories of foreign employee benefit plans should be exempt.



Most recent guidance on the foreign retirement plan exemption

- Treasury and the IRS are still considering comments received regarding types of foreign retirement plans that should be treated as posing a low risk of tax evasion and intend to provide further guidance.
- In addition, Treasury and the IRS intend to provide further guidance on foreign retirement plans or retirement accounts that may be deemed compliant if they meet certain requirements.
 - *Source: IRS Notice 2011-34*



Observations

- Systems changes and administrative expense for a pension plan to comply with FATCA and become a participating FFI would likely be substantial.
- Alternative would be to become subject to 30% withholding on US-source investment income.
- Thus, terms for exemption of non-US foreign retirement plans from FFI definition will be critical.
 - Status of certain plans not currently clear: non-employer sponsored plans; multiemployer/paritarian plans; plans with mobile US employees moving among countries; plans with participants working in the US; plans providing benefits other than solely pension benefits.
- Further IRS guidance expected (e.g., proposed regulations, participation agreement forms, refund mechanism).