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Final IRS Regulations Clarify Some Questions on Individual FATCA Reporting of Foreign Pensions and Deferred Compensation on Form 8938

Beginning with the 2011 tax year, individuals have had to report specified “foreign financial assets” valued at over certain threshold amounts on Form 8938 with their individual tax returns. Pensions and deferred compensation are generally included as one of the types of foreign assets that may have to be reported. We have written in the past on this topic and on some of the open issues under the guidance at the time. (See, for example, “FATCA Reporting by U.S. Persons of Participation in Foreign Retirement Plans and Deferred Compensation - New Rules for the 2011 Tax Year” at http://www.groom.com/resources-665.html.) The IRS has now issued final regulations under Code section 6038D addressing some of these issues, and also conforming some of the definitions to those used for entity-level FATCA withholding and its exemptions under Code sections 1471 through 1474 and regulations thereunder. 79 Fed. Reg. 73817 (Dec. 12, 2014).

The final regulations do not mark a very different approach from the prior temporary regulations, and the preamble to the final regulations devotes most of the discussion to explaining changes requested by commentators that the IRS did not choose to make. For example, the IRS:

- did not exempt foreign financial assets received in connection with an individual’s performance of personal services as an employee of a foreign employer;
- did not exempt individuals resident in the US under non-immigrant visas H, L and E from reporting;
- did not exempt from reporting on the Form 8938 accounts also reported under FBAR on Form 114;
- did not exempt persons who do not owe US taxes for the year (the rule still requires filing a Form 8938 if the person is required to file a tax return, even if there is no tax due);
- did not change the treatment of life insurance policies with a cash surrender value from the temporary regulation (which is essentially that such policies are considered financial accounts); and
- did not adopt a broad exclusion for employment contracts.

The principal new provisions or clarifications regarding pensions and deferred compensation under the new final regulations are highlighted below. The final rules are effective December 12, 2014.

Valuation of Pensions

The preamble indicates that the IRS considered whether the value of interests in pension plans and deferred compensation plans should be considered to be readily ascertainable if the taxpayer (referred to as a “specified person”) has no current rights to withdraw plan assets without penalty. However, the IRS indicated that such a rule would result in a taxpayer's interest in a pension or deferred compensation plan being valued at zero if the taxpayer has no right to withdraw, even if the taxpayer regularly receives statements providing the fair market value of the interest in the pension or deferred compensation plan. The Service did not view this as consistent with the purpose for requiring reporting of the value of a specified foreign financial asset and thus did not adopt it in the final rule. Instead, the final rules provide, similar to the temporary rule, that for purposes of determining the aggregate value of specified foreign financial assets in which a specified person has an interest, if the specified person does not know, or have reason to know based on readily accessible information, the fair market value of the person’s interest in a foreign estate, foreign pension plan, or foreign deferred compensation plan during the taxable year, the value to be included in determining the aggregate value of the specified foreign financial assets is the fair market value, determined as of the last day of the taxable year, of the currency and other property distributed during the taxable year to the specified person as a beneficiary or participant.

The apparent result of this rule is that “if the specified person does not know or have reason to know based on readily accessible information” the value of the pension, the value of the individual's interest in the plan is limited to the value of the distributions received from the plan during the year both for purposes of calculating the applicable reporting thresholds and reporting the maximum value of the interest. But as indicated earlier, if the taxpayer is receiving regular statements providing the fair market value of the pension, presumably the person “knows” the value and that must be used. For defined contribution plans, that value may be easier to determine than under defined benefit plans, though if, for example, a lump sum calculation is included, it is possible that should be reflected. Where the value of the defined benefit pension is not expressed in a lump sum or as a present value on a benefit statement and may be difficult to determine, though, it may be possible to consider the value as the fair market value of any distributions to the participant or beneficiary for the year. This may be zero if no distributions have been made.

Impact of Vesting

In one of the more significant clarifications, the final regulations adopt the position that nonvested interests in property received in connection with the performance of personal services are not required to be reported until vesting occurs. In particular, the final rule clarifies that a specified person that is transferred property in connection with the performance of personal services is first considered to have an interest in the property for purposes of section 6038D on the first date that the property is “substantially vested” (within the meaning of §1.83-3(b)) or, in the case of property with respect to which a specified person makes a valid election under section 83(b), on the date of transfer of the property. Vesting is determined under the Section 83 guidance (generally, the first taxable year in which the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture). This rule is stated expressly only in conjunction with transfers of property, however. It is not clear that the rule would extend to pensions and deferred compensation so that they do not need to be reported until vested as well.

Clarification of Interaction of Entity-Level FATCA Exemptions with Reporting on Form 8938

The final regulations state that, for purposes of Form 8938, the term “financial account” has the meaning set forth in §1.1471-5(b), provided that the exclusions of retirement and pension accounts and non-retirement savings accounts under §1.1471-5(b)(2)(i), and of retirement and pension accounts, non-retirement savings accounts, and accounts satisfying similar conditions in an applicable Model 1 IGA or Model 2 IGA under §1.1471-5(b)(2)(vi), shall not apply. However, the definition of financial account under §1.1471-5(b) does not define what is a retirement or pension account or a non-retirement savings account so much as it provides that such accounts are not financial accounts for purposes of entity-level FATCA (exemption from withholding on US source income), with the clarification that such exemption does not apply for purposes of individual-level FATCA reporting. Thus, interests in such plans will still have to appear on the participant’s Form 8938 if the dollar thresholds are met.

The final regulations under Section 6038D, though they refer to “foreign pension plans” and “foreign deferred compensation plans”, do not define those terms. The reference to “accounts” in §1.1471-5(b) might suggest that only funded foreign pension plans and foreign deferred compensation plans must be reported on Form 8938. However, the use of the term “deferred compensation” for other Internal Revenue Code purposes often includes unfunded arrangements (section 409A, for example), and not reporting such arrangements on a Form 8938 would also make it difficult for the IRS to audit tax compliance by taxpayers with unfunded foreign deferred compensation plans, so it is not at all clear that only funded plans need be reported. Additional guidance from the IRS in this area may be necessary.

Other Clarifications

Form 8891 Made Obsolete. Because Form 8891, "U.S. Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans" has been made obsolete by Rev. Proc. 2014-55, on a prospective basis, the final rule limits the taxable years for which the taxpayer’s reporting of an asset on Form 8891 will relieve the taxpayer of reporting that asset on Form 8938 to taxable years beginning after March 18, 2010, and ending on or before December 31, 2013.

Foreign Social Security and Similar Programs. Some commentators questioned whether an interest in a social security, social insurance, or similar program of a foreign government was considered a specified foreign financial asset. The preamble to the final regulations notes that the definition of a specified foreign financial asset already excludes these interests because they are not assets described in §1.6038D-3(b)(1). In addition, the preamble to the 2011 temporary regulations and the instructions to Form 8938 already illustrate the application of this rule to these interests, stating that “an interest in a social security, social insurance, or other similar program of a foreign government” is not a specified foreign financial asset. A chart comparing the Form 8938 reporting requirements to the FBAR reporting requirements, available at www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements, also addresses these programs.

Some Basic Issues Still Not Addressed

Though helpful in some respects, the final regulations do not provide guidance on a few employee benefits questions which have been frequently raised by practitioners. One is whether American Depositary Receipts (ADRs), are considered issued by a U.S. issuer (the U.S. depositary) or not, though in many cases ADRs will be held in financial accounts maintained with U.S. financial institutions and thus not be reportable on Form 8938 in any event. Another determination that can be tricky to make is whether (or when) restricted stock, stock options, warrants, and other interests derived from equity with a foreign issuer, used to compensate employees under a compensation program and administered by a U.S. financial institution, are "held" by the U.S. financial institution in a financial account or not for Form 8938 reporting purposes. It is understood that whether the U.S. financial institution performs tax reporting on distributions from the program to participants may be an important factor in making that determination.

Conclusion/Action Steps

Individual taxpayers will want to take these final regulations into account with respect to the Form 8938s they will be filing for the 2014 tax year. In many cases, those taxpayers will be looking to retirement plan administrators for information and guidance. If you would like assistance in analyzing how the final reporting rules apply to such filings, please contact your Groom attorney.