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Prepared by *David Powell,*
Groom Law Group Chartered

The American Benefits Institute is the education and research affiliate of the American Benefits Council. The Institute conducts research on both domestic and international employee benefits policy matters to enable public policy officials and other stakeholders make informed decisions. The Institute also serves as a conduit for global companies to share information about retirement, health and compensation plan issues.

UPDATE ON FOREIGN ACCOUNT TAX COMPLIANCE ACT (FATCA) ISSUES

There are a number of recent developments related to the Foreign Account Tax Compliance Act (FATCA) which we would like to call to your attention.

NEW TREASURY MODEL FATCA COMPLIANCE AGREEMENTS WITH OTHER COUNTRIES: WILL YOUR NON-U.S. RETIREMENT PLANS BE ON THE LIST? AND WILL U.S. PLANS BE REQUIRED TO REPORT NON-U.S. PARTICIPANTS TO OTHER COUNTRIES?

All sorts of "foreign financial institutions" or "FFIs", a term which includes non-U.S. retirement plans, have been closely following the implementation of FATCA, which, beginning in 2014, provides for onerous 30% withholding by the U.S. payor on U.S.-source dividends, interest and other passive investment income paid to the non-U.S. FFI investor. Past Alerts with background information on FATCA and proposed but limited non-U.S. retirement plan exemptions can be found on the International Benefits page of the Council website.

On July 26, the U.S. Treasury Department released two Model Intergovernmental Agreements to Improve Tax Compliance and to Implement FATCA. These are models for the agreements which the U.S. is currently negotiating with a number of countries, including France, Germany, Italy, Spain, and the United Kingdom (Switzerland and Japan are not listed on the public communique that accompanied the models, and are understood to be considering different forms of agreement). These are only models, and it remains to be seen what the variations will be, if any, in the final country-specific agreements.

The models are instructive for how much work non-U.S. retirement plans may have to do to avoid the FATCA withholding burden. Additionally, they point out the need for non-U.S. retirement plans to be proactive in the negotiation of these agreements to ensure they are covered by a retirement plan exemption.

As expected, the gist of the model agreements does not really modify what entities are subject to FATCA and what U.S. accounts must be reported to the U.S. Treasury. Rather, the focus is to change which revenue authority an entity must report to concerning any U.S. account holders; so the entity will report to its own revenue authority rather than directly to the U.S. Treasury. The model consists of a base agreement and two annexes. Annex I describes the due diligence requirements for identifying and reporting on specific types of accounts under FATCA. Annex II sets forth a list of financial institutions and financial products (such as retirement plans) that will be treated as exempt from or deemed compliant with FATCA.

The model agreement comes in two forms. The first is a "reciprocal" form under which the U.S. Treasury agrees to provide mirror reports of financial accounts of the citizens of the other country to that other country in a manner similar to how the relevant revenue authority will be reporting on U.S. accountholders of its FFIs to the U.S. Treasury. The second is a "nonreciprocal" form under which the reporting is only from the other country to the U.S. The agreements do not outline specifically how the non-U.S. revenue authority will ensure that FFIs in its jurisdiction provide it with the information it will then provide to the IRS. However, presumably that is being discussed in individual country negotiations.

Of important note for plan sponsors of non-US plans in countries negotiating agreements, is checking to make sure that the type of plan sponsored is included in Annex II to the applicable agreement. The agreements provide that certain types of retirement plans listed in Annex II will be treated as "deemed compliant" or an "exempt beneficial owner" for purposes of FATCA. Specifically, the plan type must be listed as "established or located in and regulated by [the other country], or a predetermined contractual or legal arrangement." It must be listed as "operated to provide pension or retirement benefits or earn income for providing such benefits under the laws of [FATCA Partner] and regulated with respect to contributions, distributions, reporting, sponsorship, and taxation."

It is not currently clear to what extent the above-quoted language describing the plans on the list may limit what plans can be included. However, once negotiated, re-opening such an agreement to add others, whether clearly satisfying that prerequisite or not, could be difficult. ***It is not too early for employers with retirement plans in the countries about to become new "FATCA partners" with the U.S. Treasury to begin focusing on what types of plans they have. Moreover, they should discuss these agreements with their relevant revenue authorities such as the HMRC in the UK, the DGI in France, and others to make sure that Annex II is sufficiently comprehensive.***

Questions also remain as to how this provision will be applied. For example, will a non-U.S. plan still need to provide the proposed IRS exemption claim form, W-8BEN-E, and provide evidence of its status to the U.S. payor to exempt the payment? Alternatively, will the U.S. payor be able to rely on the existence of the agreement to not withhold on any payments to a plan in a country that has negotiated one?

For U.S. plans, the reciprocal agreement raises a broader possible challenge. They may need to start looking for non-U.S. taxpayers -- French and UK nationals for example -- participating in their U.S. retirement plans (including plans for mobile executives) and report their accounts to the U.S. Treasury to be reported on to the other country.

Although FATCA was enacted in 2010 and considerable guidance has been released, we are still in the relatively early stages of FATCA guidance, so more information should be forthcoming, possibly this fall.

DRAFT FORM W-8BEN-E

Additionally, the IRS has issued a draft W-8BEN-E, which is to be the form that non-U.S. retirement plans will provide to a payor to claim an exemption or reduction from the 30% withholding tax. It is clearly still a work in progress, and draft instructions, which will likely provide important guidance, have not been issued. Sections of the form reflect the exemptions under the proposed regulations for plans receiving tax treaty benefits, certain defined contribution plans (large and small) and certain defined benefit plans. The form is to be signed under penalties of perjury, and for the latter two exemptions, indicates that organizational documents that support the certifications and exemption will have to be provided. The form does not reflect the exemption of non-U.S. retirement savings accounts from the definition of "financial account", presumably because those are held by a Foreign Financial Institution that must find its own exemption or comply. The draft form can be found at:

http://www.irs.gov/pub/irs-utl/formw8benentityexeccirculation2.pdf

New IRS Q&A on Form 8938 and Valuing a Foreign DB Plan Interest

The IRS has also added some new Q&As regarding Form 8938 to its website. One of these is relevant to non-U.S. retirement plans, and indicates that valuation of such plans for purposes of the form can be reasonably estimated, and an actuarial valuation is not required:

23. Am I required to hire a certified appraiser or actuary to determine the fair market value of a specified foreign financial asset? For example, if I have a foreign defined benefit plan, am I required to obtain the services of an actuary?

You may determine the fair market value of a foreign financial account for the purpose of reporting its maximum value based on periodic account statements unless you have reason to know that the statements do not reflect a reasonable estimate of the maximum value of the account during the tax year. For a specified foreign financial asset not held in a financial account, you may determine the fair market value of the asset for the purpose of reporting its maximum value based on information publicly available from reliable financial information sources or from other verifiable sources. Even if there is no information from a reliable financial information source or other verifiable source, you do not need to obtain an appraisal by a third party in order to reasonably estimate the asset's maximum value during the tax year."

The IRS FATCA Q&As can be found here:
http://www.irs.gov/businesses/corporations/article/0,,id=255061,00.html