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# **US FATCA and Its Impact on Retirement Funds**

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# Agenda

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- US FATCA withholding and why non-US retirement funds should care
  - Retirement plan exemptions
  - Claiming exemptions – Form W-8BEN-E
  - Governance Issues
  - Individual FATCA reporting
- Impact of Use of US Definitions on UK and EU/CRS FATCA

# History of FATCA

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- **US FATCA enacted in 2010** as part of the Hiring Incentives to Restore Employment Act
- To ensure that US taxpayers are not evading tax through the use of concealed financial accounts in foreign jurisdictions
- FATCA establishes a regime under which **“Foreign Financial Institutions” (“FFIs”) must agree to report certain information to the IRS about US taxpayers’ accounts**
- If an FFI does not agree to make the disclosure, it becomes subject to **30% withholding** tax on most types of US source investment income
- Separately, **individual US taxpayers must report foreign accounts** (including foreign deferred compensation) with US tax returns

# History, Cont'd.

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- In **February, 2012, draft US Treasury regulations published**, and an extensive consultation process followed.
- Draft regulations included certain foreign retirement fund exemptions, but those were generally not considered sufficient.
- Numerous groups engaged the IRS and the Treasury Department seeking amendments to exempt such plans from the ambit of FATCA.
- **Final regulations were issued in January 2013 with substantially revised foreign retirement fund exemptions.**
- **U.S Treasury began entering into Intergovernmental Agreements (IGAs) regarding FATCA** with a number of countries. These now often address application to retirement and other funds.



# Two Levels of Reporting

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FATCA targets non-compliance by US taxpayers with foreign accounts, and does so at two levels

## **Entity Level Reporting**

→ Foreign financial institutions must report to the IRS on financial accounts held by US taxpayers or foreign entities in which US taxpayers hold a substantial ownership interest, or be subject to a 30% withholding tax on most types of US source income

## **Individual Reporting**

→ Individual US taxpayers must report certain foreign financial accounts and offshore assets



# Entity Level Reporting

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- **What is a “foreign financial institution”?**
- Includes any non-US entity that holds financial assets for the account of others as a substantial portion of its business
  - a definition the US interprets to include retirement plans
- An entity generally holds financial assets for the account of others as a substantial portion of its business if the entity's gross income attributable to holding financial assets and related financial services equals or exceeds 20 percent of the entity's gross income during the most recent three year period
- Note: If an FFI has no US source income, it may not care

# Entity Level Reporting

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- In order to avoid withholding, FFIs **(that are not exempt)** may register with the IRS and agree to report to the IRS certain information about their US accounts, including accounts of certain foreign entities with substantial US owners (“Participating FFIs” or “PFFIs”)
- **In IGA countries, reporting is instead done to the local tax authority**, which then shares the information with the IRS (but a reporting FFI must still register on the IRS website to get a GIIN)
- **PFFIs must perform extensive due diligence on all accountholders** to determine any indicia of US ownership
  - See IRS Rev. Proc. 2014-13 and 38 (PFFI Agreement) for non-IGA countries
  - See Annex I to the IGA for IGA countries
  - May be required to withhold 30% on certain payments to accountholders who do not provide information (pass-thru withholding) beginning in 2017

# Some Key Implementation Dates

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**January 1, 2014:** FATCA registration portal opened for registration

**July 1, 2014:** FATCA FDAP withholding requirements went into effect **BUT 2014 and 2015 are a “good faith” transition period**

**December 31, 2014:** US Withholding Agents, PFFIs must document preexisting entity accounts identified as Prima Facie FFIs

**March 31, 2015:** PFFIs begin to report US account information with respect to 2014

**June 30, 2015:** PFFIs must document preexisting high value individual accounts by June 30, 2015 (One year from effective date if became a PFFI after July 1, 2014)

**July 1, 2015:** PFFIs begin withholding on US FDAP payments to recalcitrant accounts

**Sept. 30, 2015:** Foreign tax authorities under IGAs start reporting US account information to US (subject to terms of the IGA)

**June 30, 2016:** PFFIs to have completed all due diligence

**January 1, 2017:** Gross proceeds withholding, pass-through withholding begins (unless delayed)



# Why non-US Retirement Funds Should Care about US FATCA

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1. **30% withholding on FDAP** paid to FFIs which are not registered PFFIs (or exempt)

FDAP is US source fixed or determinable, annual or periodical gains, profits, or income. Examples include:

- Dividends
- Interest
- Real property income, such as rents, other than gains from the sale of real property
- Royalties

2. **Gross proceeds withholding beginning in 2017.** Gross proceeds refers to the gross proceeds from the sale or other disposition of any property of a type which can produce FDAP



# Benefit Plan Exemptions

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There are two general categories of exempt non-US retirement and benefit plans:

## **1. Exemptions under Intergovernmental Agreements (IGA)**

## **2. FATCA Regulation Exemptions**

- a) Tax treaty
- b) Broad participation
- c) Narrow participation
- d) Similar to 401(a) plan
- e) Investment vehicles/pension funds exclusively for retirement funds



# Benefit Plan Exemptions

## General Structure of IGA Exemptions

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**IGA exemptions fall into two categories:**

1. **“Exempt Beneficial Owners”** to whom no withholding will be made (if the fund claims its exemption)
2. **Funds held by FFIs not treated as financial “accounts”** – thus the PFFI does not have to do due diligence on the accountholder (this includes both certain retirement savings accounts and certain non-retirement accounts)

**IGAs drafting so far has** begun with the regulatory exemptions – with or without the tax treaty exemption, depending on whether a tax treaty exists – under each of these categories, **then added additional retirement funds and accounts by name**, either for clarity or because one of the regulatory exemptions does not apply



# Retirement Plan Exemptions – FATCA Regulations

## Tax Treaty Exemption

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- **Treaty-qualified retirement fund.**
- A fund established in a country with which the United States has an income tax treaty in force, provided that the fund is entitled to benefits under such treaty on income that it derives from sources within the United States (or would be entitled to such benefits if it derived any such income) as a resident of the other country that satisfies any applicable limitation on benefits requirement, and is operated principally to administer or provide pension or retirement benefits
- This means a fund that would receive tax relief on interest and dividends under an applicable tax treaty with the US (e.g., lower dividend and interest withholding rate), subject to the limitation of benefits provisions, which is a broader definition than just corresponding plans.

# Retirement Plan Exemptions – FATCA Regulation

## Broad Participation Exemption

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### **Broad participation retirement funds**

- Funds established to provide retirement, disability, or death benefits for current or former employees of one or more employers in consideration for services rendered, provided that the fund:
  1. does not have single beneficiary with a right to more than five percent of the fund's assets;
  2. is subject to government regulation and “provides annual information reporting about its beneficiaries to the relevant tax authorities in the country in which the fund is established or operates”; and
  3. is (i) exempt from tax on investment income in its home jurisdiction, (ii) made up of more than 50% employer contributions or (iii) distributions or withdrawals are allowed only upon the occurrence of specified events related to retirement, disability, or death (except rollover distributions) or penalties apply to distributions or withdrawals made before such specified events



# Retirement Plan Exemptions – FATCA Regulations

## Narrow Participation Exemption

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### **Narrow participation retirement funds**

- A fund established to provide retirement, disability, or death benefits to beneficiaries that are current or former employees (or persons designated by such employees) of one or more employers, provided that:
  1. it has fewer than 50 participants;
  2. it is sponsored by one or more employers;
  3. employee and employer contributions to the fund are limited by reference to earned income and compensation of the employee;
  4. participants that are not residents of the country in which the fund is established or operated are not entitled to more than 20 percent of the fund's assets; and
  5. the fund is subject to government regulation and provides annual information reporting about its beneficiaries to the relevant tax authorities in the country in which the fund is established or operates



# Retirement Plan Exemptions – FATCA Regulation

## Investment Vehicles/Pension Fund Exemption

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### **Investment vehicles exclusively for retirement funds:**

- A fund established exclusively to earn income for the benefit of one or more retirement funds of Exempt Beneficial Owners

### **Pension fund of an exempt beneficial owner:**

- A fund established and sponsored by an exempt beneficial owner to provide retirement, disability, or death benefits to beneficiaries or participants that are current or former employees of the exempt beneficial owner or provided to such beneficiaries or participants in consideration of personal services performed for the exempt beneficial owner

# Individual Account Exemptions

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**“Retirement savings accounts”** are treated as **not being “financial accounts”** under FATCA where the account is:

1. Subject to regulation as a personal retirement account or is part of a registered or regulated retirement or pension plan for the provision of retirement or pension benefits (including disability or death benefits)
2. Tax-favored;
3. Annual information reporting is required to the relevant tax authorities with respect to the account;
4. Withdrawals are conditioned on reaching a specified retirement age, disability, or death, or penalties apply to withdrawals made before such specified events; and



# Individual Account Exemptions Contd...

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## 5. Either

- (i) Annual contributions are limited to \$50,000 or less, or
- (ii) There is a maximum lifetime contribution limit to the account of \$1,000,000 or less

# Individual Account Exemptions

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**“Non-retirement savings accounts”** are treated as **not being “financial accounts”** under FATCA where the account is:

1. Subject to regulation as a savings vehicle for purposes other than retirement;
  2. Tax favored;
  3. Subject to withdrawal rules which stipulate that certain criteria “related to the purpose of the savings account (for example educational or medical benefits)”; and
  4. Annual contributions are limited to \$50,000 or less.
- Note: These are not necessarily an exemption from 30% withholding – these are exemptions for the FFI holding the account not to treat it as a “financial account” – for example, not to have to perform due diligence on it

# Claiming FATCA Exemption: Form W-8BEN-E

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- Exemptions are not self-executing – they must be claimed
- IRS has issued Form W-8BEN-E for a plan claiming exemptions from FATCA withholding and it is available online at [irs.gov](https://www.irs.gov) (recently revised April 2016)
- Some plans may fit under multiple exemption categories – instructions not always clear



# Form W-8BEN-E Questions

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- There are boxes for Nonreporting IGA FFIs (XII) and Exempt Retirement Plans (XV)
- If there is an IGA, does the plan complete XII or XV?
- Under XV, which box to check – (a) treaty, (b) or (c) broad or narrow participation, or (f) any exempt beneficial owner under an IGA
- Or check all that may apply?

# If not exempt, should you register?

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- FFIs may register with the IRS online and enter into agreement to do due diligence on all account holders and report to IRS (or their local tax authority under an IGA) certain information about their US accounts (Rev. Proc. 2014-13, 38, Annex I to the IGA)
- Will be required to withhold 30% on certain payments to certain “recalcitrant account holders” who do not provide information beginning in 2015 (or close their accounts)
- Burdens of being a PFFI may well outweigh any benefit for retirement or welfare funds



# Governance Issues

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1. US investments by a non-US retirement fund – is the plan minimizing the possibility of FATCA withholding by filing W-8BENs with US withholding agents?
2. If the non-US plan is using financial institutions for investing pension funds should you be confirming those service providers institutions are minimizing FATCA liabilities on the plan's behalf?
3. Governance concerns for the multinational entity with responsibilities for global benefits

# Use of US FATCA Definitions Create Issues Under UK FATCA and CRS

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- Example: Under the UK-Caymans IGA (“UK-Cayman Agreement to Improve international tax compliance”) –
  - Government means a Caymans governmental entity
  - Broad and narrow participation retirement funds are funds established in the Cayman Islands
- Thus, US or EU pension funds investing in the Caymans (e.g., through a Caymans investment vehicle) may be Financial Institutions, but may not qualify for an exemption (even though the fund would be exempt under US FATCA)



# CRS Example

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- Under CRS/OECD definitions, the broad or narrow-based retirement fund does not depend on establishment in a particular jurisdiction
- They are a “non-reporting financial institution” – a category that does not always appear on CRS self-certification forms
- Under US definitions, “non-reporting financial institution” are under IGAs only. The US reporting form (W-8BEN-E) requires description of the basis for the IGA exemption (also separate boxes for retirement plans)





# Future Considerations

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- Do the US, UK and CRS/OECD need to develop more uniform definitions of:
  - Governmental
  - Exempt Beneficial Owner
  - Retirement plan exemptions
- Do entities requesting self-certification need to improve and standardize their forms?



# Don't Forget Individual FATCA Reporting for US Individual Taxpayers

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- Not a responsibility of the employer, but US taxpayers are to report non-US deferred compensation with their individual US tax returns using Form 8938
- The entity-level FATCA exemptions do not apply to individual FATCA



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# QUESTIONS?