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Foreign asset-related compliance requirements for retirement plans

In recent years, Congress, the US Department of Treasury, and the IRS have increased the regulation of foreign assets held by US individuals and entities as a means of combatting tax evasion, money laundering, and terrorist financing. In doing so, they have created a complex — and often confusing — set of compliance requirements for US retirement plans as well as non-US retirement plans sponsored by multinational employers. Below is an overview of retirement plan compliance obligations under three separate regulatory schemes that address foreign assets held by retirement plans: the Foreign Account Tax Compliance Act (FATCA), the Report of Foreign Bank and Financial Accounts (FBAR), and regulations issued by Treasury's Office of Foreign Assets Control (OFAC). FATCA requirements apply to non-US retirement plans sponsored by multinational employers, whereas FBAR and OFAC requirements address US retirement plan compliance.

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FATCA

The US taxes US citizens and resident aliens on worldwide income — subject to certain treaty exemptions — without regard to the source of the income or the current residence of the individual. The Foreign Assets Tax Compliance Act (FATCA) is a federal statute designed to combat offshore tax evasion and recoup tax revenues by helping the IRS enforce worldwide taxation of US citizens and resident aliens.

As discussed in detail in our March 4, 2014 *FYI In-depth* and our April 17, 2014 *For Your Information*, FATCA established a complex set of registration, due diligence, information reporting, and withholding requirements for entities designated as "foreign financial institutions" (FFIs) as a way to identify US taxpayers with assets and accounts abroad. Unless excepted or exempted from FATCA under IRS regulations or an Intergovernmental Agreement (IGA), FATCA requires FFIs to enter into an agreement with the IRS to collect and report information about financial accounts held by US taxpayers — or face 30% withholding on US source income paid to the FFI.

Applicability to non-US funded benefit programs

FATCA defines the term FFI broadly to encompass many types of foreign entities, including funded non-US employee benefit programs such as retirement plans (defined benefit and defined contribution). FATCA also affects other forms of funded non-US retirement and savings programs, deferred compensation, and bonus programs, as well as stock programs, cash-value life insurance benefits, and annuities. However, as explained in detail in our previous articles and as discussed briefly below, there are a number of exceptions and exemptions relevant to non-US retirement plans and savings accounts.

> Buck comment. Enforcement via 30% withholding on payments of US source income means that plans without any investments, or with investments entirely outside the US, are not subject to FATCA withholding.

Available exceptions and exemptions

The US Department of Treasury (Treasury) issued final regulations on January 17, 2013 that removed from the definition of “financial account” certain retirement and non-retirement savings accounts, such as IRAs and educational or medical benefits savings accounts, as well as rollovers to specified retirement and non-retirement savings accounts. This means that such accounts — known as *excepted* accounts — are not subject to FATCA compliance whatsoever.

The final regulations also *exempted* from FATCA’s burdensome reporting and withholding requirements certain non-US plans established to provide retirement, disability, or death benefits. A plan can communicate its exempt status — and thereby avoid withholding — by filing a Form W-8BEN-E with the US withholding agent for each of its US-based investments.

Apart from the final regulations, a plan may be excepted from FATCA compliance or qualify for an exemption from some or all of FATCA’s withholding requirements if its home country has entered into an IGA. Many IGAs name specific retirement programs as excepted from FATCA, thus eliminating any FATCA compliance obligations. Even if not excepted or exempted under an IGA, an IGA’s provisions may lessen the burden of FATCA compliance.

Compliance requirements

Plans that are not excepted from FATCA, do not qualify for a regulatory exemption, or do not fall under an IGA must proceed with FATCA’s registration and reporting process to avoid being subject to 30% withholding on US source income. The final regulations established a compliance process for all FFIs, including retirement plans. FATCA withholding is set to begin on July 1, 2014. Although the IRS announced in Notice 2014-33 that FFIs will not be penalized if a good faith effort is made to comply with FATCA during a 2014 and 2015 transition period, plan sponsors should not consider this a reprieve from their compliance obligations.

FATCA also imposes requirements on US taxpayers who own specified foreign financial accounts or other offshore assets, including assets held in a non-US retirement plan. Multinational employers should consider notifying US taxpayer employees who participate in their non-US retirement plans of these requirements so as to minimize the potential for reputational damage.

Action steps for non-US retirement plans

Multinational employers should take stock of, and closely examine, all of the non-US funded employee benefit programs that they (and, if applicable, their foreign subsidiaries and affiliates) sponsor, on a country-by-country basis, to determine whether an exception or exemption applies under the regulations and/or an IGA.

FBAR

US persons with a financial interest in, or signature authority over, foreign financial accounts are required to file with the IRS annually by June 30 a "Report of Foreign Bank and Financial Accounts" (FBAR) if the aggregate value of all foreign financial accounts exceeds $10,000 at any time during the calendar year. The FBAR is filed electronically on FinCEN Report 114, and a FinCEN Form 114a, "Record of Authorization to Electronically File FBARs," must be maintained for those filing jointly with spouses or if the form is being filed by a third party. "United States person" is defined broadly to include US entities, including US retirement plans.

> "Signature authority"
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> … is the authority of an individual (alone or in connection with another) to control the disposition of money, funds, or other assets held in a financial account by direct communication (in writing or otherwise) to the person with whom the account is maintained.

Applicability to US retirement plans

Although the FBAR filing requirement has existed since the 1970s, historically, US retirement plan fiduciaries did not consider it necessary that the plan make an FBAR filing for most foreign plan investments. IRS guidance in 2009, however, alerted plan fiduciaries of the IRS position that foreign-based accounts or investment vehicles constitute "foreign financial accounts" subject to FBAR compliance.

Final regulations effective March 28, 2011 confirmed that employee benefit plans generally must make FBAR filings, including for foreign mutual fund investments and majority interests in foreign corporations, partnerships, or trusts.

Relief for certain employee benefit plans

The final regulations provided some FBAR relief for employee benefit plans, as described below:

- **Relief for assets held in custodial or omnibus accounts.** Plans with investments in foreign financial accounts through a US global bank custodian that maintains an omnibus account for such investments do not have to file an FBAR for those assets — provided the pension trust has no legal right in the assets of the omnibus account *and* can only access these holdings outside the US through the US global custodian bank. If the US pension trust can directly access its foreign holdings maintained at the foreign institution, then it must report such an account.

  Buck comment. Foreign assets held in segregated accounts (or sub-accounts) that identify a US person as the beneficial owner of the assets suggests legal ownership (i.e., a financial interest) in the assets and may subject the accounts to FBAR reporting.

- **Relief for most plan and investment committee members**. Plan committee or investment committee members who do not have direct authority over the foreign financial account in which the plan's assets are invested need not indicate on their personal tax returns that they have a relationship with a foreign account or file an FBAR for the account. If, for example, an investment committee of a pension plan has no authority to communicate instructions directly to the person with whom a financial account is maintained, but rather, merely has authority to communicate directions to the plan trustee, the investment committee and its members would not have signature or other authority so as to trigger an FBAR filing obligation.

  This relief does not apply, however, to any committee member with authority to instruct the custodian or holder of the foreign financial account. If a US person has authority to directly disperse funds from a foreign pension plan, then that person must check a box on his or her individual tax return to disclose a relationship with a foreign account and file an FBAR.

  > Buck comment. FinCEN Notice 2013-1 extended to June 30, 2015 the due date for filing FBARs by certain individuals with signature authority over, but no financial interest in, foreign financial accounts of their employer or a closely related entity.

- **Offshore hedge funds and private equity funds not considered "reportable" accounts.** FBAR filings are not required for most foreign hedge funds and private equity funds that are available only in private offerings.
- **Plan sponsor relief in specific circumstances.** There is no FBAR filing obligation where a plan sponsor, in its corporate capacity, establishes a trust to hold the plan's assets and appoints an individual or a committee to monitor or relay instructions to the trustee. In these circumstances, it is the trustee and each committee member who may have the obligation to file, as explained above.
- **Plan participants and beneficiaries of tax-qualified retirement plans or IRAs.** These individuals need not make an FBAR filing for any foreign financial accounts held by or on behalf of the plan or IRA. This does not mean there is no FBAR filing requirement, but it is the responsibility of the plan or the IRA trustee.
- **Filing exemption for governmental plans.** The foreign financial account of any employee retirement or welfare plan sponsored by a governmental entity need not be reported.

The civil penalties for failure to make a required FBAR filing can be significant, ranging from $500 per violation up to the greater of $100,000 or 50% of the account balance. In certain circumstances, criminal penalties may apply. The IRS has provided some relief for missed FBAR filings as part of its Offshore Voluntary Disclosure Initiative, but that relief does not extend to retirement plans.

OFAC

The Office of Foreign Assets Control (OFAC), a branch of Treasury, oversees and enforces economic and trade sanctions designed to promote US foreign policy and national security goals against "targeted foreign countries and regimes, terrorists ... and other threats to the national security, foreign policy or economy of the United States." Cuba, Iran, Sudan, and Syria are among the 22 countries where OFAC directs country-specific sanctions programs. Under these programs, OFAC regulations prohibit financial transactions with individuals and entities

owned or connected with identified sanctions targets, known as "specialty designated nationals" (SDNs). Additionally, OFAC sanctions programs prohibit financial transactions more broadly with individuals or entities in countries that are subject to a US trade embargo.

Applicability to US retirement plans

To carry out its sanctions programs, OFAC prohibits "U.S. Financial Institutions" from engaging in specified transactions that it has determined undermine foreign policy and national security goals. OFAC understands the term "U.S. Financial Institutions" to include employee benefit plans — in addition to banks, trust companies, and securities broker dealers, among other entities. Indeed, OFAC's regulations under the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 explicitly include "employee benefit plans" as part of the definition of "U.S. financial institution."

Civil penalties for non-compliance can be severe, in some cases up to $1,075,000 per violation. Criminal penalties may also apply in some circumstances.

OFAC compliance

There is no specific requirement for a retirement plan (or any other financial institution) to develop and implement an OFAC compliance program, but the existence of a compliance program may be considered a mitigating factor in the case of a civil proceeding. There are no standard OFAC compliance procedures or policies, though. Rather, in the case of a retirement plan, the nature and extent of an appropriate OFAC compliance program depends on that plan's particular risk (or lack thereof) of engaging in the types of transactions OFAC prohibits.

Two categories of retirement plan transactions are at issue in connection with OFAC compliance: investments and benefits payments. For investments, retirement plans should ensure that any internal asset management programs (in particular, those consisting wholly or in part of foreign investments) include a screening process designed to identify any possible dealings with individuals or entities appearing on OFAC's SDN list. OFAC compliance software is commercially available for these screening purposes and a retirement plan's investment staff should carefully review any transactions that the software identifies as possible "hits." Training may be necessary to ensure that investment staff can properly identify suspicious transactions, and alert OFAC as appropriate.

Retirement plans should also confirm that outside investment managers and custodians of plan assets are aware of, and compliant with, OFAC's directives. As part of the duty to monitor plan services providers, plan fiduciaries should have a basic, high-level understanding of the types of compliance programs that outside investment managers and custodians have in place. The appropriate level of monitoring will depend both on the nature of the manager or custodian (for example, a smaller, less sophisticated entity may merit more extensive monitoring) as well as the level of OFAC-related risk of the assets at issue (for example, assets located in a country that is subject to an OFAC sanctions program may merit more extensive monitoring).

> Buck comment. Plan fiduciaries should document — ideally in plan committee meeting minutes — their understanding of the OFAC compliance programs of their outside investment managers and custodians.

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As far as benefit payments are concerned, retirement plans (and their service providers) should implement a procedure that identifies any beneficiaries who are named on the SDN list and/or reside in a country subject to a trade embargo so that the plan can alert OFAC and avoid transactions with these individuals.

Electronic direct deposit payments will be automatically rejected, or "blocked," by the bank tasked with sending the funds, assuming that the bank has an appropriate OFAC compliance policy in place. In the case of paper check pension payments, OFAC compliance software and/or a word search (in the SDN list linked above) for beneficiary addresses in countries subject to a trade embargo can help a plan identify any prohibited check payments. In either scenario, a plan can apply to OFAC for a "license" to allow payment either to the individual in question or to a group of similarly situated individuals.

In closing

While FATCA, FBAR, and OFAC compliance all address foreign assets held by retirement plans, the application and procedural aspects of each regulatory regime are distinct. It is important that those responsible for retirement plans understand the differences among these requirements so they can design and maintain appropriate compliance programs.

Authors
Julia Zuckerman, JD
Joanne Jacobson, JD, LLM

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