FATCA: Implications for International Assignment Programs

Individual taxpayers on international assignment and international assignment program managers should be preparing now for upcoming rules requiring the reporting of foreign financial assets. Assets that might fall under the reporting requirements are foreign pension plans and deferred compensation plans. As this article points out, information that is available today should be gathered and organized and efforts should be made to educate taxpayers about which assets need to be disclosed.

Reporting rules enacted in 2010 may add some challenges to the 2011 filing season. Taxpayers will be required to provide more information with respect to assets maintained offshore and failure to do so can lead to substantial penalties. This article highlights the new rules and discusses what those rules mean for taxpayers on international assignment and their program managers.

The Foreign Account Tax Compliance Act (“FATCA”) provisions were enacted in March 2010 as part of the HIRE Act. The FATCA provisions are in response to tax policy concerns that some U.S. persons have avoided paying taxes by sheltering assets offshore in foreign bank accounts, trusts, or corporations. To reduce tax evasion and promote transparency, a number of measures were enacted that impose significant reporting and information collection obligations on individual taxpayers and third parties.

The reporting obligations directed at individual taxpayers—the focus of this article—promise to increase both the complexity of income tax returns as well as the time it takes to prepare the returns.

New Foreign Asset Reporting Requirements on Form 8938
Starting in 2011, U.S. taxpayers are required to report ownership of specified foreign financial assets to the extent the total value of the assets exceeds certain threshold amounts. The threshold amounts are.

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1 Pub. L. 111-147, Hiring Incentives to Restore Employment Act (the “HIRE Act”).

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based on where the taxpayer lives and his or her tax return filing status. The IRS issued a draft Form 8938, *Statement of Specified Foreign Financial Assets*, earlier this year and recently issued draft instructions to the form. Although currently in draft form, and therefore subject to change, the form instructions provide insight on the new requirements.

It is important to note that:

- Form 8938 must be included with the individual’s tax return. Failure to include the Form 8938, if required, could lead to significant penalties.

- Form 8938 does not replace Form TD F 90-22.1, *Report of Foreign Bank and Financial Accounts* (known as the “FBAR”). If an individual meets the filing requirements for both forms, both must be filed, even though some of the information reported may be duplicative. The FBAR is filed separately from the tax return, has a June 30th due date, and is required if a U.S. person’s financial interests in, and signature authority over, foreign financial accounts exceed $10,000 at any time during the calendar year.

**Who Must File?**

Specified individuals who own specified foreign financial assets, the value of which exceeds the applicable reporting threshold, are required to complete Form 8938 as part of their income tax returns. Specified individuals include U.S. citizens, U.S. resident aliens for any part of the year, nonresident aliens who make an election to be treated as residents for joint filing purposes, and nonresident aliens who are bona fide residents of American Samoa or Puerto Rico. Individuals who qualify as U.S. resident aliens but elect to be treated as nonresidents pursuant to the residency tie-breaker provisions of a treaty will still be considered residents (and thus a specified individual) for these reporting purposes.

**Reporting Threshold**

Specified individuals are required to report the ownership of specified financial assets if the value of those assets exceeds certain threshold amounts. The applicable reporting thresholds are based on filing status and where the individual lives. The draft instructions indicate higher reporting thresholds than those specified in the statute (the government has discretion under the statute to increase the threshold). This is welcome news.
The reporting thresholds from the draft instructions are provided in the chart below.

<table>
<thead>
<tr>
<th>Filing status</th>
<th>Living in</th>
<th>Meets reporting threshold if value of specified foreign financial assets is...</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unmarried/ Married Filing Separately</td>
<td>United States</td>
<td>$&gt;50,000 on last day of tax year; or $&gt;100,000 at any time during tax year</td>
</tr>
<tr>
<td>Married Filing Jointly</td>
<td>United States</td>
<td>$&gt;100,000 on last day of tax year; or $&gt;200,000 at any time during tax year</td>
</tr>
<tr>
<td>Unmarried / Married Filing Separately</td>
<td>foreign country</td>
<td>$&gt;200,000 on last day of tax year; or $&gt;400,000 at any time during tax year</td>
</tr>
<tr>
<td>Married Filing Jointly</td>
<td>foreign country</td>
<td>$&gt;400,000 on last day of tax year; or $&gt;600,000 at any time during tax year</td>
</tr>
</tbody>
</table>

**What Foreign Assets Must Be Disclosed?**

The definition of a “specified foreign financial asset” is quite broad, and this is one of the reasons for the increased complexity of tax returns. The term “specified foreign financial asset” includes:

- Any depository, custodial, or other financial account maintained by a foreign financial institution
- Any stock or security issued by foreign persons
- Any financial instrument or contract held for investment that is issued by or has a counterparty that is not a U.S. person
- Any interest in a foreign entity\(^2\)

Investment vehicles such as foreign mutual funds, foreign hedge funds, and foreign private equity funds are obvious examples of assets that are reportable on Form 8938. However, reporting is also required with respect to foreign trusts, deferred compensation plans, and foreign pension plans. In many countries, it is not uncommon for a principal residence to be held in a corporation—at first blush, it appears even this type of home

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\(^2\) Section 6038(D)(b).
ownership is subject to reporting. The IRS has mentioned it intends to issue further guidance, so perhaps further clarification with respect to what is reportable is on the horizon.

**Penalties**

Noncompliance with the new reporting requirements can result in substantial penalties. Failure to properly report foreign financial assets can result in a penalty of $10,000 with additional penalties of up to $50,000 for continued failure to disclose after receiving a request from the IRS. Additional penalties can be assessed if there is unpaid tax on unreported income. A six-year statute of limitations could apply allow the IRS to assess unpaid tax and applicable penalties if more than $5,000 of income is omitted from the taxpayer’s return and the income is attributable to assets reportable on Form 8938 (without regard to the dollar thresholds for reporting).³

**PFIC Reporting**

Another FATCA provision introduced a new reporting rule with respect to passive foreign investment companies (“PFICs”). Previously, U.S. shareholders of PFICs were only required to report their ownership interest if certain triggering events occurred during the year. The new provision requires a taxpayer to report annually, without regard to a triggering event, an ownership interest in a PFIC beginning in 2011.⁴

One of the difficulties with PFICs is the initial determination of whether the investment meets the definition of a PFIC. In some cases, the determination may be fairly straightforward (e.g., an investment in a foreign mutual fund is a PFIC); but in other situations, the taxpayer may not have access to the information needed to make the determination.

The IRS has not yet revised Form 8621, *Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund*, although it has stated its intent to do so to reflect the new reporting requirements.

**Transitional Rule for 2011**

Reporting for both foreign financial assets and PFICs is subject to a transitional rule for 2011 returns. Therefore, a taxpayer’s obligation to file

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³ Section 6501(e)(1)(A).
⁴ Section 1298(f), added by section 521 of the HIRE Act (Pub. L. 111-147).
either Form 8938 (for foreign financial assets) or Form 8621 (with respect to PFICs) is deferred until 2012 if the income tax return is filed prior to the release of the final forms. The reporting obligation is merely suspended—that is, deferred until the following year—not eliminated. As mentioned, a draft form and draft instructions for reporting foreign financial assets have been issued. It appears likely that a final Form 8938 may be available prior to the 2011 filing season. However, the IRS has not yet issued any guidance with respect to the new PFIC reporting requirement, so it is possible that the transition rule may apply for the new PFIC reporting requirement during the 2011 filing season.

Effect on International Assignment Programs

These new information reporting rules introduce another level of complexity to the income tax return. More analysis will be needed to determine whether a taxpayer is subject to these new reporting rules and what effect various taxpayer elections may have. Because the rules are new, additional time will be required to explain the new provisions to international assignees who may be uncomfortable sharing private information they were not previously required to disclose.

For program managers, there are a number of issues to consider for the upcoming tax filing season:

- More time may be required to coordinate the collection of needed information, such as foreign pension plan documents or features of a deferred compensation arrangement.

- An assignee may be reluctant to make certain U.S. tax residency elections that would subject the assignee to additional reporting, even if the election might reduce the U.S. income tax liability. When the employer pays the U.S. taxes as part of a tax equalization program, the employer’s desire to minimize tax costs will need to be reconciled with the assignee’s reluctance to disclose foreign financial holdings to the U.S. government.

- Significant penalties may apply for failure to make proper disclosures. A review of company policy to clarify who is responsible for paying any penalties (if imposed) is advised.
• Communication and outreach to educate assignees are critical to helping ensure that they understand what is required of them and how they can do their part to make the filing season go smoothly.

Conclusion

The new reporting rules expand significantly the information required to be disclosed by taxpayers to the U.S. government. As with anything new, there may be some initial reluctance to comply and some frustration with the additional time and effort needed to make a complete and accurate return. However, the consequences of not meeting tax obligations can be severe. Significant penalties apply for failure to disclose. Therefore, it is very important that international assignment program managers send regular communications to assignees to educate them with respect to these new rules.
The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

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