NAPF
Securing the future of pensions

30 April 2012

James.walsh@napf.co.uk
Direct: +44 (0) 20 7601 1720

FATCA consultation
CC:PA:LPD:PR (REG-121647-10)
Room 5205
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station,
Washington, DC 20044
USA

Dear Sir/ Madam,

Thank you for the opportunity to respond to the IRS consultation on the draft Regulations for implementation of the Foreign Account Tax Compliance Act (FATCA).

The NAPF

The National Association of Pension Funds is the UK's leading voice for workplace pensions. Our members operate 1,200 retirement plans. They provide retirement income for nearly 15 million people and have almost $1,300 billion of assets under management. Our membership also includes over 400 providers of essential advice and services to the pensions sector. This includes accounting firms, solicitors, fund managers, consultants and actuaries.

The NAPF's approach to the FATCA Regulations

The NAPF welcomes the IRS' intention to exempt retirement plans from FATCA. Our concern is to ensure that the detail is watertight and that the exemption is unequivocal for all retirement plans, whether defined benefit or defined contribution plans. The exemption should also be applicable to future forms of pension provision, including the 'defined ambition' risk-sharing models on which the UK Government has recently initiated a debate.

Discussions with NAPF members indicate that most of our members would plan to use the exemption set out in 'test 1' on page 68 of the draft Regulations, which applies to retirement plans that are:

(i) *the beneficial owner of the payment;*

(ii) *eligible for the benefits of an income tax treaty with the United States with respect to income that the fund derives from U.S. sources';*

(iii) *'generally exempt from income tax in that country'; and*

(iv) *'operate principally to administer or provide pension or retirement benefits'.*

NAPF
Securing the future of pensions

We note that a retirement plan may also be exempt under 'test 2' if:

(i) *it has been 'formed for the provision of retirement or pension benefits under the law of the country in which it is established';*

(ii) *it receives only employer, government, or employee contributions that are limited by reference to earned income;*

(iii) *no single beneficiary has a right to more than five per cent of the fund's asset, and*

(iv.a) *its investment income is exempt from tax under the laws of the country in which it is organized or in which it operates as a result of its status as a retirement or pension plan in that country, or;*

(iv.b) *it receives 50 per cent or more of its total contributions from the government or employers.*

'Beneficial owners' and defined contribution retirement plans
The draft Regulations refer to retirement plans as 'exempt beneficial owners'. In British trust-based plans, the trustees are, strictly speaking, the *legal* owners, rather than the *beneficial* owners. In addition, it is the trustees that are the legal owner, rather than the plan. It would be helpful if the Regulations could make it clear that the IRS will take a broad view of this point.

There is a further - potentially very serious concern - about the position of individual defined contribution pension accounts, where the individual member, rather than the fund, is the beneficial owner. At present it appears that these schemes would not meet the criteria for 'test 1' and would, therefore, be caught by FATCA. This appears to be contrary to the intentions of the IRS, and the NAPF strongly urges IRS to revise this part of the draft Regulations.

It appears that these schemes would also fail to meet the criteria required by 'test 2'. The criterion requiring contributions to be paid only by the employer, government or employee does not take account of the position of self-employed or unemployed people and it would be very costly for schemes to separate their employed and self-employed or unemployed members. Furthermore, the criterion limiting contributions by reference to 'earned income' would exclude many individual defined contribution schemes, where contributions may be made from unearned income. Once again, these problems would lead to many defined contribution schemes being caught by FATCA.

Contributions to defined contribution schemes in the UK are not limited by reference to earned income. Rather, tax relief is limited to pension plan contributions of 100% of earned income or £3,600 if the member has no earnings, and no tax relief is available for contributions in excess of £50,000. The draft Regulations could take account of these points through amendment of Section 1.14715(f)(2)(ii) so that either 'contributions must be limited by reference to earned income or by the tax relief limits on contributions'.

NAPF
Securing the future of pensions

The example set out on page 325 of the draft Regulations ('example 3') implies that defined contribution retirement plans are merely 'investment conduits' for the relevant employee and, therefore, would not be treated as 'beneficial owners' of any income generated. This seems to be inconsistent with the current US tax treatment. The NAPF would encourage IRS to adjust the Regulations so it is clear that defined contribution schemes are treated as the beneficial owners of any income generated for FATCA and source withholding purposes. Assurance on this point is relevant for global owners with cross-border schemes that may have a population of past, present and future US persons so as not to void the retirement plan's eligibility for exemption.

Double Taxation Convention

We note that the wording used in 'test 1' is virtually a word-for-word copy of the wording used in the UK-USA Double Taxation Convention (Article 3.1.o):[1]

> *o)* *the term "pension scheme" means any plan, scheme, fund, trust or other arrangement established in a Contracting State which is:*
>
> *(i) generally exempt from income taxation in that State; and*
>
> *(ii) operated principally to administer or provide pension or retirement benefits or to earn income for the benefit of one or more such arrangements.*

As far as we are aware, the Double Taxation Convention has proved straightforward to operate and has not caused difficulties for retirement plans, so we expect the same to be the case when the same wording is employed in FATCA. It would be helpful if the FATCA Regulations could make explicit reference to the Double Taxation Convention, indicating that FATCA will be applied in the same manner.

Earned Income

As indicated above, retirement plans that do not qualify as 'beneficial owners' under 'test 1' may still qualify as 'exempt beneficial owners' under the narrower exemption set out in 'test 2', provided they meet certain criteria, including a requirement that 'contributions be limited by reference to earned income'.

However, it is not entirely clear from the proposed regulations how this requirement that contributions be limited by reference to earned income will be interpreted. For example, would a contribution by an employer have to be made by reference to the earned income of the *employer* or the earned income of the *employees* on whose behalf the contribution is made? An example in the proposed Regulations would seem to imply that contributions by an employer that are determined as a percentage of employees' salaries should satisfy the requirement that contributions be limited by reference to earned income.

Furthermore, it is not clear from the proposed Regulations or the example whether the 'limited' aspect of the rule limits the amount that can be contributed to a pension scheme.

---

[1] *UK/USA Double Taxation Convention*, July 2001, amended July 2002

The National Association of Pension Funds Limited
Cheapside House 138 Cheapside London EC2V 6AE Tel: +44(0)20 7601 1700 Fax: +44(0)20 7601 1799

For example, in the case of a defined benefit scheme, would contributions be calculated at twice the amount of an employee's salary permitted?

The NAPF would ask IRS to clarify these issues by (i) making it explicit in the final Regulations that contributions made by an employee, employer or government which are determined as a percentage of the employee's salary qualify as contributions made by 'reference to earned income', and (ii) explicitly stating that there are no limitations, subject to national laws, on the amount that can be contributed, provided the contribution is related to an employee's salary.

Earned income and deficit funding

The IRS should also clarify how this exemption is intended to work in the context of deficit funding contributions to defined benefit schemes, where the amount paid is not usually linked to salaries. The payment of contributions to help repair a funding deficit is not something that would increase the possibility of a pension scheme being used by US citizens to escape US tax, so we would encourage IRS to confirm that the payment of deficit contributions would not prevent the use of Test 2.

Pooled funds

It would be helpful to have confirmation from IRS that the approach taken to retirement plans will also apply to pooled funds where the monies are provided entirely by retirement plans. There is a precedent for such an approach in the Competent Authority Agreement between the UK and USA relating to the Double Taxation Treaty (as summarised in your announcement 2005-30). The same approach should also apply to any other forms of common investment fund purely designed for use by occupational retirement plans.

50% contributions from employer or government

We note that criterion 4b of the requirements for exemption under 'test 2' requires retirement plans to receive at least 50% of their contributions from employers or the government. Most occupational retirement plans should meet this criterion without difficulty.

However, some plans might not pass this test, for example, in cases where employees choose to make substantial additional voluntary contributions. We would encourage IRS to ensure the definition is broad enough to cover all retirement plans, while still ensuring that the legislation achieves its objectives.

Certified deemed-compliant FFIs

A pension scheme that does not qualify as an exempt beneficial owner based on its qualification for benefits under the Dou7bel taxation Convention may qualify as an exempt beneficial owner as a type of 'deemed-compliant' foreign financial institution.

If applicable, pension schemes would most likely qualify only as *certified* deemed-compliant FFIs.

Certain investment vehicles (such as certain Investment Funds) may qualify as *registered* deemed-compliant FFIs, but only if all of their investors are certain exempt US persons, participating FFIs, other *registered* deemed-compliant FFIs, or exempt beneficial owners.

Securing the future of pensions

Since *certified* deemed-compliant FFIs are not among the authorised investors in Investment Funds seeking to qualify as registered deemed-compliant FFIs, *certified* deemed-complaint FFIs such as pension schemes relying on the certified deemed-compliant exemption will be unable to invest in these Investment Funds.

It would be helpful if IRS could make it clear that certified deemed-compliant FFIs should be allowed to invest in investment vehicles that qualify as registered deemed-compliant FFIs.

Conclusion

In conclusion, I should emphasise that the NAPF welcomes the very significant improvements in the draft FATCA legislation. We recognise that IRS fully intends to exempt the vast majority of retirement plans. There are, however, some significant points of detail on which clarification would be welcome, as explained in this letter.

The NAPF would, of course, be pleased to supply any further information.

Yours sincerely,

James Walsh:
Senior Policy Adviser: EU and International