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Review

Pensions

INTRODUCING FATCA

If you have not yet heard about "FATCA", you will in the near future. For pension plan trustees and administrators it has the potential to become an administrative and costly nightmare. We hope for US corrective legislation to exempt UK pension plans from FATCA but have been cautioned that this is unlikely, although administrative relief is a possibility. For now we would like to raise your awareness of this issue so that you are not caught unawares by any press reports, or commentary from other advisers. It is likely that there will be a need for some form of action.

FATCA has the potential to become an administrative and costly nightmare for UK pension plans.

What is FATCA?

FATCA is short for the Foreign Account Tax Compliance Act and was enacted by the United States in 2010. US citizens are subject to taxation on their world-wide income and assets. Although they are required to submit tax returns to the Internal Revenue Service ("IRS"), it is widely perceived that many US taxpayers do not fully report their non-US source income and assets. FATCA has been enacted to compel non-US financial intermediaries to assist with this reporting.

Impact on UK pension plans

FATCA imposes a 30% US withholding tax on any payments by a US entity to a Foreign Financial Institution ("FFI") or Non Financial Foreign Entity ("NFFE"), unless non-US financial intermediaries disclose the identities of any US persons who would ultimately receive some portion of that payment. In order to avoid the 30% withholding tax, a non US financial intermediary will therefore have to make disclosures or be able to certify that it has performed appropriate due diligence that there are no US persons who might benefit from US sourced payments[1]. Although under English law, it is the trustees of an occupational pension plan who hold legal title to the investments of their pension plans, it will not be sufficient simply to look at whether the trustees are US persons, but at whether the ultimate beneficiaries of the plan pass this test too. Failure to satisfy the FATCA compliance requirements could subject US payments to the non-US financial intermediary to a 30% US withholding tax, even if there is an income tax treaty exemption for that payment.

UK pension plan trustees will qualify either as an FFI or NFFE, so FATCA is a real threat to US sourced income for UK plans. Investment managers and custodians in particular will be under the compliance obligations mentioned above.

UK industry organisations have been working actively to eliminate what amounts to a US tax compliance obligation imposed on non-US persons. Efforts to date have not been successful but there are signs that the weight of pressure is such that dates for implementation have been postponed.

When will the FATCA compliance apply?

The US has deferred the effective date of FATCA until 1 January 2013. Non-US financial intermediaries will have another 18 months to establish compliance procedures and start their preliminary due diligence. However, the IRS recently announced that it would delay imposing the 30% withholding tax. Under the new procedures, if an FFI enters into a FATCA compliance agreement with the IRS by 30 June 2013, payments on or after 1 January 2014 would be exempt from the 30% withholding tax. Various other procedural steps will also be delayed beyond the original 1 January 2013 date.

1 We await clarity, through guidance, on the extent to which compliance and disclosures will in practice be dealt with via the financial intermediary or directly by the FFI.

This is the broad timeline for the introduction of FATCA.

Date	Event
31 December 2011	IRS to provide guidance
Summer of 2012	Publication of final regulations
From 1 January 2013	The IRS will begin accepting FFI applications
By 30 June 2013	The FFI must enter into an agreement (to ensure that it will be identified as a participating FFI in sufficient time to prevent withholding tax applying from 1 January 2014)
1 January 2014	Withholding tax commences. To be fully phased in by 1 January 2015.

Exemptions

Under current legislation, a non-US pension plan will be exempted from the withholding tax if:

- it qualifies as a retirement plan under the law of the country in which it is established;
- it is sponsored by a non-US employer; and
- it does not allow US persons to become members or include beneficiaries, other than employees who worked for the non-US employer in the country in which the plan is established during the period in which benefits accrued. Unfortunately, many UK pension plans could not meet this exception – occupational pension plans operating as discretionary trusts cannot easily exclude a class of persons in this way.

Further information

Our US based colleagues having been monitoring FATCA and its implementation since its enactment. Through our involvement in UK pensions industry bodies, we are lobbying the US government to provide an exemption for UK pension plans. It is however likely that some form of action will be necessary and we are working with our US colleagues to prepare for this eventuality. For further information please contact any of the partners listed below or your usual contact in the pensions team.

Francois Barker
Partner
T: +44 (0)121 222 3584
E: francois.barker@ssd.com

Emma King
Partner
T: +44 (0)121 222 3103
E: emma.king@ssd.com

Steve Southern
Partner
T: +44 (0)161 830 5172
E: steve.southern@ssd.com

Wendy Hunter
Partner
T: +44 (0)20 7655 1119
E: wendy.hunter@ssd.com

Catherine McKenna
Partner
T: +44 (0)113 284 7045
E: catherine.mckenna@ssd.com