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Perspectives

AN EXECUTIVE COMPENSATION, BENEFITS & HUMAN RESOURCES LAW UPDATE

pillsbury

Print Newsletter

IN THIS EDITION...

QUESTIONS FROM OUR READERS...

Q. Will pension plan investment committee members have to file an FBAR Report in 2011?

A. Unless the Department of Treasury and the IRS again defer the filing deadline for certain persons with signatory authority over a foreign financial account, members of a pension plan investment committee who alone or in conjuntion with others control the disposition of money, funds or other assets held in a foreign financial account, including a foreign mutual fund or similar pooled funds, will have to file an FBAR Report by June 30, 2011 and disclose on his or her individual Form 1040 Schedule B that he or she has a foreign financial account. See our March 2, 2010 Client Alert "Relief and Other Guidance on Reporting Financial Accounts (FBAR) Issued" [Link or direct to link in Perspectives column] for a discussion of who is subject to FBAR reporting and what foreign accounts may or may not be subject to FBAR reporting by pension plans.

Although participants and beneficiaries in qualified plans (and IRAs) are exempted from the FBAR filing requirement, the plan itself is not exempt with respect to any foreign financial account in which it invests and therefore has a financial interest. Thus, a pension trust will necessarily be subject to FBAR reporting. Note, persons with signatory authority over a plan's foreign account, but who do not have the authority to "dispose" of the assets held in the account, appear not to have "signatory authority" within the meaning of the Treasury's proposed regulation on FBAR requirements. Hopefully, the Treasury will confirm and clarify this when it finalizes these regulations.

Upcoming Events...

California Employment Law Outlook 2011: San Diego
March 10, 2011

2011 U.S. Europe Tax Planning Strategies
April 14, 2011
OECD Conference Centre, Paris, France

IPEBLA 2011 International Conference
May 24, 2011
Berlin Marriott, Berlin, Germany

Recent Publications...

Employee Health Benefits for Adult Children: Managing the Variations in State Income Tax

IRS Relaxes Rules on Fixing Release-Contingent Payments in Nonqualified Deferred Compensation Plan

Department of Labor Proposes Expanded Definition of Fiduciary for Providers of Investment Advice to ERISA Plans and IRAs

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International Executives: Checklist for 2011

by James P. Klein

Print this article

For 2011, there are important new areas to consider for both executives and their employers in connection with compensation and benefits for internationally-mobile executives. This year will see stepped-up enforcement of disclosure, taxation and legal compliance requirements by various government agencies. This advisory focuses on these new areas, and offers comments on what to do now.

Who Are These "International Executives?"

There are several categories of executives to be considered in this general group of internationally-mobile executives. The first category would be those executives who are assigned from the U.S. to a non-U.S. location for a period of several years, usually more than three years and less than five years. This group, from a U.S. perspective, is commonly called "expatriates." For U.S. multinational companies, this is an important group, and one that companies have had to treat carefully for many years.

Another category would be those executives, usually not U.S. citizens, who are assigned into the U.S. for fixed periods, again, usually three to five years. This is not only common for multinational companies headquartered outside the U.S., but is becoming more important even for U.S.-headquartered companies. We'll call these the "inbound executives."

A third group, historically not considered as presenting particular issues, would be the "short-term business traveler." These are executives who work for a few months outside the U.S. (or come into the U.S. from their normal business location for a short term assignment). They do not usually have any special policies applied to them by the company.

Finally, there can be a group of key executives, hired outside the U.S., who are not local nationals of their country of employment. While sometimes called "third country nationals," this is no longer a helpful designation because of the number of such executives who turn out to have significant U.S. ties, either as citizens or green card holders. We'll refer to them as "walk-on executives."

Key Issues for 2011

Expatriates

For the traditional U.S. expatriate executive, companies often provide a package of home country compensation and benefits, and host country special expense reimbursements. In an era of tight cost controls, it becomes important to determine which business unit in the company will bear the expense of an expatriate. If the U.S. company bears the expense, there is an increasing focus on whether any of that expense is deductible by the U.S. company. This will arise when the company structures the employment situation for the executive: will the executive be employed by the local company, or by the U.S. company assigning the individual and expect the individual to come back?

In the past, this decision has often been muddled, with certain items (benefits, stock options, pensions) deducted by the home country, and current compensation deducted by the host country. The IRS is looking more closely at the issue of the proper entity to claim a deduction, and if the expatriate is considered an employee of the company in the host location

International Executives: Checklist for 2011 (continued)

(using U.S. principles to determine the employment relationship), the U.S. company may have no deductions for the compensation for this executive. In addition, if the executive is employed by the non-U.S. company, there can be problems with continued coverage by U.S. social security and the U.S. company retirement plans. New U.S. rules on deferred compensation may also mean that executives assigned to low tax jurisdictions may lose tax deferral on compensation earned, but not paid currently.

For this traditional group, 2011 would be the time to determine if the executives are being treated consistently as employees of the home country company, or of the host country affiliated company. It is also the time to see if their compensation plans are still tax effective in the U.S., based on their location abroad (this is an issue for those in low or zero local tax jurisdictions).

Inbound Executives

For executives who come into the U.S., there is typically a similar approach as expatriates in terms of company policies on compensation and benefits. These inbounds will usually stay in their home country plans. For these executives, the IRS has recently started to look more closely at the issue of correct U.S. taxation of their total compensation package. This may mean current U.S. taxation of deferred compensation and of home country retirement plan coverage. It will also mean a closer look at items earned in the U.S., although taxable only at a later date, when back in the home country. Stock option gains and other forms of incentive compensation are being looked at more closely for this issue, and can (absent a few special treaty provisions) result in double taxation of gains, without full foreign tax credits being available.

A special new problem may be arising in connection with those inbound executives who receive "green cards" (U.S. immigration status of permanent residence) while on the U.S. assignment. Historically, companies have often encouraged executives to get these green cards, even when there is no certainty the executive will stay permanently in the U.S. (for example, if they retire to another country). Even before retirement, many executives leave the U.S. and do not surrender the green card. As an immigration matter, this may not be so easily accomplished in the future (and there is much stronger enforcement of the rules around such moves), and under new tax rules, the executive may find that U.S. "expatriation" tax rules will apply if the executive has held the green card for more than eight years and then tries to surrender the card or take a tax treaty position as a nonresident of the U.S.. Particularly for companies that have historically encouraged executives to get green cards, this is the time to see if the executives really intend to be permanent residents; if not, those cards should be surrendered before the eight years (which can, in some situations, be as short as six elapsed years).

Another issue for U.S. residents is the requirement that they report to Treasury and IRS their interests in non-U.S. financial accounts. This can often include interests in non-U.S. benefit plans, such as stock incentive plans. While these requirements have been around for some time (and historically have not been carefully followed), in 2010 the IRS and Treasury have indicated they will be more aggressive in enforcement of these disclosures in the future.

Short-Term Business Travelers

There is a persistent myth that the U.S. will not tax short-term business travelers unless they are in the U.S. for 183 days or more during a year. Actually, the U.S., under its domestic tax laws, will tax any income earned in the U.S. (over $3,000 a year). The reason that there is a popular view that there is no U.S. tax on short-term business travelers is that almost every U.S. income tax treaty exempts income earned in the U.S. by nonresident aliens (under 183 days residence in the U.S.). The treaties also generally protect the U.S. short-term traveler to a non-U.S. treaty partner country from local tax. However, the IRS is looking more closely at claims for treaty relief (that is, have the proper forms been filed, and filed at the appropriate time). More importantly, a key U.S. income tax treaty (the treaty with Canada) has recently been changed to make treaty protection for short-term business travelers less available than in the past.

International Executives: Checklist for 2011 (continued)

For many executives who are not in formal expatriate programs, but travel a great deal of time, there should be an examination as to whether they are exposed to tax (and the company to tax reporting) for work while on short-term assignment.

Walk-On Executives

Many companies expanding into key new markets find they are hiring executives locally who are not local nationals, or who appear to be local nationals, but technically are either U.S. citizens or green card holders. This can present significant tax issues for the company. For example, a U.S. citizen working for a non-U.S. affiliate will, of course, be subject to U.S. taxation. However, the non-U.S. employer may have an obligation to report and withhold income tax for such individuals (U.S. withholding, unless local withholding applies). This can present a special problem on nonrecurring items, such as stock options, or on any item of income not subject to local withholding.

The action point here is to have procedures in place for the company to be aware of U.S. taxpayers (citizens or green card holders) hired outside the country.

Conclusion

For the internationally-mobile executives, this is the year to keep a close eye on existing, or developing, tax and benefit plan issues. There can be problems for both the executive as well as the employer, and many of these problems are new for 2011, or are being more strictly enforced in 2011.

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JIM KLEIN JOINS PILLSBURY'S EXECUTIVE COMPENSATION PRACTICE

In December 2010, James P. Klein, an authority on international taxation issues affecting executives, joined us as Counsel in our New York office. Prior to joining Pillsbury, Jim spent 12 years as a tax partner with Deloitte Tax, LLP and 18 years as a consulting principal at Towers Perrin (now Towers Watson). As more and more of our clients become multi-national employers, Jim's experience in international tax can be critical in determining how to provide the most tax advantageous compensation and benefits to mobile executives.

Jim's practice is focused on international taxation issues affecting executives, including issues relating to participation in foreign retirement plans, global equity and executive compensation and U.S. and non-U.S. tax and labor issues. Co-author of BNA's International Pension Planning, Jim previously chaired the American Bar Association's Section of Taxation Employee Benefits Committee, that Section's Professional Services Committee, and the Tort and Insurance Section Employee Benefits Committee. He also served as Chair of the International Pension and Employee Benefits Association. A graduate of Columbia Law School, Jim holds an LLM in Taxation from New York University. We welcome Jim to our practice.

EU Prospectus Directive to Exempt Employee Share Plans of U.S. Public Companies

by Susan P. Serota

Print this article

The EU Prospectus Directive (Directive 2003/71/EC) requires companies that offer shares to their employees throughout the European Economic Area (EEA) to provide a Prospectus to employees unless an exemption applies. In addition to current exemptions for companies registered on a Regulated Market in the EU, for certain small offerings and stock option programs in certain EEA states, the Council of the European Union has now determined to expand the exemption to companies with shares listed on a market outside the EEA that the European Commission determines to have "equivalent" standards to an EU Regulated Market. Presumably, U.S. publicly traded companies will meet this standard.

We previously brought to your attention that companies that offer shares to employees in Europe through an employee share purchase scheme may need to comply with the EU Directive on Prospectuses, effective for offerings beginning July 1, 2005. (See our June 27, 2005 Client Alert, "EU Prospectus Required by July 1, 2005," which described the United Kingdom Financial Services Authority (FSA) policy statement and near final rules on the implementation of the Prospectus Directive, applicable to U.S. companies that chose the UK as their home member state.) Although the FSA took the position that option grants were not covered by the rules because an option is not treated under UK law as a transferable security, broad-based employee share purchase schemes were covered. This position required U.S. companies sponsoring SAYE plans investing in employer securities and other broad-based employee share purchase programs in the UK to comply with the FSA rules implementing the Prospectus Directive.

The European Council has recently announced its decision that the employee share plans exception will be expanded and will apply not only to companies listed on an EU Regulated Market, but also to companies outside the EEA with shares registered on a third country market that the European Commission determines has "equivalent" standards to an EU Regulated Market. Because the European Commission will determine which non-EU Regulated Markets will meet the "equivalent" standard, there will be consistency in recognizing such third country markets throughout the EEA states (which is not always the case as each state typically implements Directives under its own regulations). In addition, the company must provide a document to employees containing information on the number and nature of the securities and the reason for, and details of, the offer. The document must be made available in a language customary in the sphere of international finance.

In order for the third country market to be considered "equivalent," at a minimum, the following conditions must be met:

1. Markets in the third country are subject to authorization and to effective supervision and enforcement on an ongoing basis.
2. Markets have clear and transparent rules regarding admission of securities to trading so that such securities are capable of being traded in a fair, orderly and efficient manner, and are freely negotiable.
3. Security issuers are subject to periodic and ongoing information requirements, ensuring a high level of investor protection.
4. Third country markets insure market transparency and integrity by preventing market abuse in the form of insider dealing and market manipulation.

EU Prospectus Directive to Exempt Employee Share Plans of U.S. Public Companies (continued)

Although there is no guarantee that U.S. SEC regulated exchanges would be deemed to be “equivalent,” it is hard to imagine that they would not.

Note that private companies who offer shares under an employee share purchase plan will still need to comply with the EU Prospectus Directive in EEA countries where their employees participate in the plan unless they fit into another exemption, e.g., small offerings.

Susan P. Serota is a partner in the New York office and national leader of the Executive Compensation & Benefits practice. She can be reached at 212.858.1125 or susan.serota@pillsburylaw.com.

Relief and Other Guidance on Reporting Foreign Financial Accounts (FBAR) Issued

by Susan P. Serota

Print this article

On February 26, 2010, the Department of Treasury and the Internal Revenue Service issued (i) proposed regulations providing new guidance on Reporting Foreign Financial Accounts (FBAR), (ii) a Notice extending the filing deadline for certain persons with signature authority over a foreign financial account until June 30, 2011, stating that the IRS would not interpret the term "commingled fund" as applying to funds other than mutual funds for calendar years 2009 and prior years and providing guidance on filing 2010 federal tax returns, and (iii) an Announcement continuing the suspension of FBAR filing requirements for persons who are not United States citizens, residents or domestic entities. This guidance is especially timely as a person required to file FBAR reports for 2009 by June 30, 2010, also needs to disclose this on his or her 2009 federal income tax return due on April 15. FBAR is required pursuant to the Bank Secrecy Act and is intended to combat money laundering and enforce tax compliance with respect to financial accounts held offshore.

Under the Bank Secrecy Act, a United States resident, citizen or person who "makes a transaction or maintains a relation for any person with a foreign financial agency" must report to the Department of Treasury any foreign bank or other financial account on Form TD F 90-22.1, the FBAR, which requires such persons to report their ownership in, or signature or other authority over, a foreign financial account if the aggregate balances in such foreign accounts exceed $10,000. In 2003, the Treasury's Financial Crimes and Enforcement Network (FinCen) delegated enforcement authority to the IRS. Prior to these proposed regulations and other guidance being issued, information on these requirements were mainly set forth in the instructions to Treasury Form TD F 90-22.1 and on the IRS website. In late 2008, the instructions to the Form were changed in ways that broadened the definition of "United States person" and required disclosure of certain foreign mutual funds. Although the FBAR for 2008 was due on June 30, 2009, the IRS extended this deadline to June 30, 2010, for certain persons.

Definition of United States Person—FinCen's proposed regulations ("Proposed Regulations") define a "United States person" as a U.S. citizen, U.S. resident (as defined in Internal Revenue Code §7701(b)) or domestic entity and the United States as including the States, the District of Columbia, all territories and possessions, and the Indian lands as defined in the Indian Gaming Regulatory Act. However, in Announcement 2010-16, the IRS provided relief by suspending the filing requirement due on June 30, 2010 for persons who are not U.S. citizens, U.S. residents or domestic entities and provided that all such persons may continue to rely on the definition of "United States person" found in the July 2000 version of the FBAR instructions to determine if they have a filing requirement for 2009 and earlier calendar years.

Types of Reportable Accounts—The Proposed Regulations focus on relationship between the U.S. person and the financial agency. An account exists if there is a formal relationship with such person to provide regular services, dealings and other financial transactions. The length of time for which a service is provided does not affect the existence of a formal account relationship. However, wiring money or purchasing a money order does not establish a formal account relationship where no other relationship has otherwise been established.

Relief and Other Guidance on Reporting Foreign Financial Accounts (FBAR) Issued (continued)

In addition to bank accounts and securities accounts, the Proposed Regulations define "other financial account" to mean an account with a person that is in the business of accepting deposits as a financial agency; that is an insurance policy with a cash value or an annuity policy; with a person that acts as a broker or dealer for futures or options in a commodity on or subject to the rules of a commodity exchange or association; or with a mutual fund or similar pooled fund which issues shares to the general public that have a regular net asset determination and regular redemptions.

NOTE REGARDING PRIVATE FUNDS: The Proposed Regulations reserve the treatment of investment companies other than mutual funds and similar pooled funds for future regulatory action. Private equity funds, venture capital funds and hedge funds which are privately offered are not currently covered. The IRS confirmed in Notice 2010-23 that it would not apply its enforcement authority adversely against a person who has a financial interest in, or signature authority over, any kind of commingled fund, other than a foreign mutual fund, with respect to that account for calendar year 2009 and earlier years. The relief expressly includes foreign hedge funds and foreign private equity funds. The relief in effect provides a filing extension for U.S. advisors (and their owners and employees) of hedge funds and private equity funds until further notice.

Financial Interest—The Proposed Regulations add an anti-avoidance rule to existing rules, so that where a person creates an entity for the purpose of evading these reporting requirements, the person will be deemed to have a financial interest in any foreign account for which the entity is the owner of record or holder of legal title.

Signature or Other Authority—The Proposed Regulations provide that signature or other authority means authority of an individual (alone or in conjunction with another) to control the disposition of money, funds or other assets held in a financial account by delivery of instructions (whether communicated in writing or otherwise) directly to the person with whom the financial account is maintained. Thus, it appears that a person who has authority over an account but is not authorized to communicate directly with respect to disposition of assets held in the account would not be deemed to have signature or other authority over the account. Further, the IRS Workbook for examiners provides that signature authority only exists where a person can control the disposition of money or other property in the account by "delivery of a document containing his signature to the bank or other person with whom the account is maintained." It further explains that "other authority" exists in a person who can exercise power that is comparable to signature authority over the account by direct communication, either orally or by some other means. An example in the IRS Workbook states that a person who has investment control over the account but who cannot make disbursements or deposits to the account does not have to file an FBAR because the person has no power of disposition.

FBAR Reporting by Qualified Retirement Plans, Government Plans and Rabbi Trusts—The Proposed Regulations exempt participants and beneficiaries in qualified retirement plans (as well as owners and beneficiaries of IRAs) from the requirement to file an FBAR with respect to a foreign financial account held by or on behalf or the retirement plan (or IRA). The Retirement Plan (or IRA), however, is not exempt with respect to any foreign financial account in which it invests and therefore has a financial interest. As to signatory or other authority over a foreign financial account in which the retirement plan invests, it appears that only the person who directly can control the deposit or disbursement of plan assets to or from the foreign account by delivery of a document signed by him, or a similar communication, should be required to file the FBAR, but note filing extension below. A person or committee which only has investment discretion to move the investment to or from the foreign account but does not have authority to make disbursements should not be considered to have other authority over the foreign financial account.

Attached to the Proposed Regulations are draft instructions to Form TD F 90-22.1. These instructions specifically include within the governmental exemption from FBAR filing an employee retirement or welfare benefit plan of a governmental entity. The draft instructions also state that the tax treatment of an entity does not determine whether the entity has an FBAR filing requirement and notes that a disregarded entity for tax purposes and a grantor trust, including a rabbi trust, are subject to the FBAR requirements, if otherwise required to do so.

Relief and Other Guidance on Reporting Foreign Financial Accounts (FBAR) Issued (continued)

Filing Deadlines and Reporting on Tax Returns—Notice 2010-23 extends to June 30, 2011, the filing deadline for persons with signature or other authority but no financial interest in a foreign financial account who pursuant to Notice 2009-62 had their filing deadlines extended to June 30, 2010. The June 30, 2011 filing deadline applies as well to the 2010 calendar and prior years for persons with signature authority but no financial interest in a foreign financial account.

As noted above, relief for 2009 and earlier calendar years has been given for persons with a financial interest in, or signature authority over, a foreign hedge fund or private equity fund.

Finally, Notice 2010-23 provides that taxpayers who have no other reportable financial accounts for the year in question and who qualify for the filing relief provided in the Notice should check the “no” box in response to FBAR questions found on federal tax forms for 2009 and earlier years that ask about the existence of a financial interest in, or signature authority over, a foreign financial account.

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