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Reporting Relief for Individuals with Tax-Favored Foreign Trusts

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Key Takeaways

- Eligible U.S. citizens and residents are now exempt from Form 3520 and Form 3520-A reporting for tax-favored foreign retirement trusts that meet the requirements of Revenue Procedure 2020-17.
- The Revenue Procedure advance was released on March 2, 2020. It is scheduled to be published March 16, 2020
- The new rules will be effective from March 16, 2020, onward (when they are published) and will apply to all prior open tax years.
- U.S. taxpayers with tax-favored foreign retirement trusts such as Australian Superannuation Funds, U.K. Self Invested Pension Plans, and the Swiss Pillar Pensions System, among others, may be covered under this new exemption.
- Always check with your advisor, before acting on the new rules.

Finally, some good news from the IRS.

Taxpayers who would otherwise be required to file Form 3520, (due April 15, 2020), and/or Form 3520-A (due March 16, 2020, for the 2019 tax year), will no longer be required to file these often-burdensome forms if they qualify for the relief set out in the Revenue Procedure. For eligible taxpayers, this should alleviate the administrative burdens and related costs associated with filing these forms. The new guidance and clarity should help taxpayers avoid steep penalties for erroneous filings or omissions.

The new rules are scheduled to go into effect March 16, 2020, and they apply to all prior open taxable years, subject to the limitations of section 6511.

This new exception may exempt U.S. individuals from filing Forms 3520 and 3520-A even if they own foreign pensions and other non-U.S. retirement plans that are considered "trusts" for U.S. tax purposes. Foreign retirement accounts including Australian Superannuation Funds, U.K. Self Invested Pension Plans, and the Swiss Pillar Pensions System among other well-known plans may be covered under this new exemption. Taxpayers and their advisors will need to verify that their retirement accounts that are considered trusts meet the requirements for the new Revenue Procedure with local counsel.

If you're not up to speed on the new rules, you're not alone. The IRS just announced this new reporting exemption on March 2, 2020, through an advance of Rev. Proc 2020-17. The Revenue Procedure provides an exemption from section 6048 information reporting on an eligible individual's transactions with (or ownership of), an applicable tax-favored foreign trust. Consequently, U.S. persons who are required to file 3520 or 3520-A pursuant to IRC section 6048 may not need to file if they meet the requirements of Rev. Proc 2020-17.

Rationale for the New Rules

The IRS indicated that tax-favored foreign trusts are generally subject to restrictions under local country law. The IRS also indicated that U.S. individuals who own accounts like these may already be required to report the accounts in the U.S. on Form 8938 or on a foreign bank account report (FBAR/Form 114).

This rationale should resonate with taxpayers who often feel overwhelmed by the complexity and cost of the reporting requirements—not to mention the steep penalties for erroneous filing--for something as simple as a retirement fund they may have earned while working abroad.

The Details

As mentioned earlier, the new exemption applies to **tax-favored foreign retirement trusts** as well as to **tax-favored foreign *non-retirement* savings trusts**. Let's explore the details of the new rules on each type of trust below:

1. Tax-Favored Foreign Retirement Trust

For U.S. tax purposes, this type of trust is one that is established under the laws of a foreign jurisdiction to provide the beneficiary with retirement income, and which meets the ***six requirements*** below:

1. The trust is generally exempt from income tax or is otherwise tax-favored under the laws of the trust's jurisdiction.
2. Annual information reporting with respect to the trust (or of its participants or beneficiaries) is provided--or is otherwise available--to the relevant tax authorities in the trust's jurisdiction.
3. It only permits contributions associated with income earned from the performance of personal services.

4. Contributions to the trust are limited by a percentage of the participant's earned income and are subject to an annual limit of $50,000 or less to the trust, or are subject to a lifetime limit of $1 million or less to the trust.
5. Withdrawals, distributions, or payments from the trust are conditioned upon reaching specified retirement age, disability, or death. Also, penalties must apply to withdrawals, distributions, or payments made before such conditions are met.
6. In the case of an employer-maintained trust:

1. The trust is nondiscriminatory, and
2. The trust provides significant benefits for a substantial majority of eligible employees and,
3. The benefits provided are nondiscriminatory

2. Tax-Favored Foreign Non-Retirement Savings Trust

For U.S. tax purposes, this type of foreign trust is one that is established under the laws of a foreign jurisdiction to provide the beneficiary with income for medical, disability or educational benefits, and that meets the ***four requirements*** below:

1. The trust is generally exempt from income tax or is otherwise tax-favored under the laws of the trust's jurisdiction.
2. Annual information reporting is provided with respect to the trust (or about the beneficiary or participant), or the information is otherwise available, to the relevant tax authorities in the trust's jurisdiction.
3. Contributions to the trust are limited to $10,000 or less annually or to $200,000 or less on a lifetime basis.
4. Withdrawals, distributions, or payments from the trust are conditioned upon the provision of medical, disability, or educational benefits.

Reporting Requirements Not Affected by the Relief

The relief does not affect the Form 8938 filing requirement or any reporting obligations under any other provision of U.S. law, including the requirement to file FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR). Moreover, the Revenue Procedure does not affect previously issued guidance providing an exception from reporting with respect to distributions from certain foreign compensatory trusts and an exception from all information reporting requirements with respect to certain Canadian retirement plans.

Conclusion

Revenue Procedure 2020-17 introduces a practical approach to dealing with foreign tax-favored retirement accounts and targeted savings accounts. The practical approach provides relief for taxpayers who would otherwise be subject to costly, time-consuming and complex foreign information reporting requirements. The new rules also provide much-needed guidance and clarity about the reporting requirements that have long been challenging for taxpayers--with very steep penalties for non-compliance or erroneous filing.

Taxpayers and their advisors will want to review their tax-favored foreign trusts to determine whether they meet the requirements of the revenue procedure classified as an "**applicable tax-favored foreign trust**." With the March 15, 2020 reporting deadline fast approaching for Form 3520-A, taxpayers and their advisors will want to move quickly to determine whether they may be exempt from filing.

The revenue new procedure also provides guidelines to individuals wishing to request a penalty abatement or a refund on penalties they have already paid. An eligible individual who wishes to request an abatement or penalty refund may do so by filing **Form 843, Claim for Refund and Request for Abatement**.

The revenue procedure is effective as of the date this revenue procedure is published in the Internal Revenue Bulletin (scheduled March 16, 2020) and it applies to all prior open taxable years, subject to the limitations of section 6511.

If you or a colleague has questions about the impact of the Revenue Procedure, please don't hesitate to contact us.