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STATE BAR OF CALIFORNIA
TAXATION SECTION
INTERNATIONAL COMMITTEE

PROPOSED GUIDANCE:
WHY MEXICAN RETIREMENT FUNDS SHOULD NOT BE SUBJECT TO THE NEW REPORTING REQUIREMENTS UNDER IRC SECTION 1298(f)

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EXECUTIVE SUMMARY

On March 18, 2010, the 2010 Hiring Incentives to Restore Employment Act (the "**HIRE Act**"), enacted additional reporting requirements in the international context, including Internal Revenue Code ("**IRC**") Section 1298(f) which requires that each United States ("**U.S.**") person who is a shareholder of a passive foreign investment company ("**PFIC**") files an informational return with respect to such PFIC, subject to the exceptions to be provided by the Department of the Treasury (the "**Treasury**").

The purpose of this reporting requirement is to allow the IRS to identify PFICs and their shareholders and verify amounts reported by the shareholders, in order to ensure that U.S. persons are properly taxed under the PFIC rules.

U.S. persons participating in retirement funds organized under the Mexican social security legislation may be treated as the beneficial owners of the underlying foreign corporations, which may as a consequence fall within the definition of PFICs because they are structured as foreign corporations holding passive investments. However, the participation of U.S. persons in Mexican retirement funds represent a low-risk of tax evasion because they are not vehicles designed to make offshore investments, but instead represent a mandatory regime derived from being employed in Mexico.

Thousands of U.S. persons have participation in Mexican retirement funds, whether because they are U.S. citizens (including dual nationals) working in Mexico, or because they are resident aliens who moved to the United States after working in Mexico. Consequently, they may be subject to the reporting requirements under new IRC Section 1298(f), even if their participation in the Mexican retirement funds was not made in order to obtain a tax benefit in the United States but was instead mandatory under Mexican law.

The authors request that guidance be issued providing an exemption for U.S. persons with participation in Mexican retirement funds from the filing requirements under IRC Section 1298(f).

DISCUSSION

I. BACKGROUND: PFIC RULES

A. Purpose of PFIC Rules

In 1986, Congress adopted the PFIC rules with the purpose of eliminating the economic benefit of deferral for PFIC shareholders, to eliminate tax advantages that U.S. shareholders in foreign investment funds had over U.S. persons investing in domestic investment funds.[5] In other words, Congress intended to prevent deferral of income taxation for U.S. investors through the use of foreign corporations, instead of domestic investment vehicles generally structured as pass-through entities.

As explained below, this objective is reached through different methods, including the imposition of an interest charge on certain distributions received from PFICs, or by allowing U.S. investors to annually recognize income even if no distribution is made.

B. Definition of PFIC

A PFIC is a foreign corporation in which a U.S. person participates if it satisfies one of two tests: (i) the income test (*i.e.,* most of its income is passive), or (ii) the asset test (*i.e.,* most of its assets produce passive income).

First, in order to be a PFIC a foreign entity must be a business entity classified as a foreign corporation.[6]

Secondly, a U.S. person should be a shareholder of the foreign corporation.[7] For this purpose, the term "U.S. person" includes U.S. citizens and U.S. tax residents.[8] There is no minimum ownership requirement for U.S. persons.[9] Thus, if a U.S. person owns even a very small stake in a foreign corporation, he will be subject to these rules.

To determine whether a U.S. person is a shareholder of the foreign corporation, certain attribution rules apply to consider a U.S. person as *indirectly* owning stock in a PFIC.[10] For example, a person is treated as owning a proportionate amount of stock held by a PFIC in which he is a shareholder.[11] Stated differently, PFIC stock is attributed through an intervening PFIC, regardless of the U.S. investor's percentage interest in the intervening PFIC.[12] Also, stock owned by a trust that is a grantor trust is attributed to

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[5] *See* HR Rep. No. 841, 99th Cong., (1986).
[6] I.R.C. § 1297(a) (flush language).
[7] A foreign corporation is treated as a PFIC with respect to a shareholder only for those days included in the person's holding period during which the person was a U.S. person. Treas. Reg. § 1.1291-9(j)(1).
[8] I.R.C. § 7701(a)(30).
[9] *See* Marc P. Blum, et al., "Reporting Requirements Under the Code for International Transactions", 947 Tax Mgmt. (BNA) Foreign Income, at A-27 (Jan. 1, 2008).
[10] I.R.C. § 1298(a).
[11] I.R.C. § 1298(a)(2)(B); Prop. Treas. Reg. 1.1291-1(b)(8)(ii)(B).
[12] *See* PLR 9007014 (Nov. 16, 1989).

the grantor and any stock owned by a non-grantor trust is proportionately attributed to the beneficiaries.[13]

Finally, a foreign corporation in which a U.S. person is a shareholder is a PFIC if (i) at least 75% of its gross income is passive income (the income test), or (ii) at least 50% of its assets produce passive income (the asset test).[14] For this purpose, "passive income" means "foreign personal holding company income,"[15] which includes dividends, interests, certain royalties and rents, among others.[16]

Thus, a foreign corporation would meet the "income test" if most of its income (at least 75%) is derived from dividends, interest, capital gains from sale of property that gives rise to dividends or interest, transactions in commodities, gains from foreign currency transactions, income equivalent to interest, etc.[17] Similarly, a foreign corporation would meet the "asset test" if most of its assets (by value) produce income described in the preceding sentence.

[13] I.R.C. § 1298(a)(3); Prop. Treas. Reg. § 1.1291-1(b)(8)(iii)(C).
[14] I.R.C. § 1297(a).
[15] I.R.C. § 1297(b)(1).
[16] I.R.C. § 954(c).
[17] *See* Thomas A. O'Donnell, et al., "PFICs," 923 Tax. Mgmt. (BNA) Foreign Income, at A-7 (2006).

C. Taxation of PFIC Income

There are three alternative regimes under which a U.S. person that is a shareholder of a PFIC may be taxed: (i) the "excess distribution" regime (which is the default regime); (ii) the qualified electing fund ("QEF") regime and (iii) the market-to-market ("MTM") regime.

The default regime imposes an interest charge if a U.S. person receives an excess distribution with respect to stock in a PFIC.[18] An "excess distribution" is the amount by which the total distribution for a taxable year exceeds 125% of the average distributions on the previous three taxable years.[19] In addition, any gain on the sale (or other disposition) of the PFIC stock is treated as an excess distribution.[20] The purpose of the regime is to approximate the tax that would have been imposed if the income had been distributed currently when earned by the PFIC.[21]

On the other hand, under the QEF regime a U.S. investor may elect to provide certain information annually and treat the PFIC earnings and profits as currently distributed to the U.S. investor, with certain exceptions.[22] Therefore, the U.S. investor would pay taxes annually on his share of income obtained by the PFIC.

Finally, under the MTM regime a U.S. investor may elect to treat his PFIC stock as if it were sold at the end of each year, recognizing gain or loss annually depending on whether the stock has increased or decreased in value.[23] Hence, the U.S. investor would pay taxes annually on the appreciation (or deduct the depreciation) in the value of his shares in the PFIC.

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[18] I.R.C. § 1291(a)(1).
[19] I.R.C. § 1291(a)(2).
[20] I.R.C. § 1291(b).
[21] O'Donnell, *supra* at Note 17, at A-4.
[22] *See* I.R.C. § 1293.
[23] *See* I.R.C. § 1296. The MTM regime may apply only with respect to PFIC stock that is "regularly traded" on a "qualified stock exchange".

II. REPORTING OBLIGATIONS WITH RESPECT TO PFICS

A. IRS Form 8621

The IRC includes a general reporting requirement for certain PFIC shareholders which is contingent upon the issuance of regulations.[24] In 1992, the Treasury issued proposed regulations requiring U.S. persons to file annually IRS Form 8621, Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund ("**Form 8621**") for each PFIC in which the person is a shareholder during the taxable year; however, such regulations have not been finalized.[25] The proposed regulations provide that a U.S. person who directly or indirectly is a shareholder in a PFIC may be required to file annually with his federal income tax return a separate Form 8621 for each PFIC of which is a shareholder during the taxable year.[26]

Currently, according to the Instructions to Form 8621, a U.S. person who is a direct or indirect shareholder of a PFIC is required to file Form 8621 for each year in which that U.S. person (i) recognizes gain on a direct or indirect disposition of PFIC stock, or (ii) receives a direct or indirect distribution from a PFIC.[27]

The purpose of Form 8621 is to allow the IRS to (i) identify PFICs and their shareholders, (ii) administer shareholder elections, (iii) verify amounts reported by the shareholders, and (iv) track transfers of stock of certain PFICs.[28] In other words, the reporting requirement of filing Form 8621 is the tool that the IRS has to verify the correct application of the PFIC rules to tax the income of U.S. investors derived from their participation in PFICs.

Before the enactment of IRC Section 1298(f), there were no specific penalties for failure to file Form 8621.[29]

B. New IRC Section 1298(f)

On March 18, 2010, as part of a series of modifications aimed to ensure that U.S. persons with assets held in foreign countries properly pay taxes in the United States, the HIRE Act enacted additional reporting requirements in the international context, including new IRC Section 1298(f).[30]

Pursuant to IRC Section 1298(f), each U.S. person who is a shareholder of a PFIC is required to file an informational return with respect to such PFIC, subject to the exceptions provided by the Treasury.

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[24] *See* I.R.C. § 1291(e) by reference to I.R.C. § 1246(f).
[25] *See* Prop. Treas. Reg. § 1.1291-1(i).
[26] *Id*.
[27] *See* Instructions to Form 8621. *See also* IRS Announcement 88-94 (New Form 8621, Return By A Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund, Now Available), 1988-25 I.R.B. 51 (June 20, 1988). In addition, Form 8621 should be filed to make certain reportable elections, such as an election to apply the QEF regime or the MTM regime.
[28] *See* Notice of Proposed Rulemaking of April 1, 1992 (57 FR 11024-01, 1992-1 C.B. 1124, 1992-18 I.R.B. 23).
[29] Blum, *supra* at Note 9, at A-31.
[30] Section 521(a) of the HIRE Act.

Section 1298(f) is effective on March 18, 2010.[31] Nevertheless, this new requirement has been suspended until the revised Form 8621 is issued.[32] Currently, the IRS is developing guidance in the form of regulations regarding the reporting obligations under IRC Section 1298(f).[33] In the meantime, persons that were required to file Form 8621 prior to the enactment of IRC Section 1298(f) must continue to file Form 8621 as provided in the Instructions to such form (*e.g.*, upon disposition of stock of a PFIC or receive of distributions from a PFIC).[34]

C. Penalties for Failure to File Form 8621

Under IRC Section 6501(c)(8)(A), the statute of limitations for assessment of tax with respect to periods for which reporting is required under IRC Section 1298(f) will not expire before three years after the date on which the IRS receives Form 8621 for such taxable year. [35] Therefore, if a U.S. person is required to file Form 8621 and fails to do so, the statute of limitations for all items of income of that tax year may remain open indefinitely.

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[31] Section 521(c) of the HIRE Act.

[32] *See* Notice 2010-34, 2010-17 I.R.B. 612, and Notice 2011-55, 2011-29 I.R.B. 53.

[33] *Id.*

[34] *Id.*

[35] Nevertheless, if the failure to file Form 8621 is due to reasonable cause and not willful neglect, the statute of limitations remains open only with respect to the item or items required to be reported under Form 8621. *See* I.R.C. Section 6501(c)(8)(B).

III. OVERVIEW OF THE MEXICAN RETIREMENT SYSTEM

In 1997, Mexico reformed its social security system by replacing its traditional "pay as you go" with a fully funded system based on individual accounts. The "new" system is mandatory for all private sector and some public sector employees and is voluntary for all self employed workers. Based on official data,[36] there are almost 42 million individual participants in the system holding assets worth approximately USD $118 billion.[37]

The Mexican social security system is regulated at the federal level. One of its objectives is to grant a pension guaranteed by the Federal government.[38] The social security system is the main instrument for the social welfare, provided as a national public service.[39]

The social security system includes the mandatory regime and the voluntary regime.[40] The mandatory regime includes, among others, the retirement insurance.[41] Permanent and temporal employees are subject to the mandatory regime.[42] The voluntary regime includes to the individuals that elect to be part of the mandatory regime.[43]

Because of the breadth of the system, there are many participants in the system that are U.S. citizens or U.S. tax residents living in the United States, in Mexico and overseas.

A. Employee Individual Accounts

The Mexican Social Security Law guarantees the right of each employee to open with an *Administradora para Fondos para el Retiro* ("**AFORE**") an individual account to deposit the employer/employee contributions (*cuotas obrero-patronales*) and the government contribution (the "**Individual Account**").[44] Each employee may only have one Individual Account.[45]

The employers and the Mexican Federal Government are required to contribute to the Individual Account of each employee a percentage of his wages, in the terms provided by law.[46]

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[36] *See* Recursos Registrados en las Afores, *Comision Nacional del Sistema de Ahorro para el Retiro*, available at http://www.consar.gob.mx/SeriesTiempo/CuadroInicial.aspx?md=2 (last accessed March 21, 2012).

[37] *See* Activos Netos, *Comision Nacional del Sistema de Ahorro para el Retiro*, available at http://www.consar.gob.mx/SeriesTiempo/CuadroInicial.aspx?md=16 (last accessed March 21, 2012).

[38] Ley del Seguro Social [L.S.S.] [Social Security Law], art. 2 (Mex.).

[39] L.S.S. at art. 4.

[40] L.S.S.at art. 6.

[41] L.S.S. at art. 11. It also includes the insurance for (i) work-related injuries; (ii) sickness and maternity leave; (iii) life and disability; (iv) retirement and old-age; and (v) daycare.

[42] L.S.S. at art. 12.

[43] L.S.S. at art. 13. The individuals that may opt for the mandatory regime are (i) employees in family companies, as well as certain independent contractors; (ii) domestic workers; (iii) individuals members of certain public interest ownership regimes (*i.e.*, *ejidatarios*, *comuneros* and *colonos*); (iv) certain employers; and (v) some government employees.

[44] L.S.S. at art. 159, subparagraph I, and 174 .

[45] L.S.S. at art. 177 second paragraph.

[46] L.S.S. at art. 167.

Each employee may choose the AFORE that will manage her Individual Account.[47] Each Individual Account has 3 subaccounts: (1) retirement, unemployment and old-age; (2) housing; and (3) voluntary contributions.[48]

The amounts deposited in the employee's Individual Account are the employee's property; however, an employee cannot dispose of her Individual Account or receive any distributions until she retires (as explained below).[49] For example, the voluntary contributions made by the employee may be withdrawn only when the employee is entitled to receive the mandatory contributions.[50]

B. Investment Structure

The contributions of the employers, employees and the federal government[51] are deposited to the subaccounts of each Individual Account.[52]

The Individual Accounts are managed by an AFORE, which is a regulated Mexican financial entity which manages retirement funds.[53] The AFORES are organized as *Sociedades Anonimas de Capital Variable*.[54] Presently, most financial groups operating in Mexico own and manage at least one AFORE.

The AFORE invests the funds in a *Sociedad de Inversión Especializada en Fondos para el Retiro* ("**SIEFORE**"), which is a type of investment funds that is managed by, and is part of the same group of, the AFORE.[55] For that purpose, the AFORE acquires shares of the SIEFORES on behalf of the investors-employees.

Usually, each AFORE has five underlying SIEFORES, each one with different portfolio investments, depending on the age of the employees. A SIEFORE is an entity that must be organized as a *Sociedad Anónima de Capital Variable*.[56] The purpose of the SIEFORES is to invest the funds of the Individual Accounts maintained pursuant to the Mexican Social Security Law.[57]

C. Right to Distributions

Withdrawal of funds is operated through the redemption of the SIEFORE shares rather than through the distribution of the assets held by the SIEFORE.

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[47] L.S.S. at art. 176.

[48] L.S.S. at art. 159 subparagraph I. The subaccount for housing is separately managed by the Employee Housing Institute (*Insituto del Fondo Nacional de la Vivienda para los Trabajadores*) pursuant to another law.

[49] L.S.S. at art. 169.

[50] Ley de los Sistemas de Ahorro para el Retiro [L.S.A.R.] [Savings for Retirement System Law], art 74 fifth pararaph (Mex.).

[51] The contributions made by the federal government for pensions are considered to be a social security expense. L.S.S. at art. 168.

[52] L.S.S. at art. 167.

[53] L.S.S. at art. 175 and L.S.A.R. at art. 18.

[54] L.S.A.R. at Article 20 subparagraph I.

[55] L.S.S. at art. 188 and L.S.A.R. at article 39.

[56] L.S.A.R. at art. 41 subparagraph I.

[57] L.S.A.R. at arti. 39.

In general, individuals are entitled to receive distributions from their retirement accounts in two cases: (i) when are unemployed and are 60 years or older (*cesantía en edad avanzada*), or (ii) when reach 65 years old (*vejez*).[58] An individual that is receiving a pension for unemployment may not receive a pension for old-age or disability.[59]

[58] In addition, an individual may retire before the age of 60 if the pension derived from the annuity is more than 130% the "guaranteed pension". L.S.S. at art. 158.

[59] L.S.S. at art. 160.

1. Unemployment Retirement

In the first case, an individual must be 60 years or older, prove that is unemployed, and have at least 24 years (*i.e.,* 1250 weeks) contributing to the Mexican Social Security Institute ("IMSS").[60] If this occurs, the IMSS has to provide a "pension" to the individual.[61] The individual may choose to (a) contract an annuity (*renta vitalicia*) or (b) make scheduled retirements from his Individual Account.[62]

2. Old-Age Retirement

An individual who is at least 65 years old and has contributed at least 24 years (*i.e.,* 1250 weeks) to the IMSS is entitled to the old-age retirement.[63] In order to receive an old-age retirement pension, the individual has to request the pension and be unemployed.[64] The individual may choose to (a) hire an annuity (*renta vitalicia*) or (b) make scheduled retirements from his Individual Account.[65]

D. Mexican Taxation of Distributions from the Mexican Social Security System

1. Retirement Subaccount

Employer contributions to the retirement subaccounts are not taxable for the employee.[66] Initially, the disposition of the Individual Account and investment returns were tax-exempted.[67] Currently, the amounts from the retirement and old age subaccounts of the Individual Accounts are exempt from income taxes up to an amount of nine times the minimum wage (about USD $15,822 per year).[68] The exceeding is subject to withholding when paid.[69]

Distributions received by nonresidents are subject to withholding tax in Mexico if (i) the payments are made by Mexican residents, or (ii) the contributions to the retirement subaccounts derived from services provided in Mexico.[70] The tax is imposed as follows: the first USD $10,000 per year (MXN $125,900) are exempt; from USD $10,000 up to the amount of about USD $77,000 (MXN $1,000,000) a withholding rate of 15% applies; and any amount above the USD $77,000 is subject to a withholding of 30%.

2. Voluntary Contributions Subaccount

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[60] L.S.S. at art. 154. Nevertheless, if the individual does not meet the contribution period, he may retire the balance of his Individual Account in a lump-sum or continue to contribute until he reaches the weeks required.

[61] L.S.S. at art. 155, subparagraph I.

[62] L.S.S. at art. 157 and 159 subparagraph III.

[63] L.S.S. at art. 162. Nevertheless, if the individual does not meet the contribution period, he may retire the balance of his Individual Account in a lump-sum or continue to contribute until he reaches the weeks required.

[64] L.S.S. at art. 163.

[65] L.S.S. at art. 164.

[66] Ley del Impuesto sobre la Renta [L.I.S.R.] [Income Tax Law], art. 109 subparagraph IX (Mex.).

[67] L.S.S. at art. 184 second paragraph.

[68] For 2012, the minimum wage equals an approximate amount of MXN $62.33 (about USD $4.82) per day or MXN $22,750.45 (about $1,758) per year.

[69] L.I.S.R. at art. 109 subparagraph III.

[70] L.I.S.R. at art. 182.

Voluntary contributions are deductible to the employee within two limits: (i) up to 10% of her taxable income for the calendar year, and (ii) not exceeding five times the annual minimum wage (about USD $8,800).[71]

Currently, the proceeds from the voluntary contributions made by employees are taxed as interests at the time of withdrawing the funds.[72] However, as of January 1, 2013, the appreciation component of voluntary contributions to Individual Accounts will be taxed on an accrual basis, subject to withholding.[73]

If the proceeds from the voluntary subaccount are withdrawn before the age requirements (or disability or unemployment) are met, the full amount of the contributions is considered as income (up to the deducted amount adjusted for inflation), in addition to the interest earned by the investment.[74]

[71] L.I.S.R. at art. 176 subparagraph V.
[72] L.I.S.R. at art. 158 third paragraph.
[73] L.I.S.R. at art. 158.
[74] L.I.S.R. at art. 167 subparagraph XVIII.

IV. U.S. Tax Characterization of Mexican Retirement Funds

The IRS estimates the number of U.S. taxpayers living outside the United States at about seven million.[75] Mexico is the country with the largest number of U.S. taxpayers abroad. It is estimated that about 1,036,300 U.S. citizens reside in Mexico.[76] Mexico is followed by Canada as the country where more U.S. taxpayers reside (outside the United States), with an estimated of 687,700.

A. SIEFORES may be considered to be PFICs

As explained above, the AFORES purchase shares in a SIEFORE on behalf of the employees, with the funds available in the Individual Accounts. SIEFORES are entities that must be organized as a *Sociedad Anónimas de Capital Variable*, which are business entities classified as a *per se* corporations for U.S. income tax purposes.[77] The legal owner of the shares in the SIEFORES are the employees, even though are not entitled to receive any distribution until one of the events provided by law occurs.

Therefore, an employee would be considered as a shareholder of the SIEFORE, a foreign corporation. Usually, the shares owned by each employee would represent a minimal interest of the shares of the SIEFORE. However, this minimal ownership is enough to be subject to the PFIC rules.

Furthermore, most of the investments made by a SIEFORE are passive. Therefore, it would satisfy both the income test and the assets test, and a SIEFORE may be considered as a PFIC for U.S. tax purposes.[78]

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[75] *See* Internal Revenue Service, *Reaching Out to Americans Abroad* (Apr. 2009), available at http://www.irs.gov/businesses/article/0,,id=205889,00.html (last visited March 4, 2012).

[76] *See* National Taxpayer Advocate, 2009 Annual Report to Congress, at 134-154.

[77] Treas. Reg. § 301.7701-2(b)(8).

[78] Nevertheless, not all of the income from distributions from Mexican retirement funds may be taxable in the United States. At least part of the distributions made by the Mexican retirement funds may be considered as "social security benefits" under the income tax treaty with Mexico (the "Treaty"), taxable only on the source country (*i.e.*, Mexico). *See* Article 19, paragraph 1, subparagraph b), of the Treaty.

For this purpose, "social security benefits" include payments made by one of the Contracting States under the provisions of its social security or similar legislation, regardless of whether the social security beneficiaries contributed to the system as private sector or Government employees. *See* Technical explanation of Article 17, paragraph 2, of the 2006 U.S. Model, page 55.

The Mexican retirement system applies to employees of the private sector (and sometimes to employees of the Government) and is provided in the Mexican Social Security Law (L.S.S.), which is the social security legislation of Mexico. Consequently, distributions from Individual Accounts may be treated as social security benefits for purposes of the Treaty because they are payments made under the provisions of the Mexican social security legislation. However, this discussion is beyond the scope of this proposal.

V. MEXICAN SIEFORES SHOULD NOT BE SUBJECT TO NEW REPORTING REQUIREMENTS UNDER IRC SECTION 1298(f)

A. Treasury Has Express Authority to Exempt Reporting Requirements under Section 1298(f)

The proposed exemption for Mexican pension funds is legally feasible because Treasury has express statutory authority to provide for exceptions and determine the information required to be filed under new § 1298(f).[79]

B. Mexican Retirement Funds are Not Entities Targeted by the PFIC Rules

Taxpayers should only be required to provide information with respect to the risk that is targeted by Congress. Benefits under Mexico's social security system do not represent a risk targeted by Congress with the PFIC rules.

As previously discussed, the PFIC rules are aimed to eliminate the benefit of deferral of income taxation by U.S. persons through the use of foreign corporations instead of domestic investment vehicles. Mexican retirement funds do not fit into this category. Investing in SIEFORES is mandatory to employees in Mexico to protect economic stability at retirement of employees, under the Mexican social security legislation. Therefore, an employee may not choose not to participate in the social security system.

Furthermore, voluntary participation in the Mexican retirement system is available only to certain persons and do not represent a risk of tax evasion, as the investment returns will be taxed in Mexico on an accrual basis. Hence, no tax benefit will be obtained.

C. Failure to Report May Derive in Extending the Statute of Limitations

If Form 8621 is not filed, it may result in the statute of limitations for assessment of tax with respect to those periods will not expire, until three years after the date on which Form 8621 is filed.

If the participation in the Mexican retirement system is reportable and the beneficiaries fail to file Form 8621, the statute of limitations for years in which the information is not provided would not expire, even if the income received from such retirement funds is not taxable in that year.

Most U.S. persons employed in Mexico (*e.g.,* dual nationals) may not be aware of the PFIC rules and of the reporting obligations that may derive from participating in a PFIC. Furthermore, most of the employees may not be familiar with the complex structure of the Mexican retirement system, and only know that they are contributing to their retirement account.

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[79] *See* I.R.C. § 1298(f) ("Except as otherwise provided by the Secretary, each United States person who is a shareholder of a passive foreign investment company shall file an annual report containing such information as the Secretary may prescribe." underlined added).

It is likely that most of the U.S. persons employed in Mexico may not know that their participation in the Mexican retirement system may give rise to an informational return with respect to their indirect participation in the SIEFORES.

D. Treasury Has Provided General Exemptions for Reporting Requirements for Similar Plans

The Treasury has taken a similar approach excepting the participation in foreign social security programs from the reporting requirements under new IRC Section 6038D.

Under IRC Section 6038D, any individual who during the taxable year holds an interest in any specified foreign financial asset is required to attach to his or her income tax return for the taxable year certain required information with respect to each specified foreign financial asset if the aggregate value of all of the individual's specified foreign financial assets exceeds $50,000. This reporting requirement is fulfilled by filing Form 8938, Statement of Foreign Financial Assets.

Nevertheless, the Treasury has provided that an interest in a social security, social insurance, or other similar program should not be reported because it is not a specified foreign financial asset.[80]

Likewise, new proposed regulations exclude from the definition of a "financial account" (reportable under new IRC Sections 1471 through 1474) certain savings accounts, including both the retirement and pension accounts, meeting certain requirements with respect to tax treatment and the type and amount of contributions, because are considered as posing a low risk of tax evasion.[81]

In other words, the Treasury has already made the determination that foreign social security programs and certain retirement programs pose a low risk of tax evasion. This is especially true in the case of Mexican retirement funds that are mandatory for employees under the Mexican social security legislation and are not aimed to regular passive investors.

E. Treasury Has Exempted Retirement Plans from Specific Countries from Regular Reporting Requirements

Treasury has taken a similar approach in the case of Canadian retirement plans, when allowed a simplified reporting regime for taxpayers who held interests in Canadian registered retirement savings plans and Canadian registered retirement income funds.

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[80] *See* Treas. Dec. Int. Rev. 9567,76 FR 78553-01, *Explanation of Provisions* 2.D (3); Instructions Page 4 (Foreign Social Security). *Cfr.* Temp. Treas. Reg. § 1.6038D-5T(f)(3); Instructions Page 5 (Interests in Foreign Pension Plans and Foreign Deferred Compensation Plans), requiring to report an interest in a foreign pension plan.

[81] *See* REG-121647-10 at page 26 ("the proposed regulations expand the category of retirement plans that are treated as posing a low risk of tax evasion"); Prop. Treas. Reg. § 1.1471-5(b)(2)(i)(A) and § 1.1471-5(f)(2)(ii).

Initially, U.S. persons with participations in Canadian retirement plans were required to file Forms 3520 (Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts) and 3520-A (Annual Information Return of Foreign Trust With a U.S. Owner), to report their participation in Canadian retirement plans.[82] However, in Notice 2003-75[83] the Treasury and the IRS acknowledged that taxpayers with interests in Canadian retirement plans were unfamiliar with the requirements for filing Forms 3520 and 3520-A, and provided an alternative, simplified reporting regime for Canadian retirement plans. As a consequence, Form 8891 (U.S. Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans) was issued to permit taxpayers to meet their reporting obligations by using information that is available to them and needed for tax compliance purposes.

The case for Mexican retirement plans is similar. Taxpayers working in Mexico are unfamiliar with the structure of the Mexican retirement system and the potential reporting obligations in the United States.

Persons participating in Mexican retirement plans may not know how the Mexican retirement system works and is structured. Probably, they only know that they are contributing to their retirement account under Mexican law.

Similarly, they may be unfamiliar with the PFIC rules and the reporting requirements applicable to PFICs.

Most importantly, it is likely that taxpayers working in Mexico may not be aware they may be considered as owning stock in a PFIC derived from their participation in the Mexican retirement system.

Moreover, even if a taxpayer is aware of her potential reporting obligation regarding her participation in the Mexican retirement system, she may not have all the information available required in Form 8621.

Taking this into account, taxpayers working in Mexico should not be subject to the reporting requirements applicable to PFICs and should not be required to file Form 8621. Accordingly, it is appropriate to exempt them from the regular reporting requirement

[82] *See* I.R.S. Notice 2003-25, 2003-18 I.R.B. 855 (superseded by Notice 2003-75).
[83] 2003-50 I.R.B. 1204.

VI. CONCLUSION

The participation of employees who are or become U.S. persons in the Mexican retirement system should not be subject to the burdensome reporting requirements applicable to U.S. persons who participate in PFICs.

In short, Mexican SIEFORES should not be reportable as PFICs because do not represent a risk targeted by Congress when enacting the PFIC rules.

The Treasury has taken a similar approach excepting the participation in foreign social security programs from the reporting requirements with respect to foreign financial assets, as well as for certain retirement accounts in which U.S. persons participate. Also, the Treasury has exempted from the general reporting requirements to certain Canadian retirement plans.

Requiring U.S. persons to file Form 8621 with respect to their participation in Mexican retirement funds would impose burdensome filing obligations to U.S. taxpayers for a foreign social security program that was not targeted by Congress when enacting this reporting obligation.

The Treasury should not require U.S. taxpayers participating in Mexican retirement funds to report their participation through the reporting requirements applicable to PFICs. The proposed guidance is legally feasible because Treasury has express statutory authority to provide for exceptions and determine the information required to be filed under new Section 1298(f).