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

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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.

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.

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.

If you have any questions about the content of this client alert, please contact the Pillsbury attorney with whom you regularly work or the author below.

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