Client Alert

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Foreign Accounts: Recent IRS Enforcement Activity; June 30 Reporting Deadline

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On April 7, 2011, the U.S. Department of Justice petitioned the District Court for the Northern District of California to allow the Internal Revenue Service to serve a "John Doe" summons on U.S. affiliates of HSBC Holdings plc, seeking to determine whether U.S. residents are using accounts at the bank's facilities in India to evade U.S. taxes. The District Court signed the proposed order the same day. The John Doe summons allows the IRS to obtain the names of U.S. taxpayers with accounts at HSBC in India without having to identify the account holders.

If the recent spate of audits and summons enforcement actions involving U.S. taxpayers with accounts at Union Bank of Switzerland is any model, U.S. taxpayers with deposits exceeding $10,000 in HSBC accounts in India can expect to be contacted by the IRS concerning delinquent Foreign Bank Account Reports ("FBARs") and any undisclosed income arising from those accounts. Moreover, the fact that the summons request was filed in the Northern District of California is a strong indication that the IRS is focusing on taxpayers residing in the Northern District, which includes Silicon Valley.

Foreign Account Reporting

FBARs

Every United States person having a financial interest in or signature or other authority over a bank, securities or other financial account outside the United States during a particular calendar year must file an FBAR (Form TD F 90-22.1) on or before June 30th of the following year, if the aggregate value of those foreign accounts exceeded $10,000 at any time during that particular calendar year. **Reports with respect to calendar 2010 are due June 30, 2011.**

In February, the Treasury Department's Financial Crimes Enforcement Network (FinCEN) adopted final regulations addressing the persons required to file reports of foreign financial accounts and the types of accounts that must be reported.

A "United States person" means any citizen or resident of the United States and any entity (including a corporation, partnership, trust or limited liability company) formed in or under the laws of the United States or any of its political subdivisions. Note that a trust can be a United States person for FBAR purposes even though it is a foreign trust generally under the Internal Revenue Code (because, for example, United States persons do not control all substantial decisions of the trust).

A "bank account" means a savings deposit, demand deposit, checking or any other account maintained with a person engaged in the banking business. A "securities account" means an account with a person engaged in the business of buying, selling, holding or trading stock or other securities. "Other financial account" means:

- an account with a person in the business of accepting deposits as a financial agency,
- an account that is an insurance or annuity policy with a cash value,
- an account with a person who acts as a broker or dealer for futures or options transactions in any commodity on or subject to the rules of a commodity exchange or association, and
- a mutual fund or similar pooled fund which issues shares available to the general public that have a regular net asset value determination and regular redemptions.

The FinCEN regulations reserve as to reporting regarding other investment funds (*e.g.,* hedge funds and private equity funds). But see below under "Foreign Asset Reporting Under the HIRE Act."

A person has a financial interest in an account if that person is the owner of record or holds legal title, even if the account is maintained for the benefit of others. Each United States person in whose name an account is maintained has a financial interest in that account. A United States person also has a financial interest in an account if the owner of record or holder of legal title is:

i. a person acting as an agent, nominee, attorney or in some other capacity on behalf of the United States person with respect to the account,

ii. a corporation in which the United States person holds, directly or indirectly, more than 50 percent of the shares (by either vote or value),

iii. a partnership in which the United States person holds, directly or indirectly, more than 50 percent of the interest in profits or capital,

iv. any other entity (other than trusts described in items (v) and (vi)) in which the United States person holds, directly or indirectly, more than 50 percent of the voting power, total value of equity interests or assets or interest in profits,

v. a trust if the United States person is the grantor and has an ownership interest in the trust under the "grantor trust" rules of the Internal Revenue Code, and

vi. a trust in which the United States person has a present beneficial interest in more than 50 percent of the assets or from which the United States person receives more than 50 percent of the current income.

A United States person also has a financial interest in any account of which an entity is the record owner or holder of legal title if the United States person caused that entity to be created for a purpose of evading the FBAR requirements.

"Signature or other authority" means the authority of an individual (either alone or in conjunction with others) to control the disposition of money, funds or others assets held in an account by direct communication, written or otherwise, with the person with whom the account is maintained. An officer or employee of certain entities need not report that he or she has signature or other authority over a foreign financial account of the entity, as long as he or she has no financial interest in the account. Those entities are:

i. a bank examined by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision or the National Credit Union Administration,

ii. a financial institution registered with and examined by the Securities and Exchange Commission or Commodity Futures Trading Commission,

iii. an entity registered with and examined by the Securities and Exchange Commission that provides services to an investment company registered under the Investment Company Act of 1940,

iv. an entity with a class of equity securities (or American depository receipts) listed on any United States national securities exchange,

v. a United States subsidiary of a United States entity described in item (iv) if the subsidiary is included in a consolidated FBAR of that United States entity, and

vi. an entity that has a class of equity securities (or American depository receipts in respect of equity securities) registered under Section 12(g) of the Securities Exchange Act.

On May 31, 2011, FinCEN released its Notice 2011-1, extending until June 30, 2012 the deadline for FBARs otherwise due June 30, 2011 from the following persons in the following circumstances:

- an employee or officer of an entity described in items (i) through (vi) immediately above who has signature authority over and no financial interest in a foreign financial account of a "controlled person" of the entity, and

- an employee or officer of a "controlled person" of an entity described in such items (i) through (vi) who has signature authority over and no financial interest in a foreign financial account of the entity or another "controlled person" of the entity.

A "controlled person" is a United States or foreign entity more than 50 percent owned (directly or indirectly) by the entity described in items (i) through (vi) above. For example, an officer of a U.S. public company listed on the New York Stock Exchange, having signature authority over, but no financial interest in, a French bank account of the U.S. public company's wholly owned French subsidiary, need not file an FBAR with respect to that account until June 30, 2012. Note, however, that FinCEN Notice 2011-1 does not appear to extend the June 30, 2011 deadline, if applicable, for officers and employees of a "controlled person" with respect to foreign financial accounts of that "controlled person."

Form 90.22-1

Revised Form 90.22-1 and instructions were issued in March 2011. Reports for 2010 are due and must be **received** by the U.S. Treasury at the Detroit address specified in the instructions no later than June 30, 2011. Unlike for federal income tax and other returns, there is no "timely mailing, timely filing" rule. In addition to a P.O. box address for mailed FBARs, the instructions provide a Detroit street address for delivered FBARs and state that FBARs may be hand-delivered to any local IRS office or to IRS tax attachés at U.S. embassies and consulates for forwarding to the Detroit address. However, the instructions specify, "The FBAR is not considered filed until it is received by the Department of the Treasury in Detroit, MI."

June 30, 2011 is also the due date for reports for 2009 and prior years for certain filers (including persons having signature authority over, but no financial interest in, foreign accounts) whose earlier deadlines were extended by IRS administrative relief, such as Notice 2010-23.

Foreign Asset Reporting Under the Hire Act

Under the Hiring Incentives to Restore Employment (HIRE) Act (P.L. 111-147), individuals holding "specified foreign financial assets" in excess of $50,000 during a taxable year will now be required to provide certain information regarding each of those assets with their income tax returns for that taxable year. These rules are effective for taxable years beginning after March 18, 2010 (and so first apply for 2011 for calendar-year individuals) and also apply to domestic entities formed or availed of for the purpose of holding specified foreign financial assets, but only to the extent provided by the Treasury Secretary in regulations or other guidance.

Specified foreign financial assets are:

- any financial account maintained by a foreign financial institution (broadly defined to include investment funds such as private equity and hedge funds), and
- any stock or security issued by a non-U.S. person, any financial instrument or contract held for investment where the issuer or counterparty is not a U.S. person, and any interest in a foreign entity, in each case where the asset is not held in an account maintained by a financial institution.

Failure to provide the required information can lead to imposition of a $10,000 penalty. There is a reasonable cause exception to that penalty, although the fact that a foreign jurisdiction would impose a civil or criminal penalty on the taxpayer (or any other person) for disclosing information required to be reported is explicitly not reasonable cause. If the IRS discovers specified foreign financial assets, then for purposes of determining whether the penalty applies, those assets are presumed to have a value in excess of the $50,000 threshold unless the taxpayer provides information sufficient to determine their aggregate value. In addition, under Internal Revenue Code section 6662, a 40 percent penalty applies to any portion of an understatement attributable to any transaction involving an undisclosed foreign financial asset.

See our *March 18, 2010 Client Alert–President Signs HIRE Act, Including FATCA Provisions Combating Offshore Tax Evasion* for more information on the HIRE Act, including its foreign account tax compliance provisions.

If you have any questions about the alert, please contact the Pillsbury attorney with whom you usually work or the authors.

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