

March 2010 / Special Alert

A legal update from Dechert's Financial Services, International and Domestic Tax, and Private Client Groups

## Recent Changes to FBAR Reporting Obligations

The Internal Revenue Service ("IRS") on February 26, 2010 temporarily suspended the Report of Foreign Bank and Financial Accounts ("FBAR") filing requirement for certain persons. Under the IRS guidance, an investor will not have to file an FBAR for calendar year 2009 and earlier years if that investor only invests in offshore funds other than mutual funds, provided that such person has no other reportable foreign financial accounts for the year in question. The IRS also indicated that persons with signature authority over, but no financial interest in, a foreign financial account for which an FBAR would otherwise have been due on June 30, 2010, will now have until June 30, 2011 to file. Finally, the IRS stated that it will not require reporting by persons who are not United States citizens, United States residents, or domestic entities, for calendar year 2009 and earlier years.

In addition, on February 26, 2010, the U.S. Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN") issued a Notice of Proposed Rulemaking ("Proposed Rule") proposing to amend the Bank Secrecy Act ("BSA") implementing regulations regarding the FBAR.<sup>1</sup> The Proposed Rule would codify several of the positions taken in the IRS guidance, and provide additional clarity about the types of foreign accounts that are required to be reported on an FBAR.

### IRS Suspension of FBAR Reporting for Certain Persons

Any United States person who has a financial interest in, or signature or other authority over, financial accounts in a foreign country, is required to report the accounts on an FBAR if

the aggregate value of the accounts exceeds \$10,000 at any time during the calendar year. The FBAR is due by June 30th of the year following the year in which the account holder meets the \$10,000 threshold.

IRS Notice 2010-23 states that a person with a financial interest in, or signature or other authority over, a foreign "mutual fund" must continue to report the account on an FBAR.<sup>2</sup> Importantly, however, Notice 2010-23 further states that a person with a financial interest in, or signature or other authority over, a foreign hedge fund, private equity fund or other pooled investment vehicle is *not* required to file an FBAR for calendar year 2009 or earlier years. This represents a significant departure from the position taken by the IRS last year, when

<sup>1</sup> FinCEN, Amendment to the Bank Secrecy Act Regulations – Reports of Foreign Financial Accounts, 75 Fed. Reg. 8844 (Feb. 26, 2010).

<sup>2</sup> The Proposed Rule defines a "mutual fund" as a fund "which issues shares available to the general public that have a regular net asset value determination and regular redemptions." 31 C.F.R. § 103.24(c)(3)(iv)(A) (Proposed Rule).

several IRS attorneys publicly stated that having a financial interest in or signatory authority over a foreign hedge fund or private equity fund triggered FBAR reporting obligations.<sup>3</sup> Notice 2010-23 also provides that a person with signature authority over, but no financial interest in, a foreign financial account for which an FBAR would otherwise have been due on June 30, 2010, will now have until June 30, 2011 to file.<sup>4</sup>

The IRS also published Announcement 2010-16, which temporarily suspends the FBAR filing requirement for persons who are not United States citizens, United States residents, or domestic entities (corporations, partnerships, trusts, or estates) for the 2009 and earlier calendar years. In addition, Announcement 2010-16 provides that all persons may rely on the definition of “United States person” found in the July 2000 version of the FBAR instructions, to determine if they have an FBAR filing obligation for the 2009 and earlier calendar years.<sup>5</sup>

## The Proposed Rule

### Definition of “United States Person”

The Proposed Rule generally would codify Announcement 2010-16 by defining a “United States person” required to file an FBAR as a “citizen or resident of the United States, or an entity, including but not limited to a corporation, partnership, trust or limited liability company, created, organized, or formed under the laws of the United States, any state, the District of Columbia, the Territories and Insular Possessions of the United States or Indian Tribes.” The determination of whether an individual is a resident of the United States would be made under the rules of the Internal Revenue Code. For entities, the definition in the Proposed Rule would apply regardless of whether an election has been made to disregard the entity for federal income tax purposes.

<sup>3</sup> Jenny Strasburg and Jesse Drucker, IRS Steps Up Scrutiny of Offshore Funds, *Wall Street Journal* (June 26, 2009) available at <http://online.wsj.com/article/SB124588728596150643.html>.

<sup>4</sup> The June 30, 2011 deadline applies to FBARs for the 2010 and prior calendar years.

<sup>5</sup> The definition of United States person from the July 2000 version of the FBAR is: (1) a citizen or resident of the United States; (2) a domestic partnership; (3) a domestic corporation; or (4) a domestic estate or trust.

## Types of Reportable Accounts

The Proposed Rule would include definitions of “bank account,” “securities account,” and “other financial accounts” in a foreign country to clarify which types of accounts are subject to FBAR reporting.

### *Bank and Securities Accounts*

The Proposed Rule defines “bank account” and “securities account” with reference to the kinds of financial services for which a person maintains an account. Under the Proposed Rule, a “bank account” means a savings deposit, demand deposit, checking, or any other account maintained with a person engaged in the business of banking. This definition would encompass time deposits, such as certificates of deposit. A “securities account” would be defined as an account maintained with a person in the business of buying, selling, holding, or trading stock or other securities.

### *Other Financial Accounts*

The Proposed Rule would define “other financial account” as: (i) an account with a person that is in the business of accepting deposits as a financial agency; (ii) an account that is an insurance policy with a cash value or an annuity policy; (iii) an account with a person that 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; or (iv) an account with 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 definition of “other financial account” specifically includes an account with a mutual fund; however, other types of pooled investment companies, such as private equity funds, venture capital funds and hedge funds, are not included in the definition at this time. FinCEN believes that the characteristics of these privately offered funds vary greatly, and the lack of financial regulation makes it difficult to define and distinguish certain types of funds from others. However, the Proposed Rule notes that there are pending legislative proposals that would apply additional regulation and oversight to some of these investment companies, which implies that the

reporting requirement may be extended to other types of investment companies in the future.<sup>6</sup>

#### *Financial Interest in an Account*

The Proposed Rule would generally codify current standards for determining when a United States person has a financial interest in an account for FBAR reporting purposes. Under the Proposed Rule, a United States person has a financial interest in each bank account, securities account, or other financial account in a foreign country for which: (i) he or she is the owner of record or holds legal title, regardless of whether the account is maintained for his own benefit or for the benefit of others; or (ii) the owner of record or holder of legal title is a person acting on behalf of that United States person, such as an attorney, agent or nominee with respect to the account.

In addition, a United States person has a financial interest in each bank account, securities account, or other financial account in a foreign country for which the owner of record or holder of legal title is (i) a corporation in which the United States person owns directly or indirectly more than 50% of the voting power or the total value of the shares, a partnership in which the United States person owns directly or indirectly more than 50% of the interest in profits or capital, or any other entity (other than a trust) in which the United States person owns directly or indirectly more than 50% of the voting power, total value of the equity interest or assets, or interest in profits; (ii) a trust, if the United States person is the trust settlor and has an ownership interest in the account for U.S. federal tax purposes; (iii) a trust in which the United States person either has a beneficial interest in more than 50% of the assets or from which such person receives more than 50% of the current income; or (iv) a trust that was established by the United States person and for which the United States person has appointed a trust protector that is subject to such person's direct or indirect instruction.

Finally, a United States person that causes an entity to be created for a purpose of evading the reporting requirement shall have a financial interest in any bank account, securities account, or other financial account in a foreign country for which the entity is the owner of record or holder of legal title. The Proposed Rule notes that term "evading" is not intended to apply to persons

<sup>6</sup> FinCEN has even gone so far as to reserve a section of the Proposed Rule (section 103.24(c)(3)(iv)(B)) for future rulemaking regarding privately offered funds.

who make a good faith effort to comply with the regulations.

#### *Exceptions for Certain Accounts*

The Proposed Rule would provide an exception from reporting for certain low risk accounts, including: (i) an account of a department or agency of the United States, an Indian Tribe, or any state or any political subdivision of a state, or a wholly-owned entity, agency, or instrumentality of any of the foregoing; (ii) an account of an international financial institution of which the United States government is a member; (iii) an account in an institution known as a "United States military banking facility" operated by a United States financial institution designated by the United States government to serve United States government installations abroad; or (iv) correspondent or nostro accounts that are maintained by banks and used solely for bank-to-bank settlements.

### **Reporting by Persons with Signature or Other Authority**

Under the current law, United States persons with signature or other authority over bank, securities, or other financial accounts in a foreign country, must file an FBAR – even if they have no financial interest in the accounts.<sup>7</sup> Under the Proposed Rule, however, the following persons no longer would be required to file FBARs:

- An officer or employee of a financial institution that is registered or examined by a federal banking regulator, the SEC or the CFTC need not report that he or she has signature or other authority over a foreign financial account owned or maintained by the financial institution if the officer or employee has no financial interest in the account.
- An officer or employee of an "Authorized Service Provider" to a registered investment company need not report that he or she has signature or other authority over a foreign financial account owned or maintained by the investment company

<sup>7</sup> For FBAR purposes, 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 by whom the financial account is maintained.

if the officer or employee has no financial interest in the account.<sup>8</sup>

- An officer or employee of an entity whose equity securities are registered with the SEC or listed on any United States national securities exchange need not report that he or she has signature or other authority over a foreign financial account of such entity if the officer or employee has no financial interest in the account.<sup>9</sup>

## Special Rules

The Proposed Rule would also simplify FBAR reporting in certain cases, including:

- A United States person having a financial interest in 25 or more foreign financial accounts need only to provide the number of financial accounts and certain other basic information, unless additional information is requested;
- An entity that is a United States person and owns directly or indirectly more than a 50% interest in an entity required to report will be permitted to file a consolidated report on behalf of itself and such other entity;
- Participants and beneficiaries in certain retirement plans and individual retirement accounts

<sup>8</sup> “Authorized Service Provider” means an entity that is registered with and examined by the SEC and provides services to an investment company registered under the Investment Company Act of 1940.

<sup>9</sup> In addition, an officer or employee of a United States subsidiary of such entity need not file a report concerning signature or other authority over a foreign financial account of the subsidiary if he or she has no financial interest in the account and the United States subsidiary is named in a consolidated FBAR report of the parent.

(“IRA”) will not be required to file an FBAR with respect to a foreign financial account held by or on behalf of the retirement plan or IRA; and

- Certain trust beneficiaries will not be required to report the trust’s foreign financial accounts if the trust, a trustee of the trust, or an agent of the trust is a United States person that files an FBAR disclosing the trust’s foreign financial accounts and provides any additional information as required; and
- FinCEN “anticipates” that in the case of United States persons who are employed in a foreign country and who have signature or other authority over foreign financial accounts owned or maintained by their employer, the instructions to the FBAR form will prescribe a modified form of reporting for such persons.

Comments on the Proposed Rule must be received by FinCEN on or before April 27, 2010.

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