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FBAR Compliance Update

On Friday, February 26, 2010, the US Internal Revenue Service (IRS) issued two pronouncements concerning the 2009 Report of Foreign Bank and Financial Accounts (FBAR). These pronouncements also affect certain persons who previously had their 2008 and prior years' FBAR filing obligations postponed. With the start of the 2010 tax return filing season, the IRS has been under increasing pressure to advise affected taxpayers concerning their 2009 returns. In addition, the release of the IRS pronouncements was coordinated with the release by the US Department of Treasury, Financial Crimes Enforcement Network (FinCEN), of a proposed regulation for FBAR filings and proposed new instructions for the form.

For 2009, the IRS, which administers FBAR filings for FinCEN, issued new guidance that expands the list of persons who have FBAR compliance obligations. Previously, the IRS had issued guidance to address a number of questions and objections that had been raised. Thus, the IRS issued Announcement 2009-51, 2009-25 IRB 1005, which reinstated for 2008 and prior years the prior definition of US persons who are subject to FBAR compliance. This Announcement provided that foreign persons who had US activities would not be required to file FBARs for these years. Also, Notice 2009-62, 2009-35 IRB 260, extended the deadline for the FBAR filing of 2008 and earlier calendar years for certain US persons until June 30, 2010, and requested comments on FBAR compliance for consideration by the IRS. Under this Notice, persons with signature authority over a foreign account but no beneficial interest in that

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account and persons with interests in "commingled accounts" were excused from FBAR filings obligations until June 30, 2010. These 2009 IRS pronouncements were discussed in several 2009 Squire Sanders Tax Alerts ("FBAR Compliance – The IRS Is Listening" and "IRS Grants Final Extension for Late FBAR Filers").

For the 2010 filing season, further timely guidance has been needed. The IRS has responded with the two pronouncements released on February 26, 2010.

In Announcement 2010-16, the IRS has continued for 2009 the existing definition of a US person subject to FBAR compliance. Accordingly, persons who have US activities but are not US citizens, US residents, or domestic entities *will not have to file 2009 FBARs*. At this time, this suspension of the FBAR filing obligation applies only to 2009 and prior years. Thus, non-US persons who had US activities will not be required to file a 2009 FBAR at this time.

Similarly, in Notice 2010-23, the administrative relief provided previously by Notice 2009-62 is extended generally for 2009 FBAR filings, except for mutual funds. Specifically, *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 report these foreign financial accounts* . With respect to "commingled accounts," the IRS provides further clarification of the meaning of "commingled accounts." Persons with a financial interest in a foreign mutual fund will have to file a 2009 FBAR by the June 30, 2010, deadline. On the other hand, the "commingled account" FBAR filing exception will continue to apply for persons with a financial interest in or signature authority over a foreign hedge fund or a private equity fund. Thus, interests in foreign hedge funds or private equity funds are not subject to FBAR reporting at this time. The IRS will continue to study this issue and may reinstate an FBAR filing obligation for such funds in the future. US persons who qualify for relief under this Notice must continue to report for income tax purposes their income from an exempt account, but are no longer required to affirmatively check the box disclosing their ownership of a foreign bank account on their personal income tax returns.

In addition to the IRS pronouncements, FinCEN released a Notice of Proposed Rulemaking to amend the regulations under the Bank Secrecy Act that apply to FBARs generally. This proposed regulation, an amended 31 CFR § 103.24, Reports of Foreign Financial Accounts, has been prepared in response to the extensive

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comments that were submitted to the IRS and FinCEN in connection with the 2009 request for comments. Generally, the proposed regulation responds to several taxpayer concerns but fails to adequately address other important compliance problems. Apparently, FinCEN's primary concern is the continued deterrence of money laundering and not necessarily income tax compliance considerations. Comments from the public on the proposed regulations must be submitted by April 27, 2010. The following is a brief summary of the proposed FBAR regulation.

The proposed regulation adds an expansive definition of a "United States person" who would be subject to FBAR compliance. An FBAR compliance obligation applies to "each person having a financial interest in, or signature authority over" a foreign financial account. A "United States person" would include a citizen or resident of the United States, based on the income tax definition, and an entity 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 the Indian Tribes. For this purpose, "signature authority" is defined as "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 delivering instructions (whether communicated in writing or otherwise) directly to the person with whom the financial account is maintained."

The proposed regulation provides a specific list of reportable accounts. The list includes the following: (1) a bank account; (2) a securities account; and (3) an other financial account. An "other financial account" is defined broadly to include (1) an account with any person in the business of accepting accounts as a financial agency; (2) a life insurance policy with a cash value or an annuity policy; (3) an account with a broker or dealer for options trading; and (4) a mutual fund account. This list does not currently include a private equity fund or a hedge fund. The proposed regulation lists a number of accounts that are excepted from an FBAR filing. Generally these accounts are already subject to some type of financial regulatory supervision. The current US$10,000 filing threshold remains unchanged.

As indicated above, the proposed regulation identifies the US persons subject to FBAR compliance, lists the types of accounts subject to FBAR compliance, and, as explained below, identifies the types of financial interests in such accounts that require FBAR reporting. All three elements must be satisfied for a US person to have an FBAR filing obligation with respect to an "interest in a foreign account." For the final element, a

US person has a "financial interest" if the US person is the owner of record or has legal title, whether the account is maintained for his own benefit or for the benefit of others. In the case of a joint account, all of the US record owners have to file separate FBARs. The draft instructions include an exception for certain accounts jointly owned by spouses, but only if all foreign accounts owned by the couple are owned jointly. In that case, both spouses must sign only one FBAR. In addition, if a person is not the record owner but the account is being held for that person by an agent, nominee, or in some other capacity, then the beneficial owner is still required to file an FBAR. Even if a US person does not have "an interest in a foreign account," as indicated above, a US person with only signature authority over a foreign account, without a beneficial interest, such as the holder of a power of attorney, would still have an FBAR filing obligation under the proposed regulation.

The proposed regulation also addresses various entity foreign accounts for which a US person would have an FBAR filing obligation. In the case of a corporation, a US person who directly or indirectly owns more than 50 percent of the total voting power or total value of the corporation would have to file an FBAR for the foreign accounts owned by the corporation. A similar rule would apply to a partnership if a US person owns directly or indirectly more than a 50 percent interest in capital or income of the partnership. The proposed regulation does not provide guidance as to how to determine a person's "direct or indirect ownership" and does not limit the filing to owners of US entities only. Thus, a controlling interest in a foreign corporation or partnership beneficially owned by a US person appears to require an FBAR for the foreign accounts owned by the foreign corporation or partnership.

In the case of a trust, if a US person established the trust and retains an ownership interest in the trust for US income tax purposes, e.g., a grantor trust, such as a living trust, then that US person has an FBAR filing obligation for any foreign accounts owned by the trust. If a US person has a beneficial interest in more that 50 percent of either the capital or income of a US trust, then that person has a similar FBAR reporting obligation. If a US person has established a trust and appointed a trust protector that is subject to such person's direct or indirect supervision or control, then that US person has an FBAR reporting obligation. The proposed regulation fails to provide guidance as to how US persons who are potential beneficiaries of a wholly discretionary trust are to be treated. The proposed regulation clarifies that US persons who are participants or beneficiaries of US retirement plans, IRAs, or Roth

IRAs are not subject to FBAR compliance requirements. In addition, a beneficiary of a trust who would otherwise have a reporting obligation would be exempted if the trustee or agent of the trust is a US person and files an FBAR for the trust. Finally, the proposed regulation has a "catch-all" anti-avoidance rule to require an FBAR in the case of an entity established for the purpose of evading FBAR reporting.

In addition, the proposed regulation provides a list of entities for which a US person who has signature authority as an officer or an employee over a foreign account for that entity's benefit will not have an FBAR compliance obligation. Such entities include US financial institutions that have a financial regulator and US and foreign entities that are publicly traded on a US national securities exchange or that have issued equity securities registered with the US Securities and Exchange Commission. This exception does not extend to non-publicly traded entities or charitable entities. Special rules also apply for persons who have an interest in or signature authority over 25 or more financial accounts and for common-controlled entities.

If you have any questions concerning the IRS FBAR pronouncements discussed above or the proposed regulation issued by FinCEN, please contact one of the persons listed in this Alert. If you would like to submit any comments on the proposed regulation, we welcome the opportunity to assist with the preparation of your comments.
