



O'Connor Davies Munns & Dobbins, llp
ACCOUNTANTS AND CONSULTANTS

Tax Facts

2009 Issue No. 3

Update on Report of Foreign Bank and Financial Accounts Filing Requirements Avoid Penalties by Filing Delinquent or Amended Returns by September 23, 2009

There have been several recent developments regarding the filing requirements for Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR). Specifically, there have been changes regarding who is required to file an FBAR and what appears to be an expanded definition of a reportable “foreign financial account” to include offshore hedge funds and possibly foreign private equity funds. Since there are substantial penalties for noncompliance along with an increased focus by the IRS on finding additional tax revenue from unreported income from foreign financial accounts, a conservative position regarding your or your organization’s FBAR filing requirements may be prudent until further clarification is provided by the IRS.

This issue of *Tax Facts* provides a comprehensive analysis of the FBAR filing requirements and discusses special rules that allow you to file delinquent or amended FBARs in certain circumstances by September 23, 2009, in order to eliminate or significantly reduce penalties that can be assessed for noncompliance.

Please carefully review the following analysis of the FBAR filing requirements to determine if you may have an FBAR filing obligation.

Who is Required to File? The FBAR form is required to be filed by any U.S. person (including an individual, corporation, partnership, U.S. limited liability company, trust or estate as well as a tax-exempt entity) who has a direct, or more than a 50% indirect, financial interest or signature or other authority over any foreign financial account, if the aggregate value of all such accounts exceeds \$10,000 at any time during the calendar year. To illustrate the direct and indirect ownership requirements, assume a foreign corporation (CFC) with a foreign bank account is owned 60% by a U.S. corporation with the remaining 40% owned by four individuals who are U.S. citizens. The 60% U.S. Corporation is owned by two brothers who are also U.S. citizens. The CFC is not required to file an FBAR to report its foreign bank account since it was incorporated outside of the U.S. (however, this is expected to change in future years if the CFC also conducts business within the U.S.). Since the foreign bank account is owned within a CFC there are no direct U.S. owners. However, the only U.S. person in this example that has an FBAR filing responsibility is the 60% U.S. Corporate owner which is considered to have a greater than 50% indirect interest in the foreign bank account as a result of its CFC ownership. For purposes of applying indirect ownership, you look through chains of ownership (shareholders and corporations, partners and partnerships, trusts and beneficiaries, etc.). However, the IRS has explicitly stated that the family attribution rules do not apply when determining a taxpayer’s indirect interest in a foreign financial account. For this reason, the brothers who collectively own 100% of the U.S. Corporation that in turn has a 60% interest in the CFC have no FBAR filing requirement. In addition, any officers of the U.S. Corporation that owns 60% of the CFC will have a personal FBAR filing requirement if they are considered to have signatory or other authority over such foreign bank account.

The filing instructions for the revised Form TD F 90-22.1 expanded the definition of a U.S. person to include any individual who is “doing business” in the U.S. Under these criteria, nonresident individuals who are considered to be “doing business” in the U.S. would for the first time be required to file FBARs for all of their foreign financial accounts. However, on June 5, 2009, the IRS issued IR-2009-58 which in effect delayed for one year this expanded definition of a U.S. person. As a result, nonresident individuals will not be required to file an FBAR for years prior to 2009.

Definition of Financial Account: Based on the revised FBAR form instructions, a financial account is broadly defined and includes any bank, securities, securities derivatives, or any other financial instruments account. If assets are held in a commingled fund, such as a mutual fund, an equity interest in the fund is also considered a financial account under the form’s current instructions.

On June 12, 2009, IRS personnel issued informal guidance through their participation in a teleconference with the American Bar Association and the American Institute of Certified Public Accountants by asserting that investments in offshore hedge funds should be considered foreign financial accounts for FBAR reporting purposes. In addition, every U.S. person with a direct, or greater than 50% indirect investment in such funds should file an FBAR. It is uncertain whether this guidance is correct and whether it applies only to hedge funds or also to private equity and other funds.

In light of the above developments, reportable foreign financial accounts may now also include interests in foreign partnerships and foreign corporations that were not previously considered. However, the IRS has previously indicated that direct investments in foreign stocks or bonds are not considered to be reportable foreign investment accounts for FBAR reporting purposes.

In the absence of official IRS guidance, the inclusion of foreign hedge funds and possibly other types of foreign funds may give rise to some potentially new FBAR reporting requirements for certain individuals and organizations such as:

- U.S. investors who own more than 50% of a U.S. or foreign entity that is a direct investor in an offshore hedge fund.
- U.S. investors in a foreign blocker or other foreign corporation considered a commingled fund.
- Direct U.S. investors, including tax-exempt entities, in offshore hedge funds (or in an offshore feeder fund in a master/feeder hedge fund structure).
- U.S. fund of funds, or U.S. feeder fund, that invests in an offshore hedge fund.
- U.S. investment managers with a financial interest in an offshore hedge fund.
- U.S. individuals with signature or other authority over an offshore investment fund. **An employee of an organization who has signatory or other authority over a foreign account or fund may be required (as a U.S. person) to file his or her own FBAR separately and to report such accounts and filing requirement on their individual tax return.**

Signature or Other Authority: The FBAR Form instructions state that a person who can directly (or indirectly through an agent) control the disposition of money or other property in an account, either by signing a document or by oral or other means of communication, is considered to have authority over the account for FBAR reporting purposes. Thus, the existence of an intermediary or agent who controls the account on behalf of the U.S. person will not alleviate the U.S. person's obligation to file the form.

Penalties: There are potential civil and criminal penalties associated with noncompliance of the FBAR filing requirements for both willful and non-willful acts. Penalties of up to \$10,000 can be imposed for non-willful acts. For willful acts, the penalties may be increased to the greater of \$100,000 or 50% of the amount of the transaction or the balance of the account at the time of violation. The civil penalty can be waived if certain conditions are met or if reasonable cause can be shown.

Voluntary Disclosure Program: Taxpayers who have not reported income from foreign financial accounts on their U.S. income tax returns and have not filed FBARs for such accounts can apply for voluntary disclosure. The voluntary disclosure program requires that you report and pay tax and interest on unreported foreign income for the tax years 2003 through 2008. The benefit of voluntary disclosure is a significant reduction in the assessment of penalties. If you have not reported foreign income in prior years, please contact your ODMD tax advisor to learn more about the criteria and benefits of the voluntary disclosure program. Applications to be accepted into the program must be received on or before September 23, 2009.

Relief for Delinquent FBAR Filings Where all Foreign Income was Previously Reported for U.S. Income Tax Purposes: For taxpayers that have reported the income from foreign financial accounts on their U.S. income tax returns but have failed to make a separate FBAR filing, the IRS will waive any penalties provided such FBAR filings are made on or before September 23, 2009. The IRS will accept all delinquent FBAR filings (must use the most recent version of Form TD F 90-22.1 for all years) for the tax years 2003 through 2008 provided they are accompanied by a statement that explains the reason why the returns are being filed late and a copy of the income tax return for such year. Apparently, a copy of your 2008 U.S. income tax return does not need to be filed with an otherwise delinquent 2008 FBAR if such return has not been filed by September 23, 2009 and its legal due date (including extension) is subsequent to such date.

What Steps Should Taxpayers Take?: When evaluating whether you or your organization have an FBAR filing responsibility, it is recommended that you consider both the official and unofficial IRS guidance and then:

- Review and identify all foreign financial accounts, including investments in offshore hedge funds and similar accounts.
- Review and identify all greater than 50% ownership interests in U.S. or foreign corporations, partnerships or trusts and determine if such entities themselves have a direct, or greater than 50% indirect interest in a foreign financial account.
- Identify all persons with signatory or other authority over such accounts and notify them of their potential personal filing obligation, which is in addition to that of the organization.

With so many unanswered questions and uncertainty surrounding the recent comments made by IRS personnel during the June 12th teleconference, we anticipate that the IRS will issue a formal statement clarifying their position on this matter. This guidance, however, may not come before the September 23, 2009 deadline for voluntary disclosure or the extended deadline in cases where the foreign income has previously been reported for U.S. income tax purposes. ODMD tax professionals are working with the IRS and industry groups and will keep you abreast of any new developments. Until such official guidance is issued, it appears that investments in foreign hedge funds should be treated as “foreign financial accounts” and should be included on the FBAR to avoid penalties.

Please feel free to contact a member of the ODMD tax department for assistance in determining your or your organization’s FBAR filing requirements.

Best regards,

O'Connor Davies Munns & Dobbins, LLP

O’Connor Davies Munns & Dobbins, LLP

Copyright © 2009 O’Connor Davies Munns & Dobbins LLP

IRS CIRCULAR 230 DISCLOSURE: To comply with IRS regulations, we are required to inform you that unless expressly stated otherwise, any discussion of U.S. federal tax issues in this correspondence (including any attachments) is not intended or written to be used, and cannot be used, (i) to avoid any penalties imposed under the Internal Revenue Code, or (ii) to promote, market, or recommend to another party any transaction or matter addressed herein.

New York, NY
212.286.2600

Harrison, NY
914.381.8900

White Plains, NY
914.421.5600

Paramus, NJ
201.712.9800

Stamford, CT
203.323.2400

ODMD.com