Must I still Disclose My Foreign Account?

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As spring approaches and taxpayers turn their attention to the April 15th tax return filing deadline, the Internal Revenue Service (" IRS") has issued new guidance that changes the landscape for reporting the existence of a foreign account by US citizens and tax residents. Currently reported on both a taxpayer's tax return and on a Foreign Bank Account Report ("FBAR"), foreign accounts recently have been the subject of intense scrutiny and changing requirements. However, new guidance issued in the form of Announcement 2010-16 and Notice 2010-23 together with newly proposed regulations reduce or eliminate reporting in many instances.

Hitting the High Points

1. In good news for persons who like to keep their investments confidential, the new guidance provides that for the moment interests in foreign private equity funds, hedge funds, and venture capital funds do not have to be reported on an FBAR for any past, present or future calendar year.

2. Unlike foreign hedge funds and private equity funds, the IRS does want to know if you own an interest in a foreign mutual fund. The new guidance requires US citizens and tax residents to report any interests they have in such funds on their FBAR for 2009, as well as for prior or future years. Unfortunately, the new guidance leaves unanswered whether a person will have to report separately an interest in a foreign mutual fund when that interest is held in a foreign financial account that the person has disclosed on an FBAR.

3. Claiming it needs more time to produce adequate guidance, the IRS extended the FBAR filing deadline for persons who hold only signature authority over foreign financial accounts, giving such persons until June 30, 2011 to submit FBARs for not only 2009 but also any other year for which such person has not yet filed. This effectively provides an extra year for such persons to come into compliance with their yet unfulfilled FBAR filing obligations.

4. Reversing an earlier position, the IRS will not require certain disregarded entities, mainly limited liability companies and limited liability partnerships to file an FBAR for the 2009 calendar year. However, under the new proposed regulations such disregarded entities will have to file an FBAR in future years.

5. Finally, the proposed new FBAR regulations require that interests in commodity accounts, foreign insurance policies with a cash surrender value and foreign annuity policies be reported on a FBAR.

Delving Deeper Into Murky Waters

Announcement 2010-16: Foreign Persons and Domestic Disregarded LLCs

The Announcement and Notice mainly serve the purpose of providing relief to certain persons that otherwise might have been required to file an FBAR by June 30, 2010. In particular, the Announcement extends the suspension of the FBAR filing requirement for non-resident aliens, foreign entities, and domestic disregarded entities (such as certain limited liability companies) to the 2009 calendar year. Therefore, such persons and entities will not be required to file an FBAR for 2009, or any earlier calendar year, even if they are doing business in the US. This suspension is particularly significant for certain domestic disregarded entities that under the new definition of "United States person" used in the revised FBAR form issued in October 2008, may otherwise have been required to file a 2009 FBAR by the June 30, 2010 filing deadline. However, it is important to be aware that once the proposed new regulations discussed below are finalized, such domestic disregarded entities will have to file an FBAR for subsequent years in which they hold reportable interests in foreign financial accounts.

Notice 2010-23: Signature Authority Only Accounts and Foreign Commingled Funds

Similar to the Announcement, the Notice provides significant relief to persons who otherwise would have been required to file an FBAR for 2009. In some cases, this also provides relief for unfiled returns for earlier years, and may provide an opportunity for noncompliant taxpayers to come into compliance.

First, for persons who had signature authority over a foreign financial account, but no financial interest in such account, and would have had to file an FBAR for the account on or before June 30, 2010, the IRS announced that such persons will now have until June 30, 2011 to file an FBAR reporting such accounts. It is important to emphasize that the Notice provides an extension of the FBAR filing deadline only for persons all of whose reportable interests are merely signature authority. Such persons will now have until June 30, 2011 to come into compliance with FBAR filing requirements and file an FBAR for 2009 or any earlier years for which an FBAR was not previously submitted. These persons should continue to keep records of all the foreign accounts for which they held signature authority in 2009 or earlier years, as it is very likely that they will have to file an FBAR for such years by June 30, 2011.

Secondly, in a move that will be welcomed by the alternative investment community, persons with a financial interest in, or signature authority over, a foreign commingled fund which restricts redemptions, such as a foreign hedge fund or private equity fund, will not have to report such interests on an FBAR for 2009 or any earlier years. However, this relief will not apply to persons with a financial interest in, or signature authority over, a foreign fund that permits redemptions regularly, such as most mutual funds.

The final element of relief the Notice provides is that if after application of the above rules a person does not have to file an FBAR due June 30, 2010, then such person is instructed to check the "no" box in response to questions on their 2009 federal tax forms regarding whether they have a financial interest in or signature authority over a foreign financial account, provided they have no other reportable foreign accounts.

Proposed New Regulations Governing the FBAR Filing Requirement

The proposed new regulations define significantly change many different elements of the FBAR filing requirement. The changes made by the proposed regulations include:

- Clarifying who is required to file an FBAR by expanding the definition of a "United States person." The new definition includes US citizens, residents and domestic entities, including LLCs and other entities that are disregarded entities for US federal income tax purposes. This definition does away with the filing requirement included on the most recent FBAR form for foreign persons "in and doing business in" the US, notwithstanding that the statute would permit including them.

- Modifying the financial accounts that must be reported on an FBAR to include not only bank accounts and securities accounts, but also commodity accounts, insurance policies and annuities with a cash value, and accounts with a mutual fund or similar pooled fund. Interests in hedge funds and private equity funds are currently not included in the type of accounts that must be reported, but the IRS has simply reserved judgment on the treatment of interests in these funds and will continue to study this issue.

- Adjusting when a US person is deemed to have a reportable financial interest in a foreign account owned by a trust. The proposed regulations require reporting where a US person is deemed to own the trust's assets under the "grantor trust" rules or where the US person established the trust and such person has appointed a trust protector subject to their instruction. Similar to previous guidance, under the proposed regulations a US person is also deemed to have a financial interest in an account owned by a trust when they have a beneficial interest in more than 50 percent of trust assets or receive more than 50 percent of the current income (although beneficiaries are excused from reporting trust accounts if the trustee reports them). These new deemed ownership rules leave many questions unanswered, as no guidance was provided in regards to how a "beneficial interest" is defined or when a trust protector will be considered subject to instruction.

- Modifying when a person who has only signature authority over a foreign account is exempted from having to file an FBAR. Under the proposed regulations this exemption will apply to:

(i) an officer or employee of a bank examined by the federal banking agencies, or of a financial institution that is registered with and examined by the Securities and Exchange Commission ("SEC") or Commodity Futures Trading Commission, or of an "Authorized Service Provider", which means an entity registered and examined by the SEC that provides services to an investment company. This category generally includes persons employed by fund service providers, for example, investment advisors to a mutual fund.

(ii) an officer or employee of a domestic or foreign publicly traded entity listed on a US national exchange. Officers and employees of a US subsidiary of such an entity also need not file an FBAR, but only if the US subsidiary is named in a consolidated FBAR report of the parent.

(iii) an officer or employee of a US corporation that has a class of securities registered under Section 12(g) of the Securities Exchange Act. Currently, these are corporations which have more than $10 million in assets and more than 500 shareholders of record.

Note that there is no exemption for employees generally, even if the employer timely files the FBAR and provides all the required information. So, for example, the proposed regulations require employees of privately held companies, family offices and charitable foundations to file the FBAR with respect to employer accounts over which the employee has signature authority.

- Simplifying FBAR filing requirements for US persons who have a financial interest in, or signature authority over, 25 or more foreign accounts by requiring only that they provide the number of accounts and other basic information on the FBAR, with the added requirement that they provide more information upon request by the IRS.

- Allowing an entity to file a consolidated FBAR report on behalf of its corporate and non-corporate subsidiaries. It is important to note, as mentioned above, that the employees and officers of the subsidiary of a US parent company that is publicly traded on a US exchange are exempted from the FBAR filing requirement if the parent files a consolidated report including the subsidiary. However, this exemption does not apply for the officers and employees of a subsidiary company if the US parent company is a privately owned company.

- Exempting participants and beneficiaries of certain qualified retirement plans under the Internal Revenue Code, a category which includes traditional IRA accounts, Roth IRA accounts, and 401(k) plans, from having to file an FBAR with respect to a foreign financial account held by or on behalf of the retirement plan or account.

- Exempting certain US governmental entities, a category that includes, among others, public universities, state pension funds, and state welfare funds, from the FBAR filing requirements.

- Waiving the FBAR filing requirement for trust beneficiaries who have a beneficial interest in more than 50 percent of the trust assets or receive more than 50 percent of the trust income when the trust, trustee of the trust, or agent of the trust is a US person and files an FBAR disclosing the trust's foreign accounts.

It is important to note that these proposed regulations are not effective currently. However, the Announcement and the Notice are effective immediately and should be consulted when determining whether to file a 2009 FBAR by the June 30, 2010 deadline.

Conclusion: More than Just the FBAR?

While the IRS pronouncements and proposed regulations detailed above may provide certain persons relief from the FBAR filing requirement, Congress is currently considering potential new disclosure requirements for foreign financial assets, completely separate from the FBAR. On February 24, 2010 the Senate passed the "Hiring Incentives to Restore Employment Act", a bill which would impose new reporting obligations on persons who hold foreign financial assets which on the aggregate have a value that exceeds $50,000. This reporting obligation would apply to accounts maintained by a financial institution, and would require that persons who hold such accounts report on their tax returns the account number, the name of the financial institution holding the account and the maximum value of the account during the tax year. This separate reporting obligation would apply not only to interests in bank accounts and securities accounts, but also interests in foreign hedge funds and private equity funds. While this bill has not yet been enacted, persons concerned with these potential new reporting obligations should monitor its progress.

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