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FBAR Filing Deadline Approaches - June 30, 2010

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Background

Generally, any United States person who has a financial interest in, or signature or other authority over, any financial accounts in a foreign country whose aggregate value exceeds $10,000 must file a "report of foreign bank and financial accounts" (commonly "FBAR"). Due to a number of well-publicized unreported income cases and several other FBAR issues, considerable attention has been devoted to FBARs in the last couple of years. The FBAR form, Form TD F 90-22.1, is due on June 30th of the year following the year subject to reporting. The form is filed with the Treasury Department and is not filed as part of the tax return of a taxpayer. In 2010, the IRS and the Financial Crimes Enforcement Network ("FinCEN") of the Treasury Department issued guidance with respect to FBARs. The guidance was in the form of proposed regulations by FinCEN and IRS Notice 2010-23 and IRS Announcement 2010-16. The guidance issued in 2010 clarifies issues and provides guidance in several unsettled areas.

Under the FBAR rules, a United States person with a "financial interest in" or "signature or other authority over," any "bank, securities or other financial account" in a foreign country must report such relationship to the IRS if the aggregate value exceeds $10,000 in any one year. The aggregate value is determined by aggregating all foreign financial accounts together. While a taxpayer is required to check a box on his income tax return as to whether he has a foreign bank account, the actual FBAR filing is independent of the tax return. An extension to file an income tax return does not extend the time to file the FBAR. The FBAR must actually be received by the Treasury Department (not mailed) by June 30th.

In June of 2009, certain IRS representatives commented on the application of the FBAR rules to offshore hedge funds and private equity funds, entities which in the past were thought to be exempt from the reporting under FBAR. These comments generated a flurry of activity last year concerning exactly who needed to file. The proposed guidance during this year is partly a result of these comments and clarifies FBAR reporting for:

- persons with signature authority, but no financial interest in, foreign financial accounts; and
- certain foreign commingled funds (e.g. mutual funds)

There can be substantial penalties for noncompliance with the FBAR requirements, even for violations that are inadvertent or seem harmless. For nonwillfull violations, the civil penalty is $10,000 per violation. For willful violations, the civil penalty is the greater of $100,000 or 50% of the balance in the account at the time of the violation. Criminal penalties may also apply.

Current Guidance

As noted, the IRS issued certain guidance in 2010 and FinCEN issued proposed regulations. IRS Notice 2010-23 extended until June 30, 2011, the FBAR filing requirement for a person with signature authority over, but no financial interest in, a foreign financial account during 2010 and prior years (supplementing the previous extension to June 30, 2010). This extension would apply, for example, where a corporate officer has only signature authority over a subsidiary bank account in a foreign jurisdiction. The Notice also provides that the FBAR requirement applies to foreign "Commingled Funds" that are a mutual fund, but not a foreign hedge fund or a private equity fund. As a result, even a small interest in a foreign mutual fund will require disclosure. The proposed regulations indicate that guidance may be forthcoming on hedge fund and private equity funds.

The proposed regulations contain a number of definitions intended to clarify the FBAR requirements. As noted, any United States person must report a financial interest in, or signature or other authority over, bank, securities and other financial accounts in a foreign country. The definition of "financial accounts" is broad and is intended to capture accounts that provide ready access to liquidity. Such accounts include bank accounts, securities account and any "other financial account" in a foreign county. Under the proposed regulations, such foreign accounts would include:

1. A foreign savings deposit, demand deposit, checking or similar account maintained by someone in the business of banking, whether the balance be monetary or in the form of some other asset (e.g., gold);

2. A foreign brokerage account which is a securities account with a person who is engaged in the business of buying, selling, holding or trading stocks and securities (but not including accounts of individual securities held by the U.S. person);

3. A foreign account that is an insurance policy with a cash surrender value or an annuity account;

4. A foreign account with a person that acts as a broker or dealer for future or option transactions in any commodity on, or subject to the rules of, a commodity exchange or association; or

5. A foreign account with a mutual fund or similar pooled fund that issues shares and allows regular redemptions.

The proposed regulations reserve for further guidance the issue of reporting for private equity funds, venture capital funds and hedge funds. For 2009, however, it is clear that an interest in a foreign mutual fund must be reported.

The proposed regulations provide that a person possesses a signature authority with regard to an account if that person controls the disposition of assets held in the account by "delivery of instructions" (written or otherwise). In addition, certain limited exceptions are made for persons whose signature authority merely resides in their capacity as an employee or officer of certain corporations. Employees and officers of companies with foreign accounts should be certain that the exception applies in their situation before assuming that the FBAR requirements do not apply to them.

It should be noted that a financial interest in an account includes foreign accounts held by a corporation or partnership where the U.S. person owns more than 50% of the shares of a corporation or more than 50% of the profits or capital interest in a partnership. Thus, bank accounts held by majority controlled subsidiaries are included on the parent's FBAR.

Failure to File in Past Years

With regard to prior year filings, the IRS had an amnesty program for FBARs that ended in late 2009. Under the program, if the taxpayer came forward and met certain filing requirements, the IRS would generally not pursue criminal sanctions. In addition, the person disclosing the accounts would receive a favorable penalty resolution. The IRS has indicated that it will aggressively pursue persons who did not participate in the voluntary disclosure program and who just begin filing this year (so-called "quiet disclosure"). As a result, taxpayers should use caution for FBAR filings if they have not filed in prior years.

Conclusion

The FBAR rules require United States persons to disclose certain financial accounts. While failures to file this information in the past were relatively commonplace, recent events and increased guidance have put an emphasis on compliance. It is likely the IRS will focus on compliance in the years to come.

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