



# JONES DAY COMMENTARY

## IRS PROVIDES TARGETED RELIEF FOR FBAR FILERS, INCLUDING INVESTORS IN FOREIGN INVESTMENT FUNDS

On February 26, 2010, the Internal Revenue Service issued additional guidance on the foreign bank account reporting rules. Under these rules, U.S. persons must file Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (an “FBAR”) for each calendar year in which they have a financial interest in, or signature or other authority over, a foreign financial account with an aggregate value of more than \$10,000 at any time. The newly issued guidance provides limited relief to certain persons otherwise required to file FBARs for 2008 and earlier calendar years.<sup>1</sup>

### SUMMARY OF THE NEW GUIDANCE

IRS Notice 2010-23<sup>2</sup> and Announcement 2010-16<sup>3</sup> provide that:

- U.S. persons with financial interests in, or signature or other authority over, foreign “commingled funds” like private equity and hedge funds in 2009 and earlier calendar years will not be required to file an

FBAR. Interests in foreign commingled funds that are mutual funds remain subject to FBAR reporting.

- U.S. persons with signature authority over, but no financial interest in, a foreign financial account in 2009 and earlier calendar years now have until June 30, 2011, to file an FBAR.
- A “U.S. person” means, for 2009 and earlier calendar years, a U.S. citizen, resident, corporation, partnership, estate, or trust.

### COMMENTARY ON THE NEW GUIDANCE

There are a few things to note in the new guidance:

- Though welcome, the IRS’s decision not to enforce the FBAR with respect to interests in foreign private equity and hedge funds is limited to calendar year 2009 and prior years. As noted previously, last year the IRS surprised many by remarking informally that a “foreign financial account” included

an interest in a foreign private equity or hedge fund. The FBAR guidance issued in June 2009,<sup>4</sup> August 2009,<sup>5</sup> and now February 2010 was sparked by considerable criticism of what most perceived to be a novel interpretation of the law. Unless future guidance provides otherwise,<sup>6</sup> U.S. persons with interests in foreign investment funds like private equity and hedge funds in calendar year 2010 and thereafter will be subject to future FBAR reporting.

- The extended deadline for filing FBARs described in Notice 2010-23 builds on earlier extensions. We have summarized the deadlines for filing FBARs for accounts held in calendar year 2008 or earlier, as appropriate, in the chart below.
- The definition of “U.S. person” preserves the original (and more narrow) definition through 2009. Unless future guidance provides otherwise,<sup>8</sup> foreign persons “in and doing business in the United States” in 2010 and thereafter also will be required to file FBAR reports.

## FinCEN PROPOSALS

Coinciding with the release of Notice 2010-23 and Announcement 2010-16, the Financial Crimes Enforcement Network (“FinCEN”), a bureau of the Department of the Treasury, issued proposed regulations on FBAR reporting.<sup>9</sup> The proposed regulations clarify which persons will be required to file FBARs, which accounts will be reportable, and which persons with signature or other authority over foreign financial accounts will be exempt from reporting. Written comments on the proposed rules may be submitted on or before April 27, 2010.

There are several notable provisions in the proposed regulations:

**U.S. Person.** The definition of “U.S. person” would abandon earlier efforts to expand its meaning to include foreign persons “in and doing business in” the United States. The definition of “U.S. resident” would track the definition found in the

Type of U.S. Person	FBAR Deadline
Persons with financial interests in “traditional” foreign financial accounts.  (e.g., bank and brokerage accounts)	June 30, 2009 <sup>7</sup> <i>(for accounts held in 2008)</i>
Persons with signature authority over, or a financial interest in, a foreign financial account in which assets are held in a commingled fund.  (e.g., mutual funds)	June 30, 2010 <i>(for accounts held in 2008 or earlier)</i>
Persons with signature authority over, but no financial interest in, a foreign financial account.  (whether bank and brokerage accounts or commingled funds like mutual funds)	June 30, 2011 <i>(for accounts held in 2008 or earlier)</i>

federal income tax rules, which treat U.S. green card holders and individuals who meet the substantial presence test as U.S. residents. However, the definition of “United States” would include the Territories and Insular Possessions of the U.S. in addition to the States and the District of Columbia.

**Disregarded Entities and Trusts.** U.S. persons that are “disregarded entities,” or trusts for which trust income, deductions, or credit are taken into account by another person, for federal income tax purposes would be potentially subject to FBAR reporting.

**Other Financial Account.** A financial account subject to FBAR reporting includes any bank, securities, or other financial account, and these terms would be defined more precisely in the proposed regulations. For instance, “other financial account” would include insurance policies with a cash surrender value and shares in a mutual fund. FinCEN reserved judgment on whether interests in other pooled investment companies like private equity funds, venture capital funds, and hedge funds would be subject to FBAR reporting in the future, noting that while it is concerned about the use of such vehicles to evade taxes, it is aware of pending legislative proposals that would apply regulations and oversight to these vehicles.

**Exceptions for Governmental Entities.** Certain foreign financial accounts would not be subject to FBAR reporting, including an account of a department or agency of the United States, an Indian Tribe, a state or political subdivision of a state, or any wholly owned entity, agency, or instrumentality of the foregoing. The proposed regulations also provide an exception for foreign financial accounts of an international financial institution of which the United States government is a member. Thus, persons with financial interests in, or individuals with signature or other authority over, such accounts would not be required to file FBARs. This would include, among others, colleges or universities that are agencies or instrumentalities of, or owned or operated by, a governmental entity, as well as employee retirement or welfare benefit plans of a governmental entity. The proposed regulations would not, however, except the foreign financial accounts of U.S. tax-exempt organizations like charities, private universities, and private pension funds from reporting.

**Financial Interests and Anti-Avoidance Rule.** Generally, a U.S. person is treated as having a financial interest in a foreign financial account for which the owner of record or holder of legal title is a corporation, partnership, or other entity in which the U.S. person owns directly or indirectly more than 50 percent of the total value, voting power, or profits interest, as appropriate. Similar look-through rules apply in the case of trusts. The proposed regulations would add to the list any entity “created for a purpose of evading” the reporting requirement. It is unclear how this anti-avoidance rule would work in practice, but it may very well capture entities formed at or near the threshold of reporting if such ownership level was artificially maintained solely to avoid the reporting obligation.

**Signature Authority Exceptions.** The proposed regulations would define the term “signature or other authority” to mean the 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 with whom the account is maintained. FinCEN is proposing exceptions to the filing requirements for certain individuals with signature or other authority, as long as the individuals have no financial interest in the financial account. The exceptions would apply to officers or employees of (i) financial institutions that have a federal functional regulator (including banks, broker dealers, futures commissions merchants, and investment advisors, if properly registered and regulated), (ii) entities listed on a U.S. national securities exchange, and (iii) entities with a class of equity securities registered under Section 12(g) of the Securities Exchange Act.

**Participants and Beneficiaries in Certain Retirement Plans.** Participants in or beneficiaries of a retirement plan described in sections 401(a), 403(a), or 403(b) of the Internal Revenue Code (“Code”), as well as owners or beneficiaries of an individual retirement account (“IRA”) under Code sections 408 or 408A, would 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. However, the retirement plan or IRA itself may still be subject to reporting.

## LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at [www.jonesday.com](http://www.jonesday.com).

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## ENDNOTES

1. We previously reported on FBAR developments in two *Jones Day Commentaries*: "IRS Extends FBAR Filing Deadline for U.S. Investors in Offshore Investment Funds" (July 2009), and "Potential IRS Reporting Requirements for Investors in Offshore Private Equity and Hedge Funds" (August 2009).
2. 2010-11 IRB, 02/26/2010.
3. 2010-11 IRB, 02/26/2010.
4. Announcement 2009-51, 2009-25 IRB 1105.
5. Notice 2009-62, 2009-35 IRB 260.
6. See discussion, *below*, on "Other Financial Account."
7. Extended to September 23, 2009, for those persons who reported and paid all of their 2008 taxable income but only recently learned of the FBAR filing obligation.
8. See discussion, *below*, on "U.S. Person."
9. Separate from the FinCEN proposed regulations, there are legislative proposals, including H.R. 2847, which would require U.S. persons to report ownership of all foreign accounts, securities, financial instruments, or interests in foreign entities above a specified value. The proposals contemplate reporting that would supplement FBAR reports and accompany a person's federal income tax return.

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