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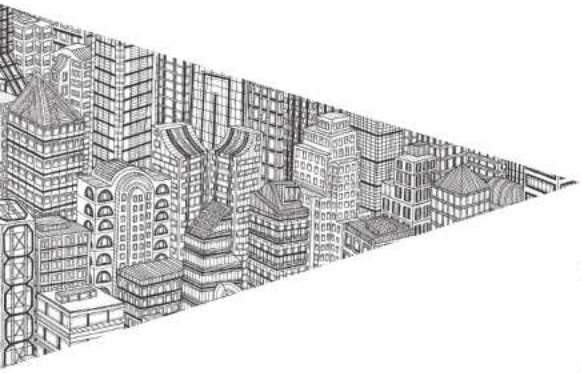

Treasury issues final regulations on Foreign Bank Account Reporting (FBAR)

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Executive summary

New final regulations under the Bank Secrecy Act (BSA)[1] have changed the Foreign Bank Account Reporting (FBAR) filing requirements for TD F 90-22.1. These rules require US persons with a financial interest in, or signature or other authority over, a foreign financial account to file a report by 30 June of the following year. The final regulations, issued on 24 February 2011, by the Financial Crimes Enforcement Network (FinCEN), a bureau of the US Treasury Department, generally adopt the rules contained in the proposed regulations issued on 25 February 2010, with some modifications.[2] The IRS issued draft revised FBAR instructions on 26 February. Key points include the following:

- The moratorium for filings to report signature authority[3] has ended, and it *will* be necessary to make filings by 30 June 2011, to report signature authority over foreign accounts for 2010 and, where required, prior years.
- The definition of mutual funds that constitute reportable financial accounts is the same as for 2009; interests in other private equity funds, hedge funds, and other commingled funds will not be subject to reporting.[4]
- Persons who hold securities through a US global custodian will not be required to report any non-US subcustody accounts, at least in certain situations.
- The reporting requirements for US beneficiaries of trusts have been simplified.
- Persons reporting signature authority only over foreign financial accounts of their employer are not required to personally maintain records of these accounts.

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- The rules allowing affiliated entities to file a consolidated report have been expanded.

The final regulations rejected several suggested changes, including the following:

- Treating FBAR reports as timely filed if they have been timely mailed, *i.e.*, adopting a mailbox rule similar to the Section 7502 rule for income tax returns;
- Aligning FBAR reporting deadlines with income tax reporting deadlines;
- Aligning certain FBAR definitions, e.g., the definition of the term trust, with those that apply for income tax purposes;
- Eliminating reporting obligations that would duplicate income tax reporting obligations;
- Exempting tax-exempt entities from FBAR reporting (although the final regulations clarify the reporting obligations for such entities) or exempting accounts in certain low-risk countries;
- Eliminating all FBAR filing requirements for persons with signature authority over, but no financial interest in, a foreign financial account.

The preamble to the final regulations contains extensive commentary, and so the regulations must be read together with the preamble. The final regulations do not address the new income tax reporting requirements for interests in foreign financial accounts contained in Section 6038D, but note that these new rules only apply to tax years beginning after 12 March 2010.

Effective date and applicability date

The final regulations apply to reports on Form TD F 90-22.1 due by 30 June 2011, for foreign financial accounts maintained in calendar year 2010 and to FBARs for all subsequent calendar years. The regulations are generally not retroactive although filers who properly deferred filing obligations for earlier years under IRS guidance, *e.g.*, for reports of signature authority, may opt to apply the final regulations to prior years.

Detailed discussion

Background

Under 31 U.S.C. Section 5314 (which is not part of the Internal Revenue Code), US persons with a financial interest in, or signature authority over, a foreign bank, brokerage, or other financial account must report it to FinCEN on Form TD F 90-22.1 if the aggregate value of all such financial accounts exceeds $10,000 at any time during a calendar year. Questions on tax returns ask about the existence of such accounts. Reports for any year must be *received* by the Detroit Data Center by 30 June of the following year and no filing extensions are granted. There is no provision for filing reports electronically.[5] Reports are filed on a calendar-year basis, regardless of the filer's fiscal year. There are civil and criminal penalties for failure to comply.[6] The imposition of criminal penalties does not preclude the imposition of a civil penalty.

Prior guidance provided certain exemptions from filing with respect to signature authority, most notably for accounts owned by widely-held or publicly-traded US-headed groups. However, the government postponed the due date for all reports for 2009 and prior years for persons with only signature authority until 30 June 2011, so that the issue could be examined further. In addition, due to confusion about when an interest in a foreign commingled fund might constitute a reportable foreign financial account, the government announced that for 2009 and prior years, only interests in foreign mutual funds would be subject to reporting, and not interests in other funds. For this purpose, a mutual fund was defined as a fund that issued shares available to the general public with regular net asset value (NAV) determinations and regular redemption opportunities. Finally, taxpayers were directed to ignore the portion of the instructions to the 2008 version of Form TD F 90-22.1 that required foreign persons "in and doing business in" the United States to report.[7]

If a US person owns more than 50% (as defined) of an entity, that person might be deemed to have a reportable financial interest in foreign accounts owned by the entity. Thus, for example, even if an interest in a foreign fund is not itself

reportable, a US investor in a fund could still have a reportable financial interest in accounts owned by the fund. In certain circumstances, a related group of entities can file a joint report.

There is a Voluntary Disclosure program currently in progress that may allow taxpayers to rectify certain reporting errors by 31 August 2011.

The final regulations

The modifications and clarifications in the final regulations, as explained by the preamble, affect the following general areas:

- The definition of a United States person required to report
- The definition of reportable foreign financial accounts
- The definition of a financial interest in a trust
- The scope of certain reporting exemptions for financial interests
- The meaning of signature or other authority and simplified recordkeeping requirements
- Simplified filing requirements for certain filers having signature or other authority over a foreign financial account
- General exemptions
- Consolidated filings
- Other issues

The definition of a United States person

The final regulations define a United States person as an individual who is a citizen or resident of the United States or an entity, including but not limited to a corporation, partnership, trust or limited liability company, created, organized, or formed under the laws of the United States, any state, the District of Columbia, the Territories, and Insular (Island) Possessions of the United States or the Indian Tribes. Note that this definition is broader than the income tax definition contained in Section 7701(a) of the Internal Revenue Code. First, it includes entities organized under the laws of US possessions, such as Puerto Rico and Guam, which are not part of the United States for income tax purposes. Second, the definition of a US trust for FBAR purposes is based solely on whether the trust is organized or created under US law. The income tax definition of a US trust, on the other hand, also looks at the residence of the trustees.[8] The preamble clarifies the following points:

- An individual who becomes a US resident for tax purposes during a year, but elects to be treated as a US resident under Section 7701(b), is required to file reports only with respect to foreign accounts held during the period covered by the election.
- An individual who is not otherwise a United States person for these purposes does not become a United States person by making an election to file a joint return with a US-resident spouse under Sections 6013(g) or 6013(h).
- A legal permanent resident, i.e., green card holder, who elects under a tax treaty to be treated as a non-resident for income tax purposes because of a closer connection with another treaty country must still file reports as a US resident for these purposes.[9]
- A foreign corporation that would not be a United States person does not become a United States person by electing under Section 897(i) to be treated as a domestic corporation for certain tax purposes. The preamble states that the same result applies for a foreign insurance company that elects to be treated as a domestic corporation under Section 953(d).[10]

It would seem that the government has permanently abandoned the suggestion that non-US persons who are "in and doing business in" the United States might have to file reports under these rules.

The definition of reportable foreign accounts

Subcustody accounts

Under prior law, there was confusion about whether one had a reportable foreign financial account if one kept one's securities in custody with a US global custodian, but the custodian kept some foreign securities in a subcustody account with a local financial institution. The preamble states that where a US bank acts as a global custodian and holds a pool of assets on behalf of its customers in an account located outside the United States, the US bank's customers do not have to report this subcustody account, provided that the customer has no legal rights in

the account and can only access the assets through the global custodian. However, if the customer can in fact directly access its foreign holdings in such accounts, the US person will be considered to have a foreign financial account.

This language in the preamble speaks in terms of pooled omnibus accounts that a global custodian establishes in order to hold securities on behalf of multiple customers. It is not entirely free from doubt whether this exemption extends to a segregated subcustody account that only holds the securities of one specified customer of the global custodian.[11] (The signature authority issues of such accounts are addressed below).

Insurance policies

The final regulations clarify that although insurance policies with cash value, and annuity contracts, are considered to be financial accounts for FBAR purposes, other life insurance policies are not. The preamble indicates that reporting would be required to be done by the policy holder, not the beneficiary.

Investment funds

The final regulations provide that interests in "mutual funds" are reportable financial accounts, and reserve on the treatment of other pooled investment funds. The preamble states that for this purpose, "mutual funds" comprise only those funds that meet all of the following three tests:

- Shares are available to the general public
- NAV is regularly determined
- The fund has a regular redemption feature

Financial interests

Trusts

With regard to the definition of financial interest, FinCEN acknowledges that, in the case of trusts, determinations regarding beneficial interest for purposes of filing reports may be difficult if the person is a beneficiary of a discretionary trust or has a remainder interest in the trust. Thus, FinCEN has changed the test for financial interest from beneficial interest to present beneficial interest. Further, the preamble clarifies that a beneficiary of a discretionary trust will not be considered to have a financial interest in a foreign account simply because of his status as a discretionary beneficiary. Unfortunately, neither the preamble nor the final regulations define the term present beneficial interest. Without such definition it is unclear at what point a discretionary beneficiary has a present beneficial interest in more than 50% of the trust assets. However, a beneficiary that has a present beneficial interest in a discretionary trust will not be required file a report with respect to the trust's foreign financial accounts if the trust, the trustee of the trust, or an agent of the trust is a US person reports the accounts. FinCEN does not intend to include a remainder interest within the scope of the term present beneficial interest for purposes of filing a report.

Further, the final regulations exclude from the definition of a financial interest under the proposed regulations an interest in a trust as to which a trust protector has been appointed. FinCEN expressed the view that the anti-abuse rule in the final regulations is sufficient to prevent the evasion of reporting through the use of a trust protector.

Anti-abuse rule

A new anti-abuse rule has been added to the regulations; under this rule, a person who creates an entity for the purpose of evading the filing requirements is deemed to have a financial interest in any foreign financial account as to which such entity is the record owner or holder of legal title.

IRAs and Pension Plans

The preamble states that participants and beneficiaries of qualified retirement plans, IRAs and Roth IRAs will not be required to report financial interests in foreign financial accounts held by the plan or IRA. This appears to infer that plans, and custodians of IRAs, would have to file with respect to accounts held by the plan or IRA.

The scope of certain reporting exemptions for financial interests

The final regulations include various reporting exceptions for certain accounts as provided in the proposed regulations. These include accounts with international financial institutions of which the US person is a member, a US military banking facility and correspondent or nostro accounts held by banks and

used for bank-to-bank settlements. The final regulations modify the proposed exception from reporting that applies to an "account of an entity established under the laws of the United States, of an Indian Tribe, of any State, or of any political subdivision of any State, or under an intergovernmental compact between two or more States or Indian Tribes [,] that exercises governmental authority on behalf of the United States, an Indian Tribe, or any such State or political subdivision." The final regulations clarify that the exception will apply when the accounts are established in exercising the governmental authority of the government or Indian Tribe. Under the final regulations, an entity is treated as exercising governmental authority only if the entity exercises one or more of the following three powers: the power to tax, the power of eminent domain and the police power.[12]

FinCEN rejected comments requesting various broad reporting exemptions, including for certain regulated entities that qualify for exempt recipient status for purposes of Form 1099 reporting, noting that the purpose of FBAR filing extends beyond tax administration.

The meaning of signature or other authority

The final regulations include a revised definition of signature or other authority, which strongly implies that the moratorium for filings with respect to signature authority will *not* be extended further, and reports with respect to signature authority only for 2010 and (to the extent required under the revised definition of signature authority) prior years will have to be filed by 30 June 2011.

Under the revised definition, reportable signature authority means 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 direct communication (whether in writing or otherwise) to the person with whom the financial account is maintained.[13] The preamble notes that the test of whether an individual has signature or other authority over a foreign financial account is whether the foreign financial institution will act upon a *direct* communication from that individual (either alone or among others in cases where the foreign financial institution requires a communication by more than one) regarding the disposition of the assets in the financial account.[14] Thus, one would not appear to have reportable signature authority over an account if one cannot give instructions with respect to the account that will be acted upon, but is merely in the chain of command over persons with such authority. The final regulations confirm the prior understanding that only individuals, and not entities, are capable of possessing signature or other authority.

The scope of certain reporting exemptions for signature or other authority with no financial interests

The final regulations retain reporting exceptions in the proposed regulations that apply to officers and employees of five types of entities with signature authority over, *but no financial interest in*, the foreign financial accounts held by these entities. These exceptions apply to the following:

- An officer or employee of a federally-regulated bank or credit union[15]
- An officer or employee of a financial institution that is registered with, and examined by the SEC or CFTC[16]
- An Authorized Service Provider, *i.e.*, an entity registered with and examined by the SEC and that provides services to an investment company that is registered under the Investment Company Act of 1940, but only with respect to accounts of clients that are investment companies as so registered
- An officer or employee of an entity (US or foreign) with a class of equity securities (including American Depository Receipts, *i.e.*, ADRs) that is listed on any US national securities exchange,[17] and an officer or employee of a US subsidiary of such a US entity if the subsidiary is named on a consolidated FBAR filed by its parent

- An officer or employee of a US corporation that is required to be registered with the SEC under Section 12(g) of the Securities Exchange Act. Currently, these comprise are corporations that have more than $10 million in assets and more than 500 shareholders of record

The reporting exceptions above for officers and employees with signature authority over, but no financial interest in, a foreign financial account of certain US companies are not new, but they continue to be important. The draft revised instructions to the FBAR issued on 26 February simplify these reporting exceptions by removing a requirement in the 2008 FBAR instructions under which the officer or employee was eligible for the reporting exception only if advised in writing that the account has been included on an FBAR of the corporation. However, the reporting exception in the final regulations is narrower than it was under the 2008 FBAR instructions in the case of officers and employees of foreign subsidiaries. As under the proposed regulations, the final regulations exclude foreign subsidiary officers and employees from the exception.

What it means to have signature authority over a reportable insurance policy or a reportable mutual fund is not entirely clear.

With respect to recordkeeping, the preamble clarifies that an employee or officer that files reports because the employee has signature authority over the employer's foreign financial accounts will not be expected to personally keep records of the employer's accounts.

Simplified filing related to persons with financial interests in, or with signature or other authority but no financial interest in 25 or more foreign financial accounts

As under the proposed regulations, in addition to filers with financial interests in foreign financial accounts, a filer with signature or other authority over, but no financial interest in, 25 or more foreign financial accounts is permitted to provide limited information on the accounts themselves. However, such filers will be required to provide identifying information about those who have a financial interest in the account if requested.

General exemptions

As described in relation to specific topics above, the final regulations do not adopt new general exemptions. Rather than granting new exemptions, e.g. where the financial account is kept in a jurisdiction with a robust set of anti-money laundering laws, the preamble refers to the regulatory modifications affecting "Reportable accounts" and "Signature authority" that clarify the scope of the exemptions as proposed and incorporated into the final regulations.

Consolidated filings

The final regulations adopt a provision in the proposed regulations permitting any US entity that owns more than a 50% interest in one or more other entities on behalf of itself and such other entities. This provision expands the consolidated filing rule that, in the October 2008 Form TD F 90-22.1 and related instructions, was limited to situations where a US corporation was head of the group. The draft revised FBAR instructions issued on 26 February 2011 reflect this change. Therefore, for example, a US partnership that owns more than 50% of one or more other entities may file a consolidated FBAR on its own behalf and on behalf of such other entities.

In the preamble, FinCEN addressed the issue of consolidated FBAR filings by non-US parent corporations and noted that it had rejected comments asking that foreign parent corporations be permitted to file consolidated FBARs on behalf of their US subsidiaries. FinCEN also did not authorize consolidated FBAR filing for all funds in the same fund family, stating that this issue is better addressed in the form of specific guidance because the factual situations may vary.

Other issues

FinCEN plans to make it possible to file reports electronically in the future, although this is not possible yet.

Reports must state the maximum value of the reported account during the calendar year. The preamble confirms that one may rely on periodic statements that provide the value of an account at the end of a statement period where bona fide statements are prepared in the

ordinary course of business. This clarification relates to the draft instructions that were attached to the proposed regulations.

Effective date and applicability
The final regulations are effective as of 24 March 2011. They generally apply to Forms TD F 90-22.1 required to be filed by 30 June 2011 with respect to foreign financial accounts maintained in calendar year 2010 and for reports required to be filed with respect to all subsequent calendar years.

However, for foreign financial accounts maintained in calendar years beginning before 2010, filers who properly deferred filing obligations as discussed above may apply the provisions of the final regulations in determining their FBAR filing requirements for reports due by 30 June 2011 for prior years.

It must be emphasized that, therefore, if reports with respect to signature authority are required under the new regulations, they must be filed with respect to 2010 *and prior years, when applicable*, by 30 June 2011.

Endnotes

1. These regulations are not part of the income tax regulations. Historically, the relevant regulations were located at 31 C.F.R. Section 103.24, but the numbering system for this portion of the Code of Federal Regulations is being changed, and the final regulations will be located at 31 C.F.R. Section 1010.350.
2. Please see International Tax Alert, *Treasury issues proposed regulations and related guidance governing Foreign Bank Account Reporting (FBAR) on Form TD F 90-22.1*, dated 2 March 2010.
3. Please see International Tax Alert, *June FBAR filing deadline fast approaching*, dated 14 June 2010.
4. Please see International Tax Alert, *June FBAR filing deadline fast approaching*, dated 14 June 2010.
5. The preamble to the final regulations indicates that electronic filing may be available in the future.
6. Civil penalties can be abated if both the violation was due to reasonable cause and income was properly reported on the relevant income tax return.
7. Please see International Tax Alert, *June FBAR filing deadline fast approaching*, dated 14 June 2010.
8. Under general principles of trust law, the settlor of a trust can specify the laws under which the trust is to be governed, i.e., the proper law of the trust. Query the intended result for a trust that was created in the United States by a US settlor with a US trustee and US beneficiaries, but the proper law of which (as chosen by the settlor) was not US law.
9. This would be relevant for anyone who is making a nonresident claim under an income tax treaty and is required to file Form 8833, Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b), as part of a US tax return.
10. One corollary of this is that an insurance policy with such an electing insurance company is a reportable financial account if it otherwise meets the requirements (discussed below) for an insurance policy to be reportable.

11. Such segregated subcustody accounts are required in certain foreign jurisdictions, and are offered by certain US global custodians in other jurisdictions.
12. Query if this definition of "governmental authority" is the same as the definition of "sovereign power" for purposes of determining when an entity is a "political subdivision" of a state or local government and capable of issuing tax-exempt bonds. See Treas. Reg. Section 1.103-1(b); Rev. Rul. 77-164, 1977-1 C.B. 20.
13. Query the treatment of persons who can authorize that assets in an account may be sold but the proceeds must be returned to the account, or that funds in the account may be used to purchase assets to be held in the account, but cannot authorize assets to be transferred out of the account without receiving other assets in return, i.e., authorize a "deliver free" out of the account.
14. One apparent corollary of this is that if a customer holds securities at a US global custodian and the global custodian holds some of these securities in a segregated subcustody account with a foreign subcustodian, then employees of the customer would only appear to have reportable signature authority over the subcustody account if the subcustodian would act on instructions received directly from such employees.
15. The preamble notes this exception does not apply to employees of credit unions and trust companies that are not subject to Federal regulation.
16. The preamble points out that this exception does not apply to SEC-registered investment advisors.
17. Presumably this would include ADRs listed on the NASDAQ market, even though that is technically not an exchange. The preamble suggests that this would not include ADRs traded on the OTC Bulletin Board or the "Pink Sheets" but not on a national securities exchange or the NASDAQ market.

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