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The New FBAR Form Raises a Stir

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by Steven Friedman and Ben Francis, Washington National Tax

Steven Friedman is a director in WNT's Practice, Procedure, and Administration Group. Ben Francis is a senior manager in WNT's International Executive Services Group.

The IRS released a revised version of the FBAR form and issued guidance as recently as June 5, 2009, clarifying the reporting of foreign bank and financial accounts. This article provides background on the FBAR form used for the reporting of foreign bank and financial accounts, highlights the changes made to the form, and discusses the scope of taxpayers potentially subject to reporting as well as several reporting issues that remain unresolved.

With the IRS increasing both its focus on offshore issues and its scrutiny of foreign investments and holdings, it has become even more vital for taxpayers to determine their foreign financial account reporting requirements.[1]

In October 2008, the IRS released a revised version of Treasury Form TD F 90-22.1, *Report of Foreign Bank and Financial Accounts*, commonly known as "the FBAR." In light of the form's significant changes, the IRS subsequently issued additional guidance on the FBAR. This article highlights the revisions made to the FBAR and identifies some important issues that remain unresolved.

Background

Legislative and Regulatory Background

The requirement for filing the FBAR arises from the Bank Secrecy Act (the "Act"), first enacted in 1970.[2] Pursuant to the Act, the Treasury Department promulgated

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1 Note that the Treasury's 2010 "Green Book"—*General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals*—includes proposals relevant to the reporting of foreign financial accounts.

2 The Bank Secrecy Act provides, "[T]he Secretary of the Treasury shall require a resident or citizen of the United States or a person in, and doing business in, the United States, to keep records, file reports, or keep records and file reports, when the resident, citizen, or person makes a transaction or maintains a relation for any person with a foreign financial agency." *See* 31 U.S.C. § 5314(a).

regulations under Title 31 of the United States Code stating, generally, that any U.S. person who has a financial interest in or signature or other authority over any foreign financial account (including bank, securities, or other types of financial accounts in a foreign country) must file the FBAR if the aggregate value of the financial accounts exceeds $10,000 at any time during a calendar year.[3] The information must be provided as specified on the FBAR.[4]

In 2003, enforcement authority for the FBAR was re-delegated to the IRS, including authority to assess and collect civil penalties, to investigate possible civil violations of the relevant statutory and regulatory provisions, to employ summons power, and to take any other action reasonably necessary—including the pursuit of injunctions—for the enforcement of the FBAR provisions.[5]

Filing Requirements

Complying with the statutory and regulatory requirements to report foreign financial accounts is a two-part process. Income tax returns filed by taxpayers (for example, Form 1040; Schedule B, Part III; or Form 1120, Schedule N, Question 6) require a taxpayer to answer yes or no as to whether the taxpayer had an interest in, or signature or other authority over, a financial account in a foreign country. The tax return directs the taxpayer to the FBAR form if a filing is required.

Persons required to file the FBAR must do so on or before June 30 of the year following the calendar year to which it relates.[6] Extensions of time for filing the FBAR are *not* available. Note that because the FBAR filing requirement does not fall under Title 26 of the United States Code (*i.e.*, the Internal Revenue Code), the

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3 "Each person subject to the jurisdiction of the United States (except a foreign subsidiary of a U.S. person) having a financial interest in, or signature or other authority over, a bank, securities or other financial account in a foreign country shall report such relationship to the Commissioner of the Internal Revenue for each year in which such relationship exists, and shall provide such information as shall be specified in a reporting form prescribed by the Secretary to be filed by such persons." *See* 31 C.F.R. § 103.24(a). *See also* 31 C.F.R. § 103.27(c).

4 31 C.F.R. § 103.27(d).

5 31 C.F.R. § 103.56. The Treasury Department initially delegated enforcement of FBAR reporting to the Financial Crimes Enforcement Network (FinCEN), a bureau of the Treasury Department. Subsequently, FinCEN re-delegated enforcement authority for the FBAR back to the IRS by a Memorandum of Agreement. *See* Financial Crime Enforcement Network; Delegation of Enforcement Authority Regarding the Foreign Bank Account Reporting Requirements, 68 Fed. Reg. 26,489 (May 16, 2003) (codified at 31 C.F.R. § 103.56(g)).

6 To file the FBAR using a private delivery service, the following address should be used: IRS Enterprise Computing Center, Attn: FBAR Mail Room, 4th Floor, 985 Michigan Avenue, Detroit, MI 48226, (contact phone number is (313) 234-1602).

mailbox rule of IRC section 7502 does not apply. Thus, the FBAR must be *received* by the June 30 due date, not just mailed by that date using the U.S. Postal Service.

Penalties

Failure to file an FBAR can lead to severe sanctions. A civil penalty of up to $10,000 can be imposed for non-willful failures to file the form.[7] This penalty can be waived if (1) there is reasonable cause for the failure and (2) the amount of the transaction or the balance in the account at the time of the transaction was properly reported.[8] For willful violations, the penalty increases to the greater of $100,000 or 50 percent of the amount of the transaction or the balance in the account at the time of the violation (without regard to reasonable cause).[9] A six-year statute of limitations applies to the assessment of penalties for FBAR violations.[10]

The Revised FBAR

The primary authorities that govern FBAR reporting are the statute and regulations under Title 31 of the United States Code.[11] The statute and regulations, however, generally provide only the basic filing requirement, without supplying certain other details (such as what constitutes a financial account or who is exempt from the filing requirement). Authority to provide such detail is delegated to the Treasury Secretary and, as a result, the FBAR form and instructions (revised October 2008) provide helpful guidance (despite certain areas that could benefit from further clarification, as discussed below).[12]

The following discussion highlights certain FBAR reporting changes and those areas where the IRS has provided clarification on procedural issues. Unless otherwise indicated, all references to the FBAR and the form instructions are to the revised form released by the IRS in October 2008.

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7 31 U.S.C. § 5321(a)(5)(A), (B). FBAR penalties are determined per account, not per unfiled FBAR, for each person required to file. *See* IRM 4.26.16,4 – FBAR Penalties (revised 7-1-2008).
8 31 U.S.C. § 5321(a)(5)(B)(ii).
9 31 U.S.C. § 5321(a)(5)(C).
10 31 U.S.C. § 5321(b)(1).
11 31 U.S.C. § 5314 and 31 C.F.R. §§ 103.24, 103.27.
12 "Each person … shall provide such information as shall be specified in a reporting form prescribed by the Secretary to be filed by such persons." 31 C.F.R. § 103.24.

Effective Date

The revised FBAR states that previous versions of the form must not be used after December 31, 2008. Thus, the revised FBAR must be used on and after January 1, 2009, with respect to reporting for calendar year 2008 (as well as filings made of delinquent or amended FBARs for prior years).

Persons Required to File

The form instructions state that the form must be filed by "Each United States person who has a financial interest in, or signature or other authority over, any foreign financial accounts. . . ." Whereas the instructions to the previous version of the FBAR limited the definition of the term "United States person" to a (1) U.S. citizen, (2) U.S. resident, (3) domestic partnership, (4) domestic corporation, or (5) domestic estate or trust, the instructions to the revised form more broadly define the term to mean "a citizen or resident of the United States, or a person in and doing business in the United States."[13]

This expanded definition resulted in myriad questions and comments from the public in an effort to understand how to interpret the revised term. In response to the concerns raised regarding the expanded definition of "United States person," the IRS announced that it is temporarily suspending the FBAR reporting requirement due on June 30, 2009, for those persons who are not citizens, residents, or domestic entities.[14] Accordingly, all persons may rely on the definition of "United States person" found in the instructions of the prior version of the FBAR (the July 2000 version) to determine whether they have an FBAR filing requirement. Thus, foreign persons that are "in and doing business in the United States" as well as branch offices of foreign entities that are not separately incorporated in the United States will not be required to file an FBAR for calendar year 2008 (due June 30, 2009).

The IRS anticipates issuing future guidance with respect to the definition of "United States person" for FBARs due after 2009. Despite this suspension, the current version of the form must be used for all FBAR filings and all other requirements of the current version of the form and instructions are still in effect for the June 30, 2009 filing.

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[13] This definition reflects the wording of section 5314 of the Bank Secrecy Act set out *supra* note 2.

[14] IRS Announcement 2009-51 (June 5, 2009).

The instructions to the revised form define the term "person" by reference to 31 C.F.R. section 103.11(z), thus including individuals and all forms of business entities (including disregarded entities), trusts, and estates.

The relief provided by IRS Announcement 2009-51 still leaves unclear the definition of the term "resident of the United States." Because the FBAR rules are promulgated under Title 31 of the United States Code, and not under the Internal Revenue Code, the definition of U.S. resident in IRC section 7701(b) is inapplicable; that provision applies only "for purposes of *this title*" (*i.e.*, Title 26).

Some guidance on this issue, however, is provided by the Internal Revenue Manual ("IRM"), which states that an individual can establish nonresidency for FBAR purposes by showing that he or she (1) does not hold a green card, (2) does not meet the substantial presence test of section 7701(b)(3), or (3) has not made a first-year residency election under section 7701(b)(4).[15]

However, this guidance in the IRM does not clarify whether individuals are required to file the FBAR if they are (1) part-year residents (whether inbound or outbound), (2) individuals who have made an election under section 6013(g) or (h) to be treated as residents for U.S. income tax purposes, or (3) individuals who invoke the residency tie-breaker provision of a treaty.

Persons Exempt from Filing

The revised FBAR instructions expand the categories of persons expressly exempt from the FBAR filing requirement.

The previous version provided that an officer or employee of a domestic corporation whose securities are listed on a U.S. securities exchange, or which has assets exceeding $10 million and has 500 or more shareholders of record (a "qualifying corporation"), need not file a report if he or she has no personal financial interest in the account and has been advised by the chief financial officer ("CFO") of the corporation that the corporation has filed a current report that includes that account. The new form provides that written notification may also come from "any similar responsible officer," in addition to the company's CFO.

The new instructions add that an officer or employee of a domestic subsidiary of a qualifying corporation need not file the form if the domestic parent meets the above requirements, the officer or employee has no personal financial interest in the account, and the officer or employee has been advised in writing by a

[15] Internal Revenue Manual 4.26.16.3.1.1 (2008).

responsible officer of the parent that the subsidiary has filed a current report that includes the account.[16] If the domestic subsidiary is named in a consolidated FBAR of the parent, the subsidiary will be deemed to have filed a report for purposes of this exception. An officer or employee of a foreign subsidiary that is more than 50 percent owned by a qualifying corporation is also covered by this exception.

Which Accounts Must Be Reported

The scope of accounts that must be reported on the form has expanded. As with the prior version, the reporting obligation applies to:

> any foreign financial accounts, including bank, securities, or other types of financial accounts, in a foreign country, if the aggregate value of these financial accounts exceeds $10,000 at any time during the calendar year.…

Clarification is provided in the instructions as to what is meant by an account "in a foreign country." The geographical location of the account, not the nationality of the financial institution in which the account is found, determines whether it is an account in a foreign country. Thus, an account located in a foreign country must be reported even if it is held at an affiliate of a U.S. bank or other financial institution. However, an account held at a branch, agency, or other office of a foreign bank or other institution located in the United States is not subject to reporting.

The term "foreign country" includes all geographical areas located outside the United States. The United States is defined as:

> the States of the United States, the District of Columbia, the Indian lands (as that term is defined in the Indian Gaming Regulatory Act), and the Territories and Insular Possessions of the United States (which includes Puerto Rico, the US Virgin Islands, Guam, and the Northern Mariana Islands).[17]

The old FBAR form included language specifying that an "account" encompassed any account in which the assets are held in a commingled fund and the account owner holds an equity interest in the fund. The new form clarifies that this would

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[16] The new instructions are consistent with previous guidance issued by the IRS. *See* FBAR Reporting by Employees of Subsidiary Corporations, IRS Headliner, Vol. 127 (June 9, 2005).

[17] 31 C.F.R. § 103.11(tt) and (nn).

include mutual funds (and, therefore, potentially foreign hedge funds). The new form also specifically identifies debit cards and prepaid credit card accounts maintained with a financial institution (or other person engaged in the business of a financial institution) as being subject to reporting.

However, the new form instructions provide that individual bonds, notes, or stock certificates held by the filer are not a financial account, nor is an unsecured loan to a foreign trade or business that is not a financial institution.

What Constitutes a Financial Interest

The definition of financial interest has been expanded by the form's instructions (indicated by the italicized language below) to include an interest held by a U.S. person through ownership in the following entities:

- A corporation in which the U.S. person owns directly or indirectly more than 50 percent of the corporation's shares by either value *or vote*;
- A partnership in which the U.S. person owns an interest in more than 50 percent of the profits (distributive share of income, *taking into account any special allocation agreement) or more than 50 percent of the capital of the partnership*; and
- A trust in which the U.S. person has a present beneficial interest, *either directly or indirectly,* in more than 50 percent of the assets or from which the U.S. person receives more than 50 percent of the current income.

In addition, the instructions now provide that a U.S. person has a financial interest in any foreign account for which the owner of record or holder of legal title is a trust, or a person acting on behalf of a trust, that was established by the U.S. person and a trust protector has been appointed. A trust protector is a person responsible for monitoring the activities of a trustee, with the authority to influence the decisions of the trustee or to replace, or recommend the replacement of, the trustee.

Signature or Other Authority

Individuals who can order the distribution or disbursement or transfer of funds or assets from the account by signing a document or by oral or other means of communication are considered to have authority over the account. The form instructions include new language that provides that an individual has authority over an account if he or she can exercise such authority either directly or through an agent, nominee, or attorney or in some other capacity on behalf of the U.S.

person (either orally or by some other means). Thus, the existence of an intermediary who controls an account on behalf of a U.S. person will not relieve the U.S. person of the obligation to file the form. Note that the ability to make investment decisions regarding the assets in the account does not cause a person to be treated as having "authority" over the account.

Maximum Value of the Account

The form now requires that the actual maximum balance of the account be reported, as opposed to the range within which the maximum balance falls (such as more than $1 million). Foreign currency must be converted using the official exchange rate in effect at the end of the year. If the foreign country uses multiple exchange rates, the filer should use the rate that would apply if the currency in the account were converted into U.S. dollars at the close of the calendar year. The value of stocks, securities, or other non-monetary assets in the account should be determined using their fair market value at the end of the calendar year or, if withdrawn from the account earlier in the year, at the time of the withdrawal.

Non-U.S. Person with Financial Interest

When a U.S. person has signature or other authority over (but no financial interest in) a foreign account in which a non-U.S. person has a financial interest, the person with the financial interest must now be identified. This information is to be provided in Part IV of the revised form. Previously, the filer could simply provide a statement that no U.S. person had a financial interest in the account.

25 or More Accounts

The instructions permit a filer with a financial interest in 25 or more foreign financial accounts to simply check a box indicating so, without the need to provide specific account-related information. The instructions do not grant such reporting relief to filers with signature or other authority over 25 or more accounts who lack a personal financial interest in the accounts. However, the IRS recently eased the reporting burden on such filers by announcing that they are permitted to simply (1) check the box in Part 1 indicating their authority over 25 or more accounts; (2) enter the exact number of financial accounts; and (3) identify the owners of the accounts.[18]

[18] IRS Headliner, Vol. 265 (Apr. 2, 2009).

Other Items to Note

Amended Filings

The revised FBAR now provides for an amended report to be filed. This is accomplished by checking the "Amended" box on the first page of the form. The original form must be stapled to the amended version, and a statement should be included explaining the changes.

Delinquent Filings

Although no extension of time is available to file the FBAR, if a delinquent form is filed, a statement should be attached explaining the reason for the late filing.

As noted, the IRS's increased focus on offshore tax issues means understanding and complying with the FBAR filing requirements have taken on even greater importance. The revised FBAR form and instructions, as well as additional guidance released by the IRS through its Web site (such as FAQs on the FBAR and the IRS Headliner series) as well as Announcement 2009-51, should be carefully reviewed. Further guidance, therefore, from the IRS in the areas discussed above could improve compliance with the FBAR reporting requirements.