

U.S. Reporting Obligations Related to Foreign Bank and Financial Accounts

1. Introduction

There has been extensive publicity surrounding the settlement and negotiation between the United States government, the government of Switzerland and UBS AG involving the release of the names of United States persons that maintain foreign financial accounts with UBS AG. The pursuit of United States persons with accounts at UBS AG is based on the United States requirement that United States persons must report interests in foreign financial accounts and the United States government's belief that United States persons were using UBS AG accounts as a means to avoid paying United States tax.

In October 2008, the Internal Revenue Service ("IRS") published revised instructions to Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts ("FBAR") that changed the definition of a U.S. person to include any person "in and doing business in the United States." These instructions created numerous questions including the definition of doing business in the United States and whether foreign persons treated as U.S. persons under this definition were required to report all of their foreign financial accounts or only those related to their U.S. business activities.

2. Background

The Bank Secrecy Act ("Act") gives the U.S. Department of Treasury authority to establish record keeping and filing requirements for United States persons with financial interests in or signature authority over financial accounts maintained with financial institutions in foreign countries. Any United States person who has a financial interest or signature authority over foreign financial accounts, the aggregate balances of which exceed US\$10,000 at any time during the calendar year, must report that relationship to the Department of Treasury by filing an FBAR by June 30 of the subsequent year.

If a U.S. person fails to comply with the FBAR requirements set forth in the Act, significant penalties, ranging from US\$10,000 for ordinary violations to the greater of US\$100,000 or half the value of the foreign account for willful violations, may apply. A reasonable cause exception is available to the ordinary penalty.

On 26 February 2010, the Financial Crimes Enforcement Network ("FinCEN") issued proposed rules relating to FBAR reporting and the IRS released two documents which further clarify FBAR reporting requirements. These recent developments are discussed below.

3. Requirements to File the FBAR

a. Who Must File FBAR?

Under the current federal regulations implementing the Act, each person subject to the jurisdiction of the United States having a financial interest or signature authority over a bank, securities, or other financial account in a foreign country must report that relationship to the IRS each year. This obligation arises only when the aggregate value of the foreign accounts exceed US\$10,000 at any time during the year.

b. Definition of United States Person.

The revised 2008 Form TD F 90-22.1 expanded the definition of "United States person" to include a citizen or resident of the United States or a person in, and doing business in, the United States. The term "person" includes individuals and all forms of business entities, trusts, and estates.

The proposed FBAR rules would revise the regulations implementing the Act to define a United States person as 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 Possession of the United States or the Indian Tribes." The proposed FBAR rules clarify that all entities meeting that definition, regardless of whether that entity is treated as a disregarded entity for United States tax purposes, are United States persons under the proposed FBAR rules. The determination of whether an individual is a resident will be determined under the rules of the Internal Revenue Code (the "Code").

In connection with this proposed definition, which does not include non-United States persons regardless of their connection to the United States, the IRS released Announcement 2010-16, which suspends the requirement to file Form TD F 90-22.1 for persons that are not United States citizens or residents, or domestic entities for 2009 and earlier years. If the revised regulations are adopted as proposed by FinCEN and the instructions to the Form TD F 90-22.1 are correspondingly revised, it is likely that the requirement of foreign persons to file a Form TD F 90-22.1 will be suspended indefinitely.

a. Definition of Foreign Financial Accounts.

Under the proposed FBAR rules, "Foreign Financial Account" means a formal relationship with a foreign financial agency to provide regular services, dealings and other financial transactions. Specifically, the proposed FBAR rules would revise the regulations to include definitions of "bank account", "securities account" and "other financial accounts". As proposed, the term (1) "bank account" means a savings deposit, demand deposit, checking, time deposit or any other account maintained with a person engaged in the business of banking (2) "securities account" means an account maintained with a person in the business of buying, selling, holding, or trading stock or other securities; and (3) "other financial accounts" would include (i) an account with a person that is in the business of accepting deposits as a financial agency; (ii) an account that is an insurance policy with a cash value or an annuity policy; (iii) an account with a person that acts as a broker or dealer for futures or options transactions in any commodity on or subject to the rules of a commodity exchange or association; or (iv) an account with a mutual fund or similar pooled fund which issues shares available to the general public that have a regular net asset value determination and regular redemptions. The definition of "other financial account" also includes an account that is an insurance policy with a cash value or an annuity policy.

In response to concerns arising after the issuance of the IRS's 2008 instructions to Form TD F 90-22.1, the proposed FBAR rules issued by FinCEN, specifically states that individuals who invest in certain types of pooled investment companies, such as private equity funds, venture capital funds and hedge funds will not have an interest in a foreign account for purposes of the Act.

b. Definition of Financial Interest.

A United States person has a financial interest in a foreign account for which the United States person is the owner of record or has legal title, whether the account is maintained for his or her own benefit or for the benefit of others including non-United States persons. A U.S. person also has a financial interest in each foreign financial account for which the owner of record or holder of legal title is: (1) a person acting as an agent, nominee, or in some other capacity on behalf of a U.S. person; (2) a corporation in which a U.S. person directly or indirectly owns more than 50 percent of the total vote or value of the shares of stock; (3) a partnership in which the U.S. person owns interest in more than 50 percent of the profits or capital of the partnership; (4) a trust in which a U.S. person either has a present beneficial interest in more than 50 percent of the assets or receives more than 50 percent of the current income.

c. Definition of "Signature Authority."

Currently, the regulations require FBAR reporting by any person who has signature or other authority over a foreign financial account if that person can control the disposition of money, funds, or other property in the account by delivery of instructions (whether or not communicated in writing) to the bank or to any other person with whom the account is maintained. The proposed FBAR rules provide that officers and employees of certain banks, financial institutions, Authorized Service Providers, or entities with a class of equity securities listed on any U.S. national securities exchange that have signature authority over foreign accounts maintained by their employer need not file a report concerning such signature authority if the officer or employee does not have a financial interest in that account.

4. Observations

The proposed FBAR rules provide welcomed relief to foreign persons with investments or business activities in the United States. However, the current regulatory climate in the United States indicates that there will be additional reporting and withholding obligations for foreign persons making payments to U.S. persons.

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