Final rules and new FBAR form issued

Earlier this year, the US released new filing rules as well as a new form for the FBAR. Scott Michel and Jennifer O'Brien of Caplin & Drysdale discuss the changes and discover that this is just yet another compliance burden for taxpayers.

For decades, US persons, businesses, trusts, and other entities have been required to file an annual form known as the "FBAR" to report financial interests in and other control over foreign financial accounts. With the US government's recent investigations of undeclared foreign accounts, the FBAR has become the focus of substantial attention. The significant penalties for FBAR non-compliance lay at the core of IRS voluntary disclosure initiatives implemented in March 2009 and February 2011.

Until recently the only IRS guidance on FBARs has been in the instructions to the form. In October 2008, the IRS issued a revised FBAR and instructions that broadened the previous reporting requirements. Practitioners struggled to interpret core issues such as who was required to file the form and what accounts should be reported. Last year in Announcement 2010-16 the IRS suspended the FBAR requirement for persons who held only signature authority over foreign accounts and for foreign private equity and hedge funds, signaling an intention to implement new rules. Tax professionals, tax compliant businesses, non-profits, and other organisations hoped that subsequent rulemaking would reduce the scope of the FBAR filing requirement.

On February 24 2011 the Financial Crimes Enforcement Network (FinCEN), which has primary rulemaking authority over the FBAR, issued final regulations (31 C.F.R. § 1010.350 (2010)) , generally dashing these hopes and making other important revisions to the filing rules. On March 25 2011, the IRS issued a new FBAR form and instructions conforming to the new regulations. The new form states that previous versions of the form should not be used. It is unclear whether the IRS therefore intends that anyone participating in a voluntary disclosure or filing amended or delinquent FBARs must, as of March 2011, use this new form.

US persons and financial interest

FBARs are required from US citizens and residents. Until the new rules, the definition of a US resident was the subject of varying, if not inconsistent IRS guidance. In a needed clarification, the term US resident is defined to mean a green card holder or any person satisfying the "substantial presence" test in the tax code (even if such person elects non-resident status under a tax treaty).

As before, an FBAR is due from any US person who is an owner of record or holds title over an account (even if the account is beneficially owned by another), and from one whose account is held in the name of an agent, attorney, or other nominee. US corporations, partnerships, trusts and limited liability companies (LLCs), even if they are disregarded entities under the tax code, must also file an FBAR. Certain corporate filers may file consolidated FBARs with their majority-owned subsidiaries. And as before, individuals with a more than 50% ownership interest in such entities also have a reportable financial interest in entity accounts.

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The new rules expand reporting requirements for foreign accounts owned by trusts, an area where authorities perceive widespread abuse. Present beneficiaries entitled to more than 50% of the trust assets or income during the calendar year being reported must continue to file an FBAR unless a trustee separately reports the accounts. The new rules eliminate the filing requirement imposed in 2008 for anyone who has established a trust with a protector, but instead they require a filing from a trust grantor if such person is considered the trust owner.

Importantly, the new rules contain a broad anti-avoidance provision, attributing a reportable financial interest to anyone who causes the creation of an entity intending to evade the FBAR filing rules.

Reportable accounts

Only foreign accounts directly accessible by US persons are reportable. Thus, one need not report a US based account holding securities of a foreign company or acting as a global custodian of a customer's foreign assets.

All foreign bank and securities accounts, as generally understood, are reportable. FinCEN extends the filing requirement to foreign insurance or annuity policies with an accessible cash value, and to foreign accounts i) with a business that accepts deposits as a financial agency; ii) used for certain commodity futures or options transactions and iii) for a mutual or pooled fund that issues shares to the public and has regular net asset value (NAV) determinations and redemptions.

As under the old rules, correspondent accounts and accounts of specified government and military entities, financial institutions, and other financial services providers are exempt from reporting. Also now exempt are participants and beneficiaries in certain specified retirement plans and individual retirement accounts (IRAs), and, for now, foreign private equity or hedge funds.

Signature authority

Revoking the prior suspension, the regulations require FBARs from anyone with signature or other authority over foreign accounts. Reportable authority now "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." Thus, anyone with a power of attorney or similar authority over a foreign account must file an FBAR.

Businesses worldwide were hopeful that FinCEN would narrow or eliminate the filing requirement for employees with signing authority over company accounts. FinCEN decided otherwise, citing law enforcement concerns.

There are exemptions for employees of the banking and financial service industries and US public companies or their subsidiaries (where the parent company files a consolidated FBAR). But FinCEN rejected proposed exemptions for persons with signing authority over pension and benefit plans and for employees of i) US subsidiaries of foreign parent companies; ii) foreign subsidiaries of US parent companies; and iii) US parents who can sign on accounts owned by the parent's foreign subsidiary, even if such accounts are reported on company FBARs. All such persons have to file FBARs.

Thus, many corporate employees now face extensive FBAR reporting, although the new rules and instructions mitigate this to some extent. Persons with a financial interest in 25 or more accounts may continue to abbreviate their filing, and now persons with signature or other authority may do the same, although such filers must report what entity has a financial interest in each account. Also, persons with only signing authority do not have to maintain account records if their employer does so.

Finally, there is a modified reporting regime in the new instructions for employees living outside the US who have signing authority on accounts owned by employers physically located outside the US.

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Retrospective compliance

There is no legal obligation requiring corrective clean-up of prior year FBAR issues, and in suspending the 2009 requirement for signature authority only filers until June 2011, the IRS also stated that such persons need not voluntarily correct prior compliance issues until then. But now, with the rules clarified US persons and business interests should consider whether to undertake retrospective clean-up of FBAR filing deficiencies. The statute of limitations for civil penalties on FBAR violations is six years. IRS guidance in the voluntary disclosure programs provides that the IRS will not impose FBAR penalties where the filer has no unreported income.

More reporting obligations

FinCEN claims substantial law enforcement benefits flowing from the FBAR. This may well be the case. For lawful business interests and tax compliant individuals however, the new rules add another set of reporting obligations to an already complex regime of tax reporting. Indeed, the FBAR will duplicate new tax reporting requirements effective for 2011 for US taxpayers holding foreign financial assets in excess of $50,000.

But the penalties for FBAR non-compliance, especially willful non-compliance, can be substantial. FBARs are due on June 30 each year for the preceding calendar year. No extensions of the deadline are available.

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Penalties, especially for wilful non-compliance, are likely to be severe