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Recent IRS Guidance Gives Certain Investors in Foreign Private Investment Funds Breathing Room Until September 23, 2009 for Potential FBAR Filings

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Responding to the recent uproar over learning that the revised instructions for the Foreign Bank Account Report ("FBAR") form[1] may require reporting of interests in foreign private investment funds (e.g., foreign private equity and hedge funds),[2] the Internal Revenue Service ("IRS") issued guidance yesterday extending the June 30, 2009 filing deadline to September 23, 2009 for certain taxpayers. Specifically, the IRS announced that taxpayers who reported and paid tax on all of their 2008 taxable income and who recently learned that they have an FBAR filing obligation but cannot gather the necessary information to file an FBAR form by June 30, 2009, should file a delinquent FBAR report according to the FBAR form instructions, together with a copy of their 2008 tax return, by the new September 23rd deadline. The IRS further stated that, in these situations, the IRS will not impose a penalty (normally $10,000 for non-willful violations and substantially more for willful violations) for failure to file an FBAR. Other taxpayers not covered by yesterday's guidance must still file their FBAR forms on June 30, 2009.

Background

The FBAR is an annual IRS form that requires a U.S. person to report the existence of, and information about, ownership in any foreign bank account, brokerage account, securities account, mutual fund, unit trust or other financial account worth more than $10,000.

Discussion

As described in our Legal Update dated June 11, 2009,[3] the FBAR rules were revised in October 2008 to expand both the types of persons subject to FBAR reporting and the types of foreign accounts which are reportable under an FBAR. On June 5, the IRS announced that it would temporarily suspend some of the new FBAR reporting rules for FBAR filings due on or before June 30, 2009 in respect of reportable

foreign accounts for the 2008 calendar year.[4] That guidance suspended the use of the new definition of "U.S. person" meaning that difficult questions regarding the "U.S. person" definition would not need to be answered by this June 30. That was followed by the IRS guidance yesterday extending the filing deadline, but only for certain taxpayers, as described above. The suspension of the new definition of "U.S. person" and the more recent IRS guidance described herein still leaves uncertainty about the new FBAR form.

First, the October changes provided a new definition of "financial account" used for purposes of the June 30, 2009 filing. Under this new definition, U.S. sponsors of, and U.S. investors in, foreign private investment funds may be required to file an FBAR form with respect to such investments. From the plain language of the new FBAR definition of "financial account," it is unclear whether an investment in a foreign private investment fund falls within that definition.[5] However, in a June 12 conference call sponsored by the American Bar Association and American Institute of Certified Public Accountants, IRS representatives stated that a foreign hedge fund would generally constitute a foreign financial account for FBAR purposes. According to a June 25 Wall Street Journal article, IRS officials confirmed this position earlier this week and added that this requirement was not new. To date, no official written IRS position on this issue has been released.

Second, because the IRS views foreign private investment funds as a type of foreign financial account subject to FBAR filings and believes that this position is not a new change brought about by the October 2008 changes, it is possible that U.S. persons with a financial interest in, or signature or other authority over, a foreign private investment fund should have been filing an FBAR prior to 2008. However, this would be contrary to our understanding of the meaning of that term in the old FBAR definition as well as contrary to what we understand to be the prevailing interpretation of the old FBAR definition among legal advisors. Nonetheless, U.S. sponsors of, and U.S. investors in, foreign private investment funds may wish to avail themselves of a voluntary compliance measure, with respect to FBAR filings for years prior to 2008. The availability of this measure is the result of IRS guidance issued in May (and revised yesterday) providing that taxpayers who otherwise reported all taxable income appropriately but simply failed to file FBARs for the last six years should file the delinquent FBARs by September 23, 2009 with an appropriate explanation regarding why they were filed late. The IRS added that, in this situation, it will not impose a penalty for the failure to file the FBARs.

Third, it is possible that a U.S. sponsor of a foreign private investment fund who has a "carried" interest or other equity interest in the foreign investment fund would be subject to FBAR reporting requirements as well.[6]

Fourth, the IRS recently clarified that any U.S. person with signature or other authority over a foreign financial account is subject to FBAR reporting rules, regardless of whether or not such U.S. person has any financial interest in any foreign financial account.[7] This is merely a statement of existing law, and does not address any area of uncertainty under either the former FBAR or the new FBAR. However, for U.S. tax-exempt persons who did not file a 2008 tax return and are seeking to file a delinquent FBAR by September 23, 2009, it is unclear what evidence such persons could provide to show that it has "reported and paid tax on all of its 2008 taxable income."

For questions or comments concerning this alert, please contact Arthur Man (aman@mofo.com) or Robert A.N. Cudd (rcudd@mofo.com).

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[1]The Report of Foreign Bank and Financial Accounts, Form TD F 90.22-1.

[2]In general, a "U.S. person" who has a financial interest in, or signature or other authority over, any foreign financial accounts must file an FBAR form if the aggregate value of such accounts exceeds $10,000 at any time during the year.

[3] Morrison & Foerster LLP Legal Update, "IRS Announcement Permits Use of Old Definition of 'U.S. Person' for June 30, 2009 FBAR Filing," *available at* http://www.mofo.com/news/updates/files/15668.html.

[4]Specifically, the IRS announced that the newer, more expansive definition of "U.S. person" for FBAR purposes would not apply to FBARs due on or before June 30, 2009 in respect of reportable foreign accounts for the 2008 calendar year. Accordingly, for FBAR forms due June 30, 2009 in respect of reportable foreign accounts for the 2008 calendar year, the definition of a "U.S. person" is (1) a citizen or resident of the U.S., (2) a domestic partnership, (3) a domestic corporation, or (4) a domestic estate or trust. *See* footnote 3.

[5]Under the FBAR rules, a "financial account" is broadly defined to include any bank, securities, securities derivatives or other financial instruments accounts. The definition also includes assets held in a "commingled fund" where the owner holds an equity interest in such fund. There is no definition of what type of account constitutes a "commingled fund," although one example, that of a mutual fund, is given in the FBAR form instructions. It is unclear if a foreign private equity or hedge fund would be treated as a "commingled fund," for which reporting is required or whether these funds would be treated like individual bonds, notes or stock certificates held by the U.S. person for which there is no FBAR reporting requirement.

[6]For FBAR purposes, a U.S. person has a "financial interest" in a foreign financial account if (1) the U.S. person is the owner of record or has legal title in a foreign financial account, regardless of whether the account is maintained for the U.S. person's own benefit or the benefit of others, and (2) the U.S. person is the beneficial owner of the foreign financial account and the owner of record or legal title holder of such account and is either (a) a nominee, attorney or some other agent of the U.S. person or (b) a trust or person acting on behalf of a trust that was established by such U.S. person.

[7]A U.S. person has "signature authority" over a foreign financial account if such person can control the disposition of money or other property in such account by delivery of a document signed by such person to the institution with whom the account is maintained. A U.S. person has "other authority" over a foreign financial account if such person can exercise power comparable to that of signature authority (for example, if the U.S. person can orally control the disposition of funds in a foreign financial account, such person has "other authority" for FBAR purposes).
