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Breaking Developments in Tax Law

Expanded Scope of Requirement to Report Foreign Bank and Financial Accounts 03/11/09

Every U.S. person that has an interest in or authority over a foreign financial account must annually file Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts ("FBAR") by June 30. In October 2008, the U.S. Treasury revised the FBAR to expand the list of persons obligated to file and required more detailed reporting of information concerning foreign financial accounts. The revisions were effective January 1, 2009, and any individual with foreign accounts or businesses with foreign accounts for general investment or day-to-day purposes should be aware of the expanded reporting requirements.

U.S. law requires any U.S. person having a financial interest in, signature authority or other authority over foreign account(s), with an aggregate value exceeding \$10,000 at any time during the year, to file the FBAR. To avoid penalties, a U.S. person must file by June 30 or attach a statement to explain the reason for late filing. A summary of the revisions to the FBAR are provided below.

I. Changes to Reporting of Foreign Accounts

Expanded list of parties required to file the FBAR

A U.S. person includes a citizen or resident of the United States. "U.S. person" has been expanded to include a person in and doing business in the United States. A person is not considered to be in and doing business in the United States unless that person is conducting business within the United States on a regular and continuous basis. Foreign corporations with U.S. branches and non-resident aliens conducting a trade or business within the U.S. would now appear to be subject to FBAR reporting requirements. For individuals or entities without a U.S. tax identification number (*i.e.*, social security number or employer identification number), the FBAR requires a foreign passport or other foreign identification number.

Broader definition of "financial interest"

A "financial interest" in a foreign account now includes:

- U.S. persons listed as the owners of record or having legal title over a foreign account;
- A person with legal title to the account acting as agent, nominee, attorney, or similar capacity on behalf of a U.S. person;
- Corporate accounts where a U.S. person owns more than 50 percent of the shares or controls more than 50 percent of the voting power of the corporation;

- Partnership accounts where a U.S. person owns an interest in more than 50 percent of profits or capital of the partnership; and
- Trust accounts where a U.S. person's beneficial interest exceeds more than 50 percent.

The revisions broaden the list to include foreign accounts where the owner of record is a trust or is a trust protector (*i.e.*, a person responsible for monitoring the trustee or can influence the trustee's decisions).

Signature or other authority over a foreign financial account

Signature authority exists if a U.S. person controls a foreign account, or if property or money in the account can be disposed of by delivery of a document containing a signature to a bank or other person maintaining the account or property. For example, a U.S. person maintaining a bank account in a foreign country for personal use could have signature authority over the account. Other authority exists when an individual or entity exercises comparable authority by communicating with a bank or agent, nominee or attorney on behalf of a U.S. person.

A foreign financial account includes any bank, securities or other financial instruments accounts. The revisions add co-mingled funds where the holder has an equity interest, such as mutual funds. Further, FBAR considers financial accounts including savings, demand, checking, deposit, and time deposit accounts and accounts with debit cards or prepaid credit cards as financial accounts.

Determination of aggregate value of foreign financial accounts

When the aggregate value of foreign financial accounts exceeds \$10,000 in currency or non-monetary assets at any time during the calendar year, the U.S. person must file the FBAR. Revisions require a filer to report the highest dollar amount for each foreign financial account during the calendar year. If a U.S. person owns multiple foreign bank accounts and mutual funds, the highest maximum value for each account during the calendar year must be reported.

The revisions also expand the FBAR to include reporting based on the type of account. Filers must disclose individual accounts owned separately, owned jointly, and where the filer has signature or other authority but no financial interest. Also, corporate filers filing a consolidated report must complete a separate part of the FBAR. The value of stock or securities or other non-monetary assets in a foreign account is the fair market value at the end of the preceding calendar year.

II. Penalties for Failing to Comply with FBAR

The revisions enhance the criminal and civil penalties for failing to comply with the FBAR. Penalties include monetary penalties (*e.g.*, \$10,000, 50 percent of your financial account balances, etc.) and possibly criminal prosecution.

Civil penalties for non-compliance with FBAR

For an intentional violation of the FBAR, the penalty is 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. No maximum dollar limit exists for a willful violation. Examples of an intentional violation include deliberately failing to file the FBAR or knowingly misreporting financial account information on the FBAR.

Civil penalties also include a penalty as high as \$10,000 per violation for unintentional violations of FBAR. However, the filer can request removal of the penalties for reasonable cause. Filers filing the FBAR late or making an unintentional mistake when completing the FBAR are subject to this penalty.

Criminal penalties for non-compliance with FBAR

The primary penalty for a violation of the FBAR is a fine not to exceed \$250,000, a prison term not to exceed five years or a combination of both. An alternate penalty applies if the failure to file is part of a violation of any other U.S. law, or if the violation is part of a pattern of an illegal activity involving more than \$100,000 in a 12 month period. Under the alternate penalty, a fine not to exceed \$500,000, a prison term not to exceed 10 years or a combination of both applies. Finally, a filer could face a criminal violation for false statements made on the FBAR.

III. Proposed Legislation S.506 Stop Tax Haven Abuse Act

On March 2, 2009, Senator Carl Levin introduced Senate Bill 506 ("S.506"). The proposed legislation mainly restricts transactions in certain foreign countries (see Tax Law Hot Sheet titled "Proposed Federal Tax Legislation Would Alter U.S. Taxation of Foreign Entities"), but the proposed bill also affects the FBAR. S.506 clarifies that the IRS has the authority to use tax information when reviewing the FBAR and alters the civil penalty calculation for an intentional violation.

For an intentional violation of FBAR, the proposed penalty is the greater of \$100,000 or 50 percent of the amount of the transaction or the highest balance in the account during the year. The current penalty only applies to 50 percent of the balance in the account at the time of the violation. Thus, the proposed bill increases the civil penalty for an intentional violation of the FBAR.

IV. Summary

The revisions to the FBAR expand the classes of individuals required to file and the types of reportable financial accounts. With the likelihood of intensified enforcement and enhanced penalties for noncompliance, parties with foreign accounts or businesses with foreign accounts should review their accounts to ensure compliance with the FBAR.

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