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IRS Confirms Its Position That U.S. Investors in Foreign Private Equity and Hedge Funds Must File FBARs

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As reported in a prior Legal Update, the Internal Revenue Service (“IRS”) has informally taken the position that U.S. sponsors of, and U.S. investors in, private investment funds were required to file the Foreign Bank Account Report (“FBAR”) form^[1] with respect to such investments.^[2] Last Friday, an IRS spokesperson confirmed that position with Tax Analysts when he stated that the IRS’s position is that investments in foreign hedge and private equity funds are reportable for FBAR purposes.^[3]

Since the FBAR form was revised in October 2008, there has been heated debate as to whether an investor in a private investment fund, with no “signature authority” over the fund, and no “control” over the fund, must file an FBAR. Under the revised FBAR rules, a reportable foreign “financial account” is broadly defined to include, among other things, “assets held in a ‘commingled fund’ where the owner holds an equity interest in such fund (including a mutual fund).” There is no definition of what type of account constitutes a “commingled fund,” (other than the example of a mutual fund) but it seems clear now that the IRS believes a foreign private equity or hedge fund is a type of “commingled fund,” for which FBAR reporting is required.

The IRS’s position on this issue conflicts with the prior practice of the U.S. hedge fund industry. Indeed, our understanding is that most U.S. sponsors of, and U.S. investors in, foreign private investment funds have not been filing FBARs with respect to such investments. Interestingly, with respect to certain U.S. investors (such as U.S. investors who own at least 10% in a foreign hedge fund that is a “controlled foreign corporation”), the IRS and the U.S. Treasury Department would not be gaining any new information by requiring such investors file an FBAR because the current U.S. tax rules already subject such U.S. investors to tax reporting.

Furthermore, there are a number of important unresolved issues even after Friday’s statement. For example, it is still unclear whether the IRS view is that an FBAR filing requirement existed under the old FBAR form, before the October 2008 revision (*i.e.*, for 2007 and earlier years). In addition, it is unclear what constitutes “signature or other authority” over a foreign private investment fund where the managing

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member or general partner has discretion over whether to allow distributions.

The deadline for filing an FBAR with respect to calendar year 2008 is June 30, 2009. However, as described in our Legal Update dated June 25, 2009,^[4] the IRS recently announced that an FBAR may be filed by September 23, 2009, if certain conditions are met. This September 23, 2009 deadline is not a true extension. Rather, the taxpayer would file with a special IRS unit, the Philadelphia Offshore Identification Unit, and would explain the reason for not filing by June 30, 2009 and indicate that all income tax has been paid with respect to the accounts listed on the FBAR. This does provide a measure of relief for taxpayers who only recently learned of the filing requirement. There is, however, no standard mentioned with respect to what reasons for filing by September 23, 2009, rather than June 30, 2009, will be respected. At a minimum, we recommend that a filer who wishes to take advantage of the September 23, 2009 date detail their efforts to file timely (*i.e.*, by June 30, 2009) and the reasons why this timely filing was not possible.

Footnotes

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

^[2] Morrison & Foerster LLP Legal Update, "Recent IRS Guidance Gives Certain Investors in Foreign Private Investment Funds Breathing Room Until September 23, 2009 for Potential FBAR Filings," available at <http://www.mofo.com/news/updates/files/15725.html>.

^[3] Parillo, Kristen A., "Hedge Fund, Private Equity Investors Must File FBAR, IRS Confirms," 2009 TNT 122-3 (June 29, 2009).

^[4] See footnote 2.