

[Alerts and Updates]

IRS Announces Foreign Hedge Funds and Private Investment Funds Subject to FBAR Reporting

July 21, 2009

In June 2009, we reported that the U.S. Department of the Treasury has implemented a [Voluntary Disclosure Program](#) (VDP) for taxpayers with offshore assets. We noted that any U.S. person with a financial interest in, or signatory authority over, any financial account in a foreign country (e.g., foreign trusts, corporations, banks, mutual funds, hedge funds, life insurance policies, annuities, and debit and prepaid credit card accounts) is required to disclose annually such assets and accounts via Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR), if the aggregate value of these accounts exceeds \$10,000 at any time during the calendar year. A financial account is considered "foreign" if the entity or institution where the account is maintained is located in a jurisdiction other than the United States. Taxpayers must also report annually income earned from those accounts on their U.S. income tax returns.

Historically, no published guidance by the IRS or courts expressly provided that offshore hedge funds or private investment funds are "foreign financial accounts" subject to the FBAR reporting requirements. In October 2008, new language was added to the definition of financial accounts included in the revised FBAR form and instructions, stating that they "generally also encompass any accounts in which the assets are held in a commingled fund, and the account owner holds an equity interest in the fund (including mutual funds)." Since this revision to the instructions, the debate has intensified over whether such investors are subject to the FBAR reporting requirements.

In response to confusion generated by statements in June from an IRS lawyer to industry lawyers and accountants that investors in offshore funds must file an FBAR, IRS spokesman Bruce Friedland confirmed on June 26 that the IRS has taken the position that a "financial account" includes a direct or indirect interest in an offshore hedge fund or private equity fund requiring the filing of an FBAR, regardless of ownership interest in the fund.

As a result of—and given the potentially broad sweep of—the FBAR reporting obligations, the substantial penalties that can be imposed for failing to file the FBAR and limited IRS guidance, those listed below may want to consider making the FBAR filing:

- Taxpayers who directly hold equity interests in any offshore fund, including mutual funds and hedge funds.
- Taxpayers who hold more than a 50-percent equity interest in an offshore corporation that holds a foreign account or a U.S. feeder fund that invests in offshore master funds.
- Taxpayers who hold more than a 50-percent present beneficial interest (either directly or indirectly) in the assets or current income of a non-U.S. trust.
- Investment managers that have a financial interest (for example, through their carry) in or signature authority over any offshore hedge funds (whether stand-alone, feeder or master).

It appears that taxpayers holding a 50-percent-or-less equity interest in a U.S. fund of funds do not have an FBAR filing obligation (as only the U.S. fund that directly holds an interest in the offshore fund would have the filing requirement).

Those who have an investment in an offshore hedge fund or private investment fund and have not yet filed an FBAR for 2008 will likely have until September 23, 2009, to file a report. The IRS recently posted on its website that taxpayers who have reported and

paid taxes on all 2008 taxable income but only recently learned they have an FBAR filing obligation and had insufficient time to gather information may file a delinquent FBAR by September 23. It is believed that penalties can be avoided if taxpayers reported and paid tax on all of their 2008 offshore income.

For Further Information

As this is a very complicated and fluid topic, if you believe you are affected or have any questions, please contact [Barbara Ruth](#), Senior Manager in the [Tax Accounting Group](#), or the practitioner with whom you are regularly in contact.

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