Final FBAR Regulations Clarify Filing Obligations

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The final FBAR regulations, effective on March 28, 2011, help to clarify the filing obligations of limited liability companies, trust beneficiaries and those holding signatory authority over foreign financial accounts.

On February 24, 2011, the Financial Crimes Enforcement Network, a division of the U.S. Department of Treasury, issued final regulations at 31 CFR Part 1010 (Final Regulations) concerning the scope of required reporting to the Commissioner of Internal Revenue by U.S. persons with financial interests in, or signature or other authority over, financial accounts in foreign countries. A U.S. person's interest in, or signature or other authority over, a financial account in a foreign country must be reported on Internal Revenue Service form TD-F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR), by June 30 of each year in which the aggregate value of such accounts exceeded $10,000 at any time during the preceding year. The Final Regulations were intended to clarify who must file an FBAR and what foreign accounts are reportable.

While the Final Regulations are comprehensive, this summary highlights only those clarifications or revisions of particular relevance to private clients and trust beneficiaries.

Who Must File?

Entities Formed in the United States—The Final Regulations include in the definition of a U.S. person any entity "created, organized, or formed under the laws of the United States, any State [and certain territories of the United States]." This definition includes any limited liability company (LLC), without regard to whether the LLC is "doing business in" the United States. Note that duplicative reporting may be required because both the LLC (through its manager, for example) and any owner of the LLC who is a U.S. person will be required to file an FBAR disclosing the LLC's foreign financial accounts (even if the LLC is a disregarded entity for U.S. federal tax purposes).

Note further that this definition of a U.S. person includes trusts formed under the laws of a state of the United States, even if these trusts are foreign trusts for U.S. federal tax purposes.

Trust Beneficiaries and Grantors—The Final Regulations clarify when a beneficiary of a trust has a reportable financial interest in the trust. The proposed regulations determined that a U.S. person has a reportable financial interest if the U.S. person had more than a 50 percent beneficial interest in a trust's assets or if such person received more than 50 percent of the income from the trust's assets. The Final Regulations now require that such beneficial interest in the trust's assets be a "present" beneficial interest to be reportable. The Final Regulations also clarify, with

respect to a trust's income, that only a beneficiary who receives more than 50 percent of a trust's "current" income has a financial interest. The supplemental commentary to the Final Regulations clarifies that the Treasury Department does not intend for a remainder beneficiary or for a beneficiary of a discretionary trust to have a reportable financial interest in the trust merely because of such remainder or discretionary interest.

The Final Regulations continue to exempt trust beneficiaries from any FBAR reporting requirement on account of the interest in the trust if a U.S. person trustee (or agent) of the trust files an FBAR disclosing the trust's foreign financial accounts and provides additional information as required. In comparison, no similar exemption is available for beneficiaries (or U.S. person trustees) of a trust treated as a "grantor" trust under the applicable U.S. federal tax laws where the grantor is a U.S. person otherwise filing an FBAR disclosing the trust's foreign financial accounts.

Signature and Other Authority—The Final Regulations revise the definition of "signature or other authority." A reportable signature or other authority is defined as the power held by an individual (alone or with another) to control the disposition of assets in the financial account by direct communication (whether in writing or otherwise) with the foreign financial institution. Significantly, the supplemental commentary to the Final Regulations clarifies that the phrase "in conjunction with another" encompasses those situations where communication to the foreign financial institution from more than one individual is required in connection with the disposition of assets in the account. Thus, even where an individual's direct communication with the foreign financial institution will not, by itself, control the disposition of assets in the financial account because additional communications are required, the individual will still have a reportable signature or other authority. The Final Regulations represent a departure from the former regulations which did support an interpretation that under the circumstance described in the preceding sentence the signature or other authority was not reportable.

However, a power that does not control the *disposition* of assets (such as a power to participate in asset allocation) is not a reportable authority. Only a signature or other authority held by an individual is reportable.

The Final Regulations now exempt persons with signature authority over 25 or more accounts from detailed reporting, although they are required to provide personal information and information concerning those with a financial interest in the account. (A similar exemption from detailed reporting was previously provided for in the proposed regulations for persons with a financial interest in, as opposed to signature authority over, 25 or more accounts. The Final Regulations retain and extend this exemption.)

What Foreign Accounts Are Reportable?

Custodian Accounts—The supplemental commentary to the Final Regulations clarifies that the mere fact that a U.S. bank acts as a global custodian over assets, including assets held in accounts outside the United States, does not

trigger a reporting requirement of those foreign assets for the customer who is a U.S. person. However, where the custodial arrangement does permit the U.S. person to directly access the foreign holdings at the foreign institution, the U.S. person would have a reportable foreign financial account.

Foreign-Issued Life Insurance and Annuity Policies—The Final Regulations amend the definitions to clarify that only foreign-issued life insurance and annuity policies with a cash value will be considered an "other financial account" potentially reportable by the policy holder. The supplemental commentary to the Final Regulations clarifies that foreign-issued life insurance and annuity policies with no cash value are not reportable; foreign-issued life insurance and annuity policies may be reportable even if there is no payment of an income stream; and policy holders (by which we assume the authors of the supplemental commentary mean policy owners and not the insured), not beneficiaries, of the policies must report them.

Foreign Hedge Funds and Private Equity Funds—Under the Final Regulations, interests in foreign hedge funds and private equity funds are not considered reportable "financial accounts," but shares in a foreign "mutual fund or similar pooled fund" available to the general public are considered reportable "financial accounts.

The Final Regulations provide welcome clarification of uncertainties that had previously surrounded the FBAR filing obligation. They were effective on March 28, 2011, and apply to any 2010 reports required to be filed by June 30, 2011, any reports for previous years not yet filed that have been properly deferred and all future reports.