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Re: Request for Formal Guidance
on FBAR Reporting Obligations

Dear Sirs:

We write to urge the Treasury Department and the Internal Revenue Service (the "IRS") to issue prompt, clear and definitive guidance with respect to a number of important issues relating to the requirement imposed on certain U.S. persons to file the Report of Foreign Bank and Financial Accounts (the "FBAR" or TD F 90-22.1). The immediate impetus for this letter was the recent chaos, confusion, and consternation over the application of the FBAR filing requirements to investors in hedge funds and private equity funds, described below, although our request

for guidance is not limited to these areas. Prompt guidance is needed because many U.S. persons who did not previously believe that they were required to file FBARs are now subject to substantial compliance burdens as they prepare to file a large volume of reports that may or may not be required by a September 23 deadline.[1]

The requirement to file an FBAR is, of course, not new. For several decades, United States persons with a financial interest in, or signature authority over, financial accounts in a foreign country with an aggregate value exceeding $10,000 at any time during the calendar year have been required to file the FBAR by June 30 of the following year.[2] As the events of the past five weeks have made clear, however, what types of interests may constitute "financial accounts" for purposes of the FBAR may well, at a minimum, be much broader than previously understood. In addition, the process by which this issue has become apparent to the broader community is, to say the least, unfortunate. It involved no official guidance at all with respect to the breadth of the filing requirements, just views attributed to informal statements reported to have been made by IRS officials (starting with a panel discussion on June 12 of this year), which spread quickly through word of mouth and media reports. Many of these reported statements are in direct conflict with statements previously made by IRS officials and indicate interpretations of the filing guidelines that would not otherwise have come naturally to practitioners. As a result, potential filers have been left in the dark about their filing responsibilities, while practitioners have been placed in the unenviable position of weighing whether it is worse to dispense advice based upon hearsay than to give no advice at all. This uncertainty, combined with the timing and the risk of harsh penalties for failure to file, arguably led to over-filing. Many filings (not contemplated before the June 12 ABA/AICPA Teleconference, discussed below) were made hastily on or before June 30, 2009, and many more are planned on or before a quasi-extended filing deadline of September 23, 2009 that was offered to some FBAR filers (the "September 23 Filing Deadline," discussed below).

The purpose of this letter is twofold: we write first to express our significant concerns with respect to the process leading up to the filing deadline for 2008 FBARs and to urge Treasury and the IRS to implement procedural relief to undo some of the damage that this confused process caused. Our primary procedural recommendation is a one-year moratorium on requiring any FBAR filing that does not relate to a "traditional financial account." The moratorium should give the IRS time to address our second primary recommendation, which is to issue prompt and authoritative official guidance on a number of important substantive issues we highlight below relating to the scope of the FBAR filing requirements. We also touch on

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[1] The principal drafter of this letter was David R. Sicular, with the substantial assistance of Allison J. Friedman, and input from Michael Farber, Carlyn S. McCaffrey, and Erika W. Nijenhuis. Helpful comments were received from Kimberly S. Blanchard, Andrew H. Braiterman, William L. Burke, Patrick N. Karsnitz, David S. Miller, Andrew W. Needham, Andrew L. Oringer, Michael L. Schler, Jeffrey N. Schwartz, Willard B. Taylor, Richard R. Upton, and Diana L. Wollman.

[2] Unlike tax return deadlines, this deadline cannot be extended.

certain other aspects of the FBAR regime that we believe could be improved.

This letter has several parts. Part I provides background, including a discussion of recent events. Part II makes recommendations about what steps the IRS and Treasury should take with respect to filings for 2008 and earlier years in light of the current state of confusion with respect to the filing obligations for non-traditional "financial accounts" that were only recently understood to be potentially covered by the FBAR instructions. We believe these issues need to be resolved, and IRS positions formally announced, well in advance of the September 23 Filing Deadline. Part III of this letter highlights the immediate need for formal guidance clarifying certain substantive issues: (i) the definition of "financial account" and scope of the types of arrangements that may be considered "financial accounts" for FBAR purposes; (ii) the basis on which a "financial account" may be treated as located in a "foreign country"; (iii) the meaning of the term "financial interest"; (iv) signatory authority issues in various contexts, and (v) the amount to be reported where FBAR reporting is required.[3] We also make certain suggestions as to how other parts of the FBAR compliance process could be improved and streamlined. Ideally, the IRS and Treasury would answer some or all of these questions well in advance of the September 23 Filing Deadline, although we recognize that resource constraints and other factors may make this unrealistic. Part IV notes some issues relating to the administrative and enforcement aspects of FBAR that we believe could benefit from further attention.

I. Background

The "Currency and Foreign Transactions Reporting Act" (the "Bank Secrecy Act" or "BSA") was enacted in 1970, in part to address the concern that United States persons were using financial institutions located in certain foreign jurisdictions to evade tax and regulatory requirements.[4] 31 U.S.C. § 5314, which is part of the Bank Secrecy Act, provides that U.S. persons must keep records and file reports concerning transactions with foreign financial agencies. Pursuant to this statutory authority, the Treasury promulgated regulations under 31 C.F.R. § 103.24 that have long required United States persons to report to the IRS certain

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[3] Of course, there are further issues under FBAR that are beyond the scope of this letter. For example, this letter does not address the important issue of the definition of a "United States person," which the IRS expanded in its October 2008 revisions to the FBAR instructions, then deferred the effective date of the change in Announcement 2009-51, 2009-25 I.R.B. 1105 (which also requested comments on this issue and the other changes to the FBAR and its instructions).

[4] *See* 31 U.S.C. §§ 5311-5330 and 12 U.S.C. §§ 1818(s), 1829(b), and 1951-1959. *See also* IRS Workbook on the Report of Foreign Bank and Financial Accounts (FBAR), noting that "[t]he reports filed as a result of this regulation provide leads to investigators that facilitate the identification and tracking of illicit funds or unreported income, as well as providing additional prosecutorial tools to combat money laundering and other crimes." The IRS Workbook is available online at http://www.irs.gov/businesses/small/article/0,,id=159757,00.html.

financial interests in, or signature or other authority over, a bank, securities or other financial account in a foreign country, by filing an FBAR form prescribed by the Secretary of the Treasury.

The FBAR is not a tax return, but is a separate report filed with the Secretary of the Treasury. An individual filing a U.S. tax return (IRS Form 1040), however, is required to state on Schedule B, Part III whether the taxpayer has an interest in a financial account in a foreign country by marking "Yes" or "No" in the designated box. If the individual checks "Yes," the Form 1040 instructs the taxpayer to file the FBAR. The FBAR is authorized under Title 31 of the U.S. Code and not Title 26, and as such, is not protected by the disclosure restrictions of Section 6103 of the Internal Revenue Code of 1986, as amended (the "Code") (relating to confidentiality and disclosure of tax return information).[5] Accordingly, the information in the FBAR may be (and is) shared with other agencies.

Until April 2003, the Financial Crimes Enforcement Network (FinCEN) of the Department of the Treasury had official authority for enforcement of FBAR reporting. In an effort to improve compliance and enforcement, FinCEN delegated this enforcement authority to the IRS by a memorandum of agreement, announced in IRS News Release 2003-48.[6] This enforcement authority includes the ability to investigate possible civil violations related to FBAR filings, employ summons power, assess and collect civil FBAR penalties, issue administrative rulings, and take any other reasonably necessary action for the enforcement of these provisions.[7]

As reported by the U.S. Joint Committee on Taxation in 2008, one of the primary reasons FBAR compliance has been historically low is that potential filers have been "unaware or confused about filing requirements."[8] The IRS has made a number of efforts to increase awareness of the filing requirements since assuming enforcement authority and we commend such efforts. As discussed below, however, there is a continuing need for guidance and clarity on the FBAR filing requirements.

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5 *See, e.g., A Report to Congress in Accordance with Section 361(b) of the Uniting and Strengthening America By Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001*, submitted by the Secretary of the Treasury, April 26, 2002, n. 4 ("The FBAR is not a tax return and is not to be attached to a taxpayer's Form 1040. Because an FBAR is a Title 31 report, it is not subject to the dissemination restrictions of 26 U.S.C. 6103.").

6 *See* 31 C.F.R. § 103.56(g) and IRS News Release, IR 2003-48, April 10, 2003.

7 68 Fed. Reg. 26, 468 (May 16, 2003) (codified at 31 C.F.R. § 103.56(g)).

8 Cited in U.S. Government Accountability Office, Testimony before the Committee on Finance, U.S. Senate, "Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS" (Statement of Michael Brostek, Director Strategic Issues Team), GAO-09-478T (March 17, 2009).

Penalties for failure to file an FBAR are severe. Civil penalties may be imposed for willful or non-willful violations, and criminal penalties may be imposed for willful violations (or for knowingly making false, fictitious or fraudulent statements or representations). The civil penalty for non-willful violations of FBAR reporting requirements is up to $10,000, and for willful violations is up to the greater of $100,000 or 50% of the amount of the transaction or the account balance at the time of violation.[9] Criminal violations may result in the imposition of a fine of up to $250,000 and/or five years imprisonment, and if part of a pattern of illegal criminal activity, violations may result in a fine of up to $500,000 and/or ten years imprisonment.[10] For any violation, both civil and criminal penalties may be imposed. There is a six-year assessment period with respect to civil penalties, and a five-year statute of limitations for criminal violations.[11] Clearly these are serious potential penalties, and we have serious concerns about their appropriateness in the context of a filing requirement whose scope is unclear.

Recent "Guidance" on Issues Relating to Investment Funds

Other than the statute and some very limited regulations, there is no other authoritative guidance on the FBAR filing requirement. That is, no guidance has been issued of a kind similar to the Revenue Rulings, Revenue Procedures, or Notices typically provided to inform taxpayers as to the government's interpretation of tax law. Since the statute and regulations do not address many issues, taxpayers have relied upon the instructions to the FBAR filing form and upon information on the IRS's website as the only source of more detailed information about how the government expects taxpayers to comply with the law. As described below, individual IRS officials have also from time to time informally commented on their views on specific questions. While the instructions, website statements and oral comments of individual government officials obviously are not law, taxpayers take them very seriously in view of the significant penalties for failure to comply with FBAR filing requirements.[12]

One of the key concepts of the FBAR is a "financial account," which the FBAR instructions define as including "any bank, securities, securities derivatives or other financial instruments accounts." Moreover, "[s]uch accounts 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)." The parenthetical "including mutual funds" was added to

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9 *See* 31 C.F.R. § 5321(a)(5). We note that currently the only guidance with respect to how the IRS administers the civil penalties is located in the Internal Revenue Manual.

10 *See* 31 C.F.R. § 103.59.

11 *See* 31 U.S.C. § 5321(b)(1) and 18 U.S.C. § 3282, respectively.

12 Instructions to the FBAR may have some weight because 31 C.F.R. § 103.24 requires persons subject to the jurisdiction of the United States to "provide such information as shall be specified in a reporting form prescribed by the Secretary to be filed by such persons." Website and oral statements have no such official authority.

the instructions during revisions made to the FBAR in October 2008, although it had been alluded to as early as 2007.[13] This change to the instructions triggered some questions, based on concerns with the lack of guidance as to what types of equity interests, in what types of funds, would be considered "financial accounts" for FBAR purposes. To our knowledge, however, it was months later, with less than three weeks to the filing deadline for 2008 FBARs, when an IRS official first publicly stated (even then, probably not speaking in an official capacity) that the FBAR reference to "financial account" might also include interests in hedge funds held as an investment. This statement was made on a now (in)famous June 12, 2009 teleconference, hosted by the American Bar Association and the American Institute of Certified Public Accountants (the "ABA/AICPA Teleconference"), during which an IRS panelist stated that the term would include interests in hedge funds "that function like mutual funds." In response to a follow-up question, the IRS panelists advised one tax-exempt caller who had not filed with respect to hedge fund investments in prior years to file FBAR forms for these investments for 2008 and the preceding five years.[14]

Reports of this colloquy gave rise to a major flurry of activity among fund investors and their advisors. Tax lawyers and others who had previously had little involvement with the FBAR rules were deluged with client questions about who needed to file what. A rough consensus arose that the answers were far from clear, but that at least with respect to hedge funds (and perhaps with respect to private equity funds) organized in offshore jurisdictions, the better course of action was to file (in part, because of the magnitude of the potential penalties of being wrong) even though many practitioners believed (and told their clients) that this advice might well be over-broad.[15]

In the middle of this flurry, there were first rumors (and then confirmation on June 24 through the posting of a new Frequently Asked Question on the IRS website) of an "extension" of the deadline for certain 2008 filings (normally due on June 30 without the ability to get an

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[13] While no explicit reference to mutual funds appeared in the FBAR instructions until October 2008, the IRS has included ownership interests in mutual funds on a webpage listing the persons required to file the FBAR since February 2007. *See* http://www.irs.gov/newsroom/article/0,,id=168194,00.html. The IRS also discussed FBAR filing requirements with respect to mutual funds during the 2007 National Phone Forum.

[14] The statute of limitations for civil assessments of FBAR penalties for the failure to file the FBAR is six years. *See* 31 U.S.C. § 5321(b)(1).

[15] For example, most practitioners were aware that the FBAR does not generally use the jurisdiction of formation of a financial institution to determine whether an account of that institution is foreign, but nonetheless (lacking any other obvious standard) generally recommended filings with respect to foreign-formed funds.

extension) until September 23.[16] Many practitioners and clients, with little time to reflect or analyze, pushed forward to file by June 30, seeing some drawbacks and uncertainties (discussed below) with the September 23 Filing Deadline.

The final week of June saw more "guidance" in the press. On June 25, 2009 the Wall Street Journal published an article on FBAR filings and reported that an unnamed source at the IRS had stated that FBARs were required with respect to offshore fund interests.[17] The Wall Street Journal reported the official as noting that "the requirement wasn't new." It reflects "a much stronger emphasis on international matters," the official said. "So I wouldn't say we weren't enforcing it in the past, but we're now turning to issues that hadn't been emphasized in the past." Whatever the merits of this view, given the timing, its principal effect was to reinforce the advice many practitioners at this point found themselves giving several times a day — when in doubt, file. Then on June 29, 2009, Tax Analysts reported on a June 26 conversation with IRS spokesman Bruce Friedland, in which he confirmed the statement in the Wall Street Journal and

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[16] *See* "Frequently Asked Questions," (the "June 24, 2009 FAQs") available online at http://www.irs.gov/pub/newsroom/voluntary_disclosure_faqs.pdf. The June 24 release of the Q&A was, of course, widely circulated in the community.

One little known fact is that the June 24 release is apparently not the IRS's latest word on the September 23 extension. The IRS has also posted on its website a separate, stand-alone version of the information in Q&A 43 in the June 24, 2009 FAQs, which stand-alone version has been "Last Reviewed or Updated" on July 14, 2009, and has slightly different language than Q&A 43 in the June 24 release (which has been widely circulated). *See* "September 23 Deadline for Some FBAR Filers," available online at http://www.irs.gov/newsroom/article/0,,id=210174,00.html. This is but one example of the phenomenon of multiple, inconsistent and non-authoritative guidance on FBAR issues. There are also several different FBAR FAQs available on the IRS website that contain overlapping, but in some cases, additional information beyond the June 24, 2009 FAQs. *See* " FAQs Regarding Report of Foreign Bank and Financial Accounts (FBAR) - United States Person", available online at http://www.irs.gov/ businesses/small/article/0,,id=210252,00.html; "FAQs Regarding Report of Foreign Bank and Financial Accounts (FBAR) - Filing Requirements", available online at http://www.irs.gov/businesses/ small/article/0,,id=210244,00.html, and "FAQs Regarding Report of Foreign Bank and Financial Accounts (FBAR) - Financial Accounts", available online at http://www.irs.gov/businesses/small/article/ 0,,id=210249,00.html. This means that the guidance process is so informal that potential filers and practitioners are required to engage in a scavenger hunt to find relevant information, with no guarantee that the information will not be "reviewed or updated" the next day on the IRS website. At a minimum, pending more formal guidance, the IRS should collect this scattered FBAR guidance and put it all in one place (perhaps pursuant to a formal announcement), and then only "review or update" the guidance subsequently using the same form.

[17] Strasburg, Jenny and Jesse Drucker, "IRS Steps Up Scrutiny of Offshore Funds," Wall Street Journal, June 25, 2009, page A21.

said "the IRS's position is that investments in foreign hedge funds and private equity funds are reportable for FBAR purposes."[18] This statement, to our knowledge, was the first time the IRS made explicit reference to the FBAR filing requirements for private equity fund investors. The IRS did not make the statement publicly, post it on the IRS website, nor did the statement appear in any official pronouncement, regulation, or ruling. Instead, it was simply reported in *Tax Notes* magazine on the last possible day that FBARs could be mailed with any expectation of meeting the filing deadline; just one day before FBARs for the 2008 calendar year were required to be *received* by the Department of the Treasury at a post office box in Detroit (or hand delivered to another IRS office).[19] To our knowledge, the IRS has still not yet issued an official statement on these issues.

Leaving aside the timing and manner in which the IRS's apparent views were disseminated (which many of us view as outrageous), there is another important point — the IRS's (apparent) current position on FBAR filings with respect to interests in private funds is in tension, if not direct conflict, with the IRS's previously stated positions regarding FBAR filings with respect to investment fund interests, expressed only two years earlier (in another informal, but perhaps more official, forum). On June 20, 2007, the IRS hosted a National Phone Forum to increase awareness of the FBAR and filing obligations and answered questions that had been submitted by the public. Following the National Phone Forum, the IRS apparently disseminated the questions and answers from the program (which were approved by the IRS Small Business/Self-Employed Division Counsel).[20] These questions and answers included statements about the filing responsibilities of a U.S. person with respect to an interest in an offshore hedge fund. When asked about the FBAR filing responsibilities of an individual retirement account ("IRA") custodian (domiciled in the United States) with respect to an IRA owning an interest in an off-shore hedge fund, the IRS's published response was that "[t]he owner of the IRA does not have to report the interest in the foreign hedge fund that is held in the IRA located in the United States. If the custodian does not have signature authority (or other authority comparable to signature authority) over the hedge fund account, but instead, is only holding units of the hedge fund as an investment in the IRA, and does not control the hedge fund, then the custodian does not have to file an FBAR either."[21] In the same Questions and Answers, however, another IRS

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

[19] Unlike tax returns, FBARs are considered filed on the date received, not the date of mailing.

[20] Toscher, Steven and Michel Stein, "FBAR Enforcement—Five Years Later." Journal of Tax Practice & Procedure, June-July 2008, 37-58 (which includes the full text of these Questions and Answers as an exhibit). While these Questions and Answers were apparently disseminated following the 2007 National Phone Forum, they have not been widely discussed and their existence is not well-known. Apart from as an exhibit to the Toscher article, we know of no other place where these Questions and Answers may be accessed (they are not available on the IRS's website).

[21] *Id.*

response confirmed that a U.S. individual owner of stock of a passive foreign investment company ("PFIC") has an FBAR filing obligation with respect to the shareholder's interest in the PFIC based on the principle that the shareholder's interest in the PFIC "is an interest in an account in which the assets are held in a commingled fund and the account owner holds an equity interest in the fund." As tax practitioners, we find these statements hard to reconcile. Most of us have never seen a "traditional" offshore hedge fund that is not a PFIC.[22]

II. Procedural Concerns — Filings for 2008 and Earlier Years

Perhaps recognizing that at least the timing of the events described above was inappropriate, on June 24, 2009 (just six days before the filing deadline), the IRS issued advice (on its website) to U.S. persons who "only recently learned they have a 2008 FBAR obligation," and did not have "sufficient time to gather the information necessary to properly file the FBAR by the June 30, 2009 due date." With respect to such persons, the IRS "extended" the FBAR filing deadline to September 23, 2009, provided that certain conditions were also met.[23]

The full text of these conditions, which is not a model of clarity or precision, is as follows:

> Taxpayers who reported and paid tax on all their 2008 taxable income but only recently learned of their FBAR filing obligation and have insufficient time to gather the necessary information to complete the FBAR, should file the delinquent FBAR report according to the instructions and attach a statement explaining why the report is filed late. Send a copy of the delinquent FBAR, together with a copy of the 2008 tax return, by September 23, 2009, to the Philadelphia Offshore Identification Unit at the address in FAQ 9.
>
> In this situation, the IRS will not impose a penalty for the failure to file the FBAR.
>
> Additionally, if all 2008 taxable income with respect to a foreign financial account is timely reported and a United States person only recently learned they have a 2008 FBAR obligation and there is insufficient time to gather the

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[22] Conversely, many PFICs do not even remotely resemble mutual funds (or for that matter any type of fund). For example, many non-bank finance companies and high-tech companies with a more than one year start-up period (because the research and development takes more than one year before the business generates operating revenues, etc.) meet the statutory definition of a PFIC.

[23] *See* "September 23 Deadline for Some FBAR Filers," available online at www.irs.gov/newsroom/article/0,,id=210174,00.html. *See also* "Voluntary Disclosure Questions and Answers" May 6, 2009 (revised June 24, 2009) Question 43, available online at www.irs.gov/pub/irs-utl/faqs-revised_6_24.pdf.

> necessary information to complete the FBAR, the United States person may follow the procedures set forth above and no penalty will be imposed.
>
> For 2008 tax returns due after September 23, 2009, the tax return does not need to accompany the 2008 FBAR.[24]

We commend the IRS for recognizing that relief was needed, but in light of the background described above, we do not believe the relief given is adequate, and we believe, as discussed below, that additional relief should be announced promptly. We also believe that certain aspects of the relief need prompt clarification.

A. One-Year Moratorium

Our primary recommendation is that the IRS issue a one-year moratorium on FBAR filings for U.S. persons with respect to potential filers holding interests or signatory or other authority in arrangements not traditionally considered within the scope of interests covered by the FBAR filing requirement. Without deciding one way or the other what the rules may previously have been, we recommend that the moratorium apply to all interests other than interests in what we will call "Traditional Financial Accounts," which would be limited to bank accounts, brokerage accounts and mutual funds (at least open-end mutual funds[25]), cash surrender value insurance policies, and unit trusts (with respect to each of which the IRS has previously published its position that filing is required).

The moratorium we propose would enable the Treasury to be in a position to issue formal guidance with respect to such interests and to apprise potential filers of their filing duties proactively, and assuming prompt guidance is issued, will give filers sufficient time to systematically gather the information necessary in order to file the FBAR, while avoiding unnecessary filings. For certain individuals, and for entity filers, the FBAR filing requirements are very burdensome, much more burdensome than the 20 minute estimated average burden noted on the form itself would suggest.

There is recent precedent for granting a moratorium within the FBAR context itself. On June 6, 2009, the IRS granted a one-year moratorium with respect to filing obligations of non-U.S. persons that might otherwise be subject to FBAR filing requirements.[26] Other recent

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[24] The "updated" version of Q&A 43 (see note 16, *supra*) makes it clear that two filings are required – one in Detroit and a duplicate in Philadelphia.

[25] Closed-end mutual funds, such as exchange-traded funds, do not provide liquidity in the same sense as "accounts" traditionally do (by giving the owner the ability to withdraw), and perhaps should not themselves trigger FBAR filings at all.

[26] Announcement 2009-51, 2009-25 I.R.B. 1105, June 5, 2009.

precedents include deferrals of the effectiveness of certain deferred compensation rules under Section 409A.[27]

B. Alternative Relief

If the IRS and Treasury do not adopt our one-year moratorium recommendation, we believe the IRS should announce the following relief for filing with respect to accounts that are not Traditional Financial Accounts:

1. No Required Filings for Prior Years

The comment an IRS official made during the ABA/AICPA Teleconference, that a tax-exempt investor in a hedge fund would be required to file an FBAR for 2008 and each of the previous five years is very troubling, because it will impose large burdens that are indefensible unless the filing requirement with respect to investment funds was a filing obligation that always existed. But in the 2007 National Phone Forum, IRS officials stated that filings with respect to hedge fund interests were *not* required in cases where the U.S. person had no signatory or other comparable authority over the hedge fund. We would respectfully suggest that the IRS refrain from taking the position that prior year filings are required with respect to interests in investment funds, in light of these contradictory statements. The IRS and Treasury should inform U.S. persons, clearly and in advance, of the FBAR filing obligations applicable to them; retroactively imposing filing obligations is, in our view, inappropriate. This is particularly true in the context of investment fund interests. Many investment funds will no longer have the information and records necessary that would enable their investors to complete the FBAR forms, and thus the investors may find it difficult, if not impossible, to get this information. For example, if filings back to 2003 are required, there is a high likelihood that the investor may no longer have an interest or relationship with the investment fund. Indeed, the fund may no longer exist. For these reasons, among others, the cost of preparation of these forms and filing costs would be very high. Each of these problems is magnified in the entity or investment fund context given the additional requirement that FBARs be filed by all persons holding "signature or other authority over an account," given the large number of U.S. persons that may be considered to possess such authority. As a technical matter, employees who no longer work for particular employers have no possible way of obtaining access to records but may have a filing obligation for prior years in which they were employed. This cannot be the right result. *See* "Signature or Other Authority" below at Section III.D.

2. September 23 Filing Deadline: Additional Conditions

In the June 24 Q&As permitting "extension" for certain 2008 filings, the IRS imposed additional conditions on potential filers for qualification for the September 23 Filing Deadline. The conditions are that the filer (i) "reported and paid tax on all their 2008 taxable income" (or, under the alternative "all 2008 taxable income with respect to a foreign financial account is timely reported"), (ii) "only recently learned of their FBAR filing obligation", and (iii) "[has]

[27] IRS Notice 2008-115, 2008-52 I.R.B. 1367 (December 29, 2008).

insufficient time to gather the necessary information to complete the FBAR." In that case, the filer must (iv) "file the delinquent FBAR report according to the instructions and attach a statement explaining why the report is filed late," and (v) at least under the first alternative, "send a copy of the delinquent FBAR, together with a copy of [the filer's] 2008 tax return" to the Philadelphia Offshore Identification Unit (although the return need not accompany the 2008 FBAR if it is due after September 23, 2009). We respectfully suggest that the IRS and Treasury reconsider each of these conditions (other than an appropriate condition relating to the condition of reporting all income).

(a) The Extension Should Be Automatic for "Accounts" that are not "Traditional Financial Accounts"

First, we suggest that, in light of the significant uncertainty surrounding filing obligations with respect to accounts that are not Traditional Financial Accounts, no additional showing should be required to qualify for the September 23 Filing Deadline. The current language, focused on potential filers that "only recently learned they have a 2008 FBAR obligation" and did not have "sufficient time to gather the information necessary to properly file the FBAR by the June 30, 2009 due date," suggests that some additional showing may be required in order for potential filers to qualify for relief. In addition, the current procedures require that potential filers, to qualify for relief, "attach a statement indicating why the report is filed late" to their FBAR. We do not believe that any such showing should be required for arrangements that are not Traditional Financial Accounts – these should qualify automatically. Any other approach will lead to confusion and more compliance burdens. For example, if the IRS takes the position that the filing requirement with respect to interests in non-Traditional Financial Accounts is not "new" and is pre-existing, it is unclear what additional showing may be required. Is the person who knew of the FBAR filing requirement, but didn't believe the filing requirement applied to that person's interest in an offshore hedge fund protected by this "extension"? What types of "statements" will be acceptable for purposes of the "extension"? What is "insufficient time" – did a filer who learned of the obligation on Friday before the Tuesday, June 30th deadline have insufficient time if the filer could have spent the weekend completing the forms? If there are particular requirements that potential filers must satisfy to qualify for this relief, the IRS should publish these requirements.

(b) To Protect the Integrity of Section 6103 of the Code, Tax Returns Should Not Be Required (or Alternative Steps Should be Taken)

The IRS should eliminate or revise the requirement that the September 23 filing include a copy of the filer's tax return. The September 23 Filing Deadline currently requires that FBAR filers submit a copy of their 2008 tax return together with their FBAR for the 2008 calendar year to the Philadelphia Offshore Identification Unit. The requirement that filers submit FBARs accompanied with tax returns is particularly troubling because, as discussed above, the disclosure protection offered by Section 6103 of the Code does not extend to FBARs, and thus might not extend to tax returns filed with FBARs in order to qualify for the September 23 Filing Deadline. We believe that the IRS should withdraw the requirement that FBARs be accompanied (or followed) by tax returns for the years in question. It is not appropriate to require potential filers

to choose between FBAR penalty relief and potentially waiving their statutory rights under Section 6103. In addition, of course, the IRS already has these returns and can match the September 23 FBARs it receives against the returns it already has (or will receive if, by reason of an extension, they are not yet due).

If the IRS believes that some additional conditions are appropriate to help it enforce the requirement of Q&A 43 that income from the account has been appropriately reported, we have two alternative suggestions to address the Section 6103 concern we discuss above. One possibility would be for the IRS to provide, in formal guidance, that any tax returns that are required to be attached to FBAR reports pursuant to the delinquent filing procedures or the voluntary disclosure practice will be extended the same protection under Section 6103 of the Code as any other tax return filed by the taxpayer.[28] This solution seems to be the easiest alternative, but we have some concern given the framework of Section 6103 of the Code whether the IRS is able to take this position in an authoritative manner with respect to tax return information that is filed with non-tax returns.[29] Alternatively, to reconcile this goal with the need to give potential filers appropriate protection, one possibility might be to have potential filers file a duplicate copy of their returns with the IRS for this limited purpose, at the same IRS office to which amended returns would be sent, so that the IRS would receive the filer's return in its tax enforcement capacity as opposed to its FBAR enforcement capacity.[30]

Note that the same concerns arise if the IRS does not accept our recommendation with respect to filings for pre-2008 periods. If this is the case, presumably, with respect even to accounts for which all taxable income had been properly reported, persons may be required to file FBARs for 2008 and each of the previous five years in order to avoid the imposition of penalties (*see* Question 9 of IRS Frequently Asked Questions), and such FBARs would be required to be accompanied by tax returns for each of the relevant years.[31] We strongly believe

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[28] Guidance is also necessary on whether FBAR filers who filed their individual tax returns are required to amend these returns if the appropriate box on Schedule B, Part III is not checked with respect to disclosure of foreign financial accounts.

[29] For example, Section 7213 imposes potential criminal penalties for unauthorized disclosure of returns or return information in violation of 6103. Could Section 7213 be enforced in the context of unauthorized disclosure of filings that the IRS states it will treat as having the protections of Section 6103 if it is not otherwise clear that Section 6103 applies?

[30] The IRS, however, will usually already have the tax returns of late filers, and should be able to retrieve those returns internally without requiring a duplicative filing from late filers.

[31] The IRS "Frequently Asked Questions" are available online at http://www.irs.gov/pub/irs-utl/faqs-revised_6_24.pdf . Note that the FBARs must be accompanied, under these circumstances, by a statement explaining why the reports are late (which requirement we would suggest deleting with respect to interests held in non-traditional "financial accounts," for the reasons mentioned above). Note further that for periods in which taxable income was not properly reported, such potential filers may be eligible to participate in the IRS's

this requirement should be dropped, or revised as discussed above, for the reasons stated.

Finally, while we do not object to conditioning the "extension" on an appropriate requirement that taxable income be reported and taxes paid, we do have a number of questions and suggestions about what the requirement is (and thoughts as to how those questions should be resolved). First, we note that the first paragraph of the answer to FAQ 43 refers to "all their 2008 taxable income" and the third paragraph to "all 2008 taxable income with respect to a foreign financial account." It is not clear why these requirements should be different and we would think that the second formulation, limited to income from the account, is more appropriate.[32] Second, the answer to FAQ 43 can be read to apply this requirement (and indeed a requirement to send tax returns) to a filer who has signatory authority only (*i.e.,* no financial interest). In this context, however, the requirement seems unfair, as the signatory generally will have no way to find out whether the account owner filed its returns (nor, a fortiori, any way to ensure that the owner does so). As to the requirement to include a tax return, while the signatory may be *able* to do so (if this means filing the *signatory's* return), it is unclear what possible relevance the signatory's tax return would have. We would suggest that the IRS announce that persons with mere signatory authority will not be subject to these requirements.

III. Substantive Issues

The lack of formal guidance regarding the FBAR filing requirements has been frustrating to many, and the informal guidance — disseminated through teleconferences and press reports — has led to confusion and misinformation. Although much of the discussion last month in practitioner circles and the press focused on investment funds, the issues raised highlighted the more general concern that the FBAR instructions, when interpreted broadly, give rise to seemingly endless categories of potential filers. These instructions, however, have not historically been interpreted in their broadest possible sense, either by the IRS or practitioners.

It is disconcerting that the IRS has seemingly taken the stance that they can "emphasize" new categories of filers without clarifying the application of the rules through advance guidance. This is highly problematic, especially within the FBAR framework where the penalties for noncompliance are so severe and especially where one of the reasons for noncompliance is

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Voluntary Disclosure Practice (which practice also requires the filer to submit copies of tax returns for years with respect to which delinquent FBARs are being filed).

[32] We also would suggest that the IRS consider whether it would be appropriate to loosen the requirement somewhat to account for the possibility that a filer who filed returns in good faith but it turns out on audit that the amount reported is not correct for reasons that the filer could not easily have known (e.g., the FBAR filer owned stock in a foreign corporation that paid a dividend (in the corporate sense) but miscalculated its earnings and profits for U.S. federal income tax purposes and underreported the amount to be treated as a dividend under Section 316). This suggestion would be even more important if the broader formulation is retained.

known to be confusion about the filing requirements themselves.[33] Potential filers must be apprised in advance of the FBAR filing requirements in order to satisfy them and to comply with their legal responsibilities. Promulgating clear requirements will also spare the IRS from being deluged with filings that may not ultimately be required and would help the IRS's ability to enforce the FBAR filing requirements that are clearly spelled out in that guidance. In addition, in the absence of more formal guidance, the IRS may well have difficulties enforcing FBAR with respect to any intended expanded scope. For example, although many of us have advised clients to file with respect to foreign hedge fund and private equity fund interests, we have serious doubts as to whether a court would in fact sustain serious penalties for failure to do so for 2008 under the current state of guidance. For these reasons, we believe it is of critical importance that the parameters of the FBAR filing requirements be clearly defined.

As a threshold matter, we note that there may be questions as to how the IRS and Treasury would go about providing formal guidance. These stem in large part from the fact that the 2003 delegation of enforcement authority from FinCEN to the IRS does not expressly address authority to promulgate formal guidance, such as regulations (although it does specifically mention "administrative rulings").[34] We understand that some IRS and Treasury officials believe that there may be limits on the IRS's authority to do so, and that this perceived lack of authority has contributed to a lack of timely and clear guidance on the application of the FBAR rules. We express no views as to whether there is in fact a lack of authority or, if so, whether the most appropriate solution is a statutory one or an administrative or regulatory one (such as a re-delegation of authority within the Treasury Department). We believe, however, that potential-FBAR filers are entitled to the same type of guidance on FBARs as they receive on other issues administered by the IRS, and we urge that the Treasury Department and IRS take such action as necessary in order to ensure that result to the extent they are permitted to do so by law. We intend to express similar views in a separate report addressed to Congress.

The balance of this section discusses specific areas that we would urge the IRS and Treasury to address in formal guidance. In general, we do not attempt to resolve these ambiguities or uncertainties under current "law," or to propose particular interpretations or clarifications (although, in the case at least of funds our instinct is to limit FBAR filing requirements to arrangements which provide liquidity to the owners and on the issue of signatory authority our inclination is to limit this to persons who have the authority to cause the funds in the account to be transferred somewhere else (other than in a purely ministerial capacity as an

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[33] Given the lack of clarity on reporting obligations, the penalty scheme is deeply flawed. Individuals concerned about the harsh penalties are being advised to (possibly) overreport, and many potential filers have filed or are contemplating filing FBARs in an effort to avoid the potential penalties, which in many cases we suspect will not further the purposes of the FBAR rules and could indeed hinder those purposes.

[34] *See* 31 C.F.R. § 103.56(g) and IRS News Release, IR 2003-48, April 10, 2003.

employee of the financial institution)[35] because, in each case, these seem most relevant to the underlying money-laundering, anti-terrorism purpose of the BSA). This section notes some examples of cases where the language of the instructions at least arguably permits a reading that would dramatically expand the volume of FBARs filed by expanding the scope of FBAR filing requirements in ways at least some of which we suspect were unintended and in some cases that we believe do not constitute a reasonable application of the statute and regulation. First and foremost, however, our effort is to provide a sense of the potential breadth of the rules as they currently exist (or may exist) and to emphasize the need for detailed rules promulgated via a deliberative process including opportunity for notice and comment.

A. "Financial Account"

The contours of a "financial account" for purposes of the FBAR are unclear. If, as has been suggested, an equity interest in a fund can be a "bank, securities or other financial account" to which the statute refers, then the "plain meaning" of these terms is evidently not applicable. It is imperative that the IRS define the parameters of the types of arrangements that may be considered "financial accounts" for FBAR purposes. Potential filers need guidance on whether the concept of a "financial account" implies a certain level of liquidity, on the type of assets that may cause a "fund" or "commingled fund" to be treated as a financial account, and on the meaning of "equity interest" in relation to an interest held in a commingled fund.

1. Do the References to "Account" and "Mutual Fund" (or the Policies of the BSA) Identify Liquidity as a Necessary Element?

The term "financial account" is not specifically defined in the United States Code, Federal Regulations, or the FBAR. 31. C.F.R. § 103.24 provides simply, " [e]ach person subject to the jurisdiction of the United States (except a foreign subsidiary of a U.S. person) having a financial interest in, or signature or other authority over, a bank, securities or other financial account in a foreign country shall report such relationship to the Commissioner of the Internal Revenue for each year in which such relationship exists . . . ." The instructions to the FBAR state that "this term *includes* any bank, securities, securities derivatives or other financial instruments accounts" (emphasis added). The next line of the instructions details the additional types of accounts that the term "generally also encompass[es]," but the instructions give no indication of what the term itself means or how one would figure that out. The FBAR statute suggests that a "financial agency" should perhaps be involved, and current BSA regulations define a "financial agency" as "a person acting outside the United States for a person (except for a country, a monetary or financial authority acting as a monetary or financial authority, or an international financial institution of which the United States Government is a member) as a financial

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[35] As discussed below, we do not believe that this category should include "operations personnel" or other back office staff of the financial institution at which the account is maintained, who may have the technical ability to transfer funds from accounts, but whose authority is ministerial in the sense that they do not have the authority to initiate the transfers without direction from supervisors.

institution, bailee, depository trustee, or agent, or acting in a similar way related to money, credit, securities, gold, or a transaction in money, credit, securities, or gold."[36] It is not clear which of these is present in the case of, say, a private equity fund, and this may raise a question as to whether regulations or instructions that purport to require FBAR reporting in that context would be valid or enforceable.[37]

For many, the term "financial account" would connote that a holder may be expected to have the capability to withdraw funds, and the references the form includes to the type of accounts meant to be covered are, on their surface, consistent with this view. The questions and answers distributed following the 2007 National Phone Forum also reinforce the notion of liquidity as an essential component of the definition of an "account" for FBAR purposes. For example, in response to a question about whether a cash surrender value insurance policy is to be understood as a "financial account" for purposes of the FBAR, the IRS confirmed that it was, "[s]ince a cash surrender value insurance policy can be used to store cash and withdraw it at a later time." Whether the term "financial account" does in fact include a liquidity requirement must be clarified.

Similarly, there is no definition of "mutual fund" for FBAR purposes, making it impossible to determine what types of investments might be considered to function similarly to mutual funds.[38] The Securities and Exchange Commission defines a mutual fund as a "company that pools money from many investors and invests the money in stocks, bonds, short-term money-market instruments, or other securities."[39] Mutual funds offer their shares continuously and are required to provide their shareholders with the right to redeem shares at net asset value on a daily basis.[40]

Most hedge funds and private equity funds (the principal topic of FBAR-related discussions in June) function very differently. Private equity funds generally buy substantial

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[36] 31 C.F.R. § 301.11(p).

[37] On the other hand, the regulations under 31 C.F.R. § 103.24 do not expressly require the involvement of a "financial agency" for FBAR reporting obligations to apply.

[38] Note, however, that a proposed amendment to the BSA would define "mutual fund" as "an 'investment company' (as the term is defined in section 3 of the Investment Company Act (15 U.S.C. 80a-3)) that is an 'open-end company' (as that term is defined in section 5 of the Investment Company Act (15 U.S.C. 80a-5)) registered or required to register with the Securities and Exchange Commission under section 8 of the Investment Company Act (15 U.S.C. 80a-8)." *See* Proposed Amendment to 31 C.F.R. § 103.11, 74 Fed. Reg. 27,000 (June 5, 2009).

[39] *See* "Mutual Funds" under SEC's "Fast Answers-Key Topics," available online at http://www.sec.gov/answers/mutfund.htm.

[40] *See* 67 Fed. Reg. 21,118 (April 29, 2002).

positions, often controlling interests, in companies, and hold those interests for as much as five to seven years, sometimes longer. Investors in private equity funds generally invest for the life of the fund (10 years is standard, subject to the possibility of extension), and do not have the right to withdraw cash on demand (or, for that matter, at all, unless the fund has first disposed of an investment). Private equity investors do not even control when they transfer money into the fund – instead their commitments are available to be called at any time during what is usually a multi-year commitment period by the general partner (or its equivalent). Hedge funds often hold investments for much shorter periods, and generally provide for limited investor liquidity rights, but these liquidity rights are light years away from a traditional bank account, securities account or open-ended mutual fund. Investors in hedge funds are frequently subject to lock-up periods on entry, typically of one to two years, and following this initial period have the right to withdraw from the fund only at designated intervals (*e.g.,* at quarterly periods, or sometimes longer intervals, and often with other limitations) and typically only upon significant advance notice.

Hedge funds and private equity funds thus function very differently from mutual funds, and have been subject to different levels of regulation based on these differences. The FBAR, as a component of the Bank Secrecy Act, is rooted in a program to prevent and detect international money laundering and the financing of terrorism, and mutual funds have been viewed with suspicion within this context.[41] The Treasury has discussed the possible connection between mutual funds and money laundering at length and has noted that mutual funds may be a particularly attractive form of investment for money launderers by helping to distance "illegal proceeds from their criminal source through the creation of complex layers of financial transactions."[42] The Treasury noted that "[m]oney launderers could use mutual fund accounts to layer their funds by, for example, sending and receiving money and wiring it quickly through several accounts and multiple institutions, or by redeeming fund shares purchased with illegal proceeds and then reinvesting the proceeds received in another fund."[43] Following from these concerns, mutual funds have generally been subjected to higher degrees of Bank Secrecy Act regulation in these contexts, by cross reference to the definition of "open-end company" in the Investment Company Act of 1940 (the "1940 Act").[44] For example, mutual funds are required to

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[41] All references to "mutual fund" should probably be read as to "open-end companies" (which issue and redeem their shares), and not to "exchange traded funds," which function for these purposes like publicly traded stock. Publicly-traded stock is not an account. The liquidity concerns the BSA apparently aims to address are relevant in the case of mutual funds, where holders obtain liquidity by redeeming shares. Holders of exchange-traded funds do not achieve liquidity by redemption, but do so through sales. Note that references to "mutual funds" in the BSA are generally defined by cross-reference to the definition of "open-end company" in the 1940 Act. *See, e.g.*, 31 C.F.R. § 103.130.

[42] 67 Fed. Reg. 21,117 (April 29, 2002).

[43] *Id.*

[44] *See* Section 5(a)(1) of the 1940 Act, codified at 15 U.S.C. § 80a-1 et seq.

establish anti-money laundering and customer identification programs.[45] Investment funds such as hedge funds, private equity funds and venture capital funds are all specifically excluded from these particular reporting obligations; each falls outside of the 1940 Act definition of an investment company.[46]

Because of their lack of liquidity, private investment funds (such as private equity funds and hedge funds) do not seem to present the same issues as other types of investment vehicles when viewed within the context of the Bank Secrecy Act itself. For example, they do not afford the ability that mutual funds may provide for fund investors to receive money and "wir[e] it quickly through several accounts" or redeem fund shares purchased with illegal proceeds and then reinvest the proceeds in another fund (without waiting for a one or two year lock-up period).[47] Thus, it is possible that the concerns that gave rise to the FBAR reporting requirement (of which, we readily acknowledge, we are by no measure experts) are not activated by such illiquid investments. Irrespective of the way the IRS and Treasury come out on the policy issues, however, additional guidance and clarity is necessary for potential FBAR filers to be able to understand their reporting obligations and comply with them.

2. What Is a Securities Account?

A second element of the definition of account in the FBAR instructions seems to look to the type of assets held in the account (*e.g.*, securities, securities derivatives). In order to identify the types of accounts that need to be reported, potential filers need additional guidance on the types of assets that may cause a fund or "commingled fund" to be treated as an "account" for purposes of the FBAR.

According to the FBAR instructions, a "financial account" includes a "securities" account. However, the term "securities" is not self-defining, and may be understood differently depending upon the context. For example, under the U.S. securities laws, the definition of "security" is broad and generally based on whether the instrument in question is, in economic reality, an investment contract, but because of market practice, the definition may exclude a

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[45] *See* 31 C.F.R. Part 103, §§ 103.130 and 103.131.

[46] This is not to imply that investment funds are outside the scope of financial regulation or that anti-terrorism and anti-money laundering concerns are wholly irrelevant to entities such as investment funds. Funds, like all persons, are subject to prohibitions against accepting terrorist financing under the "Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001" (the "Patriot Act"). They are not, however, subject to the increased regulatory standards applicable to "financial institutions" under the Patriot Act.

[47] *See* 67 Fed. Reg. 21,118 (April 29, 2002).

number of liquid tradable assets, such as bank loans, that the FBAR might wish to include.[48] In the tax area, there are a number of different definitions, some of which clearly would seem inapplicable for FBAR purposes.[49] Potential filers would benefit from guidance on what the governing standard is for FBAR purposes.

The types of interests that may constitute "securities" must also be explored. In the Questions and Answers disseminated after the 2007 National Phone Forum, the IRS stated that "an ownership interest in real estate or collectibles is not a financial account for FBAR purposes and is not reported on an FBAR." However, would these real estate assets become reportable assets if held through special purpose vehicles ("SPVs") by an investment fund? A separate section of the Questions and Answers from the 2007 National Phone Forum indicates that the answer should be "No"; the IRS confirmed, for example, that a Mexican Foreign Bank Trust holding a real estate interest "is not an interest in a foreign account for FBAR reporting purposes." However, if a 1% interest in a fund is itself (potentially) an account, the 1% interest in the SPV that this "account" would be considered to hold starts to look more like a security. Clarification is required on whether interests in any entities holding real estate or other assets that are not themselves securities, such as the SPV interest scenario posited above, would ever be considered reportable "securities" or otherwise as an interest in a "foreign account" for FBAR reporting purposes.

Finally, while "securities" accounts and "securities derivatives" accounts are seemingly covered by the term "financial account," are there potentially other "asset" accounts that are subject to FBAR reporting but not explicitly identified in the form or its instructions? Guidance should clarify whether other types of financial assets (*e.g.*, commodities) are considered reportable assets for FBAR purposes.

3. What is an "Equity Interest" In a "Commingled Fund"?

The FBAR instructions specify that financial accounts "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)." Guidance is needed on the meaning of "equity interest" in this context. The definition of "equity," like the definition of "security,"

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[48] *See SEC v. W.J. Howey Company*, 328 U.S. 293 (1946) and *United Housing Foundation v. Forman*, 421 U. S. 837 (1975). *See also* the definition of "security" found in Section 2(a)(1) of the Investment Company Act of 1940, 15 U.S.C. § 80a-2(a)(36).

[49] For example, the concepts of Subchapter C, which depend on whether the instrument represents a continuing interest in the affairs of a corporation, would clearly seem inapplicable. *See, e.g., Pinellas Ice & Cold Storage Co. v. CIR*, 287 U.S. 462 (1933) (short-term notes received in exchange for property do not constitute "securities" for purposes of the reorganization provisions); *see generally* Lipton & Katz, "'Notes' Are Not Always Securities," 30 Bus. Lawyer 763 (1975).

means very different things in different areas — its meaning for FBAR purposes needs to be nailed down.

If FBAR filings are required with respect to interests in investment funds, is the requirement limited to interests denominated as equity in those investment funds? For example, collateralized loan obligations ("CLOs") are SPVs that issue, for example, different tranches of securities and, liquidity aside, may be viewed as commingled funds. Investors make cash contributions to a CLO in exchange for interests, and in doing so, their contributed capital is commingled with the capital of other investors. The "true" equity of a CLO is frequently denominated subordinated notes (although for tax and economic purposes it is equity). For FBAR purposes (if held directly) is this subordinated note an "individual bond," not treated as an account under the express language of the instructions, or is it an equity interest that would require U.S. persons that are subordinated noteholders of CLOs to make FBAR filings with respect to their interests? If so, are only the subordinated noteholders subject to FBAR reporting, or are the holders of interests of debt of a CLO (debt that constitutes debt for tax purposes) also subject to FBAR reporting? These uncertainties must be resolved before filing obligations with respect to such types of interests may be imposed.

4. "Individual Bonds, Notes, or Stock Certificates Held By the Filer are Not a Financial Account, Nor is an Unsecured Loan to a Foreign Trade or Business That is Not a Financial Institution."

The language in the instructions that "individual bonds, notes or stock certificates are not a financial account, nor is an unsecured loan to a foreign trade or business that is not a financial institution" is far from self-explanatory and its implications lead to further ambiguity. The IRS and Treasury should issue guidance clarifying how this language should be understood.

(a) Stock Certificates

A number of seemingly conflicting statements have been made concerning whether an interest, or when an interest, in foreign stock constitutes a reportable "financial account" for FBAR purposes. Some thought that the language implied that stock of foreign corporate investment funds was exempt. As noted above, however, in the Questions and Answers distributed following the 2007 National Phone Forum, one IRS response confirms that a U.S. individual owner of stock of a PFIC has an FBAR filing obligation with respect to the shareholder's interest in the PFIC based on the principle that the shareholder's interest in the PFIC "is an interest in an account in which the assets are held in a commingled fund and the account owner holds an equity interest in the fund." In an earlier statement made during the same teleconference, however, the IRS confirmed that no FBAR filing obligation arises with respect to an offshore hedge fund interest held by an IRA with a U.S. owner where the IRA "is only holding units of the hedge fund as an investment in the IRA and does not control the hedge fund." As discussed above, in Part I, "Background: Recent 'Guidance' on Issues Relating to Investment Funds," the two statements appear contradictory because most offshore hedge funds will be PFICs. It is not clear how all of these statements may be reconciled.

(b) Individual Bonds, Notes

Is a bond held not "by the filer" but through a clearinghouse (*i.e.*, an interest in a global bond) a financial account? Is debt of foreign financial institution a foreign financial account, or does it remain an individual bond or note for FBAR purposes? Is an option, swap, structured note or repurchase agreement entered into with a foreign financial institution automatically a "foreign financial account"? What if, as would typically be the case, the institution establishes an "account" or ledger entry reflecting the rights and obligations of the counterparty?

(c) Loans Other than Unsecured Loans to a Foreign Trade or Business that is Not a Financial Institution

The instructions to the FBAR state that an unsecured loan to a foreign trade or business that is not a financial institution is not a foreign financial account. What inferences should one draw from this statement? Is *secured* debt of a non-financial institution a foreign financial account? Furthermore, what constitutes a "financial institution"? Is this to include solely those entities identified as "financial institutions" in the definitions section of the BSA regulations (*i.e.*, by reference to 31 C.F.R. § 103.11(n))?

(d) Additional Questions

The instructions do not reference deferred compensation arrangements. Might a deferred compensation obligation of a foreign employer constitute a "financial account" for FBAR purposes? What if the obligation is designated as an "account" that the employee can monitor electronically and manage (*e.g.*, change investment elections) periodically? What if the employer holds a hedge, or a "for the benefit of" ("FBO") account in the employee's name? *See* Section III.D. below on other, related, signatory issues. Does it matter that deferred compensation "accounts" do not involve money owned by the employee (*i.e.*, that an employee has not, in any natural sense, "invested" its own money).

B. "Account in a Foreign Country"

If interests in investment funds are "accounts" that must be reported on FBARs if they are located in a foreign country, then when is the "account" considered located in a foreign country? The instructions specify that the "geographical location of the account, not the nationality of the financial entity institution in which the account is found determines whether it is in an account in a foreign country," but how this should be understood in the investment fund context is not apparent.[50] While interests in brokerage accounts, bank accounts, and other similar accounts are generally associated with a physical location (a physical branch of the relevant financial institution), the geographical location of an investment fund is not so easily ascertained. To qualify as a reportable interest, is the investment fund required to have a foreign account or only a foreign place of organization or business? Consider an investment fund

[50] *See also* IRM 4.26.16.3.3(2) (it is "not the nationality of the financial institution with which the account is held that determines the geographical location of an account").

organized under non-U.S. law with no foreign bank account, with all key executives located in the United States, with all investment decisions made in the United States, and with all fund assets located in the United States. In this example, the only foreign connection is the place of organization of the issuer. In the chaos last month, many practitioners advised clients to file FBAR reports with respect to such funds, but it is certainly far from clear whether this connection is adequately "geographically foreign" so as to make the investment fund reportable for FBAR purposes.

Perhaps the answer to where the account is located depends on whether the "foreign account" would be the investment fund itself or the investor's interest in such fund. If the "investment fund" itself would be the operative "financial account," is the place of the fund's formation enough to cause the fund to be located in a foreign country or should one look at other, more complex factors (like, for example, where its principal place of business, management, or control is located)? However, if the investor's interest is the "financial account," then maybe a different answer is ultimately reached depending upon where the back-office functions are performed. Of course, all of these tests involve complex factual inquiries that will be far less administrable than looking to the jurisdiction of formation. We urge the IRS and Treasury to consider this issue of administrability in formulating guidance.

C. Financial Interest in an Account

The instructions to the FBAR state that a person has a "financial interest" where a U.S. person is "the owner of record or has legal title, whether the account is maintained for his or her own benefit or for the benefit of others . . ."; or has a financial interest in a foreign account for which the record owner is "a person acting as an agent, nominee, attorney, or in some other capacity *on behalf of* the United States person" (emphasis added). Specific rules apply to attribution through corporations, partnerships and trusts. In the case of corporations, a U.S. person has a financial interest in a foreign account for which the record owner is a corporation in which the U.S. person owns directly or indirectly more than 50% of the total value of shares of stock or of the voting power of all shares of stock. In the case of partnerships, a U.S. person has a financial interest in a foreign account for which the record owner is a partnership in which the U.S. person owns an interest in more than 50% of the profits or capital.

1. "On Behalf of"

The meaning of "on behalf of" is far from clear. For example, is a U.S. "feeder" fund that owns interests in a Cayman "master" fund holding those interests "on behalf of" its partners who are U.S. persons? As a U.S. tax matter, the answer is clearly no, but the FBAR is not (clearly) governed by U.S. tax principles. Is an account at Euroclear or Clearstream a foreign financial account held "on behalf of" (among others) U.S. beneficial owners? Is collateral posted by a U.S. person to a foreign person and deposited by the foreign person in a foreign account held "on behalf of" the U.S. person? If a U.S. customer has a brokerage account at a U.S. broker-dealer, and the broker-dealer as a matter of course sweeps excess cash into a Cayman account each night (whether the customer knows it or not), does it hold that foreign account on the customer's behalf? What if the Cayman account is, or has a sub-account that is, designated as FBO the

customer? What about deferred compensation accounts—are they held "on behalf of" the employee whose compensation they hold (or hedge)?

2. Financial Interests in Trusts

The confusion caused by the June 12, 2009 ABA/AICPA Teleconference was not limited to the investment funds area. In the trusts context, a number of issues, some discussed during the ABA/AICPA Teleconference and some not discussed, require further clarification. The instructions to the FBAR state that U.S. persons that have a "financial interest" in a foreign account for which the record owner is a trust in which the U.S. person either has a present beneficial interest, either directly or indirectly, in more than 50% of the assets or from which such person receives more than 50% of the current income, are subject to the FBAR reporting regime. In the case of trusts, the FBAR instructions state that a U.S. person also has a financial interest in a financial account for which the owner of record or holder of legal title is a trust, or a person acting on behalf of a trust, that was established by such U.S. person and for which a "trust protector" has been appointed.[51] These concepts, and statements made during the ABA/AICPA Teleconference, raise at least the following additional issues:

(a) Discretionary Trusts

- What is "income" for FBAR purposes (*e.g.*, trust accounting income under applicable local law, distributable net income for federal income tax purposes, or something else.

- Does a beneficiary of a discretionary trust (*i.e.*, a trust held under a trust instrument that gives the trustee broad powers to determine which beneficiaries are to receive distributions and the timing and size of those distributions) have a financial interest in the foreign accounts owned by the trust when the beneficiary has no fixed right to receive more than 50% of the principal or more than 50% of the income of the trust and does not actually receive more than 50% of the principal or more than 50% of the income of the trust in a particular year? On the ABA/AICPA Teleconference the IRS suggested that all beneficiaries of discretionary trusts have FBAR reporting obligations. This statement requires clarification. Presumably (based on the existing instructions) this would only be the case for discretionary beneficiaries treated as having a more than 50% interest. But unless one wishes to apply an uncertain facts and circumstances test or a maximum exercise of discretion rule, which the instructions clearly reject with respect to discretionary income interests and which may have associated

[51] It is not immediately apparent to us why the appointment of a trust protector should be relevant to the issue of financial interest, but at least the rule in the instructions is (moderately) clear.

complications,[52] it is difficult to conclude that any beneficiary has a greater than 50% beneficial interest in trust principal unless there is only one beneficiary.

- In the case of a discretionary trust, to what extent should prior patterns of distributions be taken into account (if at all) in determining whether a beneficiary has a greater than 50% interest?

- In the case of a discretionary trust, what role (if any) should a "letter of wishes" play in making this determination if: (a) the trustee has the discretion to distribute among only a closed list of named of beneficiaries (*e.g.,* to A, B or C as the trustee decides, but not to anyone else); or (b) the trustee has the discretion to distribute among an "open" list of beneficiaries (*e.g.*, to A, B or anyone else the trustee decides)?

(b) Remainder Beneficiaries

Does the beneficiary of a remainder interest in a trust (*i.e.*, one that will not give the beneficiary any rights until the death of another person or the expiration of a term) have a financial interest in the foreign accounts owned by the trust that would require reporting? If the answer to this question is yes (in some cases, such as when the actuarial value of the remainder interest is more than 50%), should the answer be different if the trustees or the holder of a power of appointment have the power to defeat the remainder interest by distributing or appointing the trust property to other individuals?

(c) Powers of Appointment

- Do potential appointees under a limited or general power of appointment over trust property have financial interests in the foreign accounts owned by the trust? If so would this test be applied with or without a 50% rule as set forth in the current FBAR instructions? What if the class of potential appointees is very broad, such as a class including any person other than the holder, the holder's creditors, holder's estate or the creditors of the holder's estate, or a class including any charitable organization, or a class including the holder of the power?[53] Would the holder of a general power of appointment

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[52] For example, how should a trustee's ability to add additional trust beneficiaries be treated under a maximum exercise of discretion rule?

[53] To take an extreme interpretation, in the case of a broad limited power of appointment exercisable in favor of anyone other than the holder, the holder's creditors, the holder's estate and the creditors of the holder's estate, would every U.S. person who is not the holder, the holder's estate or a creditor of either have to file (on the theory that each potentially could get a more than 50% interest if the power of appointment is exercised in favor of such person)? And in the case of a general power of appointment exercisable in favor of any person (including the holder, the holder's creditors, the holder's estate and the creditors of the holder's estate), would every U.S. person need to file an FBAR? These questions cannot possibly be answered in the affirmative.

have a financial interest in the accounts of the trust to which its power could apply?[54]

- Is there a distinction between powers of appointment that are currently exercisable (*e.g.*, would give the trustee a written notice today exercising the power and the trustee would be required to pay over the property today) and those that are not (*e.g.*, a power that may be exercised at death under a will)?

D. "Signature or Other Authority"

The instructions to the FBAR state that a person has signature authority over an account if such person "can control the disposition of money or other property in it by delivery of a document containing his or her signature . . . to the bank or other person with whom the account is maintained." "Other authority" exists if a person "can exercise comparable power over an account by communication with the bank or other person with whom the account is maintained, either directly or through an agent, nominee, attorney, or in some other capacity on behalf of the U.S. person, either orally or by some other means." Despite this guidance, the concept of "signature authority" seems essentially unclear to us. For example, does control over the disposition include the power to effect the disposition of a security on the open market when so instructed (directly or indirectly) by the owner where the sole proceeds will be received by the account, or does it connote something more substantive (*e.g.*, the ability to transfer value in the account to someone or somewhere else).[55]

1. In General

The language in the instructions, if read broadly, could pick up operations personnel at a financial institution where the account is maintained, whose sole authority is to execute instructions given by others, such as the owner of the account or the owner's designee, or even another employee who received such instructions. But if the question is whether the institution

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[54] With respect to a presently exercisable general power of appointment (one exercisable in favor of the holder, the holder's creditors, holder's estate or the creditors of the holder's estate) the 50% rule may not be necessary. It is possible to view a general power of appointment as the right to withdraw a portion of the trust assets directly from the trust, which may arguably be more analogous to a direct interest in the account itself than the more traditional ownership of an entity that can access the account (where the 50% rule would apply).

[55] On a related note, the IRS, on its website in informal guidance, has helpfully clarified that the term "other authority over a financial account" does not apply to a person, who has the power to direct how an account is invested, but who cannot make disbursements to the accounts, because the person has no power of disposition of money or other property in the account. "FAQs Regarding Report of Foreign Bank and Financial Accounts (FBAR) - Financial Accounts", available online at http://www.irs.gov/businesses/small/article/0,,id=210249,00.html.

maintaining the account has been instructed to honor the instructions of a particular person or entity (even if, for example, the individual or entity is otherwise legally or contractually prohibited from or restricted in exercising that authority), then all of the foregoing may meet this requirement and many, many individuals and/or entities may have signature authority over a single account. For example, consider someone (*e.g.*, back-office or operations personnel) who has the authority, "as against the account," to control the disposition of its assets, but is not permitted to exercise that authority, as a matter of his or her employment, without instructions from others (*e.g.*, the account's owner, or the employee's superiors). Thousands of U.S. employees may meet this criterion, each with respect to many thousands of accounts.[56] This result is counterintuitive, given that in the typical case the account's owner will undoubtedly have given none of those people any signature authority and would be surprised to know they would be considered to have it. However, the instructions exempt employees of certain banks with signature or authority with respect to accounts maintained by the bank, clearly implying that these people would otherwise have been required to report, and therefore that at least some people so situated (but not entitled to the exemption, such as U.S. employees of broker-dealers or foreign banks) are required to report. While most practitioners would not have viewed this as signature authority, additional guidance would be welcome, especially in light of recent indications from IRS personnel to the contrary.

Similarly, is there signature authority if a trader at a financial institution can decide whether/when to book and/or terminate a swap between the institution and a client, if the swap is booked by the institution at a non-U.S. location? What if the booking is reflected as an account for the client? What if the collateral associated with that swap is held by the institution in a foreign collateral account? What if a collateral or credit manager can decide each day that some of the assets in that collateral account can be released from the account (*e.g.*, because the mark-to-market value of the client's obligation to the institution declines)? What if they can be released only back to the counterparty? Does this relationship constitute "control over the disposition" or "disposition of" the collateral?

The potential scope of signature authority could be enormous, and could include even persons with supervisory authority over persons with signature authority. It could also include an executive who has charter or other authority to move money out of accounts, even though the executive never exercises that authority.

2. Investment Funds

In the investment funds context there is typically nothing that operates like a signature card. It is not clear how the "signature or other authority" concept may be applied for an entity holder of an interest in an investment fund. If the central question is who has the corporate

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[56] One possibility for distinguishing between operations personnel, who should not have FBAR filing obligations with respect to accounts even if they do have technical signature authority, and those who do have filing obligations would be that operations personnel do not take instructions from anyone with a financial interest in the account (see below).

power to deal with the fund interest, many U.S. persons could be regarded as possessing such authority (*e.g.*, all officers of an entity holder, such as a corporation, pension fund or foundation, who have general authority not specifically related to a "financial account").

3. Trusts

In the trusts context, there are additional concerns, particularly when considering powers of appointment that are either limited or testamentary. It is unclear, for example, whether the holder of a power of appointment over a trust has a signature authority over the foreign accounts owned by the trust because of the holder's ability to direct the trustee to distribute the accounts to another. Does the answer depend on whether or not the power is presently exercisable? Moreover, is a testamentary power of appointment (*e.g.*, one exercisable only by will) treated as signature authority when it becomes presently exercisable (*i.e.*, in the year of the death of the power holder)? If yes, is an executor of the estate of the holder of a testamentary power of appointment required to report on an FBAR form filed in the year of the decedent's death that the decedent had signature authority over a foreign account?

E. FBAR Reportable Amounts

Where a person holds a reportable interest in a foreign financial account, such person is required to file an FBAR where the aggregate value of foreign accounts exceeds $10,000 at any time during the calendar year. The instructions state that the "maximum value of the account" should be reported, and define such amount as the "largest amount of currency or non-monetary assets that appear on any quarterly or more frequent account statement issued for the applicable year." However, the instructions also state that "[t]he value of stock, other securities, or other non-monetary assets in an account reported on TD F 90-22.1 is the fair market value at the end of the calendar year or, if withdrawn from the account, at the time of the withdrawal." While the reportable amount of a Traditional Financial Account containing currency is clear, it is not clear whether the appropriate amount to be reported with respect to an account containing non-monetary assets would be the amount reported on a quarterly statement or the fair market value at the end of the calendar year. Additional guidance would be helpful.

As a related question, in the context of investment funds, what specifically would constitute the "financial account" reportable on the FBAR? Is the "account" to be understood as the investment fund itself or as the U.S. person's interest in the investment fund? If it is the former, presumably the reportable amount would reflect the value of fund assets; if it is the latter, the investor's interest would need to be valued (which would add additional complexity given the often complex economic carried interest and other arrangements between the fund and its sponsor). There is also a need to clarify how an interest in an investment fund would be reported on the FBAR itself. Neither answer is obvious from the face of the form (which barely accommodates information with respect to funds at all). For example, an interest in an investment fund has been understood by some as an interest in a "commingled fund" that is a "joint account," held with other investors in the fund. However, if the reportable "financial account" is instead the interest in the investment fund, then such account would generally be reported as a "separately owned" financial account by an FBAR filer. The classification of either

the "interest" or the "fund" as the reportable account may in turn have other consequences that should be explored.

IV. Other Proposed Changes

In addition to the points discussed above (which need to be addressed to clarify when FBAR reporting is required), we have the following suggestions for possible changes that might be made to the FBAR instructions that we think would streamline the process without sacrificing the presumed purpose of gathering adequate information about offshore accounts. As we readily acknowledge that we are not experts in bank secrecy, money laundering, terrorism or other potential areas of interest, we are not recommending that these changes be made; rather, we are attempting to highlight components of the rules that result in significant duplication of reporting or other inefficiencies that we are doubtful, from a layperson's perspective, are outweighed by their utility in enforcing various regimes.

A. Exemptions for Certain Persons with Signatory Authority.

We believe (as laypersons) that it would be appropriate to exempt an employee with signature or other authority over but no financial interest in an account maintained by his or her employer (and perhaps even accounts that are not) if his or her employer or any of its affiliates has filed an FBAR with respect to that account. In particular, we think that it seems appropriate to exempt an employee of any entity (corporate or non-, domestic or foreign, public or private) with respect to accounts (at least those maintained by the employer or any of its affiliates) over which the employee has only signature or other authority, if the employer or any of its affiliates has filed an FBAR with respect to those accounts.

B. Expanded "Consolidated FBAR"

Another possible change that might be considered is to broaden the notion of a "consolidated FBAR" to include noncorporate entities, and perhaps also to include entities controlled by members of the otherwise-consolidated group (such as a vehicle managed by a group member or of which a group member is the sole general partner).

C. Broaden Circumstances Where No FBAR Report is Required For Employees.

The current instructions provide certain exceptions for officers or employees of banks "currently examined by Federal bank supervisory agencies for soundness and safety", which officers and employees need not report that they have signature or other authority over foreign bank, securities or other financial accounts maintained by the bank, if the officer or employee has no financial interest in the account. Consider whether this exception should be extended to (i) broker-dealers regulated by the SEC and/or (ii) to the extent not already covered, US branches of foreign banks under U.S. regulatory supervision. We also suggest that the IRS and Treasury consider expanding the public company exception to all U.S. public companies that file periodic

reports with the SEC under the Securities Exchange Act of 1934, whether or not they have 500 shareholders.[57]

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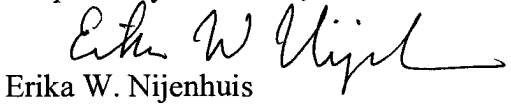
We appreciate your consideration of our comments. Please let us know if you would like to discuss this letter further or if we can otherwise assist you.

Respectfully submitted,



Erika W. Nijenhuis
Chair

[57] This would, for example, include closely-held companies with public debt outstanding that are required to file 10-Ks and 10-Qs.

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