New York State Bar Association
Tax Section

Report on the Rules Governing Reports on Transactions with Foreign Financial Agencies (FBARs)

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Report No. 1194

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I. Introduction

This report responds to Notice 2009-62, which requested comments on a number of issues relating to the Report of Foreign Bank and Financial Accounts (Form TD F 90-22.1, known as the "**FBAR**").[1]

The instructions to the FBAR require any U.S. person that has a financial interest in, or signature or other authority over, foreign financial accounts with an aggregate value of more than $10,000 at any time during a calendar year to file an FBAR reporting certain information with respect to those accounts by June 30 of the following year. The penalties for failing to comply are severe.

The FBAR is intended to assist the Internal Revenue Service ("**IRS**"), the U.S. Department of the Treasury ("**Treasury**") and other governmental agencies in gathering information that is of a high degree of usefulness in criminal, tax or regulatory investigations or proceedings or in the conduct of intelligence or

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[*] This report was prepared by an *ad hoc* committee of the Tax Section. The principal drafters of this report were Michael Farber and Mario J. Verdolini, with substantial assistance from Arie Rubenstein, Ethan Goldman, Juelle Gomes, Sarah Joy and Rhiannon Nakano and significant input from Micah Bloomfield, Shlomo Boehm, Michael T. Brown, Oggie Caginalp, Mary Conway, Albert Feuer, Brian Foley, Janna Freed, John Grimes, Amy Heller, David Higgins, Deborah Jacobs, Oleg Kotov, Richard LeVine, John Lutz, Carlyn McCaffrey, Jennifer Mario, Dean Marsan, Jeremy Matz, Marnin Michaels, Elaine Murphy, Andrew Needham, Richard Nichols, Erika W. Nijenhuis, Andrew Oringer, Chris Pinho, Jeff Robins, Allison Rosier, Jeffrey Schwartz, Adam Stella, and Willard Taylor. Additional contributors to the report include Jacob Amato III, John Barrie, Jack Battaglia, Jennifer Bell, Angelo Ciavarella, Lawrence Cohen, Dale Collinson, Peter Connors, Marcy Geller, Rich Gold, Adam Gunnerson, Metin Ismailov, Stephen Jordan, Barbara Kaplan, Harvey Kitay, Ernest Leonardini, Jennifer Mario, David Mattingly, Michael Meisler, David Miller, Stephen Mills, John Narducci, Michael Nassau, Kenneth Raskin, Richard Schneyer, and David Schulder. Helpful comments on the report were received from John Barrie, Kim Blanchard, S. Douglas Borisky, Sam Dimon, David Hardy, Yaron Reich, Michael Schler and Bryan Skarlatos.

This report was prepared prior to the introduction of S. 1934 by Senators Max Baucus and John Kerry and H. 3933 by Congressmen Charles Rangel and Richard Neal on October 27, 2009 (the "Foreign Account Tax Compliance Act of 2009"), and does not discuss or reflect the proposed legislation.

[1] Notice 2009-62, 2009-35 I.R.B. 260 (Aug. 7, 2009)

counterintelligence activities to combat international terrorism. The authorizing statute requires Treasury, in implementing the FBAR regime, to consider the need to avoid impeding the import and export of monetary instruments and unreasonably burdening persons transacting with foreign financial agencies.

Unfortunately, we think the FBAR rules have evolved away from these goals of gathering highly useful information while avoiding unreasonable burdens on filers. We believe that the FBAR rules can and should be revised to improve the quality of the information gathered and to reduce the burden on persons required to file FBARs and on the IRS and Treasury. We have prepared this report and offer our recommendations in that spirit.

On July 17, 2009, the Tax Section submitted a letter expressing concerns regarding many aspects of the FBAR rules as interpreted by various representatives of the IRS and Treasury in recent months (the "**July 17 letter**").[2] In the July 17 letter, the Tax Section requested a temporary reprieve from the application of the FBAR rules to accounts other than "traditional financial accounts" and identified many aspects of the rules as currently interpreted that are unclear, incorrect and/or subject to conflicting interpretations. In the interest of time, however, in the July 17 letter we did not provide specific recommendations regarding many or most of the issues identified therein, instead merely noting the extraordinary complexity, unclarity and confusion caused by the sudden focus of the bar and government personnel alike on a variety of aspects of the rules.

On August 7, 2009, the IRS and Treasury released Notice 2009-62, extending until June 30, 2010 the period for filing FBARs for 2008 and prior years in the cases of "(i) persons with signature authority over, but no financial interest in, a foreign financial account, and (ii) persons with a financial interest in, or signature authority over, a foreign commingled fund."[3] Notice 2009-62 also requested comments regarding a variety of aspects of the FBAR rules, including:

(i) when a person with signature authority over, but no financial interest in, a foreign financial account should be relieved of filing an FBAR for the account, and specifically whether relief from filing would be appropriate if a person with a financial interest in the account has filed an FBAR;

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[2] *See* New York State Bar Association Tax Section, *Request for Formal Guidance on FBAR Reporting Obligations* (Report No. 1186, July 17, 2009), *available on the NYSBA Tax Section website at* Hhttp://www.nysba.org/AM/TemplateRedirect.cfm?template=/CM/ContentDisplay.cfm&ContentID=29755H (last visited Oct. 23, 2009).

[3] *See* Notice 2009-62, 2009-35 I.R.B. 260 (Aug. 7, 2009).

(ii) in what circumstances the exception from FBAR filing currently available for officers and employees of banks and certain publicly traded domestic companies might be expanded to apply to all officers and employees with only signature authority over, and no financial interest in, an employer's foreign financial account, including circumstances in which an individual has been advised that an FBAR has been filed with respect to a foreign financial account for which that person has signature authority;

(iii) how the bank and publicly traded company exception (including the requirement of notification that an FBAR was filed by a U.S. person with a financial interest in the account) might apply to officers and employees with only signature authority over accounts owned by clients of their employer;

(iv) when an interest in a foreign entity (*e.g.*, a corporation, partnership, trust or estate) should be subject to FBAR reporting, including the possibility of applying the principles of Sections 1297 and 1298(b) of the Internal Revenue Code[4] to determine when an interest in a foreign entity should be subject to FBAR reporting, as well as whether the passive asset and passive income thresholds of 50 percent and 75 percent, respectively, are appropriate and whether the tests should apply conjunctively; and

(v) whether a U.S. person should be relieved from an FBAR filing requirement with respect to a foreign commingled fund in other circumstances, such as when filing would be duplicative of other reporting.

We address requests (i) through (iii) in Part VII.D.1(b). We address requests (iv) and (v) in Part VII.A.2(a).

We commend the IRS and Treasury for their prompt action in promulgating the Notice, and specifically for providing much-needed relief to thousands of potential filers who have only recently learned of the possibility of extremely burdensome (indeed, in many cases, owing to the passage of time, insurmountable) recordkeeping and filing obligations.

The purposes of this report are to respond to Notice 2009-62, including its specific requests for comments, and to provide additional recommendations regarding many other aspects of the FBAR rules. The report is divided into several parts. Part II lays out what we understand to be the congressional

[4] "Code Section" references are to the Internal Revenue Code of 1986, as amended (the "**Code**") unless the context otherwise requires.

purposes of the rules, as well as our own views as to how the rules might best achieve their intended purposes (although conceding that we are tax professionals and not expert in issues relating to non-tax crimes). Part III briefly summarizes the current FBAR rules and the penalties for failure to comply. Part IV recites the history of the FBAR rules (in somewhat more detail than was described in the July 17 letter). Part V analyzes at a very general level the application of the FBAR rules to particular categories of potential filers, including whether those filers are more or less likely than others to be committing or facilitating the types of crimes the FBAR rules target, are more or less able than others to comply with the FBAR rules and/or maintain records, or have special issues that are not addressed, or are not well addressed, by the current rules. Finally, Parts VI and VII present our principal recommendations and offer more detailed comments and recommendations, including our responses to the IRS and Treasury request for comments in Notice 2009-62.

As discussed in more detail below, this report departs somewhat from our usual practice of discussing only tax policy and technical tax issues, because FBARs may be used in connection with both tax evasion and other financial crimes and it seemed undesirable to us to make recommendations for improving the FBAR's application to preventing or identifying tax evasion without considering the possible effect of those recommendations on non-tax crimes. With some hesitation, we therefore venture below some thoughts about how the FBAR reporting regime may or may not "work" for non-tax purposes and base some of our recommendations on our best judgment, as non-experts who have examined the available data, as to what might make sense in those contexts. As a result, we offer many, sometimes overlapping, recommendations in the hope that some portion of them will be found suitable notwithstanding our lack of expertise in the issues relating to non-tax financial crimes.

A. Summary of Principal Recommendations

This report makes a large number of recommendations and suggestions for further consideration. In brief, our primary substantive recommendations, each of which is addressed in Part VI, are that Treasury and the IRS should:

- minimize duplicative reporting by promulgating rules to permit or require certain persons or classes of persons to act as "qualified" or "registered" FBAR filers whose filing with respect to an account would eliminate any filing requirement for others, and to expand significantly the scope of the employee and consolidated group filing exceptions;

- study whether it would be feasible to identify jurisdictions in which "financial accounts" are or are presumptively exempt from FBAR reporting;

- consider raising substantially the minimum dollar threshold for reporting foreign financial accounts;

- follow a more formal notice-and-comment process for providing guidance, and promulgate regulations covering the details of the rules;

- allow electronic FBAR filing for all filers, and mandate it for institutions that are currently required to file returns and reports electronically;

- not require FBAR filings with respect to private investment funds for years prior to 2009; and

- not require reporting by foreign entities doing business within the United States for years prior to 2009.

B. Summary of Other Proposals and Suggestions

The remainder of our recommendations and suggestions (many of which are alternatives to some of our principal recommendations) are described throughout this report, primarily in Part VII. Following is a brief summary of our material recommendations and suggestions, more or less in the order in which they appear in Part VII.

Proposals relating to the definition of a "financial account"[5]

Investment Funds: We believe that the income and asset tests under Code Sections 1297 and 1298(b) should not be used to determine whether an equity investment in a foreign entity is a reportable foreign financial account. Rather, if additional tax reporting is useful, we recommend that Treasury and the IRS consider revising Code Section 6038B as a means of obtaining information regarding transfers of cash to foreign investment vehicles. As a policy matter, we generally do not believe the balance between the burdens and benefits of requiring FBAR reporting with respect to an equity investment in a foreign investment vehicle favor reporting. We recommend that Treasury adopt rules that determine whether an equity investment in a foreign investment vehicle is a "financial account" based on delineated standards of the entity's liquidity. Under these rules, interests in offshore mutual funds that allow investors to redeem interests on a frequent basis would be subject to FBAR reporting. Conversely, interests in offshore investment vehicles that do not issue redeemable interests, or that permit redemptions only at substantial intervals with substantial prior notice, would not

[5] See discussion in Part VII.A.

be subject to FBAR reporting. Alternatively, we suggest that equity investments in offshore funds be subject to reporting only under an anti-abuse rule.

Securities Accounts: We recommend that Treasury and the IRS confirm whether or not arrangements with foreign clearinghouses, such as Euroclear and Clearstream, constitute foreign financial accounts. We also request clarification as to whether non-deposit debt of, or other securities issued by, a foreign financial institution are reportable foreign financial accounts. More generally, we recommend that Treasury and the IRS clarify the governing legal standard, for purposes of the FBAR rules, to determine what constitutes a "security."

Securities Derivatives Accounts: We recommend that Treasury and the IRS confirm that derivatives entered into with foreign financial institutions are not for that reason alone reportable financial accounts. We recommend explicitly exempting at least exchange-traded derivatives and associated collateral arrangements from the scope of the rules, and believe that consideration should be given to exempting all derivatives entered into with foreign financial institutions and associated collateral.

Compensation Arrangements: In general, we recommend relaxing or eliminating otherwise applicable FBAR filing requirements for compensation arrangements. We suggest that Treasury and the IRS specify that an "account" relating to non-U.S. compensation arrangements will be considered to exist, if at all, only once income relating to such arrangement has been required to be reported for U.S. federal income tax purposes. We also propose an anti-abuse rule where (i) the service provider does not participate in the plan on a basis that is consistent with that applicable to other similarly situated service providers, or (ii) there is no clear and convincing evidence that the compensation arrangement is *bona fide* and is not intended to foster the secreting of assets in non-U.S. locations. The exemption could be conditioned on the existence of procedures to ensure U.S. tax reporting of the compensation.

Transient Accounts: We recommend that Treasury and the IRS consider whether and when an account needs to be reported if it is "transient."

Proposals relating to the definition of a "United States Person"[6]

"In and doing business in": We request that consideration be given to whether bringing non-United States persons within the scope of the filing regime was intended by Congress or is a desirable step. We recommend that Treasury clarify, perhaps by regulation, its understanding of what it means to be "in" the United States (*e.g.,* domicile, permanent presence, etc.). We think it would be advisable to define being "in" the United States to mean being a domiciliary

[6] See discussion in Part VII.B.

thereof, but we believe further consideration of this issue is needed. We also recommend that Treasury and the IRS clarify that "doing business in the United States" means being involved in a United States business, as opposed to simply "doing business" for very brief time periods in the United States (*e.g.*, a telephone conversation). Finally, we request guidance on whether and when a non-U.S. person not actually in or doing business in the United States will be ***treated*** as being in and doing business in the United States (for example, as a result of being a partner in a partnership that is doing business in the United States).

Trusts and Estates: We recommend that Treasury and the IRS clarify that trusts and estates have no independent filing obligation but that their assets should be treated as owned by their trustees/executors for purposes of determining whether ***those persons*** have any filing obligations. Under this proposal, a "United States person" would not include either a trust (other than a statutory business trust) or an estate but instead would include a trustee of a trust and a representatives of an estate. Each trustee (or executor) who is a United States person would have a financial interest in each account titled in either the name of the trust (or estate) or the name of the trustee (or the decedent's estate). However, the FBAR filed by the trustee (or executor) could be required to provide information about beneficiaries and holders of presently exercisable powers of appointment who are United States persons. If one or more trustees (or executors) are United States persons, the trust (or estate) should be treated as a domestic trust (or estate) for FBAR reporting purposes.

Tax-qualified plans and certain governmental plans, and IRAs: In general, we recommend that tax-qualified plans and IRAs, and their participants and beneficiaries, should be exempt from FBAR filings, subject in some cases to certain conditions. More specifically, we propose that tax-qualified plans and IRAs subject to ERISA, and non-participant-directed governmental and non-electing church plans, as well as their participants and beneficiaries**,** should be exempted from FBAR filing obligations. Non-ERISA plans that are not governmental or non-electing church plans and non-ERISA IRAs (other than participant-directed governmental and non-electing church plans) should be exempt from filing if they are administered by a qualified regulated entity and are in compliance with applicable federal reporting requirements. In the case of participant-directed governmental and non-electing church plans, because participants control the investment of assets and because such plans are less heavily regulated, FBAR filings by the plan may be appropriate. In any case, duplicative filings (*e.g.,* by plan participants, administrators, investment advisers or their employees) should not be required where FBARs are filed by the employer (where applicable), a trustee or other custodian and no filings by plan participants etc. should be required if the plan is exempt from filing.

Regulated Entities: We recommend that Treasury and the IRS consider exempting from the FBAR reporting regime foreign financial accounts not located

in secrecy jurisdictions that are held by well-regulated entities. For example, it might be determined to be appropriate to exempt banks from reporting these accounts, particularly in view of the fact that banks are subject to significant other reporting obligations under the Bank Secrecy Act. Similarly, we suggest that Treasury consider an exemption for domestic broker-dealers that are registered with the SEC, and perhaps for other highly regulated entities, such as insurance companies. Registered investment companies might also be candidates for exemption.

If these proposals are adopted, consideration would need to be given to whether also to exempt their employees with signature authority but no financial interest, as that might result in no FBAR filings at all by the entity or its affiliates.

Tax-Exempts: We propose that tax-exempt organizations be permitted to report FBAR information on Form 990 as an alternative to filing an FBAR, with an appropriate exception from public inspection.

Proposals relating to the definition of a "financial interest"[7]

General: If our proposals to minimize duplicative filings discussed in Part VI.A (especially our "qualified filer" proposal) are not adopted, we request guidance on whether and when a United States person with an interest in a foreign financial account held through a United States institution is or should be viewed as having a "financial interest" therein. We recommend that Treasury and the IRS consider an exemption from filing with respect to foreign accounts created for the benefit of United States persons by domestic banks or other regulated entities (perhaps including broker-dealers and insurance companies) in the ordinary course of the financial institutions' business, such as "sweep" accounts, gold accounts, multi-currency accounts, etc.

We also recommend consideration of a rule specifying that any person determined to control another's investments, whether via ownership, rights to acquire, managerial or other authority or otherwise, may be viewed as indirectly owning the latter's foreign financial accounts. We suggest that perhaps a rule to the effect that majority ownership is rebuttably presumed to meet this criterion would be appropriate.

Trusts: We propose that FBAR reporting not be required by beneficiaries who have (i) no access to trust information, (ii) no power to control disposition of trust assets, and (iii) no U.S. tax liability associated with their interest in the trust in the relevant year. However, FBAR reporting would be required where the beneficiary receives distributions in excess of 50% of the trust's aggregate distributions during the calendar year. Specifically, we propose the following

[7] See discussion in Part VII.C.

rules for determining when United States person has a reportable interest in trust assets:

- A United States person who has a purely discretionary interest in a trust should not be treated as having a financial interest in the trust's foreign accounts except for years in which he or she has received distributions sufficient to trigger reporting on that basis per the rule below.

- A United States person who receives more than 50% of the total amount of distributions made from a trust during a calendar year should be treated as having a financial interest in the trust's foreign accounts for the year, regardless of the amount of the trust's income for the year and regardless of whether the trustee treats the distributions as being made out of trust income or trust principal.

- A person who is only a contingent beneficiary or a remainder beneficiary of a trust should not be treated as having a financial interest in the trust's foreign accounts.

- Potential and actual appointees under limited and general powers of appointment over trust property should be treated the same as trust beneficiaries, *i.e.,* the same rules above should apply to beneficiaries of a trust and potential and actual appointees under powers of appointment in the same way. Moreover, amounts paid out of a trust to appointees pursuant to the exercise of a power of appointment should be treated as trust distributions in making the determination whether a U.S. person has received more than 50% of the total amount of trust distributions.

- A United States person who has a right of revocation or a presently exercisable general power of appointment over more than 50% of the trust fund (generally measured by value) should be treated as having a financial interest in the foreign accounts owned by the trust. However, if these powers can be exercised only over a portion of a trust and that portion does not contain interests in reportable foreign accounts, then the power holder should not be treated as having a financial interest in the trust's foreign accounts.

- In the case of a foreign trust the trustee of which is not a United States person, the grantor of the trust, if he or she is then living, should be treated as having a financial interest in the trust's foreign accounts. The "grantor" would be defined as any person who created the trust or made a gratuitous transfer to the trust.

If a trust is both a "person" and the "owner of record or holder of legal title" of trust property, we ask for additional guidance clarifying (i) whether a United States person acting as trustee has a financial interest in a trust account separate from the trust by reason of holding record ownership of the account as a matter of property law or by reason of a particular financial institution's account naming conventions, and (ii) the proper mechanism for attributing financial interests in trust holding company accounts to U.S. trust beneficiaries.

We observe that the filing requirement for trust protectors would be unnecessary if the proposals set forth above are adopted. If it is determined to retain this provision, we recommend that (i) the provision should not apply if under applicable law the trust protector is considered to be a fiduciary, (ii) the applicability of the provision be conditioned the on the trust protector having trustee removal powers, (iii) the terms "responsible for monitoring the activities of a trustee" and "authority to influence the decisions of the trustee" be clarified, and (iv) the power to "recommend the replacement of" a trustee be removed from the definition of "financial interest."

Proposals relating to the definition of "signature or other authority"[8]

Bank employees: We believe that it would make sense for the bank employee exception (indeed, any employee exception) to apply where the bank, any of its affiliates or FBAR consolidated group members, or any of their employees, is filing an FBAR, provided that appropriate information relating to the account is maintained in the United States. To ensure adequate reporting, banks could file FBARs that list the employees who have signature or other authority over accounts because of their employment with the bank or its affiliates. We also recommend that Treasury and the IRS consider extending the exemption to cover any accounts (whether or not of banks, and whether or not of domestic entities) the customer data with respect to which are subject to the jurisdiction of federal – or even state – regulators (whether bank regulators or not). Treasury and the IRS should also consider identifying non-U.S. jurisdictions whose banks are sufficiently well regulated to qualify their employees for an exemption.

Employees of regulated entities: We recommend that Treasury and the IRS consider expanding the bank employee exception to cover employees of subsidiaries of nonpublic banks (and domestic branches of foreign banks). We also recommend expanding the bank employee exception to include employees of broker-dealers that are registered with the SEC, and that consideration be given to expanding the employee exception to cover employees of other types of regulated entities.

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[8] See discussion in Part VII.D.

Public and non-public company employees: If our proposal that all employees of any entity be exempt from filing with respect to accounts over which they have only signature authority in the course of their business, if their employer or anyone else in the employer's group is filing a report, is not adopted, we would support a determination that going forward, foreign corporations doing business in the United States (assuming it is determined that foreign corporations must file FBARs if they are doing business in the United States) be entitled to the public corporation employee exception provided that adequate records are maintained in the United States.

We also recommend that the public company exception be expanded to include LLCs, partnerships and other entities (as opposed to only corporations). We would further recommend exempting from filing company employees responsible for pension accounts, given the degree of regulation and supervision to which they are subject.

If our proposal to expand the employee exceptions significantly is not adopted, we think Treasury and the IRS should clarify that "subsidiaries" whose employees are entitled to the exception should be controlled by the parent (*i.e.*, majority-owned). If the rule is retained in its current form, Treasury and the IRS should clarify that a subsidiary's employee is exempt with respect to any account of the subsidiary, the parent or any other subsidiary over which he or she has signature authority but no financial interest if the parent states that it has filed. We see no need for a condition to the availability of the exception that the CFO or another responsible officer of the parent state in writing that it is filing the FBAR.

Trusts: We propose that holders of powers of appointment over trusts with foreign financial accounts be required to file FBARs pursuant to the following rules:

- In the case of a power of appointment that is not presently exercisable (*e.g.,* the power is exercisable only upon the holder's death), the holder of the power should not be considered to have "signature or other authority" over a foreign financial account held by the trust.

- In the case of a presently exercisable general power of appointment, the holder of the power should be treated as a beneficiary of the trust and subject to the FBAR rules that are applicable to trust beneficiaries.

- In the case of a presently exercisable limited power of appointment, it may be appropriate to treat the holder of the power as having "signature or other authority" over a foreign account held by the trust.

Government Employees: We recommend that Treasury and the IRS consider exempting employees of government agencies from filing.

Proposals relating to the definition of "foreign"[9]

We recommend that Treasury and the IRS clarify that an offshore investment fund managed in the United States, with books and records maintained in the United States, is treated as "foreign" for FBAR purposes. It might be appropriate to treat accounts maintained at foreign institutions as foreign unless those accounts are ***both*** in the United States (*e.g.,* at a U.S. branch) ***and*** subject to U.S. regulatory oversight.

Proposals relating to the information to be reported on the FBAR form[10]

Maximum value: We recommend that Treasury and the IRS clarify the proper valuation rule for accounts that hold securities and other non-monetary assets but do not issue periodic statements.

TINs: We recommend implementing a procedure by which "United States persons" without a TIN or other available identifying number can receive a U.S. identifying number.

25 or more accounts: We propose eliminating abbreviated filing rules for filers with financial interests in or signature or other authority over 25 or more accounts.

Account values: We propose that the IRS restore the requirement that filers report only the aggregate maximum value of their foreign accounts, within a range of values.

Beneficial owner information: We recommend that Treasury and the IRS consider requiring disclosure of the identities of not only the legal owners of foreign financial accounts but also (when known) the beneficial owner(s) thereof for tax purposes.

Proposals relating to procedure[11]

General: We recommend that taxpayers be required to file FBARs with their tax returns, pursuant to all the procedural processes of the income tax rules but subject to a legislative FBAR exception to the Section 6103 tax return confidentiality requirements. If this proposal is not adopted, or until a legislative

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[9] See discussion in Part VII.E.

[10] See discussion in Part VII.F.

[11] See discussion in Part VII.G.

FBAR exception to Code Section 6103 confidentiality is adopted, we recommend that Treasury and the IRS subject the FBAR regime to procedures analogous to those in Title 26, including electronic filing for all filers, with mandatory electronic filing for large institutions, and reconsider permitting reporting based on a fiscal rather than a calendar year. If our suggestion to adopt the procedural framework of Title 26 *in toto* is not accepted, we recommend at least allowing extensions for FBAR filing and adopting a mailbox rule.

Paperwork Reduction Act: We recommend that Treasury and the IRS reevaluate the Paperwork Reduction Act notice provided at the bottom of the first page of the FBAR.

Penalties: A possible reading of the statutory reasonable cause exception is that if a filer has reasonable cause for not filing the FBAR, the filer will benefit from the reasonable cause exception only if the filer files an FBAR at some later date. We recommend that Treasury and the IRS clarify whether or not a filer is required to file without prompting from the government in order to establish reasonable cause, and consider whether it is appropriate to take account of other types of voluntary reporting in determining whether the reasonable cause exception is available.

II. Purposes and Principles

Before discussing the history of the FBAR, we briefly review Congress's purposes in creating (and updating) the FBAR statutory regime and summarize our own views of the principles underlying the rules and how those principles might guide construction of a foreign bank account reporting regime "on a blank slate." This analysis leads us to several over-arching recommendations, discussed further below and in Parts VI and VII.

A. Statutory History and Purpose

The FBAR rules originated as one of several regulatory regimes established under the Currency and Foreign Transaction Reporting Act of 1970 (informally known as the "**Bank Secrecy Act**" or "**BSA**") in response to a congressional perception of widespread use of transactions with foreign financial agencies to commit a variety of crimes.[12] Although the FBAR rules today are largely enforced by the IRS, the BSA is codified not in Title 26 of the United States Code, but rather in Title 31 (Money and Finance), Subtitle IV (Money), Chapter 53 (Monetary Transactions), Subchapter II (Records and Reports on Monetary Instruments Transactions). As a result, FBAR information may be

[12] *Currency and Foreign Transaction Reporting Act*, Pub. L. No. 91-508, 84 Stat. 114 (codified at 31 U.S.C. Section 5311 *et seq.*).

shared with agencies other than Treasury, because the information is not subject to the privacy rules that prevent sharing of information provided under Title 26.[13]

The primary purpose of the BSA was to furnish U.S. law enforcement authorities with "the tools necessary to cope with the problems created by so called secrecy jurisdictions."[14] Congress observed that some of those jurisdictions did not recognize cheating on taxes, violating securities laws or other similar acts as criminal, and that those countries and their financial institutions do not "afford the slightest cooperation to American authorities."[15] Congress acknowledged that it was not feasible to apply U.S. law in foreign countries. The BSA therefore authorized the imposition of recordkeeping and reporting obligations on persons in the United States who deal with foreign financial agencies.[16]

The relevant committee reports indicate that Congress was concerned with a wide variety of financial crimes. The House Committee explained that foreign bank accounts were being used to commit "white collar" crime; support organized crime; evade income taxes; conceal assets illegally and purchase gold; avoid securities regulations; defraud the United States; serve as depositories for proceeds from illicit activities in Vietnam; serve as "a source of questionable financing" for stock acquisitions, mergers and takeovers; support conspiracies to steal from U.S. defense and foreign aid funds; and permit money laundering.[17] The Senate Committee added to that list avoidance of capital gains taxes on sales of securities, market manipulation, insider trading, avoiding Federal Reserve margin requirements and other financial misdeeds.[18]

The statutory "declaration of purpose" of the BSA recites the goal of gathering or preserving information that has a "high degree of usefulness" in criminal, tax or regulatory investigations:

> It is the purpose of [the BSA] to require certain reports or records where they have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings. . . .[19]

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[13] The confidentiality rules are set forth in Code Section 6103, which is applicable only to tax filings required under Title 26.

[14] H.R. REP. No. 91-975, at 10 (1970), *reprinted in* 1970 U.S.C.C.A.N. 4394, 4404.

[15] *Id.*

[16] *See id.* at 13.

[17] *Id.* at 3.

[18] S. Rep. No. 91-1139, at 3-4 (1970).

[19] 31 U.S.C. Section 5311.

Pursuant to this statement of purpose, the BSA introduced regimes in addition to the FBAR that allow the government to obtain information that may be useful for investigative purposes. For example, the BSA authorizes the Secretary of the Treasury to require domestic financial institutions and their directors, officers and employees to file reports, known as suspicious activity reports ("**SARs**"), of suspicious transactions relevant to possible violations of law or regulation.[20] The BSA also requires a person transporting more than $10,000 in monetary instruments into or out of the United States to report that information to the U.S. government.[21] Similarly, the BSA authorizes the Secretary of the Treasury to require information reporting for certain transactions involving domestic coins and currency,[22] as well as transactions in foreign currency.[23]

The provision of the BSA specifically authorizing the FBAR (the "**FBAR Provision**") has two parts. The main part grants Treasury the authority to impose reporting and recordkeeping requirements on persons in the United States making a transaction or maintaining relations for any person with a foreign financial agency:

> the Secretary of the Treasury shall require a resident or citizen of the United States or a person in, and doing business in, the United States, to keep records, file reports, or keep records and file reports, when the resident, citizen or person makes a transaction or maintains a relation for any person with a foreign financial agency.[24]

Under this rule, to come within the scope of the statute, one must either transact with, or maintain a relation for another person with, a "foreign financial agency." The BSA defines the term "financial agency" as follows:

> "financial agency" means a person acting for a person . . . as a financial 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.[25]

By highlighting financial institutions, bailees and depositary trustees that deal in money, credit, securities and gold, the statute suggests that the term "financial

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[20] *Id.* Section 5318.

[21] *Id.* Section 5316.

[22] *Id.* Section 5313.

[23] *Id.* Section 5315.

[24] *Id.* Section 5314(a).

[25] *Id.* Section 5312(a)(1).

agency" encompasses persons that transact in cash and other highly liquid investments.

The BSA definition of "financial institution"[26] has a similar focus on businesses that handle cash. The term includes not only traditional financial institutions such as insured banks, commercial banks and credit institutions, and brokers and dealers in securities, but also persons and entities that deal in cash on a regular basis, such as casinos and pawnbrokers. In addition, a "financial institution" includes persons and entities associated with the transportation of cash and other monetary instruments, such as a business engaged in vehicle sales (including automobile, airplane and boat sales), travel agencies, and telegraph companies.[27] Finally, the phrase includes "any other business designated by the Secretary whose *cash transactions* have a high degree of usefulness in criminal, tax or regulatory matters."[28] Based on the statutory definition, Treasury has characterized the term "financial institution" as "generally includ[ing] businesses that deal in cash, securities, or other types of assets that can be readily converted into cash."[29] In 2008, Treasury considered taking regulatory action to treat hedge funds, private equity funds, and venture capital funds as "financial institutions" subject to an unrelated provision of the BSA, and stated that it would not do so before publishing a notice and providing an opportunity for comments.[30]

Consistent with the goal of gathering information about dealings outside the United States, the statute treats a financial agency as domestic or foreign based upon whether it is acting inside or outside the United States. The statute provides that the terms "foreign financial agency" and "foreign financial institution" will "apply to an action outside the United States of a financial agency

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[26] *Id.* Section 5312(a)(2).

[27] *Id.*

[28] *Id.* Section 5312(a)(2)(Z) (emphasis added).

[29] 67 Fed. Reg. 60,617, 60,618 (Sept. 26, 2002). In *United States v. Clines*, 958 F.2d 578, 582 (4th Cir. 1992), the Fourth Circuit held that a company that provides bookkeeping, accounting and financial management services can be considered a "financial institution." In that case, the defendant claimed that his financial account was not "maintained with a financial institution" and thus was not reportable for FBAR purposes. The court disagreed, holding that because the capital account was maintained by the financial services company and its employees, who transmitted funds for the defendant at his direction, the company constituted a "financial institution": "By holding funds for third parties and disbursing them at their direction, CSF functioned as a bank . . . ." *Id.* (citing 31 U.S.C. Section 5312(a)(2)(C); 31 C.F.R. Section 103.11(e)(1)). Because it maintained accounts for its clients that consisted of various securities, currencies and commodities, the court concluded that it was "an investment banker or investment company," one of the BSA's enumerated types of financial institutions. *Id.* (citing 31 U.S.C. Section 5312(a)(2)(I)). The court further held that in sending wire transfers of funds to appellant's bank accounts, the company also operated as a "licensed sender of money" *Id.* (citing 31 U.S.C. Section 5312(a)(2)(R)).

[30] *See* Part IV.C.1.

or institution."[31] Similarly, the term "domestic financial agency" or "domestic financial institution" will "apply to an action in the United States of a financial agency or institution."[32] The "United States" for this purpose includes the States of the United States, the District of Columbia and, to the extent provided in regulations, territories or possessions of the United States or military or diplomatic establishments.[33]

Although the FBAR Provision provides a broad and general grant of authority to Treasury to determine the scope of the filing and recordkeeping requirements, the statute requires Treasury to consider the need to avoid burdens on commerce and filers. Specifically, the FBAR Provision directs Treasury, in exercising this authority, to consider:

> the need to avoid impeding or controlling the export or import of monetary instruments and the need to avoid burdening unreasonably a person making a transaction with a foreign financial agency . . . .[34]

Congress was conscious of the burden that reporting could impose on filers and actively sought to minimize that burden. The House Committee observed that it "considered it of high importance . . . not to create obstacles to the free flow of legitimate international trade and commerce."[35] Accordingly, Congress authorized the Secretary of the Treasury to exempt "a reasonable classification" of persons, foreign countries or transactions,[36] noting that:

> Obviously, the Secretary [of the Treasury] could impose recordkeeping and reporting requirements which would create a substantial and harmful burden on the free flow of legitimate international commerce or could result in a requirement of much valueless paperwork, but [the] committee has every confidence that he will not, especially in view of his broad powers of exemption.[37]

Consistent with the goals of collecting highly useful information while minimizing the compliance burden, the FBAR Provision contemplates that

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[31] 31 U.S.C. Section 5312(b)(2).

[32] *Id.* Section 5312(b)(1).

[33] *Id.* Section 5312(a)(6).

[34] *Id.* Section 5314(a).

[35] H.R. REP. No. 91-975, at 4.

[36] 31 U.S.C. Section 5314(b)(2) (authorizing the Secretary of the Treasury to use its power of exemption "if the Secretary decides applying the requirement or regulation to all foreign countries. . . is unnecessary or undesirable").

[37] H.R. REP. No. 91-975, at 46.

Treasury would provide for appropriate exceptions and limitations. Specifically, the Secretary may prescribe:

> (1) a reasonable classification of persons subject to or exempt from a requirement under this section or a regulation under this section;
>
> (2) a foreign country to which a requirement or a regulation under this section applies, if the Secretary decides applying the requirement or regulation to all foreign countries is unnecessary or undesirable;
>
> (3) the magnitude of transactions subject to a requirement or regulation under this section;
>
> (4) the kind of transaction subject to or exempt from a requirement or a regulation under this section; and
>
> (5) other matters the Secretary considers necessary to carry out this section or a regulation under this section.[38]

As discussed in greater detail below, Treasury has not identified any significant classification of persons exempt from the FBAR regime (apart from relatively narrow exceptions for employees of domestic banks and certain domestic corporations and for consolidated filings by domestic corporations). Nor has it identified foreign countries to which applying the FBAR regime is unnecessary or undesirable. It has established a minimum value for transactions and accounts subject to reporting but has not changed that threshold since 1986. Also, the current rules often require multiple FBARs to be filed for the same account and require the forms be filed on paper, with only three accounts reported per page, even for persons required to report thousands of accounts.[39] Thus, in some cases filers are required to file reams of paper to meet their FBAR requirements as currently interpreted by the IRS and Treasury. We believe this is the kind of burden Congress had "every confidence" Treasury would avoid. One theme of our recommendations is to urge Treasury and IRS to focus on the core purposes of the FBAR Provision and to use their exemptive authority more broadly so that the congressional goals might be better achieved.

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[38] 31 U.S.C. Section 5314(b).

[39] As discussed in Part VII.F.3, filers with a financial interest in more than 25 accounts need not separately identify each of them, persons filing on a consolidated basis must identify the owner of each account and filers with signature authority over more than 25 accounts also must identify the owner of each account, although they need not complete every field on the form for each account.

B. Observations on the Purposes of the FBAR Regime

In this Subsection, we make general observations about the original purposes of the FBAR regime, how those purposes might be affected by developments since 1970 and how the FBAR regime relates (or should relate) to federal income tax enforcement, as well as some "blank slate" observations about the FBAR regime in general.

1. Original purposes of the FBAR regime

It is clear that Congress's primary concern in passing the FBAR Provision in 1970 was the use of secret foreign bank accounts.[40] Indeed, the Senate Committee observed that while the general purpose of the BSA was to combat white-collar crime, the Act "is particularly directed at obtaining more information on the use of secret foreign bank accounts by U.S. citizens or residents."[41] The Senate Committee explained that when "seeking to track down [] U.S. lawbreakers, our law enforcement officials are frequently stymied by the iron wall of secrecy surrounding bank accounts in foreign countries with strict secrecy laws."[42] The House Committee, moreover, heard what it described as:

> considerable testimony . . . from the Justice Department, the United States Attorney for the Southern District of New York, the Treasury Department, the Internal Revenue Service, the Securities and Exchange Commission, the Defense Department and the Agency for International Development about serious and widespread use of

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[40] For financial crimes, secrecy is virtually a requirement. Indeed, there is a "presumption by Congress that secret foreign bank accounts and secret foreign financial institutions are inevitably linked to criminal activity in the United States." *United States v. Hajecate*, 683 F.2d 894, 899 (5th Cir. 1982) (citing H.R. REP. No. 91-975, at 4-5; S. REP. No. 91-1139 (1970); Foreign Bank Secrecy and Bank Records: Hearings on H.R. 15073 Before the House Committee on Banking and Currency, 91st Cong. (1969-1970); Foreign Bank Secrecy: Hearings on S. 3678 & H.R. 15073 Before the Subcommittee on Financial Institutions of the Senate Committee on Banking and Currency, 91st Cong. (1970)). Congress was also aware in originally enacting the BSA of the importance of secrecy in committing tax crimes. *See* S. REP. 91-1139, at 4 ("With the growing use of secret foreign bank accounts, law enforcement officials have become increasingly concerned with the loss of tax dollars."). The House Committee heard testimony on "serious and widespread use of foreign financial facilities located in secrecy jurisdictions for the purpose of violating American law." H.R. REP. 91-975, at 38. They identified "[s]ecret foreign bank accounts and secret foreign financial institutions" as the tools that enabled crimes and tax evasion. *Id.* Further, the House Committee was concerned with the difficulty of obtaining information not from all overseas sources, but only from secrecy jurisdictions. *See id.* (discussing the difficulties in receiving evidence and testimony from secrecy jurisdictions).

[41] S. REP. No. 91-1139, at 1.

[42] *Id.* at 2.

foreign financial facilities located in secrecy jurisdictions for the purpose of violating American law.[43]

In fact, however, we tend to think the focus of the rules should not be solely on secrecy but also on what we'll call "anonymity." That is to say, while we understand that a number of jurisdictions have laws in effect to protect the identity of owners of financial accounts located in that jurisdiction (and we believe accounts located in those jurisdictions were intended to be within the scope of the regime), we are also confident that there is a larger universe of jurisdictions that do not have what Treasury would view as sufficiently adequate supervision of banking and other financial activities conducted in the jurisdiction to ensure that information regarding financial assets held in that jurisdiction could be provided, were Treasury or other enforcement agencies to request it.

We also believe that the focus of Congress in 1970 was on dealings in cash and cash equivalents. The legislative history repeatedly refers to bank accounts. The FBAR provision requires that there be a transaction or relation with a "foreign financial agency," a term that is defined with a focus on businesses whose "cash transactions" have a high degree of usefulness in "criminal, tax, or regulatory matters."[44] Other provisions of the BSA enacted at the same time were generally focused on cash transactions, including the transport of more than $10,000 in monetary instruments into or outside the United States,[45] transactions involving domestic coins and currency[46] and the reporting of transactions in foreign currency.[47] This is not to say that the FBAR should be limited to transactions or relationships involving dealings in cash or cash equivalents, but serious consideration should be given to how far this clear statutory focus should be expanded.

In summary, we think Congress's objectives in enacting the FBAR Provision were to increase the likelihood of learning about malfeasance committed by using readily available funds maintained in "secrecy" or "anonymity" jurisdictions, while minimizing the burden on legitimate commerce and avoiding wasteful reporting. The current FBAR rules do not address well either of these concerns. They (arguably) require reporting of virtually all foreign investments, imposing extraordinarily burdensome and wasteful obligations on both filers and the government.

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[43] H.R. REP. No. 91-975, at 38.

[44] 31 U.S.C. Section 5312(a)(2)(Z).

[45] *Id.* Section 5316. The original reportable amount was $5,000. *See* Pub. L. No. 91-508, Section 231, 84 Stat. 1114 (1970). The amount was increased to $10,000 in 1984. *See* Pub. L. No. 98-473, Section 901(c), 98 Stat. 1837 (1984).

[46] 31 U.S.C. Section 5313.

[47] *Id.* Section 5315.

2. Effects of intervening events

Several intervening events have arguably changed the landscape in ways that may have led some to consider it appropriate for the BSA to reach beyond its originally contemplated grasp. First, the USA PATRIOT Act, passed on October 26, 2001, expanded the purposes of the BSA to include deterring and investigating terrorism.[48] The USA PATRIOT Act further instructed the Secretary of the Treasury to "study methods for improving compliance" with the FBAR rules and report to Congress on those methods on an annual basis.[49]

The adoption of the BSA as a weapon against terrorism could be viewed as implying a de-emphasis on the importance of "secrecy," on the theory that terrorists are less interested than other criminals in "getting away with" their crimes without anyone ultimately discovering their identities. Also, a focus on terrorism could be viewed as affecting the calculus of the trade-off between discovering malfeasance and burdening legitimate commerce, although we consider it significant as a textual matter that the USA PATRIOT Act did not change the language of the FBAR Provision or indicate an intention to de-emphasize Congress's clearly articulated concerns in this regard.

In addition, SARs have become a more common tool in reporting information to Treasury's Financial Crimes Enforcement Network ("**FinCEN**") pursuant to the BSA. In addition to manual monitoring, financial institutions use increasingly sophisticated automated technologies to detect suspicious patterns of activity.[50] More than 1.2 million SARs were filed in 2007, more than half by domestic depository institutions (banks, thrifts and federally chartered credit unions).[51] Law enforcement agencies, FinCEN and financial institutions work

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[48] *See USA PATRIOT Act*, Pub. L. No. 107-56, Section 358(a), 115 Stat. 272, 326 (2001) (adding "in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism" to the purpose provision of the BSA).

[49] *See id.* Section 361(b).

[50] Government Accountability Office, *Suspicious Activity Report Use Is Increasing, but FinCEN Needs to Further Develop and Document Its Form Revision Process*, at 4 (Feb. 2009), *available at* Hhttp://www.gao.gov/new.items/d09226.pdfH (last visited Oct. 23, 2009).

[51] FinCEN, *The SAR Activity Review – By the Numbers*, Issue 12, at 4 (June 2009), *available at* Hhttp://www.fincen.gov/news_room/rp/files/sar_by_numb_12.pdfH (last visited Oct. 23, 2009); GAO, *Suspicious Activity Report Use*, *supra* note 50, at 15. Most of the rest of the SARs filed in 2007 were filed by money services businesses (*i.e.,* money transmitters; money order and traveler's check issuers, sellers and redeemers; and the U.S. Postal Service); the securities and futures industry filed slightly more than 1% of all SARs, while casinos and card clubs filed just under 1%. FinCEN, *The SAR Activity Review – By the Numbers*, *supra*, at 4. SARs filed by the 31 largest depository institutions represented about half of all SARs filed. In total, more than 9,000 depository institutions filed SARs in 2007. GAO, *Suspicious Activity Report Use*, *supra* note 50, at 16-17.

together to ensure that SARs will be structured in a useful manner.[52] In turn, FinCEN, law enforcement (federal, state and local) and financial regulators use SARs to investigate and examine financial institutions, as well as to provide "public and nonpublic analytical products to law enforcement agencies and depository institution regulators."[53] Law enforcement agencies report that SARs "can be useful in investigations months or years after they have been filed . . . ."[54] Agencies that make use of SARs include the Federal Bureau of Investigation; the Drug Enforcement Agency; the Bureau of Alcohol, Tobacco, Firearms and Explosives; the Department of Homeland Security Criminal and National Security Divisions; the Executive Office for U.S. Attorneys; U.S. Attorneys; the Secret Service; Immigration and Customs Enforcement and the IRS.[55]

Much of the recent increase in filings of SARs relates to fraud (including check fraud, mortgage loan fraud, consumer loan fraud, wire transfer fraud, commercial loan fraud and debit and credit card fraud).[56] The number of SARs filed in relation to terrorist financing has been decreasing since 2004.[57] SARs related to money laundering or structuring transactions constitute almost half of all SARs filed by domestic banks.[58]

This information is perhaps suggestive of the types of criminal activity that are most commonly associated with the misuse of bank and financial accounts and might inform the structuring of the FBAR regime, although it is possible that some types of crimes may be less likely to be discovered by SARs because ***only*** domestic financial institutions are obligated to file them. For example, we expect that persons engaging in tax evasion are not likely to deal with institutions that are subject to U.S. tax information reporting rules.

Some further information on the types of criminal activity associated with foreign financial accounts can be gleaned from reported cases that mention FBARs. Of the fifteen cases that involve penalties for failure to file an FBAR,

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[52] *See* GAO, *Suspicious Activity Report Use*, *supra* note 50, at 5.

[53] *Id.* at 6.

[54] *Id.* at 2.

[55] *Id.* at 10. Treasury tracks FBAR filings and other BSA forms, such as SARs, on the same system. Filed FBARs are entered into the Treasury's Currency and Banking Retrieval System, a database accessible by government agencies engaged in criminal, tax and other regulatory matters. *See generally* I.R.M. Sections 4.26.4, 4.26.16.3.7. Presumably the IRS, FinCEN and other government agencies use the system to link transactions reported by financial institutions on various other BSA forms, perhaps including SARs, with the account owners reported on FBARs.

[56] FinCEN, *The SAR Activity Review – By the Numbers*, *supra* note 51, at 5.

[57] *Id.*

[58] *Id.*

seven involved criminal prosecutions for tax crimes.[59] Three of these involved defendants who were of interest for activities unrelated to tax crimes (namely, health-care fraud, arms trading and drug crimes).[60] We do not know whether review of FBAR filings or failures to file FBARs led to these prosecutions. All of the other reported cases discussing failures to file an FBAR involved civil tax violations.[61]

We also, obviously, have no way to know how many criminal or other prosecutions (including plea agreements and other settlements) may have involved alleged FBAR violations. For a bit of anecdotal evidence, Treasury, in its April 2002 report to Congress on the FBAR regime, stated that prosecutors "prefer charges that are easily understood and which have greater jury appeal, such as tax evasion, fraud, or money laundering," rather than the technical and unnecessarily complicated charge of a failure to file an FBAR.[62] In addition, the

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[59] *See Anderson v. Commissioner*, T.C. Memo. 2009-44 (Feb. 24, 2009) (criminal tax evasion); *United States v. Srivastava*, 444 F. Supp. 2d 385 (Dist. Md. 2006) (criminal health-care fraud was impetus for investigation; criminal tax evasion and tax fraud added based on search warrant findings, though the tax crimes evidence was suppressed and defendant was not convicted); *Clines*, 958 F.2d 578 (tax crimes; also involved in providing arms to Nicaraguan contras); *United States v. Holland*, 956 F.2d 990 (10th Cir. 1992) (criminal tax fraud; also involved in money laundering scheme); *United States v. Sturman*, 951 F.2d 1466 (6th Cir. 1991) (tax crimes; also involved in pornography distribution scheme); *United States v. Harvey*, 869 F.2d 1439 (11th Cir. 1989) (criminal failure to report interest income from proceeds of illegal drug-related activities; informal immunity from DEA on drug crimes).

[60] *See Berrettini v. Federal Bureau of Prisons*, 2009 U.S. Dist. LEXIS 58116 (S.D.N.Y. July 8, 2009) (financial and tax crimes; civil case regarding procedural issues with habeas petition); *Srivastava*, 444 F. Supp. 2d 385 (criminal health-care fraud was impetus for investigation; criminal tax evasion and tax fraud added based on search warrant findings, though the tax crimes evidence was suppressed and defendant was not convicted); *Clines*, 958 F.2d 578 (tax crimes; also involved in providing arms to Nicaraguan contras); *Harvey*, 869 F.2d 1439 (criminal failure to report interest income from proceeds of illegal drug-related activities; informal immunity from DEA on drug crimes).

[61] *See Williams v. Commissioner*, 131 T.C. No. 6 (Oct. 2, 2008) (civil tax deficiencies); *United States v. Simonelli*, 614 F. Supp. 2d 241 (D. Conn. 2008) (bankruptcy discharge issues); *Thompson v. United States*, 2008 U.S. Dist. LEXIS 70515 (S.D. Tex. 2008) (civil tax deficiencies); *Heydemann v. United States*, 2008 U.S. Dist. LEXIS 53875 (D. Md. 2008) (civil tax penalties); *Chan v. Commissioner*, T.C. Memo. 1997-154 (Mar. 26, 1997) (civil tax deficiencies and accuracy-related penalties); *Polidori v. Commissioner*, T.C. Memo. 1996-514 (Nov. 19, 1996) (civil tax deficiencies and civil tax fraud; petitioner previously pled guilty to and was convicted of filing false income tax returns); *Lerch v. Commissioner*, T.C. Memo. 1987-295 (June 15, 1987) (civil tax deficiencies and civil tax fraud); *Fisher v. Commissioner*, T.C. Memo. 1986-217 (May 29, 1986) (civil tax deficiencies).

[62] Secretary of the Treasury, *A Report to Congress in Accordance with § 361(b) of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001*, 9 (Apr. 26, 2002).

report states that it is often difficult to prove that the failure to file an FBAR was willful, presenting substantial litigation risk in FBAR prosecutions.[63]

Further, we have no way to know from this case history or any other source whether or to what extent filed FBARs are used as tools in the investigation or prosecution of criminal activity. We therefore can do no more than observe, from a layperson's perspective, that there is a distinct lack of evidence that FBARs have been widely or systematically used by law enforcement in the investigation or prosecution of potential criminal activity, other than tax crimes.

A third category of intervening events, the recent focus on FBAR obligations in the context of tax crimes, might lead to a de-emphasis on the importance of the ready availability, or "liquidity," of offshore assets. This is because the most salient factor in using offshore assets to commit or conceal tax crimes, as opposed to other financial crimes, is the ability to maintain those assets secretly (and in a low- or no-tax environment).

This of course may be true. However, we are concerned that the attempt to use the FBAR to identify a multitude of different and unrelated categories of crimes, with different characteristics, features and patterns of activity, risks causing the regime to collapse under its own weight. A regime that is intended to cover everything that could conceivably be associated with criminal activity could in fact end up achieving little, and will in any event surely be quite burdensome and potentially unenforceable. We therefore think it critical to articulate the finite purposes of the FBAR regime, and to take care to ensure that the regime is narrowly and clearly crafted to meet those purposes. We believe that it remains the case that the FBAR will most effectively achieve its purposes of helping Treasury to combat financial crimes if it is directed at collecting information regarding assets maintained in suspect (*e.g.,* secrecy/anonymity) jurisdictions, while minimizing the burden on legitimate commerce and wasteful reporting.

To accommodate the recent focus on tax crimes, we think consideration might be given to whether the importance of "liquidity" or "ready availability" of offshore assets remains as important as it was when the BSA was enacted. As discussed further in Part VI.B, depending on how broadly Treasury and the IRS choose to interpret the scope of the FBAR rules, we think that it might be appropriate to add low or no tax to the list of suspect features (along with secrecy and anonymity) that Treasury might use in exempting from FBAR reporting transactions with financial agencies in certain jurisdictions.

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[63] *Id.* at 10.

3. Relationship to federal tax enforcement

The need to structure the FBAR regime to address tax crimes is far from obvious, however, given that it is in general already a crime for U.S. taxpayers willfully to fail to report taxable income and many other items of information, including in general amounts invested in foreign corporations, partnerships and trusts. Moreover, as we discuss further below, the FBAR is not structured to elicit information about tax crimes – it must be filed by non-taxpayers, is a calendar-year rather than a taxable-year report and requires information about asset values, not income.

There are several potential virtues of the FBAR from the perspective of tax crime discovery and enforcement, none of which we think is particularly well embodied in the FBAR rules as compared with more direct and efficient alternative approaches. First, the FBAR regime acts as a *de facto* statute of limitations extender – while the failure to report income is only one crime (in the year the income is earned), failure to report the amount of that income can be a crime ***every year*** that the amount remains in one or more foreign accounts. However, we think the regime is at best a blunt instrument in that regard; if it is desirable to extend a statute of limitations with respect to tax crimes, that should be done directly.

Second, the FBAR regime potentially makes *many* people liable to report the same information about a foreign bank account over which they have some amount of control, unlike the tax laws, which in general impose this sort of burden only on the taxpayer and a small number of information reporters and/or withholding agents that are in a position to know about or have custody over income of the taxpayer (typically, brokers, advisers and agents of the taxpayer). While the Code's various information-reporting regimes are complex and in some cases in need of repair, we think they work fairly well in this regard. Thus, we think an expansion of, or a regime modeled on, one of those regimes (*i.e.,* requiring one or a few people with knowledge of account-related information) would be more sensible than a regime that purports to require many people to do so. It is therefore an important question whether the FBAR regime's current emphasis on requiring potentially many people and entities to report the same information with respect to the same account is better than the typical tax reporting regime. We believe that it is extremely useful to have many people *potentially* required to report the same information, but that the ideal regime would have only one *actually* required to do so (in addition to the beneficial owner(s) of accounts). There are many ways to accomplish this goal, which we will discuss in more detail in Part VI.A, below.

We recognize that there are several potential benefits to having more than one person required to file FBARs with respect to any account, but we have significant concerns about whether those benefits outweigh the inefficiencies, burdens and risks inherent in structuring the regime in that manner. First, we

understand that the various enforcement agencies may well prefer to have as many people as possible filing an FBAR with respect to accounts of a single owner so that if there is prosecutorial or investigative interest in those accounts or that owner, there is a ready list of witnesses to call upon to see if relevant information can be learned. As we hope to illustrate throughout this report, the cost of this approach to the FBAR regime is an extraordinary burden on many thousands of people and the financial system as a whole, for the sake of perhaps marginally enhancing the information-gathering process with respect to a relatively small number of people and accounts. While we understand the desire to achieve such a result, we think this objective can be met otherwise than by attempting to deputize many, many people who have only a tangential (at best) relationship to relevant accounts and/or their owner(s). In any event, we think this effort to bring many, many people into the FBAR net puts an extraordinary burden on the government to define clearly and thoroughly every aspect of the rules, in particular who must file reports and under what circumstances, in order to ensure that the compliance obligations are enforceable – a burden that we honestly do not think has been met to date.

A second possible reason for multiple filings with respect to an account, applicable specifically in the context of tax crimes, would be that financial accounts tend to generate income, and "hidden" financial accounts tend to generate hidden income. This reason would in theory require only two filings – one by the owner of the account and one by someone with knowledge of the account and its owner. Presumably, anyone failing to file a required FBAR is likely not to be reporting the associated income (if any) on a tax return. Thus, there is a reason to want to "match" or "cross-check" third-party FBAR reports against the account owner's reports to determine whether the account owner is in compliance. However, the FBAR is at best a very blunt instrument in the effort to uncover unreported income. In particular, because the regime was not crafted specifically to deal with tax crimes, it among other things (i) treats as "account owners" (*i.e.,* persons with a "financial interest") people who are not taxpayers (including tax-exempts, disregarded entities, non-U.S. persons and, in general, persons that do not "beneficially own" the relevant account(s) for tax purposes), (ii) makes no effort to discern what (if any) taxpayer beneficially owns a financial account (with the result that cross-checking of this sort is of at best only very limited utility) and (iii) doesn't ask whether the relevant account even generates income. Moreover, as alluded to above, there already exist a number of crimes involving failures to report income.

If there is a desire to facilitate cross-checking of this sort, as discussed further in Part VI.A, we would recommend adding a schedule to ***tax returns*** requiring reporting of foreign financial accounts in which the taxpayer has a direct

or indirect beneficial ownership interest for U.S. tax purposes.[64] Alternatively, we would support a regime that required the "beneficial owners" of a foreign financial account or portion thereof, again *for U.S. tax purposes*, to file an FBAR. Also, as we discuss in Part VII.F.5, we think in this case it would make sense to develop rules requiring filers to state, when known, the identity of the beneficial owners of foreign financial accounts, as determined for U.S. tax purposes. This would minimize the number of "false positives" in the cross-checking process.

A third possible virtue of the FBAR regime in the context of tax crimes is that the FBAR rules are so broadly drafted, and their penalties so severe, that they might be viewed as easier to enforce than the underlying rules relating to tax crimes. This "virtue" (viewed from the narrow results-oriented perspective of a law enforcement agency, and assuming enforceability of the rules) encapsulates our principal concerns with these rules, discussed throughout this Part and elsewhere. We can understand the desire to have a regime that is so broadly crafted as to permit an argument that almost any foreign investment is reportable and the penalties for violations of which are so severe that most law-abiding citizens would be willing to help the government in its investigations of suspected tax crimes. However, as discussed in detail in Part VI.D, we have real concerns that the regime as currently crafted is for those very reasons unenforceable in a number of respects and in any event that it imposes a heavy burden on the IRS and Treasury to delineate clearly the scope of the various definitions and other rules composing the regime.

4. General observations about the uses of the FBAR

Turning now to the more general question of how the FBAR can be used to learn about malfeasance committed through the use of accounts in secrecy jurisdictions, we believe it useful to explore an ideal FBAR regime, one that would be narrowly focused on the original statutory and congressional purposes. We undertake this exercise at the outset not with the purpose of proposing such a regime but rather to examine more closely the balance between the need to secure highly useful information and the goal of avoiding unnecessary and undue burdens. In doing so, we focus solely on the goal of uncovering potential malfeasance while avoiding unnecessary compliance burdens, and we therefore

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[64] *See* Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals* (May 2009), *available at* Hhttp://www.treas.gov/offices/tax-policy/library/grnbk09.pdfH (last visited Oct. 23, 2009) (proposing that individual taxpayers be required to submit with their tax returns information on foreign financial accounts similar to that disclosed on the FBAR). We discussed this proposal in a recently submitted report. *See* New York State Bar Association Tax Section, *Report on Qualified Intermediary and Related Withholding and Information Reporting Legislation Proposed by the Administration* at 44-51 (Report No. 1189, Sept. 10, 2009), *available on the NYSBA Tax Section website at H*http://www.nysba.org/Content/ContentFolders20/TaxLawSection/TaxReports/1189Rpt.pdfH (last visited Oct. 23, 2009).

do not address other policy considerations that might be relevant to an analysis of the regime, including administrability, fairness, effects on international commerce and intergovernmental politics. We also reiterate that we are not experts in the investigation or prosecution of non-tax crimes. We think the ideal regime would result in the collection of exactly one report with respect to each bank or similar account maintained in a secrecy or anonymity jurisdiction (not including the beneficial owner(s) of the account). We also think that this regime would require reporting only where there is knowledge or reason to know that the relevant account might be used in the commission or concealment of a U.S. crime and would not otherwise be reported.

There are several observations embedded in those statements, some of which are obvious and others of which might be less so. First, as we discuss in somewhat greater detail below, there are many legitimate reasons for U.S. people to hold financial assets even in secrecy and/or anonymity jurisdictions. Thus, we suspect that most data collected – even under a regime that has eliminated duplication of reporting and limited reporting to "secret" or "anonymous" accounts that might be used in a financial crime – would not, in fact, be useful in combating financial crimes. The likelihood that irrelevant information will be collected of course does not mean that it is inappropriate to collect such information; we point out only that even so narrowly crafted a regime might not produce a high concentration of useful information.

Second, our supposition is that the most useful information the regime could collect is likely to come from persons that ***do not*** have a financial interest in the relevant accounts. As we discuss throughout this report, it seems clear to us that any person who both has a financial interest in a secret or anonymous foreign account and is using that account in or in connection with the commission or concealment of a crime can be expected not to file an FBAR, no matter how the rules are crafted. Moreover, we think it clear that the idea of the FBAR regime was to "deputize" U.S. people to report information regarding such accounts because the financial agencies maintaining accounts in these jurisdictions are likely to be either prohibited by local law from providing information about those accounts or unable to do so (for example, because they do not know the name(s) of the beneficial owner(s) of the accounts). Thus, we suspect that the most useful information is, in fact, likely to come from a U.S. person who does not have any interest in the relevant account but who, because of that person's employment or relationship either to the malfeasor or the relevant financial agency, can be expected to know or have reason to know (i) the name(s) of the beneficial owner(s) of the account, and/or (ii) that the account is being used for a nefarious purpose and/or (iii) that one or more persons with a financial interest in the account who should file an FBAR will not do so.

Our strong suspicion is that a regime crafted along these lines would be too narrow to serve its purposes effectively because the requirement that a person

know or have reason to know that the account might be used to commit or conceal a financial crime would be too subjective and impractical to apply. Given that there will be few circumstances in which a U.S. person other than the criminals themselves will in fact have sufficient information to know that the relevant account is being used in or in connection with criminal activity, such a regime might be unlikely to produce much useful information. We suspect that Treasury would be better served by learning about too many accounts rather than too few.

However, we think it important to pause on what this conclusion says about the history and effectiveness of the regime: A regime that attempts to target accounts likely to be involved in malfeasance might be expected to produce very little information relevant to criminal investigations. As we have already highlighted, however, the current regime is very broadly drafted, and so seems likely to us (as laypersons) to produce very low "concentrations" of useful information (*i.e.,* information leading to or relevant to financial crimes like money laundering, organized crime and terrorism), when compared with the very large volumes of filings and accounts subject to reporting. And at least anecdotally, we see little evidence that the FBAR regime ***has*** in fact been particularly helpful in that regard. Indeed, as discussed above, the available evidence seems to suggest that much of the emphasis in FBAR enforcement and compliance in recent years has been on tax crimes (to the effective detection of which we think it adds little) rather than other crimes. All of these observations point to the perverse possibility that the FBAR is being co-opted to fight tax crimes because it doesn't work well to fight any other crimes, without regard to whether it is necessary or efficient as a weapon against tax crimes.[65]

We obviously cannot know whether this is the case. But we have concerns that it is at least possible that the FBAR regime, at least as currently crafted, has shown itself to be ineffective for its intended purposes and so has become at best an appendage to the tax Code – in our view an unnecessary, or at least unnecessarily burdensome, one – and at worst a self-perpetuating waste of resources that is in need of dramatic overhaul if not outright repeal. We ask that Treasury give serious consideration to whether the FBAR gathers or preserves a high enough "concentration" of information with a "high degree of usefulness" to make it worth the substantial burden placed on recordkeepers, filers and the government (which must process those reports). The remainder of this report assumes that the FBAR regime can be a useful tool in law enforcement and focuses on how the burden on recordkeepers and filers might be reduced while maintaining or even improving the quality of the information gathered and preserved.

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[65] This reminds us of the joke about the man who is out late at night looking for his keys under a streetlight even though that's not where he lost them because that's where the light is.

One final but important observation: Throughout this report, we will make recommendations based upon our sense (once again, as laypersons) that the FBAR (at least as currently crafted) is so opaque and blunt a tool that it cannot be useful in ***detecting*** criminal activity in the first instance. Rather, if it is of help at all, we suspect it might be of help in investigating known suspects to learn about their assets and activities. As we repeat many times throughout this report, we do not and cannot know that this is the case; all we can do is observe that based on the available evidence, we see no indication that the FBAR is helpful in finding theretofore unknown bad actors. Accordingly, we make a number of recommendations that, if adopted, would result in the government not receiving information about accounts ***unless and until*** it seeks that information (*i.e.,* once it already has a name, taxpayer or employer identification number – which we will collectively refer to as "**TINs**" – or other identifying information, presumably based on other leads as to suspected criminal activity). We think this approach to the FBAR regime is clearly consistent with the original history of the BSA, where Congress explicitly identified the inability to collect desired information from secrecy jurisdictions as the impetus for the enactment of the FBAR Provision. Moreover, it is also consistent with Congress's emphasis on ***recordkeeping*** as well as reporting, and with the rule that filers with more than 25 accounts need not report all information, presumably on the theory that the government is then free to follow up if interested.

In any event, we will at appropriate points note where our proposals rely on this assumption. Moreover, at many points throughout this report we will note that if one wants to find suspicious conduct in the first instance, the best way to do so is to create a narrow information-reporting and cross-checking or matching regime that will highlight when someone potentially of interest (*e.g.,* a taxpayer) is failing to account for assets or income. We think such a regime would be much more narrowly tailored than the FBAR regime, and one over-arching theme of this report is that if such a regime is desired, it might be sensible to adopt (or expand) one rather than attempting to use the FBAR to that end. A compromise position, if it is determined that our assumption in this regard is incorrect (as we readily acknowledge it may be), would be to provide that a particular exemption is available only if the relevant account is in fact otherwise being subjected to some form of federal information reporting (such as a SAR, or an IRS Form 1096 (broker proceeds), 926 (transfers to foreign corporations) or 8865 (transfers to foreign partnerships)). However, these reporting regimes are all limited in one respect or another, as we discuss throughout this report, and in many cases there simply is no such reporting regime under current law. Accordingly, in the event such a compromise approach is adopted (and perhaps in any event), we would strongly encourage Treasury and the IRS to study the development of a set of information-reporting and cross-checking rules that would be narrowly targeted to collect relevant information about U.S. holders of foreign accounts.

III. Brief Summary of Current FBAR Rules

The rules currently require a "United States person" to file an FBAR in respect of a calendar year if, at any point during the year, the United States person has a "financial interest" in, or "signature or other authority" over, one or more "financial accounts" outside the United States with an aggregate value in excess of $10,000.[66] An individual filing a U.S. tax return (IRS Form 1040) is required to state on Schedule B, Part III whether the individual has an interest in a financial account in a foreign country by marking "Yes" or "No" in the designated box. If the taxpayer marks "Yes," Form 1040 instructs the taxpayer to identify on Schedule B the country where the account is maintained and to file an FBAR. Similar information appears on IRS Form 1120, Schedule N for corporations and on IRS Form 1065, Schedule B for partnerships. The deadline to file the FBAR with Treasury is June 30 of the year following the calendar year in respect of which reporting is required, with no extension of time available for filing.[67]

The FBAR regime currently applies to "United States persons," including citizens or residents of the United States and domestic corporations, partnerships, estates and trusts. Thus, a foreign subsidiary of a United States company is not required to file an FBAR, although its U.S. parent may be required to do so. Changes that were made to the FBAR instructions in October 2008 would also have applied the filing requirements to all domestic business entities and all foreign persons "in and doing business in" the United States. These changes were suspended for the purpose of FBARs filed for the year 2008, but will apply in the future absent a further change in the rules.[68]

The FBAR instructions state that a "financial account" includes any bank, securities, securities derivatives or other financial instruments account. The term also includes "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) . . . ."[69] Savings, demand, checking, deposit, time deposit and any other accounts, including debt card and prepaid credit card accounts, maintained with a financial institution or person in the financial institution all fall under the definition of a financial account. However, the instructions specify that individual bonds, notes or stock certificates do not qualify as a financial account, nor does an unsecured loan to a foreign trade or business that is not a financial institution. The financial account must be located in a foreign country to fall under the FBAR reporting requirements. The geographical location of the

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[66] *See* Form TD F 90-22.1 (rev. 2008) [*hereinafter* 2008 FBAR Form].

[67] *But see infra* note 138 (discussing extensions for 2009).

[68] *See* Announcement 2009-51, 2009-25 I.R.B. (June 5, 2009).

[69] Instructions to 2008 FBAR Form [*hereinafter* 2008 FBAR Instructions].

account, not the nationality of the financial institution in which the account is found, determines whether the financial account is in a foreign country.[70]

To be required to file an FBAR with respect to one or more foreign financial accounts, a person must have either a "financial interest in" or "signature or other authority over" those accounts. The instructions provide that a "financial interest" may be present in one of the following ways:[71]

(1) A United States person has a financial interest in each account for which such 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 including non-United States persons.

(2) A United States person has a financial interest in each bank, securities, or other financial account in a foreign country for which the owner of record or holder of legal title is:

(a) a person acting as an agent, nominee, attorney, or in some other capacity on behalf of the U.S. person;

(b) a corporation in which the United States person owns directly or indirectly more than 50 percent of the total value of shares of stock or more than 50 percent of the voting power for all shares of stock;

(c) a partnership in which the United States person owns an interest in more than 50 percent of the profits . . . or more than 50 percent of the capital of the partnership; or

(d) a trust in which the United States person either has a present beneficial interest, either directly or indirectly, in more than 50 percent of the assets or from which such person receives more than 50 percent of the current income.

(3) A United States person has a financial interest in each bank, securities or other financial account in a foreign country 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

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[70] Accounts are not considered foreign if they are maintained with a "United States military banking facility." *Id.*

[71] 2008 FBAR Form.

> by such United States person and for which a trust protector was appointed.

The instructions provide that a United States person who lacks a financial interest in a foreign financial account but has "signature or other authority" over it may also be subject to the reporting requirements. A person has signature authority over an account if the person can control the disposition of money or other property in it by delivery of a document that contains the person's signature to the institution where the account is maintained.[72] "Other authority" exists if the person can exercise comparable power through direct communication, oral or otherwise, with the bank or other institution where the account is maintained.[73]

There are certain exceptions to the FBAR filing requirement that are applicable to employees of specified classes of institutions. First, "an officer or employee of a bank which is currently examined by Federal bank supervisory agencies for soundness and safety need not report that he has signature or other authority over a foreign bank, securities or other financial account maintained by the bank, if the officer or employee has NO personal financial interest in the account."[74]

Second, an employee with signature authority over but no financial interest in an account of his or her employer is exempted from the FBAR filing requirement if (i) the employer is a domestic corporation and either has issued equity securities that are listed on a U.S. national securities exchange or has assets exceeding $10,000,000 and has 500 or more shareholders of record and (ii) the employee has been notified in writing that the employer has filed an FBAR that includes the account.[75] In addition, officers and employees of domestic subsidiaries of such corporations need not file an FBAR if the domestic parent meets these requirements, the employee has no personal financial interest in the account and the employee has been advised in writing by an officer of the parent that the subsidiary has filed a report that includes the foreign account.[76] Finally, officers and employees of foreign subsidiaries of such domestic corporations are exempt from filing if more than 50% of the foreign subsidiary is owned by such a domestic corporation, the employee has no personal financial interest in the account and if the employee has been advised in writing by a responsible officer of the parent that the parent has filed a report that includes the account.[77]

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[72] *Id.*

[73] *Id.*

[74] *Id.*

[75] *Id.*

[76] *Id.*

[77] *Id.*

For those who are required to file an FBAR, the consequences of failing to do so include civil and/or criminal penalties. Civil penalties may be imposed for willful or non-willful violations. The civil penalty for non-willful violations of the FBAR reporting requirement is a fine of up to $10,000.[78] For willful violations, the penalty is the greater of $100,000 and 50% of the amount of the transaction or the account balance at the time of violation.[79] Criminal penalties may also be imposed for willful violations, including fines of up to $250,000 and up to five years' imprisonment.[80] If the IRS finds that the failure to file is part of a pattern of illegal criminal activity, a fine of up to $500,000 and up to 10 years' imprisonment may be imposed.[81]

The law provides that the civil non-willfulness penalty may not be imposed, however, if the violation was due to reasonable cause and the balance in the account was properly reported. The House Report to the BSA observed that "mere isolated lapses ought not ordinarily be the occasion for the imposition of heavy penalties."[82] Consistent with this spirit, when the American Jobs Creation Act of 2004 introduced the $10,000 penalty for non-willful violations (including failure to file), the statute was amended to provide that the $10,000 civil penalty may not be imposed where (1) the "violation was due to reasonable cause" and (2) "the amount of the transaction or the balance in the account at the time of the transaction was properly reported."[83]

IV. History

The FBAR rules use many terms of art, which are not clearly defined and leave many open-ended questions as to the precise scope of the filing and recordkeeping requirements. Moreover, many of the FBAR rules are found solely in the instructions to the FBAR form rather than in Treasury regulations. This Part discusses how the FBAR rules have evolved in part through Treasury regulations but mainly through informal rulemaking by Treasury and the IRS. As a result, the rules that exist today in many ways depart from the spirit, the purpose and, arguably, the scope of the original legislation, and much of the confusion regarding the FBAR rules is attributable to the process by which they have been created.

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[78] 31 U.S.C. Section 5321(a)(5)(B)(i).

[79] *Id.* Section 5321(a)(5)(C).

[80] *Id.* Section 5322(a).

[81] *Id.* Section 5322(b).

[82] H.R. REP. No. 91-975, at 10.

[83] American Jobs Creation Act of 2004, Section 821(a)(5)(B)(ii), Pub. L. No. 108-357, 118 Stat. 1418 (codified at 31 U.S.C. Section 5321(a)(5)(B)(ii)).

A. The Regulations

As discussed in Part II.A, the FBAR Provision grants the Secretary of the Treasury significant flexibility in determining the scope of the reporting requirements and appropriate exceptions. The resulting Treasury regulations, first introduced 1972, however, require reporting nearly to the full extent authorized by the statute:

> Each 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 Internal Revenue for each year in which such relationship exists, and shall provide such information as shall be specified in a reporting form prescribed by the Secretary to be filed by such persons.[84]

The requirement that "[e]ach person subject to the jurisdiction of the United States" make an annual report is broader than the FBAR Provision in that it applies to (a) non-U.S. persons present in the United States even if they are not doing business here and (b) non-U.S. persons doing business in the United States and subject to United States jurisdiction, but not present in the United States. The statute applies only to "a resident or citizen of the United States or a person *in, and doing business in*, the United States."[85]

The regulations also specify when reports must be filed. Specifically, a person must file a report "each year" that the person has "a financial interest in, or signature or other authority over a bank, securities or other financial account." None of these terms has ever been adequately defined in the regulations. Although the regulations do not state that the relevant financial account must be maintained with a "foreign financial agency," the FBAR Provision applies only to persons who "make a transaction or maintain a relation for any person with a foreign financial agency." This point is important given the recent confusion over whether investments in foreign hedge funds, foreign private equity funds and passive foreign investment companies ("**PFICs**") constitute foreign financial accounts.

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[84] 31 C.F.R. Section 103.24. This is the current version of the regulation. The original regulation was similar but required a filer to "report such relationship as required on his Federal income tax return for each year in which such relationship exists, and shall provide such information concerning each account as shall be specified in a special tax form to be filed by such persons." 31 C.F.R. Section 103.24 (1972). *See also* 37 Fed. Reg. 6912, 6913 (Apr. 5, 1972).

[85] 31 U.S.C. Section 5314(a) (emphasis added).

Despite the statutory authorization to do so, the regulations did not provide any specific exemptions of the types contemplated by Congress, such as for accounts located in certain foreign countries, certain types of people, transactions of a certain magnitude or certain types of transactions. Regulations issued in 1977 did provide relief to persons having a financial interest in 25 or more accounts by exempting them from providing detailed information about each account.[86] This rule did not, however, exempt any person from the filing and recordkeeping requirements.

B. The Instructions

Although the regulations do not define the specific contours of the FBAR filing requirement, Treasury and the IRS have rarely used traditional means, such as revenue rulings, revenue procedures or notices to communicate additional guidance to potential filers with respect to their specific obligations.[87] Instead, Treasury, FinCEN and the IRS have left the details of who must file, the types of accounts with respect to which filing is required, and the persons and accounts that are exempt from filing to be addressed in the instructions to the FBAR form.

Significantly, Treasury and the IRS historically have taken the position that the FBAR instructions are not subject to the notice-and-comment rulemaking procedures generally required to issue legislative regulations.[88] For example, in 1987, in response to a request for comments on the FBAR regulations, commentators requested permission to comment on the FBAR form. Treasury responded that this was unnecessary because "information contained on the forms originally is specified in regulations which have been published for notice and comment."[89] However, in 2006, Treasury did solicit general comments on the FBAR form.[90] More recently, the IRS on its website stated in a "frequently asked question" page regarding the FBAR (the "**FBAR FAQs**") that "[i]ssuing instructions for the FBAR form is one way the Secretary may exercise [the] discretion" delegated to it by Congress.[91]

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[86] 42 Fed. Reg. 63,774 (Dec. 20, 1977).

[87] For an example of a formal notice published in the Federal Register, see 42 Fed. Reg. 42,276 (Aug. 22, 1977) (allowing filers with 25 or more accounts to make use of abbreviated filing) (codified at 31 C.F.R. Section 103.24).

[88] *See* 5 U.S.C. Section 553(d) (stating that substantive rules are generally not effective until after publication, notice and comment except in the case of interpretive rules, rules that narrow the scope of application and certain other rules).

[89] *See* 52 Fed. Reg. 11,436, 11,438.

[90] *See* 71 Fed. Reg. 13,674 (Mar. 16, 2006).

[91] This statement appeared in an earlier version of the FBAR FAQs currently available on the IRS's website, but it has since been removed.

The authority to provide additional rules in the FBAR instructions is arguably found in the regulations, discussed above, which require FBAR filers to provide "such information as shall be specified in a reporting form prescribed by the Secretary . . . ."[92] However, the rules contained in the FBAR instructions do not simply specify information to be reported, but rather expand and narrow the scope of the reporting requirements. This is particularly troubling because, at least as regards federal income taxes, informal publications such as instructions generally are not considered authoritative law.[93] Where courts have permitted reliance on instructions for interpretive guidance, they have been determined to be "clearly less authoritative than the legislative history."[94] We thus have some concerns regarding the enforceability of the FBAR instructions in general, where they purport to materially alter the rules set forth in the statute and regulations. We also have some doubt as to whether and to what extent potential filers may safely rely on the exceptions found in the instructions.

1. Original FBAR form and instructions

The 2008 FBAR Instructions contain undefined terms that result in numerous ambiguities and uncertainties discussed throughout this report. By contrast, the original FBAR, IRS Form 4683 (the "**Original FBAR**"), provided clear, if overly narrow, definitions as well as what we view as a sensible approach to the kinds of information required to be reported.[95]

The Original FBAR, which was attached to the filer's tax return, required reporting of "a bank, securities or other financial account," and defined each of these terms in its instructions. A "bank account" meant "a savings, demand, checking, deposit, loan, or any other account maintained with a person engaged in the business of banking [including] certificates of deposit." A "securities account" meant "an account maintained with a person who buys, sells, holds or trades stock or other securities for the benefit of another." An "other financial account" meant "any other account maintained with any person who accepts deposits, exchanges or transmits funds, or acts as a broker or dealer for future

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[92] 31 C.F.R. Section 103.24.

[93] *Smith v. Commissioner*, 80 T.C. 1165, 1171 (1983) (rejecting taxpayer's attempt to rely on instructions to Form 1040 because "[i]nformal publications of the Internal Revenue Service . . . are not authoritative sources of law"). *See also Gold-N-Travel, Inc. v. Commissioner*, 93 T.C. 618, 621 (1989) (rejecting Commissioner's attempt to rely on instructions to Form 1120S); *Zimmerman v. Commissioner*, 71 T.C. 367, 371 (1978) (rejecting petitioner's reliance on IRS pamphlet entitled "Your Federal Income Tax" because "authoritative sources of Federal tax law are in the statutes, regulations and judicial decisions and not in such informal publications").

[94] *Wilkes v. United States*, 50 F. Supp. 2d 1281, 1287 (M.D. Fla. 1999) (rejecting the Commissioner's attempt to disavow instructions to the estate tax form, Form 706).

[95] The Original FBAR is attached to this report.

transactions in any commodity on (or subject to the rules of) a commodity exchange or association."

The Original FBAR also did not require the filer to determine the exact maximum value of its accounts during the calendar year. Instead, the form merely required the filer to specify whether the accounts' aggregate maximum value was less than $50,000, between $50,000 and $100,000 or over $100,000. If the aggregate value of the accounts was less than $10,000, the filer was required to complete the form but was not required to provide any specific information about the accounts.

The Original FBAR instructions, like the current form, used the term "United States person" to define the persons subject to the rules. However, the definition of "United States person" in the Original FBAR instructions (which was in every evolution of the instructions prior to 2008) was much narrower than what is found in the FBAR Provision or the regulations, and mirrored the definition of a "United States person" for U.S. federal tax purposes:[96]

> The term "United States person" means (1) a citizen or resident of the United States, (2) a domestic partnership, (3) a domestic corporation, and (4) a domestic estate or trust.[97]

The Original FBAR also contained a special rule for reportable accounts in which no United States person has a financial interest. For these accounts, the filer did not need to disclose the identity of non-U.S. owners and, instead, was permitted to write "No U.S. person had any financial interest in the foreign accounts."[98]

2. Later versions

Between 1977, when the FBAR was separated from the federal income tax return,[99] and 2008, the instructions underwent significant revisions. For example, the exceptions for employees of banks and public companies, as well as increases in the minimum aggregate account value thresholds, were added to the FBAR form and instructions without, as far as we are aware, any formal announcement

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[96] *See* Code Section 7701(a)(30).

[97] Instructions to the Original FBAR.

[98] *Id.*

[99] *See* 42 Fed. Reg. 63,774 (Dec. 20, 1977) (codified at 31 C.F.R. Section 103.24). The first Form 90-22.1, Report of Bank, Securities, and Other Financial Accounts (Oct. 1977), contained instructions substantially similar to those of the Original FBAR.

by Treasury.[100] In addition several rules have been expanded to broaden significantly the scope of the filing requirement.

The current FBAR instructions have replaced the rule requiring reporting of a "bank, securities, or other financial account" with a reporting requirement for any "foreign financial account," without any definition of the term or any of its components:

> Financial Account. This term includes any bank, securities, securities derivatives or other financial instruments accounts. Such accounts generally also encompass any accounts in which the assets are held in a commingled fund, and [*sic*] the account owner holds an equity interest in the fund (including mutual funds) . . . .[101]

The elimination of the Original FBAR's definitions has created significant new uncertainty regarding what constitutes a reportable account, particularly because we are aware of no indication of the reasons for or the intended implications of that elimination. In addition, although the FBAR instructions have required reporting of "foreign financial accounts" since at least 2000, the parenthetical "(including mutual funds)" was added in 2008,[102] triggering additional questions as to what types of equity interests would be considered "financial accounts" for FBAR purposes. While we are not aware of any formal explanation by Treasury of its reasons for any of these changes, we suspect that Treasury intended to expand the scope of the rules to include certain types of transactions or relations not covered by the earlier rules. However, it would seem extremely unlikely that Treasury intended to make a radical departure from the previously understood meanings of the terms "bank account," "securities account" and "other financial account" without any explanation or statement to this effect and without notice and opportunity to comment.

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[100] *See* 1978 Instructions for Schedule B (Form 1040) (no reporting required for accounts less than $1,000); 1979 Instructions for Schedule B (Form 1040) (first appearance in instructions of exception for employees of banks and public companies); Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (rev. Sept. 1983) (minimum account threshold raised to $5,000); 1986 Instructions for Schedule B (Form 1040) (minimum account threshold raised to $10,000).

[101] 2008 FBAR Instructions.

[102] *See* Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (Rev. July 2000) [hereinafter the 2000 FBAR Form]. As discussed in the July 17 letter, the IRS has since February 2007 included persons holding ownership interests in mutual funds on a webpage identifying persons required to file the FBAR. *See* NYSBA Tax Section, *Request for Formal Guidance*, *supra* note 2, at 6; Foreign Financial Accounts Reporting Requirements, FS-2007-15 (Feb. 2007), *available at H*http://www.irs.gov/newsroom/article/0,,id=168194,00.htmlH (last visited Oct. 23, 2009).

The current FBAR, unlike the Original FBAR, also requires that the filer state the maximum account value for the calendar year in which the account is being filed rather than specify a particular range of values. We believe that this requirement, added without explanation in 2008,[103] significantly increases the compliance burden on filers by requiring calculation of the precise maximum value of assets in each account.[104] It is notable that for the IRS's Voluntary Disclosure program for offshore accounts and assets, the IRS has requested only ranges of values.[105]

The current FBAR instructions also provide a significantly expanded definition of "United States person" as compared to the Original FBAR:

> The term "United States person" means a citizen or resident of the United States, or a person in and doing business in the United States. See 31 C.F.R. 103.11(z) for a complete definition of "person." The United States includes the states, territories and possessions of the United States. See the definition of United States at 31 C.F.R. 103.11(nn) for a complete definition of United States. A foreign subsidiary of a United States person is not required to file this report, although its United States parent corporation may be required to do so. A branch of a foreign entity that is doing business in the United States is required to file this report even if not separately incorporated under U.S. law.[106]

This definition, which closely mirrors the language in the BSA, was introduced in 2008. The new rule created so much confusion among potential filers that on June 5, 2009, the IRS announced that filers could continue to rely on the definition of "United States person" in the 2000 FBAR Instructions, which was nearly identical to that of the Original FBAR instructions.[107]

This confusion has recently been further compounded by a statement from the Joint Committee on Taxation that we understand some have interpreted to be suggesting that the IRS's June 2009 announcement was misguided in its assumption that the term "United States person" as used in the pre-2008 FBAR

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[103] The 2000 FBAR Form required the filer to indicate whether the account value was less than $10,000, between $10,000 and $99,000, between $100,000 and $1,000,000 or over $1,000,000.

[104] *See* Part VII.F.4 (discussing issues surrounding the calculation of the maximum value of accounts).

[105] *See* IRS, Voluntary Disclosure: Questions and Answers, A.6 (follow link to form letter), Hhttp://www.irs.gov/newsroom/article/0,,id=210027,00.htmlH (last visited Oct. 23, 2009).

[106] 2008 FBAR Instructions.

[107] Announcement 2009-51.

instructions was not as broad as the statutory definition of a person "in and doing business in" the United States. The Joint Committee stated:

> Although the revised instructions track the language of the statute in stating that a person in or doing business in the United States is within its purview, *and thus arguably merely clarify what has long been required*, the IRS announced that pending publication of guidance on the scope of the statute, people could rely on the earlier, unrevised instructions to determine whether they are required to file a FBAR. Announcement 2009-51 (June 5, 2009).[108]

The Joint Committee's reference to "clarification" is evidently based on the regulatory definition of the word "domestic," which is admittedly quite broad:

> When used in this part *and in forms prescribed under this part* where not otherwise distinctly expressed or manifestly incompatible with the intent thereof, terms shall have the meanings ascribed in this section. . . . (k) *Domestic*. When used herein, refers to the doing of business within the United States, and limits the applicability of the provision where it appears to the performance by such institutions or agencies of functions within the United States.[109]

We note in this regard that this regulation was promulgated in 1971,[110] whereas the instructions' use of the term "domestic" in defining who must file FBARs was first introduced in 1970.[111] Thus, we think it plain that any effort to read the regulation into the instructions would be manifestly inconsistent with the intent of the instructions' drafters, who could not have seen the regulatory language.

The implications of this reading would be far-ranging and quite troubling. For one thing, ***all foreign corporations and partnerships*** that were "doing business within" the United States (an undefined term that we think must for various reasons be read quite broadly, as discussed in Part VII.B.2(a)) in any year since at least the promulgation of the regulation would have been be required to file FBARs for ***all of their foreign financial accounts, and those of their majority-owned subsidiaries***. Moreover, it would follow that the vast majority of

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[108] Joint Committee on Taxation, *Description of Revenue Provisions Contained in the President's Fiscal Year 2010 Budget Proposal, Part Three: Provisions related to the Taxation of Cross-Border Income and Investment* 193 n.540 (Comm. Print Sept. 2009) (emphasis added).

[109] 31 C.F.R. Section 103.11 (emphasis added).

[110] 37 Fed. Reg. 6,912 (Apr. 5, 1972).

[111] *See* Instructions to the Original FBAR.

foreign investment vehicles (discussed extensively throughout this report) would be treated as "domestic" and thus not as "foreign financial agencies." And it would follow that employees of foreign public corporations doing business in the United States, and their subsidiaries, would be entitled to an exemption from filing if the parent files. As we will discuss in Part VI.G, we believe this reading is incorrect under current law.

The current FBAR instructions also require that the identity of each non-U.S. owner be disclosed, even if no United States person has a financial interest in the reported account. The earlier rule that exempted disclosure of such non-U.S. persons was removed without explanation in 2008, without addressing its effective date and any transition issues, even though the change significantly expands the breadth of information that the federal government now gathers through the FBAR regime.

These changes to the FBAR form and instructions, many of which were made in the 2008 revisions, have significantly changed the scope of filing requirements without any opportunity for public comments, and without even a formal notice from Treasury, FinCEN or the IRS explaining the reasons for the changes. We commend Treasury's and the IRS's recent request for public comments in Notice 2009-62 and, as discussed below in Part VI.D, strongly urge Treasury and the IRS to discontinue this practice of informal rulemaking.

C. Guidance Regarding Private Investment Funds

In considering the BSA definitions of "financial institution" and "investment company" for purposes of the anti-money-laundering rules of the BSA, Treasury has observed that the statutory terms in the BSA have never been defined, and that it would not be "sound regulatory policy" to apply the rules to specific businesses without careful consideration of the nature of the businesses, the burden of compliance and the likelihood that those businesses would be associated with the criminal activities that are the focus of the statute. Treasury proposed but ultimately withdrew a rule that would include certain hedge funds, private equity funds and venture capital funds within the meaning of "financial institution." The IRS, by contrast, has followed a much less formal process in providing FBAR guidance on this issue, in which IRS representatives made comments in 2007 suggesting that foreign hedge funds do not constitute foreign financial accounts and comments in 2009 suggesting that certain foreign hedge funds do constitute foreign financial accounts.

1. Treasury's formal consideration of relevant terms

Treasury and FinCEN considered the scope of the term "financial institution" under the BSA in connection with the implementation of the anti-money-laundering rules when they were amended by the USA PATRIOT Act in 2002. Although the specific financial institutions that are required to maintain

anti-money-laundering programs (mostly those operating in the United States) differ from those that maintain accounts subject to FBAR reporting (mostly those operating outside the United States), the anti-money-laundering rules and the FBAR rules start from the same statutory definition of "financial institution" in the BSA.[112] Treasury's observations about the meaning of that term in a formal rulemaking process thus are relevant for FBAR purposes.

Treasury first discussed the meaning of the term "financial institution" in the preamble to a 2002 "interim final rule" that required domestic mutual funds to establish anti-money-laundering programs but specifically exempted closed-end companies, unit investment trusts, hedge funds, private equity funds and venture capital funds from the requirement.[113] Treasury observed that the definition of "financial institution" in the BSA is "extremely broad," and described the long list of businesses that were included within the meaning of that term.[114] Treasury gave several reasons for temporarily exempting most of the businesses on that list from the anti-money-laundering rules. First, it stated that "these businesses have never been defined for purposes of the BSA."[115] Treasury and FinCEN did not believe that it was sound regulatory policy to subject the broad categories of BSA "financial institutions" to the rules without specifically defining the businesses that would be included.[116] In addition, Treasury and FinCEN stated that they had not had sufficient time and opportunity to analyze the nature of the businesses and the scope of anti-money-laundering or terrorist-financing risks associated with the businesses.[117] They stated that including all potential financial institutions raised many significant practical and policy issues, and they expressed concerns about the quality of such an expansive rule and about whether its burdens would justify the regulatory benefit:

> An inadequate understanding of the affected industries could result in poorly conceived regulations that impose unreasonable regulatory burdens with little or no corresponding anti-money laundering benefits.[118]

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[112] *See* 31 U.S.C. Section 5312(a)(2).

[113] *See* 67 Fed. Reg. 21,117 (Apr. 29, 2002) (promulgating an interim final rule including mutual funds and distinguishing closed-end companies). *See also* 67 Fed. Reg. 21,110, 21,112 (Apr. 29, 2002) (promulgating an interim final rule exempting hedge funds, private equity funds, venture capital funds, etc.).

[114] 67 Fed. Reg. 21,110.

[115] *Id.* at 21,112.

[116] *Id.*

[117] *Id.*

[118] *Id.*

For these reasons, Treasury said that it was "deferring determination of the scope of the BSA definition of 'investment company . . . .'"[119]

Later in 2002, Treasury published notice of and solicited comments on a proposed rule, later withdrawn, that would have required certain domestic hedge funds and other domestic private funds to establish anti-money-laundering programs under the BSA.[120] Observing that the financial institutions covered by the BSA "generally include businesses that deal in cash, securities, or other types of assets that can be readily converted into cash," Treasury proposed to exclude funds that did not permit investors to redeem their investments within the first two years of purchase.[121] Treasury noted the breadth of the term "unregistered investment company," which is a subset of "investment company," could be quite broad:

> [The term "unregistered investment company"] could include a large range of entities from small investment clubs to large corporate holding companies, and, in between, a vast array of financing vehicles that are unlikely to be used for money laundering purposes.[122]

Treasury observed, however, that including the full range of businesses would unnecessarily burden businesses, tax the resources of regulators and diminish the effectiveness of the rules.

In November 2008, in response to comments that focused on the breadth of the proposed rule, FinCEN withdrew the 2002 notice of proposed rulemaking with the assurance that Treasury would not proceed with anti-money-laundering requirements for these entities without "publishing a new proposal." According to Treasury, "[t]his will give industry and other interested parties an opportunity to provide comments on the contents of any such proposal . . . ."[123]

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[119] *Id.* at 21,111 (expressing an expectation that entities excluded from the Investment Company Act of 1940 (the "**1940 Act**") definition of "investment company" would likely be subject to anti-money-laundering program requirements, after further review and analysis).

[120] 67 Fed. Reg. 60,617 (Sept. 26, 2002). The proposed definition of an "unregistered investment company" for purposes of this rule would have excluded funds with lock-up periods longer than two years or with less than $1 million in assets, employee securities companies as defined in Section 2(a)(51)(A)(ii) of the 1940 Act and employee benefit plans (as defined in 17 C.F.R. Section 4.5(a)(4)) that are not construed to be pools. *Id.* at 60,623-24.

[121] *Id.* at 60,618.

[122] *Id.*

[123] 73 Fed. Reg. 65,569, 65,570-71 (Nov. 4, 2008). *See also* FinCEN, Press Release, *FinCEN Withdraws Dated AML Rule Proposals for Unregistered Investment Companies, Commodity Trading Advisors, and Investment Advisers* (Oct. 30, 2008).

2. Uncertainty in IRS informal guidance

While Treasury and FinCEN were engaged in a formal notice-and-comment process to evaluate the scope of the BSA term "financial institution" for anti-money-laundering purposes, the IRS, to our knowledge, has addressed the status of private investment funds in relation to FBAR reporting only informally: in an IRS National Phone Forum held on June 20, 2007 (the "**IRS National Phone Forum**"),[124] in a teleconference that was hosted by the American Bar Association and the American Institute of Certified Public Accounts on June 12, 2009 (the "**ABA/AICPA Teleconference**")[125] and in statements attributed to IRS representatives in reports in the *Wall Street Journal* on June 25, 2009[126] and in *Tax Analysts* on June 29, 2009.[127] The materials relating to the IRS National Phone Forum were reportedly posted on the IRS website in 2007, but now are available only in an article in a trade publication.[128]

One Q&A in the IRS National Phone Forum considered the situation in which a U.S. citizen owned an individual retirement account (an "**IRA**"), which held an investment in an offshore hedge fund and whose custodian was domiciled in the United States. On these facts, the IRS concluded that the IRA was "an account located in the United States" and that the owner of the IRA did not have to report "the interest in the foreign hedge fund that is held in the IRA located in the United States."[129] In addition, the IRS stated that the custodian also did not have to file:

> 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, then the custodian does not have to file the FBAR either.[130]

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[124] *See* Steven Toscher & Michel R. Stein, *FBAR Enforcement – Five Years Later*, J. TAX PRAC. & PROC. 37 (June-July 2008) (reprinting the entire text of the questions and answers from the IRS National Phone Forum).

[125] We received an audio recording of the ABA/AICPA Teleconference upon request from the ABA.

[126] Jenny Strasburg & Jesse Drucker, *IRS Steps Up Scrutiny of Offshore Funds*, WALL ST. J., June 25, 2009, at A21.

[127] Kristen A. Parillo, *Hedge Fund, Private Equity Investors Must File FBAR, IRS Confirms*, TAX ANALYSTS, 2009 TNT 122-3 (June 19, 2009).

[128] *See* Toscher & Stein, *supra* note 124.

[129] *Id.* at 51.

[130] *Id.*

The meaning of the term "hedge fund account" is not entirely clear. It does not appear to refer to an interest in the hedge fund itself, first because that interest is already described in terms of "units of the hedge fund," and second because the custodian presumably has the ability to dispose of the units, which would seem to be a form of signature or other authority. It seems more likely that "hedge fund account" refers to a bank account owned by the hedge fund itself. Thus, the IRS guidance during the IRS National Phone Forum appears to have been that an interest in a foreign hedge fund does not constitute an interest in a foreign financial account for FBAR filing purposes.

However, the reasoning of the Q&A is hard to reconcile with another Q&A in the IRS National Phone Forum, which stated that a U.S. individual owner of shares of stock in a PFIC must report his or her interest in the shares for FBAR purposes: "The shareholder's interest in a PFIC . . . is an interest in an account in which assets are held in a commingled fund, and the account holder holds an equity interest in the fund."[131] Many foreign hedge funds constitute PFICs for U.S. federal income tax purposes, although there are many PFICs that are not hedge funds. This perhaps suggests that an equity investment in units of a hedge fund would not be reportable for FBAR purposes but that investments in other PFICs would be, which would be a very odd result. In any event, the instructions also provide that "stock certificates held by the filer are not a financial account." To our knowledge, most units in a hedge fund are held directly, effectively in certificated form, and so would appear to fall within the stock-certificate exception. It is equally unclear clear why stock of a PFIC would not also fall within the stock-certificate exception. In any event, as we discuss, in Part VII.A.2(a), many PFICs bear no resemblance to the financial institutions listed in the BSA. For example, a foreign corporation carrying on an active business can temporarily become a PFIC if it raises a significant amount of capital in an initial public offering and does not deploy it quickly enough. More fundamentally, a "PFIC" is a creature of tax law, so its status turns on concepts entirely unrelated to the BSA's definition of a "financial agency." Thus, as discussed below, we do not believe that PFIC stock (without more) constitutes a foreign financial account under current law (or that it should, normatively).

Statements at the ABA/AICPA Teleconference on June 12, 2009 added to the uncertainty. There, an IRS official first stated publicly, but 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. The IRS panelist stated that the term would include interests in hedge funds "that function like mutual funds." This comment seems to reflect thinking similar to that in the rules that were proposed and ultimately withdrawn by Treasury in connection with the formal rulemaking process discussed above, in which Treasury intended

[131] Toscher & Stein, *supra* note 124, at 56.

to identify classes of private funds that could be used in a manner similar to that of mutual funds.

Following the statements made at the ABA/AICPA Teleconference, 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. The *Wall Street Journal* reported the official as stating that "the requirement wasn't new" and that the IRS's position reflects "a much stronger emphasis on international matters."[132] The official said, "[s]o 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."[133] The report did not address whether the filing requirement was limited to offshore fund interests that "functioned like mutual funds."

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 said "the IRS's position is that investments in foreign hedge funds and private equity funds are reportable for FBAR purposes."[134] This, to our knowledge, was the first time the IRS made explicit public reference to the FBAR filing requirements for private equity fund investors. It was particularly surprising given that most private equity funds were not even within the rules that Treasury withdrew, because most private equity funds do not permit any redemptions, much less redemptions within the first two years of investment. The IRS spokesman did not make his statement publicly or post it on the IRS website; nor did the statement appear in any official pronouncement, regulation or ruling. To date, we are not aware of any official IRS explanation as to its reasons for treating an interest in a hedge fund or a private equity fund as a transaction or relation with a foreign financial agency within the meaning of the BSA.

D. Recent IRS Guidance Regarding LLCs

IRS guidance regarding the reporting obligations of LLCs has also resulted in some confusion. The IRS National Phone Forum included the following Q&A, which suggested that a domestic LLC was not then defined as a United States person for purposes of FBAR filings:

> Q: Why would a domestic legal entity of an LLC not be included as a US person?

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[132] Strasburg & Drucker, *supra* note 126.

[133] *Id.*

[134] Parillo, *supra* note 127.

> A: The definition in the FBAR instructions for "United States person" was not updated to include LLCs and other types of legal entities that may not have existed or that were not as common when the FBAR instructions were first published. The next version of the FBAR will include all legal entities in the definition of "United States person." Because LLCs share characteristics of both corporations and partnerships, we believe that the instructions may be interpreted to include such organizations in the definition of "United States person." For this reason, we advise that LLCs file FBARs . . . .[135]

In the revised FBAR instructions published in October 2008, the definition of a "United States person" was broadened to include all legal entities.[136] However, due to questions that arose regarding the new definition, on June 5, 2009, the IRS announced that a taxpayer that was required to file an FBAR by June 30, 2009 "may rely on the definition of 'United States person' found in the instructions for the prior version of the FBAR (the July 2000 version)."[137] This might suggest that LLCs are encouraged, but not required, to file FBARs for the year 2008 and prior years.

On June 29, 2009 (the day before the 2008 FBAR was required to be received by the IRS),[138] an FAQ was posted on the IRS website stating that a domestic single-member LLC is a United States person.[139] The reason given for this conclusion was that the FBAR Provision is set forth in Title 31, not Title 26, such that the U.S. federal income tax rule for disregarded entities does not apply. The FAQ did not state under which part of the pre-2008 definition – U.S. citizen or resident, domestic partnership, domestic corporation or domestic estate or trust – an LLC is a United States person.

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[135] *See* Toscher & Stein, *supra* note 124, at 51-52.

[136] See Part IV.B.2.

[137] *See* Announcement 2009-51.

[138] The IRS also used a website FAQ to announce on June 24, 2009 that it had extended the deadline for FBAR filing from June 30, 2009 to September 23, 2009 for filers 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 June 30. An additional extension from September 23, 2009 to October 15, 2009 was announced, again by website FAQ, on September 21, 2009.

[139] IRS, FAQs Regarding Report of Foreign Bank and Financial Accounts (FBAR) – United States Persons, *available at* Hhttp://www.irs.gov/businesses/small/article/0,,id=210252,00.html#UPS8H (last visited Oct. 23, 2009).

E. Division of Responsibility Within Treasury

Further complicating the status of FBAR filing requirements is the absence of a clear delegation by Treasury to either the IRS or FinCEN of authority to administer the FBAR regime. As discussed above, the FBAR has been administered by Treasury, separate from the federal income tax return, since 1977. FinCEN, established in 1990, held official authority for civil enforcement of FBAR reporting through April 2003. However, beginning in 1987, the IRS was delegated authority to investigate FBAR violations.[140] If the IRS discovered a criminal FBAR violation, the case would be reviewed by the Criminal Investigation Division, then referred to the IRS Office of Chief Counsel, which would conduct its own independent review of the case.[141] If the IRS Office of Chief Counsel believed criminal prosecution was warranted, it would refer the case to the Department of Justice to enforce (or not) the criminal penalties.[142] However, if the IRS determined that there was a civil FBAR violation, it would refer the case to FinCEN for possible civil penalties.[143] This split of authority between the IRS and FinCEN proved ineffective, and studies conducted by Treasury in 2002 estimated that compliance rates may have been as low as 20%.[144]

In April 2003, FinCEN delegated its civil enforcement authority to the IRS by a Memorandum of Understanding (the "**MOU**") in an effort to improve compliance and enforcement.[145] The Secretary subsequently issued a final rule to reflect that FBAR enforcement authority, including the power to issue administrative rulings and to revise the FBAR form and instructions, had been delegated to the IRS.[146] However, this delegation of authority to the IRS did not explicitly address authority to promulgate formal guidance, including regulations, and we understand that some IRS and Treasury officials accordingly believe that there may be limits on the IRS's authority to do so.[147] We further understand that there appears to be internal uncertainty regarding the role of the Office of Tax

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[140] 52 Fed. Reg. 11,436, 11,445 (Apr. 8, 1987); Treasury Directive 15-41 (Dec. 1, 1992) (granting authority to the IRS to "investigate possible violations of . . . the regulations on record keeping and reporting on foreign bank accounts"). *See* Secretary of the Treasury, *A Report to Congress*, *supra* note 62, at 4-5.

[141] *Id.* at 4.

[142] *Id.* at 4-5.

[143] *Id.* at 5.

[144] *Id.* at 6.

[145] Press Release, *IRS and FinCEN Announce Latest Efforts to Crack Down on Tax Avoidance Through Offshore Accounts*, IR 2003-48 (Apr. 10, 2003).

[146] *See* 68 Fed. Reg. 26,468 (May 16, 2003) (codified at 31 C.F.R. Section 103.56(g)).

[147] *Id.*

Policy in formulating FBAR rules. We believe that this is unfortunate and encourage Treasury to clarify that the Office of Tax Policy has authority for policymaking with regard to the foreign financial account reporting rules.

F. Penalties

While the substantive FBAR rules have been promulgated through informal communications from two separate agencies, neither of which has clear authority to promulgate rules, the penalties have been established and increased through legislation. The American Jobs Creation Act of 2004 amended the BSA to increase the potential civil penalty for willful violations of the FBAR requirements.[148] Prior to the amendment, the civil penalty for willful violations was limited to the greater of $25,000 and the balance in the account at the time of violation, up to a maximum of $100,000 per violation.[149] The statute now prescribes a maximum penalty for willful violation of the FBAR requirements of the greatest of $100,000, 50% of the amount of the transaction and 50% of the balance in the account.[150]

The American Jobs Creation Act also established a new FBAR penalty for non-willful violations. Prior to the amendment, there was no penalty for a non-willful violation of the FBAR requirement.[151] Now, the IRS can impose a civil monetary penalty of up to $10,000 on any person that violates the FBAR requirements, regardless of intent.[152] The Senate Finance Committee Report explains that the non-willfulness penalty is intended to improve compliance.[153] The Committee "believes that improving compliance with this reporting requirement is vitally important to sound tax administration, to combating terrorism, and to preventing the use of abusive tax schemes and scams."[154]

The statute includes a reasonable cause exception to the imposition of a civil penalty. The IRS cannot impose a civil penalty if the FBAR violation was due to reasonable cause and the amount of the transaction or the balance in the account at the time of the transaction was properly reported.[155] In addition, the

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[148] *See American Jobs Creation Act of 2004*, Pub. L. No. 108-357, Section 821, 118 Stat. 1420 (amending 31 U.S.C. Section 5321(a) with respect to FBAR penalties). The law applies to violations occurring after October 22, 2004.

[149] *See* Steven Toscher & Michel R. Stein, *FBAR Enforcement – An Update*, J. Tax Prac. & Proc. 57, 59 (Apr.-May 2006).

[150] *See* 31 U.S.C. Section 5321(a)(5)(C).

[151] *See* Toscher & Stein, *supra* note 124, at 38.

[152] 31 U.S.C.. Section 5321(a)(5).

[153] *See* S. REP. No. 108-192, at 108 (Nov. 7, 2003).

[154] *Id.*

[155] *See* 31 U.S.C. Section 5321(a)(5)(B)(ii), as amended by Pub. L. No. 108-357.

statute imposes only a *maximum* penalty, leaving the IRS discretion to determine what penalty to assess.[156] The IRS has established internal mitigation guidelines for determining when to assert less than the maximum penalty.[157] There are four threshold conditions that a person must meet in order to be subject to less than the maximum FBAR penalty: (1) A person must have no history of past FBAR penalty assessments and no history of criminal tax or BSA convictions for the preceding 10 years; (2) no money passing through the foreign accounts can be from illegal sources or have been used for criminal purposes; (3) the person must cooperate during the examination; and (4) the IRS must not sustain a civil fraud penalty against the person for underpayment for the year in question for failure to report income related to a foreign account.[158]

If all four of these threshold requirements are met, the civil penalties are reduced according to the highest amounts in the account at issue. Mitigated non-willfulness penalties are reduced to (i) $500 for each violation, not to exceed $5,000 total, for an aggregate account balance of not more than $50,000 or (ii) the lesser of $5,000 and 10% of the highest balance in the account for aggregate balances over $50,000 but less than $250,000. If the account balance exceeds $250,000 there is no mitigation; the penalty per violation is the statutory maximum of $10,000.[159] Penalties for willful violations are similarly reduced if the mitigation threshold is met; these penalties also fall into one of four levels depending on the maximum account balance.[160]

This Part has attempted to demonstrate that, contrary to the expectations of Congress, the current FBAR rules require Treasury to collect large quantities of non-useful information, increasing both the burden on legitimate commerce and the administrative burden on the government. Missing from the current regime is the balance, envisioned by Congress in enacting the BSA, between gathering information necessary to provide "a high degree of usefulness" in criminal, tax, and other regulatory investigations while avoiding undue burdens on legitimate transactions with foreign financial agencies. Contributing to the problem is the fact that the FBAR rules have been created through informal written guidance and remarks by government officials rather than traditional notice-and-comment rulemaking procedures, and that there is little clarity as to which agency of Treasury, the IRS or FinCEN, has authority to promulgate new regulations. All of

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[156] *See id.* Section 5321(a)(1).

[157] *See* I.R.M. Section 4.26.16.4.6.

[158] *See id.* Section 4.26.16.4.6.1. For violations on or prior to October 22, 2004, the first requirement was only that the person have no history of past FBAR penalty assessments. *See id.*

[159] *Id.* Section 4.26.16.4.6.2.

[160] *Id.* Section 4.26.16.4.6.3(3).

this is particularly troubling because Congress continues to impose severe civil and criminal penalties for failure to comply with the rules.

V. Overview of Categories of FBAR Filers

In this Part, we attempt to present a "big picture" view of the FBAR rules, from the perspective of various categories of potential filers (*e.g.,* individuals, trusts, various types of tax-exempt organizations, governmental entities, banks, broker-dealers, insurance companies, investment funds and fund managers, other for-profit entities, whether privately or publicly held). The purpose of this undertaking is two-fold: First, we think it quite useful in considering how the FBAR rules do and should operate to be aware of the salient characteristics of the various categories of potential filers. For example, we think it worth considering why in general filers in a particular category might be making use of foreign financial accounts, for good or bad purposes; whether potential filers in the category are in general more or less likely than others to commit or facilitate crimes of the type the FBAR rules were intended to help uncover; whether that category of filers is more or less likely to be willing or able to comply with complex reporting and record retention rules; etc. Second, although we will focus more on this aspect in the detailed discussion of the current rules in Part VII, it is obviously also quite important to understand in general whether and to what extent various categories of filers are or should be subject to special rules or should be given additional guidance, either because application of the current rules to the category of filers is particularly unclear (trusts, exempt plans and investment funds are good examples) or because the category of filers does or should shoulder disproportionate burdens under the FBAR rules (banks, trustees, broker-dealers and investment fund managers are good examples).

This Part will not focus on all FBAR issues relevant to each category of potential filer, but only on the unique characteristics of various categories of filers that either lead us to conclusions about how the rules ought to operate or raise particular issues under the rules as they currently exist.

A. Individuals

We think it intuitively obvious that individuals are the primary category of intended targets of the FBAR rules. The evidence to support this hypothesis is at best inferential, but we think the inference is both clear and sensible. Ultimately, it is individuals who commit financial crimes, even if "on behalf of" or under the aegis (or cover) of entities. Indeed, every FBAR prosecution of which we are aware has named individuals rather than organizations. Moreover, it is self-evident, and not unimportant, that there simply are more individuals than there are members of any other category of potential filer.

It is also worth observing that individuals have more possible *reasons* for using foreign financial accounts than any other category of filers. In addition to

the possibility that a foreign account might be used in or in connection with the commission of financial crimes or terrorism, individuals might use foreign accounts to make legitimate foreign investments, to maintain or support a residence or family in the foreign jurisdiction, because the individual immigrated from, is or was employed or temporarily stationed in or travels frequently to the relevant jurisdiction, has inherited assets in the relevant jurisdiction or has liabilities in the relevant jurisdiction (*e.g.,* educational expenses, alimony). In addition, an individual might choose to maintain a foreign "secrecy" or "anonymity" account specifically and intentionally either for safekeeping against fears of geopolitical or economic crisis or to conceal assets from creditors or family members.

And in this regard, it is worth pausing to consider how these facts tie into a key aspect of the structure of the FBAR regime. The FBAR regime is constructed to make potentially criminal the failure to report information that *might* – with a great deal more investigation – lead to the discovery of other, unrelated, criminal activity. And it seems that a key component of that effort, as reflected by the current breadth of the "signature or other authority" component of the instructions, is an attempt to impose liability for reporting information with respect to foreign accounts on as many people and entities as possible – *i.e.,* anyone with the ability to move assets out of that account. The effort, therefore, is to "deputize" people with sufficient nexus to foreign financial accounts, presumably reflecting the understanding that the actual criminals will not be any more likely to comply with the BSA than they were to comply with the underlying statute.

If the object of the FBAR rules is to maximize the number of potential filers with respect to any particular foreign financial account in order to learn as much as possible about as many such accounts as possible, then we think it is critical that individuals be a significant, if not the principal, focus of the rules. On the other hand, we think there are many reasons why ultimately, it would be in the interest of good administration of the rules if as few individuals as possible were actually required to file FBARs. In particular, individuals tend to be less able than other categories of potential filers to organize and store large volumes of data for long periods of time or to have access to substantial record-maintenance or compliance resources (including attorneys and accountants). Moreover, they are more mobile than any other category of filers and more susceptible to changes in status (including changes in employment, name changes, etc.). Finally, because of individuals' many legitimate and even happenstance reasons for having a foreign bank account, many individuals are likely to overlook a filing obligation, assuming they are even aware of it. In this regard, Congress has found that

potential filers are often "unaware of or confused about the filing requirements."[161]

The more complex and non-obvious the rules are, and the larger the volume of data that needs to be reported and maintained, particularly with respect to non-traditional investments, the less likely individual filers will be to comply properly (or indeed will be able to comply properly) and thus the less likely it is that the IRS will be able to collect highly useful information from them. Moreover, those same features – non-obviousness of the rules and volume of data required to be reported and maintained, coupled with the ease with which individuals can and do change location and status – will inevitably necessitate relatively substantial investigative and enforcement resources in order to squeeze out this minimal amount of relevant information.

These observations lead us to conclude that it is reasonable to require an individual to file an FBAR to report readily available information with respect to accounts that are obviously within the scope of the rules if the individual either has a financial interest in the accounts or knows or has reason to know that the accounts are not being reported. In addition, if no entity is in a position to be responsible to provide information with respect to accounts that might be of interest to the government, the deputization of individuals with relevant information regarding those accounts may be warranted. We think a rational regime would, however, endeavor to minimize the obligation of individuals to file reports under the latter circumstances. We therefore favor the adoption of "qualified filer" and "designated filer" rules under which organizations with better access to, and ability to maintain and report, data could file and maintain records on behalf of individuals otherwise required to file. These rules would entail fairly liberal employee, "signature authority," "on behalf of" and other exemptions, in an effort to minimize the number of situations in which individuals who are not complicit in illegal activity would be required to engage in complex analysis and interpretation of the FBAR rules and to comply with burdensome data collection, maintenance and reporting obligations.

B. Banks

Banks[162] are well equipped to play a key role in foreign financial account reporting in part because, FBAR requirements notwithstanding, banks are already

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[161] The Joint Committee on Taxation reported in 2008 that one of the primary reasons FBAR compliance has historically been low is that potential filers have been "unaware or confused about filing requirements." Government Accountability Office, Testimony Before the Senate Committee on Finance, *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for IRS*, 5 (Mar. 17, 2009), GAO-09-478T (Statement of Michael Brostek, Director of Strategic Issues Team).

[162] The FBAR instructions refer in separate instances to a "bank" (in the context of the Bank Exception, the Bank-to-Bank Settlement Exception, and the explanation of signature (…continued)

subject to an extensive regulatory apparatus that oversees banking operations. They generally have in place comprehensive recordkeeping policies and substantial resources devoted to compliance with the various laws and regulations to which they are subject, whether domestically on both the state and federal levels or in other jurisdictions. Financial institutions operating in the United States are subject to federal regulation by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the National Credit Union Administration. Additionally, banks may face regulation from the Securities and Exchange Commission (the "**SEC**"), in the enforcement of the antifraud provisions of the securities laws, and the Department of Justice, in the area of antitrust. Foreign branches of U.S. banks and U.S. branches or agencies of foreign banks may also be subject to regulation by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation or state regulators.

Banks' reporting and record-keeping competency supports two observations about the requirements the FBAR imposes on banks. First, banks are in a unique position to maintain and aggregate information with respect to the many accounts they hold on behalf of their clients and themselves efficiently. Second, under the various regulatory regimes to which they are subject, financial institutions already have a number of reporting requirements (other than their FBAR obligations) specific to targeting abusive use of bank accounts. Banks are required to maintain anti-money-laundering programs, under which they must perform (i) customer identification, (ii) customer due diligence, (iii) suspicious activity reporting, (iv) currency transaction reporting, (v) information sharing requirements, (vi) purchase and sale of monetary instruments recordkeeping, (vii) funds transfers recordkeeping and (viii) foreign correspondent account recordkeeping and due diligence. Each of these reporting requirements is directed toward "enabl[ing] law enforcement and regulatory agencies to pursue investigations of criminal, tax, and regulatory violations, if warranted, and provide evidence useful in prosecuting money laundering and other financial crimes."[163] One of the most detailed forms of reporting is the SAR, millions of

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(continued…)

authority), a "financial institution" (in the definition of "financial account" and in the form itself), a "United States bank" (in the description of an "account in a foreign country") a "foreign bank" (in the descriptions of an "account in a foreign country" and recordkeeping requirements) and a "financial entity institution" (in the description of an "account in a foreign country"), although this last may be an error. 31 C.F.R. Section 103.11(c), (n), (o). While the terms "bank," "financial institution" and "foreign bank" are all defined in the regulations under the BSA, these definitions, as discussed further below, do not appear to be consistently sensible as used throughout the instructions. However, there is no other apparent source with which to clarify the definition of these terms.

[163] Federal Financial Institutions Examination Council, *Bank Secrecy Act/Anti-Money Laundering Examination Manual*, at 3 (2007).

which have been filed by banks and other depository institutions.[164] Under know-your-customer rules, banks must gather and retain significant records with respect to their clients.[165] In addition, the qualified intermediary ("**QI**") program allows the IRS to collect some information directly from QIs with respect to their accounts, targeting tax non-compliance as well as providing an administrative regime for withholding.[166] These systems are far more comprehensive and provide substantially more information than does a simple count of how many foreign financial accounts are maintained by the bank. Much of this information is already required to be reported to the IRS.[167]

All of that said, ***because*** banks are subject to exhaustive regulatory and reporting responsibilities, the FBAR represents a substantial and potentially redundant administrative burden for them. A single bank may easily hold millions of foreign financial accounts and may also make significant use of accounts for its own purposes. While the FBAR regime is generally not designed to minimize the unique burdens it places on financial institutions, it does relax reporting requirements with respect to banks in two regards. First, the FBAR rules currently exempt accounts that are used solely for interbank settlement.[168] However, no such exemption exists for a bank's use of "nostro" accounts for intrabank purposes, to address foreign currency issues, to facilitate commodity trading, to sweep deposits offshore temporarily, to maintain collateral and for many other purposes unrelated to the bank's customers.

Second, the FBAR rules exempt bank employees from reporting requirements with respect to accounts of their employer bank in which they have no financial interest if the bank is "currently examined by Federal bank supervisory agencies for soundness and safety . . . ."[169] However, this exception is subject to a number of points of confusion and limitation. It is not clear when an account is an account of the bank, nor does the rule cover officers or employees of bank subsidiaries or affiliates. Employees of banks and their affiliates may have significant overlap in their businesses and in their duties: an affiliate may be a broker-dealer or similar related entity that does business with the bank regularly, employees of an affiliate may have signature authority over the bank's accounts held with another financial institution or employees of another entity may have signature authority over accounts of the subsidiary or affiliate solely through their employment. While these cases are similar to that of

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[164] *See* Part II.B.2 (discussing SARs).

[165] 31 C.F.R. Section 103.121.

[166] *See* Rev. Proc. 2000-12, 2000-1 C.B. 387.

[167] *See, e.g.*, Form 1096; Form 1042-S.

[168] *See* 2008 FBAR Instructions.

[169] *Id.*

a bank employee with signature authority over an account of the bank, the bank exception by its terms does not apply to these employees, even though the bank must report the accounts. If for any reason a bank or any of its employees is not covered by an applicable exception (for example, U.S. citizen employees of a foreign bank), the potential reporting requirements can be overwhelming. One bank and trust company noted that it has hundreds of thousands of accounts that are subject to FBAR filing.[170]

Thus, the bank employee exemption lacks sufficient clarity and scope. These limitations are significant because while banks may be uniquely equipped to deal with heavy compliance burdens, their employees are not. Some banks have in excess of 10,000 employees that may have authority, in a direct or managerial sense, over some of the bank's foreign financial accounts. Simplistically, if no exception applies, a bank with thousands of employees and thousands of foreign financial accounts would need to devote an extraordinary amount of resources to match employees with accounts and so, necessary, would need to assist employees to make a high volumes protective filings. This would require thousands of determinations. This illustrates the magnitude of the administrative burden that could result if the FBAR bank employee exception is not more fully articulated and expanded.

We think the existing exceptions provide limited and insufficient relief to the uniquely substantial and arguably redundant burdens the FBAR rules place on banks and their employees. Significantly, no exception exists for the bank itself despite the fact that these institutions are already subject to such extensive oversight. Banks can, of course, make use of abbreviated reporting for holders of financial interests in more than 25 accounts. However, this reporting currently requires the bank to provide the number of foreign financial accounts that it holds. For some large banks, determination of a precise number is very complicated and requires hundreds of hours of labor and considerable cost.[171]

A brief examination of the roles banks fill illuminates this complexity. Domestic investors often use U.S. financial institutions as a means to invest throughout the world. The U.S. institution typically holds the investor's assets in a pooled offshore account (an "omnibus account") in the name of the institution. While the domestic investor would technically have legal title to the funds in an

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[170] *See* Letter from Robert J. Foley, State Street Bank and Trust Company, *Attention: Announcement 2009-51 and Notice 2009-62*, 2009 TNT 173-19 (Aug. 27, 2009).

[171] For example, one domestic financial institution has estimated that it and its advisers spent approximately 8,500 hours preparing almost 13,000 FBARs for 2008. Another estimates that its primary 2008 filing covered over 7,000 accounts. A third estimates it prepared or filed almost 400 separate 2008 FBARs, totaling over 150,000 pages, and paid nearly $500,000 to external service providers in connection with the preparation of these filings.

overseas account, the investor has no ability to effect any transaction with regard to that account except by acting through the U.S. financial institution.[172]

In addition to their roles as depository institutions, banks typically play a number of roles in the financial sector. Many banks or their subsidiaries serve as trustees, hold interests in investment funds and other investments as agent or nominee for their customers, serve as asset managers for mutual funds, hedge funds and private equity funds, and otherwise provide financial services. In this way, banks can encounter virtually every aspect of the FBAR reporting regime.

Foreign banks may face even more pronounced reporting burdens than do domestic banks, given the lack of an exception for foreign banks' employees. The public company exception, by its terms, applies only to domestic companies. The bank exception seems to apply only to banks that are examined by federal authorities; and it is not clear whether a foreign bank that has a domestic branch may assert that the bank itself is examined by federal authorities because its domestic branch is so examined. Because of the lack of exceptions for their employees, foreign banks face significant logistical hurdles in assisting their employees with their FBAR obligations. Possibly, employees of domestic banks and not foreign banks are entitled to an exception because the government has more confidence in its own regulatory apparatus than those of foreign governments, and because with a domestic bank the records of foreign accounts will be maintained in the United States. However, the tremendous burden the FBAR rules place on foreign banks and their employees is a major factor that must weigh against imposing this burden.

C. Broker-dealers

Domestic broker-dealers are subject to a detailed regulatory regime broadly similar to the regime that applies to domestic banks. Due to this regulatory oversight, broker-dealers may have fewer opportunities to commit various financial crimes than do unregulated entities. However, unlike banks, there is no specific FBAR exception available for employees of broker-dealers.

Registered broker-dealers are subject to regulation and supervision by the SEC, the states and the self-regulatory organizations ("**SROs**") of which they are members, similar to the manner in which banks are regulated and supervised. Broker-dealers are also subject to anti-money laundering compliance obligations

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[172] *See id*. The letter also discusses "segregated accounts," which are similar except that they are held in the name of the investor, and requests that "Treasury . . . provide general guidance that an absence of practical control results in an absence of financial interest and signature authority" on the part of the investor. *Id.* We join this recommendation. *See generally* Part VII.C.

similar to banks[173] and tax information reporting requirements. The broker-dealer regulatory regime primarily covers the activities of the broker-dealer itself, and not its affiliates, however, while the bank regulatory regime covers activities of bank affiliates as well.

As with banks, broker-dealers are subject to supervision and examination by a federal regulatory agency. A broker-dealer is required to register with the SEC if it uses the mails or any instrumentality of interstate commerce to effect any transactions in any purchase or sale of any security.[174] The SEC has the authority to inspect broker-dealers' records on a periodic basis.[175] Furthermore, under the Exchange Act, broker-dealers are required to maintain all records required by the Bank Secrecy Act,[176] which are available for inspection by the SEC. These records are identical to those that banks must maintain pursuant to the Bank Secrecy Act and contain the same information sought by the FBAR.

In addition, broker-dealers must join an SRO before effecting transactions in securities.[177] Broker-dealers are also inspected by SROs in which they are members to assess compliance with securities laws (including an assessment of the broker-dealer's anti-money-laundering program) and the SRO's rules.[178]

The Securities Exchange Act of 1934 (the "**Exchange Act**") defines a broker as an entity engaged in the business of transacting in securities on behalf of its clients,[179] and a dealer as an entity engaged in the business of transacting in

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[173] In connection with anti-money-laundering compliance, broker-dealers must (a) implement customer identification programs, (b) conduct risk-based due diligence, (c) keep records of funds transfers of $3,000 or more and (d) share information with federal law enforcement agencies. In addition, like banks, broker-dealers must report currency transactions that exceed $10,000 and transportation of more than $10,000 in currency or monetary instruments into or outside of the United States. *See* 31 C.F.R. Section 103.35(b). Under the enforcement rules that implement the Bank Secrecy Act, the authority to assess compliance with the Bank Secrecy Act's anti-money-laundering obligations have been delegated to the Federal Reserve with respect to banks that are subject to examination by the Federal Reserve, and to the SEC with respect to broker-dealers. *See id.* Section 103.56.

[174] Securities Exchange Act of 1934 Section 15(a)(1), 15 U.S.C. Section 78o(a)(1) [*hereinafter* the Exchange Act].

[175] *See* 15 U.S.C. Section 78q(b). However, the SEC does not conduct examinations of broker-dealers in a manner comparable to the periodic examinations to which banks are subject.

[176] *See* 17 C.F.R. Section 240.17a-8.

[177] *See id.* Section 78o(b)(8).

[178] *See id.* Section 78s(g).

[179] *See id.* Section 78c(a)(4)(A).

securities for its own account.[180] Broker-dealers in the U.S. are required to join an SRO, most commonly the Financial Industry Regulatory Authority (FINRA).

In addition to the foregoing regulatory regimes, broker-dealers, like banks, are required to report to the IRS on Form 1099 specified types of income and gross proceeds from securities sales of individual U.S. clients with the broker-dealer. Accordingly, they are subject to IRS information reporting audits in the same manner as banks.

Broker-dealers face many of the same issues with FBAR compliance as do banks. Like a bank, a broker-dealer typically manages a vast number of accounts for its clients, and may act as a custodian, nominee or investment adviser. Many broker-dealers are large entities with many employees that have some measure of authority over those accounts. In addition, a broker-dealer or one of its subsidiaries may have fiduciary duties to ensure FBAR compliance by certain clients (*e.g.,* trusts). For many broker-dealers, because of the various implications of the FBAR rules, FBAR reporting is a substantial organizational and logistical challenge.

D. Investment Funds

Investment funds include various types of pooled investment vehicles, with widely different investment strategies and types of investors. Different types of funds can be subject to very different levels of governmental regulation. For example, funds that are registered as investment companies under the Investment Company Act of 1940 (the "**1940 Act**")[181] are subject to significant regulation by the SEC, while funds that are exempt from this registration requirement are lightly regulated. Managers of investment funds also vary significantly, from large, sophisticated financial institutions to "boutiques" that are thinly staffed. While many fund manager are registered as investment advisers under the Investment Advisers Act of 1940 (the "**Advisers Act**"), managers of many private funds are not registered advisers.[182]

An investment fund, its investment manager and an investor with a greater than 50% interest in the fund may have FBAR filing obligations if the fund has a financial interest in a foreign financial account. Investment funds may, of course, hold foreign bank accounts in order to facilitate investments outside the United States. Given the nature of an investment fund's assets, however, many funds and their managers, as well as any greater-than-50% investors, currently face great

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[180] *See id.* Section 78c(a)(4)(A).

[181] *Id.* Sections 80a-1 *et seq*.

[182] Registration under the Advisers Act subjects advisers to a host regulations, including regulations governing record keeping. *See id.* Section 80b-1 to 80b-21.

uncertainty as to whether any of their other positions constitute "foreign financial accounts." For example, it is unclear whether arrangements with foreign clearinghouses, such as Euroclear or Clearstream, constitute "securities accounts" and whether a derivative financial instrument with a counterparty that is a foreign financial institution is a "securities derivative account." A fund vehicle that serves as a "feeder" fund for an offshore "master" fund, or that invests in underlying investment funds sponsored by third-party managers, must wrestle with the question whether an interest in a foreign investment fund constitutes a "foreign financial account." The suggestion that stock of a PFIC may constitute a "foreign financial account" creates a great deal of uncertainty for funds that focus on investments outside the United States. Depending on how expansively a "foreign financial account" is defined, a fund that invests outside the United States could be required to report an extraordinarily large number of "accounts." For a discussion of the uncertainties with respect to the definition of a "foreign financial account" for FBAR purposes, see Part VII.A.

The managers of some investment funds are large institutions that are well-positioned to comply with FBAR filing requirements. Many fund managers, however, are small operations with few employees and limited operating budgets. Imposition of material costs and person-hour requirements on managers of this type would require a reallocation of their resources and divert their attention from the management of the fund and compliance with other regulatory regimes. While larger fund managers have more expansive resources with which to handle FBAR compliance, they also would potentially have filing requirements with respect to a significantly larger number of accounts.[183] All fund managers are challenged by the current confusion regarding what positions constitute "foreign financial accounts," and many may have difficulty identifying all of the people who have signature or other authority over the fund's "foreign financial accounts."

E. Trusts

Trusts exist in a wide variety of legal arrangements, from estate planning to investment funds to complex business arrangements. Individuals commonly use trusts for estate planning, privacy and asset protection. Business entities may use trusts for the pursuit of charitable purposes, the structuring of retirement plans and the formation of investment funds that are organized as trusts. Because of the varied nature of entities that are characterized as "trusts," it is difficult to address them as a single category.

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[183] For example, the Private Equity Council has estimated that, in its membership alone, treatment of a limited partner interest in a private equity fund as an interest in a "financial account" would require "literally tens of thousands of additional FBAR filings." *See* Letter from the Private Equity Council, to the Hon. Douglas H. Shulman, Commissioner of the IRS, *FBAR and Private Equity Funds*, at 8 (Aug. 4, 2009).

In the most general sense, a "trust" is the relationship formed when a grantor gives fiduciary control of property to a "trustee" to manage for the benefit of a third party. There is ambiguity in determining how the FBAR reporting requirements apply to trusts, specifically, how the location of the trust is determined, who should file, whether a power of appointment conveys "signature or other authority" over a foreign financial account, and when a beneficiary has a "financial interest."

The location of a trust is not always easy to determine. Its location could be considered the location of the assets, the location of the trustee, the jurisdiction whose law governs the arrangement or a more obscure possibility. For U.S. federal income tax purposes, a trust is considered a domestic trust if a court within the United States can exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust.[184] However, U.S. federal income tax principles generally do not apply to the FBAR rules, which are authorized under Title 31, not Title 26. The question of whether a foreign trust is itself a foreign financial account is addressed in Part VII.A.2(e).

A trust generally involves at least three relevant people: the settlor, the trustee and a beneficiary. Also, for certain purposes, the trust itself can be considered an entity. Thus, for each trust, there are potentially at minimum four people that could have foreign financial account reporting requirements. Unfortunately, the FBAR rules do not generally provide clear guidance as to when each of these persons must file.

The FBAR instructions regarding beneficiaries give rise to interpretative uncertainty. The rules provide that a United States person with a present beneficial interest in more than 50% of the assets of a trust, or a United States person who receives more than 50% of the current income of a trust, has a financial interest in all foreign financial accounts of the trust.[185] These rules are still unclear, however, when applied to remainder beneficiaries or beneficiaries of discretionary trusts.

Because of the number of persons involved in a trust arrangement, a large number of individuals may have some measure of control over, or some interest in, a foreign financial account owned by a trust. For example, a wealthy individual might set up a trust to provide certain benefits for the individual's family. The individual might appoint a domestic trust company as trustee. Assuming the trust holds a single foreign financial account, if there were six beneficiaries of the trust and the trust company had five employees with authority over the assets of the

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[184] Code Section 7701(a)(30).

[185] *See* FBAR Instructions.

trust, there could, depending on the nature of the trust agreement, be as many as fourteen FBARs required for that single foreign financial account – one from each beneficiary, one from each employee, one from the trust company as an entity, one from the grantor and one from the trust itself.

In determining whether to file an FBAR, beneficiaries may not be able to verify easily whether they have met the threshold level of "financial interest." The current FBAR rules assume that all U.S. persons have access to complete information regarding foreign financial accounts in which they hold a "financial interest." With respect to trusts, this assumption is false in a significant number of cases. For example, beneficiaries of discretionary trusts may, depending on the terms of the trust instrument and the underlying law governing the trust, have little or no right to obtain information regarding the current or historic value of the assets held within a trust. This is particularly true where no distributions have been made to the beneficiary.

Moreover, there are strong policy reasons, having nothing to do with tax planning, to enable settlors to create so-called "quiet trusts" in which beneficiaries have no or only limited rights to information regarding the trust. Many wealthy settlors are concerned about the negative impact on personal motivation when relatively young beneficiaries are given extensive information as to the value of trusts established for their benefit. These settlors do not want the existence of the trust and knowledge of its value to dissuade beneficiaries from furthering their education or entering into productive employment or business activities. Other beneficiaries may have existing problems with gambling or drugs, which argue for limitations on the ability of beneficiaries to use information about the trust's assets to force distributions to support unhealthy behaviors. Where there are legitimate reasons for trustees to administer a quiet trust, U.S. beneficiaries should not be penalized for failing to report information regarding trusts whose existence is not known to the beneficiary.

Strict application of FBAR definitions to the relevant parties of a trust would likely lead to unreasonable results. The FBAR rules should balance the need to obtain information relevant to administration of U.S. tax and regulatory regimes against the legitimate needs of trustees to administer trusts in the best interests of the beneficiaries. For this reason, we recommend that, to the greatest extent possible, the FBAR rules favor reporting by trustees or settlors, rather than beneficiaries. This approach would limit duplicative FBAR filings, and would ensure that reporting is required only from those who are in a position to obtain access to the required information.

F. Retirement Plans and Individual Retirement Accounts

Retirement plans qualified under Code Section 401(a) or 403(a) or (b) and IRAs qualified under Code Section 408 or 408A are exempt from taxation and are subject to comprehensive regulation and supervision. The existing limitations on

contributions and withdrawals, as well as the existing filing and public inspection requirements for these accounts, make these accounts unlikely candidates for secret or criminal activity.[186] The Employee Retirement Income Security Act of 1974, as amended ("**ERISA**") contains fiduciary standards, often requiring the use of trustees with fiduciary responsibility, that have been referred to as "the highest known to the law"[187] and, even where ERISA is inapplicable (*e.g.,* in the case of most IRAs and certain "Keogh" plans covering only an owner-employee), the companion prohibited transaction provisions of Section 4975 (which were added by ERISA) may provide substantial disincentives to the use of plan (including IRA) assets for a fiduciary's own account and other self-dealing. The legal structures of retirement plans may differ. Some, like IRAs, utilize trusts that raise many of the same issues discussed in the previous section.

Employer-sponsored tax-qualified plans are generally established by employers for the purpose of providing retirement savings for the employer's eligible service providers and their beneficiaries on a tax-advantaged basis, and are required to be funded. Fiduciaries of employer-sponsored plans covered by ERISA are required to hold those assets for the exclusive purpose of providing benefits to plan participants and fiduciaries.

Every person who maintains a qualified retirement plan or IRA is required to file an annual report on Form 5500, and those forms are subject to public inspection.[188] In addition, they (like U.S. taxpayers) are required to report transfers of property to foreign corporations on Forms 926, report certain interests in foreign corporations on Forms 5471, file a separate return with respect to each investment in a PFIC on a Form 8621, and report interests in certain foreign partnerships on Forms 8865.

Government plans and non-electing church plans may be exempt from ERISA and Code Section 4975. (Non-electing church plans are church plans that have not made the election under Code Section 410(d) to be subject to certain Code qualification provisions and, by virtue of Section 4(b)(2) of ERISA and Code Section 4975(g)(3), to ERISA and Code Section 4975.) However, numerous considerations, including large constituencies supervising them and their exemption from U.S. federal income tax, arguably make it unlikely that many such plans would be expected to be used to hide assets outside the United States. In addition, there are other considerations that inform reduced

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[186] *See, e.g., id.* Section 401(a)(13) (limiting assignment and alienation of plan benefits); Treas. Reg. Section 301.6058-1 (requiring funded deferred compensation plans to file an annual report on Form 5500): *id.* Section 601.702(d)(5) (providing for public inspection of Forms 5500).

[187] *E.g., Donovan v. Bierwirth*, 680 F.2d 263, 272 n.8 (2d Cir. 1982).

[188] *See* Treas. Reg. Section 301.702(d)(5). *See also* Code Section 6058.

enforcement with these plans by Treasury (indeed as reflected by their exemption from ERISA and Code Section 4975).

Plans subject to Code Section 457(a) (certain governmental plans and certain plans maintained by tax-exempt organizations) are subject to trust or other custody requirements under Code Section 457(g). These requirements provide additional procedural obligations for covered plans.

The entities that serve as plan administrators and IRA custodians typically are large financial institutions and themselves are also subject to extensive regulation and supervision, often by federal or state bank regulators and insurance regulators, and are subject to regulation under laws, such as the 1940 Act, applicable to investment advisers. In the cases where major institutions are not present, such as small retirement plans administered by employer representatives, investments in foreign assets are usually restricted to international mutual funds provided by U.S. broker-dealers, which investments are not subject to the FBAR requirements.

Over the past decades, plans have increased their international investments, both to diversify their investments and to achieve tax efficiency. Plans that are potentially subject to unrelated business income tax from leveraged investments, for example, often invest in offshore "feeder" funds, which in turn invest in a master fund organized and managed in the United States.

If these foreign investments are considered financial accounts, there is a great potential for duplicative filings, depending on how the FBAR rules are interpreted. Potential filers include the plan itself, trusts established under the plan, plan trustees, plan custodians, the employer in the case of an employer-sponsored plan, officers of the employer, employees of the plan, plan administrators and their employees, investment advisers and their employees and plan participants. All of this is in addition to the requirement under the BSA that a financial institution must disclose investor information to Treasury upon request.[189]

G. Tax-Exempt Organizations

Tax-exempt organizations are distinguishable from other FBAR filers in that their tax-exempt status makes tax avoidance less of a concern. In addition, tax-exempt organizations are generally subject to filing requirements and other governmental oversight. In 2009, many of these organizations were first required to comply with significantly more complex annual tax reporting rules on Forms 990, which under Code Section 6104(d) must be made available to the public and in practice are published on the Internet not long after filing. Thus, not only are

[189] *See* 31 C.F.R. Section 103.33(e), (g).

tax-exempt organizations subject to extensive tax reporting, but that reporting is usually open to scrutiny by a large number of people, often the public at large. This reduces the chance that improper activity, much less criminal activity, will go undiscovered, even without FBARs.

Tax-exempt organizations conduct a wide variety of activities that may require them to establish accounts subject to FBAR filing requirements, as presently comprehended. In addition, as with most private organizations, employees of tax-exempts must make duplicative filings for accounts of the organization over which they have signature authority.

For example, an educational organization described under Section 501(c)(3) may publish a small newsletter overseas. In connection with publishing that newsletter, the organization may maintain an overseas bank account that would be subject to FBAR filings. The fact that the organization conducts the publishing activity overseas would generally be publicly available through the organization's Schedule F to Form 990 or Form 990-EZ. While those forms do not require the disclosure of specific accounts, (i) Schedule F to the Form 990 does require a description of foreign activities and amounts expended in connection with such activities, and (ii) Form 990-EZ, Part III, requires descriptions of program services.[190] Even though these disclosures are made public, both the organization and employees must file duplicate FBARs.

Endowments often make foreign investments in order to meet their fiduciary and sometimes statutory duty to diversify their portfolios. They maintain foreign bank accounts for purposes of making and receiving payments and foreign currency transfers, and payments to those accounts are reportable with the Form 990. Although most Forms 990 are published on the Internet, the endowments and their employees must make duplicative filings.

H. Government Organizations and NGOs

In the fight against tax and financial crimes and terrorism, agencies of the U.S. government and their employees are presumptively of less interest than their counterparts in the private sector. Employees of many agencies are subject to security clearance procedures and background checks. Government agencies are less likely to have financial accounts in foreign secrecy jurisdictions. Further, the U.S. government already has access to information concerning these accounts.

There are two ways in which governmental entities might be subject to FBAR reporting requirements. First, the BSA provides that a "person" includes a

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[190] The instructions to Form 990-EZ describe a program service as "a major (usually ongoing) objective of an organization, such as adoptions, recreation for the elderly, rehabilitation, or publication of journals or newsletters."

"governmental entity" "when the Secretary prescribes" (which, to our knowledge, has not been done).[191] Second and more important, it is not entirely clear whether "hybrid" government entities (*e.g.,* government-owned corporations) are subject to FBAR reporting requirements. Entities such as the Federal Deposit Insurance Corporation, the Corporation for Public Broadcasting, the Social Security Trust Fund and Government National Mortgage Association and Federal National Mortgage Association may be subject to filing requirements if they hold or have signature authority over foreign accounts. We might speculate that some such entities should be subject to FBAR reporting requirements, but we feel confident that at least some should not.

Regardless of whether a U.S. governmental entity falls within the definition of a "person," ***employees*** of governmental entities would (absent some exception) nonetheless be subject to FBAR filing requirements with respect to accounts over which they have "signature or other authority." A significant issue in this regard is that the current non-bank employee exception (and the expansions thereof that we are proposing) would turn on the employer filing FBARs, something that may not be possible or appropriate where the employer is a governmental agency. Consideration should be given to whether and to what extent this issue needs addressing, and if so, how a suitable exception could be crafted.

Similarly, U.S. citizens who work for foreign government agencies or international organizations such as the United Nations or the World Bank might have signature authority or other authority over foreign financial accounts.[192] These organizations and their employees might be subject to legal constraints on their ability to report information about those accounts. These types of organizations are unlikely to be engaged in criminal activity, yet they, or, more likely, their employees, may face substantial and unnecessary hardship in complying with the FBAR reporting requirements.

VI. Principal Recommendations

As discussed in Part II.B.4, the available evidence suggests that the FBAR as currently crafted is not likely to be an efficient tool in the investigation or

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[191] 31 U.S.C. Section 5312(a)(5).

[192] A September 23, 2009 letter written on behalf of the World Bank notes its employees who work in the U.S. on G-4 visas and are classified as non-resident aliens exempt from federal and state taxation are nonetheless required to file FBAR reports – an outcome the World Bank contends is inconsistent with sections of the Code as well as the spirit of the International Organizations Immunities Act, which generally guarantees international organizations and their employees certain privileges and exemptions while working in the United States. *See* Letter from Richard Skillman of Caplin & Drysdale, *Firm Seeks Exception from FBAR Reporting Requirement for Some International Organizations* (Sept. 8, 2009), *reprinted at* 2009 TNT 182-14 (Sept. 23, 2009).

prosecution of any crimes. In this Part, we set forth five proposals that we think are essential to the efficient functioning of the regime, in that they will streamline the process of reporting so as to minimize the collection of useless information while not materially reducing the likelihood of collecting useful information. Indeed, we believe if properly structured, these proposals would increase the likelihood of collecting useful information.

We think that the adoption of one or more (but ideally all) of these proposals would make the operation of the FBAR rules materially more manageable and efficient, without regard to the resolution of the various substantive issues addressed in Part VII. Indeed, we view these proposals as relatively simple ways to limit the burden and complexity of the FBAR rules significantly (again, we believe and hope without reducing their likelihood of collecting useful information), thereby reducing the urgency of the need to resolve some of the very complex and nuanced issues raised in Part VII.

We also identify in Parts VI.F and VI.G two substantive issues that we think are particularly in need of immediate attention: The questions whether in 2008 and prior years, (i) foreign investment vehicles were "accounts" subject to FBAR reporting and (ii) non-U.S. persons doing business in the United States were required to file FBARs with respect to their foreign accounts. As discussed below, we believe, and strongly encourage Treasury and the IRS to confirm that, the answer to both these questions is no.

A. Minimize Duplication of Reporting

As discussed in Part II.B.3, the "ideal" financial account reporting regime would maximize the number of people with potential liability for reporting relevant information but minimize the duplication of such information. These goals suggest a system in which (apart from the "true" beneficial owners of accounts) a single entity would report the relevant information on behalf of all persons that would otherwise be obligated to do so. Ideally, this reporting entity would be the person best suited and most reliably likely to file the required reports. We have several suggestions for ways to accomplish these objectives.

1. Qualified filer regime

First, we think Treasury should adopt a "qualified filer" regime, in which certain entities, either because they meet specified criteria or by virtue of a closing or similar agreement with Treasury, would be presumptively permitted or obligated to file FBARs on behalf of persons holding foreign financial accounts through them. For example, we think the system would be significantly rationalized if any person other than the beneficial owner of the account that is otherwise obligated to file an FBAR, whether by virtue of a financial interest or signature authority, were relieved of that obligation with respect to any account held through a U.S-regulated financial institution (for example, a bank, broker-

dealer or perhaps an insurance company), provided that the potential filer has no knowledge or reason to know the financial institution will not perform its obligations.

More broadly, we think Congress's concerns with respect to foreign financial accounts are likely to be inapplicable to many accounts held "through" regulated U.S. financial institutions, in particular where the institution has full access to information regarding the account and is not subject to any jurisdiction's secrecy laws regarding the account. Because any disbursement of funds from a foreign financial account under these circumstances is channeled through the U.S. institution, our sense is that activity relating to these accounts is essentially subject to the same regulation as activity relating to domestic financial accounts. The BSA indicates Congress's understanding that domestic financial institutions are sufficiently monitored and regulated that it is not generally necessary to require equivalent reporting of domestic financial accounts. Indeed, the House Committee observed that "the Committee's general purpose [was] to put an American or person doing business in the United States in the same position with regard to his secret foreign transactions as he would be if he were dealing with a domestic United States institution."[193] Note that this proposal would not exempt the account from filing altogether; it would merely exempt all potential filers ***other than*** the qualified institution and the beneficial owner of the account from filing. A broader version of this proposal could exempt the beneficial owner of the account from filing as well. Indeed, under this proposal, the qualified filer might file on behalf of others (*e.g.,* accountholders, persons with signature authority) even though it had no filing obligation of its own (for example, if it had no financial interest in or signature authority over an account but was simply retained by customers to do so, or if our proposal in Part VII.B.2(d) to exempt certain regulated financial institutions from filing were adopted).

In order to ensure that potential filers do not attempt to avoid their filing obligations by spreading their assets among financial institutions in such a way that none of them holds assets exceeding the dollar threshold, we would recommend applying a lower reporting threshold for qualified filers or adding a provision that the exemption does not apply to any accounts in which a potential filer has a financial interest that are held through a financial institution if those accounts, in the aggregate do not exceed the dollar threshold (*i.e.,* that such accounts must be aggregated by the potential filer with its other foreign financial accounts, not held through "qualified" institutions, to determine whether it must file an FBAR for them).

In addition, we do suggest that the IRS and Treasury study the question whether it would be appropriate simply to exempt from FBAR filing altogether

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[193] H.R. REP. No. 91-975, at 39-40.

accounts held through domestic regulated institutions, at least where the institution has full access to information regarding the account and is not subject to any foreign jurisdiction's secrecy laws with respect to the account. At a minimum, as we discuss in Part VII.C.2(a), we think certain accounts created by U.S. financial institutions on their customers' behalf, where the account is created for the institution's benefit (and perhaps without the knowledge or consent of the customer) should be exempt from reporting. We note that, as discussed in Part II.B.4, this is a proposal that might result in the government not receiving information regarding foreign accounts (in this case, those held through U.S. financial institutions) unless and until the institution was asked about these accounts in connection with an investigation or inquiry. If this is not viewed as an acceptable outcome, it might be appropriate to consider whether this exception could be made contingent upon a showing that the institution or the accountholder has filed or will file one of specified information reports with respect to the relevant accounts, such as an SAR or a Form 1096 (in the case of the institution) or a Form 926 or 8865 (in the case of the accountholder).

We also think Treasury and the IRS should implement a regime (as an *addition* to a "qualified filer" regime) that allows ***any*** entity, such as a foreign bank, to establish its status as a qualified filer, for example by contract with Treasury. We imagine such a contract might look similar to a "qualified intermediary" agreement;[194] its key elements would be an undertaking to maintain, within the reach of Treasury's jurisdiction, data regarding customers' foreign financial accounts, and to file an FBAR reporting that information to Treasury on the customers' behalf (again, even though the entity might itself not be required to file an FBAR). We think it would also be sensible to consider identifying foreign jurisdictions whose banks are sufficiently well regulated to qualify as *per se* qualified filers.

2. Registered filer regime

We also think it would be productive for Treasury to consider a regime under which ***any*** person could undertake to file FBARs and maintain relevant data on behalf of others who would otherwise be obligated to report the same information. This regime might work something like the registration system for promoters of tax shelters.[195] Any entity that maintains foreign financial accounts could have the option of registering with Treasury as an information provider, and could then provide information on all foreign financial accounts that it maintains and certify to its account holders and employees, agents, etc., that it has filed an FBAR with respect to the relevant account(s), in which event those persons (or all of those persons other than the beneficial owner of the account(s)) could be

[194] *See* Rev. Proc. 2000-12, 2000-1 C.B. 387, as amended.

[195] *See* Code Section 6111.

exempt from duplicating the reporting. Alternatively, the regime could be less formal, allowing one person to file an FBAR including a statement that it is filing on behalf of others. There are ancillary questions, including whether the designated filer should name the persons on whose behalf it is filing (presumably, at least regarding persons who have a financial interest in or beneficial ownership interests in the account, the answer should be yes), and also whether those persons should be fully exempted from liability in this event or only to the extent the filer actually and properly provides all relevant information, who would be permitted to rely on the designated filer's filing, and on what showing the reliance would be justified.

3. Expanded employee exception

If our "qualified filer" and/or "registered filer" proposals are not adopted, we think in any event that the current exceptions for bank and public company employees should be significantly expanded. As we said in the July 17 letter, we generally believe these exceptions should apply to all employees of any entity with respect to accounts – whether or not the accounts are "of" or "maintained by" the employer – over which the employees only have signature or other authority by virtue of their employment, provided the employer, any of its affiliates, any entity with which it files a consolidated FBAR or any other employee of any of them has filed an FBAR with respect to those accounts and maintains appropriate records in the United States. These issues are discussed in more detail in Part VII.D.2. Consideration also needs to be given to the treatment of employees of governmental entities and any other "exempt filers" (see Part VII.D.2(d)).

4. Expanded consolidated filing option

Fourth, the concept of consolidated FBAR filings should be expanded significantly to include non-corporate entities, as well as entities over which the consolidated group does not have majority ownership but has control, such as trusts, entities managed, administered or sponsored by a group member, partnerships and investment vehicles of which a consolidated group member is the sole general partner or manager, and other entities managed or controlled by a group member). All employees of the consolidated group should be exempt from filing with respect to any account of any member in which they have no financial interest if the account is included in the consolidated report.

There are in any event significant questions regarding whether and when accounts "maintained by" an entity can or should be brought within its consolidated filing. For example, as we discuss in Part VII.C.2(a), accounts like retirement plans and IRAs may or may not be "owned" by the entity sponsoring them. Similarly, trust accounts may or may not be "owned by" the trustee. We think it should be made clear that these "satellite" accounts are or can be treated

as part of an entity's consolidated FBAR, to the extent they are not exempted from filing.

5. Trust qualified filer regime

As discussed further in Part VII.B.2(b), we recommend that a trust (other than a statutory business trust) be disregarded for FBAR purposes, and instead that the trustee of a trust be treated as the record owner of the trust assets. In that event, if our qualified filer proposal in Part VI.A.1 is adopted, then in cases in which the trustee is a qualified filer, only the trustee would file an FBAR, on behalf of all United States persons who are grantors, beneficiaries or holders of powers over the trust.

If the trustee of a trust is not a United States person, we believe that the following persons should be required to file FBARs:

- a grantor of the trust who is a United States person, if he or she is then living. For this purpose, a "grantor" of the trust would be defined as any person who created the trust or made a gratuitous transfer to the trust;

- a United States person who holds a presently exercisable power of appointment over the trust fund;

- a beneficiary of the trust who receives more than 50% of the total amount of distributions made from the trust during the calendar year (regardless of the amount of the trust's income and regardless of whether the trustee treats the distribution as being made out of trust income or principal); and

- an appointee pursuant to a power of appointment who receives more than 50% of the total amount of distributions made from the trust during the calendar year (regardless of the amount of the trust's income and regardless of whether the trustee treats the distribution as being made out of trust income or principal).

However, again in order to minimize the burden of duplicative filings, we suggest that if a grantor of a trust who is a United States person certifies that it has filed or will timely file an FBAR in respect of foreign financial accounts held by the trust, then other prospective filers should be relieved of the responsibility to file an FBAR in respect of those accounts. An FBAR filed by a grantor who is a United States person could be required to provide information about holders of presently exercisable powers of appointment, beneficiaries and appointees who are United States persons.

6. Conclusion

The critical aspect of these rules (and indeed, in our view, of the FBAR rules in general) is that they should impose the burden of filing a report with respect to a suspect account on an individual or entity with no "true" financial interest in that account (*e.g.,* an employee of a bank, trustee, partnership, etc.) ***if, but only if,*** no other person or entity reports (or should be expected to report) the relevant information with respect to that account and maintains appropriate records within the jurisdiction of the United States. We think it important in considering the adoption of each of these proposals to establish clear rules regarding what showing must be made that a report was or can be assumed to have been filed in order for a potential filer to be exempt from reporting. In general, we think it appropriate for potential filers to be entitled to assume that a "qualified" person will meet its reporting obligations and maintain appropriate U.S. records, unless the potential filer knows or has reason to know it will not. Similarly, we think it appropriate for the employees and affiliates to be entitled to rely on a statement from the filer (or one of its officers or directors) to the effect that it has filed or will file a full and complete report and maintain appropriate U.S. records, unless the recipient of the statement knows or has reason to know the statement is false. As indicated above, in the case of "designated filers," the issue is somewhat more complex and merits further consideration.

As discussed in Part II.B, we understand that there may be perceived benefits to not following these recommendations but instead to requiring as many people as possible to file FBARs with respect to any foreign financial account, or at least to requiring a filing in all events by the "tax owner(s)" of the account. We obviously are not in a position to know how valuable these perceived benefits are, but we are certain that requiring multiple filings with respect to a single account has a large number of very negative consequences, including (1) an extraordinary compliance burden on filers and the government alike, (2) the risk that people and entities that are only tangentially involved with or knowledgeable about an account could be liable for civil (or even criminal) penalties and (3) the consequent need to define very thoroughly the scope of who is required to file reports and with respect to what types of accounts. Our sense is that the sheer volume and complexity of issues associated with any effort to maximize the actual (as opposed to potential) number of filers is likely to make the regime unenforceable, and thus that this is an ill-advised approach to implementation of the FBAR Provision. As mentioned in Part II, we would support either a modification of the tax return rules to require taxpayers to schedule foreign financial accounts in which they have a direct or indirect ownership interest for tax purposes or an additional FBAR requirement (assuming our qualified filer and employee proposals are adopted) that the beneficial owner(s) for U.S. tax purposes of any income from a foreign financial account must file an FBAR with respect to that account. Otherwise, we feel strongly that, consistent with the statute and Congress's intent, the regime should be reviewed and revised with a

view to minimizing the number of required filings, while obtaining the same (or better) quality of information on foreign accounts.

B. Exclude Accounts in Certain Jurisdictions

We suspect, to paraphrase the words of the FBAR Provision, that applying the FBAR regime to all foreign countries may be both unnecessary and undesirable. In particular, we think Treasury should study the idea of exempting from the FBAR rules accounts located in jurisdictions that do not protect the privacy of participants in financial transactions, and/or that impose a reasonable level of tax on ordinary investment income.

The relevance of whether there is a reasonable level of tax may depend on whether investments in hedge funds and investment funds are treated as foreign financial accounts. If they are not, so that foreign financial accounts principally consist of bank accounts, then the general level of local tax may not be a very useful indicator of whether the account is being used to facilitate a crime, because a bank account maintained in a particular jurisdiction by a non-resident of that jurisdiction will generally not be subject to any local tax in any event. As a result, while persons using offshore accounts in or in connection with financial crimes will presumably attempt to avoid taxes on amounts in those accounts, they may be able to do so in an otherwise high-tax jurisdiction (which is generally the only type of jurisdiction the United States enters into tax treaties with). A low general level of tax or the absence of a U.S. tax treaty thus would be relevant only if it tends to indicate something about whether the jurisdiction is likely to have bank secrecy laws or lax bank regulation, which from our layperson's perspective seems like a tenuous connection.

On the other hand, if an "account" includes an equity investment in an entity, such as an investment fund or PFIC, then it may become relevant whether that entity (or a distribution paid by it to a U.S. investor) is subject to a comprehensive income tax or is entitled to the benefits or otherwise subject to the provisions of a comprehensive income tax treaty with the United States.

In any event, we think a simple and reasonable way to effect this result would be to exempt accounts located in jurisdictions with no bank secrecy laws and with which the United States has a comprehensive income tax treaty that provides an adequate basis for Treasury to obtain access to information concerning foreign financial accounts in these jurisdictions. To the extent that Treasury already receives reports of suspicious activity with regard to financial accounts in those jurisdictions, or to the extent that it can obtain information on those accounts through information exchange or other forms of cooperation, reporting may be unnecessary and duplicative. This approach assumes that any jurisdiction with which the United States has a comprehensive income tax treaty has an adequate bank supervisory regime, which we have not tried to confirm.

Another possibility would be to provide a presumption that accounts in specified jurisdictions (*e.g.,* jurisdictions having no bank secrecy laws and that have comprehensive tax treaties with the United States or are determined by some metric to have adequate bank supervision, including know-your-customer rules) are not reportable, but to specify that if any person with signature or other authority over such an account knows or has reason to know that it is being used in or in connection with crimes against the United States, then that person must report it. This would have the virtue of allowing Treasury to hold persons with knowledge of such misconduct liable under the FBAR Provision and also to gather information regarding the appropriateness of the presumption with respect to a particular jurisdiction (*i.e.,* if Treasury discovers that a presumptively "exempt" jurisdiction is involved in a significant amount of financial misconduct, it can remove that jurisdiction from the "presumptively exempt" list).

A third approach would be to specify and maintain a list of jurisdictions that do provide secrecy, anonymity, low or no tax on investment vehicles or their distributions (if determined to be relevant), inadequate financial regulation or haven for terrorism or other "suspect" features, and provide that *only* accounts in such jurisdictions need be reported. We generally do not believe that such lists are effective and maintainable, however, and in any event we suspect that Treasury might find it undesirable for the "default" presumption with respect to a jurisdiction to be that accounts therein are not reportable.

We make this recommendation because it seems to us (although again, we do not know) that is it is fairly unlikely that persons attempting to commit crimes against the United States would do so by availing themselves of accounts in jurisdictions that do not have bank secrecy laws and with which the United States has a comprehensive treaty. Moreover, even if criminals maintained accounts in these jurisdictions, the United States is more likely to be able, without recourse to the FBAR regime, to gather the kinds of "highly useful" information it would need to discover and punish the criminals. In addition, we think the FBAR regime would benefit greatly from any action that Treasury determined could prudently be taken along these lines. Focusing on secrecy jurisdictions is clearly an appropriate use (indeed, we think the BSA itself indicates it was an expected use) of the Secretary's regulatory power. As the House Committee observed, the Secretary of the Treasury has "broad powers of exemption."[196] Both Houses of Congress in deliberations regarding the BSA evidenced both their focus on secrecy jurisdictions and their desire to minimize the burden imposed by the regime on legitimate commerce. The Senate Committee explained that it had "no intention of creating a mountain of paperwork when the benefits to law

[196] H.R. REP. No. 91-975, at 40.

enforcement officials are only marginal."[197] Without such an exemption, that is exactly what occurs.

This exemption would relieve many potential filers (predominantly, we think, those related to accounts having no nefarious purpose) of the burden of filing, while imposing the full FBAR reporting regime on filers associated with accounts that pose the greatest risk of being involved in the commission of financial crimes and terrorism. While we expect that such a rule would vastly decrease the quantity of reports, we also hope and expect that it might significantly increase the concentration of information received by Treasury that would have a "high degree of usefulness" in fighting financial crimes.

That said, as we discussed in Part II.B.4, an obvious consequence of this proposal is that the government would not learn of accounts in "exempted" jurisdictions unless and until it sought information about those accounts, presumably in connection with a pre-existing inquiry or investigation. And it is also quite clear that, absent particular circumstances (such as a person holding an account in an exempt jurisdiction through a U.S. financial institution, or an "account" that is also a vehicle transfers to which are subject to reporting under, for example, Code Section 6038B), no other information reporting with regard to these accounts is likely to be done. Thus, unless an information reporting regime with regard to transfers to accounts in exempt jurisdictions is adopted, any "information reporting" condition to a jurisdictional exemption is tantamount to no exemption at all.

C. Raise the Minimum Value Threshold

The FBAR rules currently require reporting of accounts the maximum aggregate value of which in any year is at least $10,000 (or the foreign currency equivalent thereof).[198] We recommend analyzing whether it would be appropriate to raise this threshold, perhaps substantially. First, we note that it would seem appropriate to adjust (and thereafter to index) this number for inflation. It was originally set at $1,000 in 1978, raised to $5,000 in 1983, and then raised to the current $10,000 in 1986.[199] $10,000 in 1986 would be worth approximately $20,000 today.[200]

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[197] S. REP. No. 91-1139, at 3.

[198] 2008 FBAR Instructions.

[199] *See* 1978 Instructions for Schedule B (Form 1040) (no reporting required for accounts less than $1,000); Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (rev. Sept. 1983) (minimum account threshold raised to $5,000); 1986 Instructions for Schedule B (Form 1040) (minimum account threshold raised to $10,000).

[200] *See* Bureau of Labor Statistics, *Consumer Price Index*, *CPI Tables*, *available at H*http://www.bls.gov/CPI/#tablesH (last visited Oct. 23, 2009).

We question whether the object of rooting out or collecting information with respect to suspect foreign accounts is served by collecting information regarding accounts even at a $50,000 threshold. In terms of tax crimes, the annual income on $50,000 worth of accounts, while nothing to laugh at if unreported, is unlikely to be worth the cost and effort of hiding the assets (or of enforcing the regime) – it would generally require a 10% annual return merely for that unreported income to amount to a "substantial understatement" for an individual under Code Section 6662(d). We suspect similar observations regarding magnitude could be made in terms of money laundering, terrorism and other crimes. The FBAR is a blunt instrument, which does not attempt to correlate directly with any underlying crimes. Its utility is "inferential," *i.e.,* it is a method of cross-checking or investigating other crimes. It is therefore obvious to us that there is a significant risk (indeed, a certainty) that the FBAR as crafted sweeps into its net large volumes of accounts that are entirely innocuous and uninteresting to Treasury.

Raising the dollar threshold is the simplest way to minimize this "collateral damage" and reduce the likelihood that the net of the FBAR regime inadvertently picks up extremely large numbers of potential filers who hold "ordinary" accounts in foreign jurisdictions, in all likelihood (at those dollar amounts) for perfectly legitimate reasons. Thus, while the question of where to draw the minimum value threshold is a highly policy-driven one, we recommend at a minimum raising the threshold to $25,000 and indexing it to inflation, and we think it would be appropriate to consider raising the threshold even further than that.

D. Notice-and-Comment Rulemaking

We are hopeful that the issuance of Notice 2009-62 reflects the beginning of a formal notice-and-comment rulemaking process for FBAR guidance. In a similar vein, we hope a reduced emphasis on informal rulemaking is indicated by the removal from the FBAR FAQs of an FAQ stating that "[i]ssuing instructions for the FBAR is one way the secretary may exercise [its] discretion."[201] We believe that it is imperative that the IRS and Treasury develop comprehensive regulatory guidance for the FBAR regime.

For three decades, there has been a lamentable contrast between the process by which the FBAR rules have been developed and how the penalties for noncompliance have been revised. As discussed in our July 17 letter and described in Part IV.E above, the means by which the IRS and Treasury have provided guidance has become increasingly informal. Very general regulations were promulgated in the 1970s. More specific guidance appeared in the instructions to various iterations of the FBAR and its predecessor, IRS Form 4683,

[201] This statement is not included in the current version of the FAQs.

but as discussed in Part IV.B.1, the earlier versions of the instructions to some extent provided more specific guidance than the later ones. More recently, the IRS has provided guidance by quietly posting FAQs on its website, without an adequate record of the dates on which they were revised. IRS representatives also made statements (taken as guidance) in the IRS National Phone Forum in 2007 (the materials for which were for some period posted on the IRS website but are available now only as an attachment to an article in a trade publication) and in an ABA Panel Discussion in 2009. Neither of those events was open to the public, and both were open only to paying subscribers.

As the IRS and Treasury guidance has become less formal, Congress has used the formal means of legislation to increase the penalties for failing to comply with the FBAR rules, which are described in detail in Part IV.F. Congress subsequently recognized that a primary cause of non-compliance was that potential filers are often "unaware of or confused about the filing requirements,"[202] but it has not reduced the penalties.

This state of affairs benefits neither FBAR filers nor the government. From a compliant filer's perspective, there is a strong incentive to interpret the vague and ambiguous rules expansively, out of fear that the filer might be subject to severe penalties for "getting it wrong." IRS representatives themselves have encouraged filers to "play it safe" and file. Taking this approach is enormously burdensome. We are aware of some filers who historically have filed FBARs and who have spent thousands of person-hours, at great expense, to review their compliance and expand the scope of their FBAR filings in light of the informal statements made by an IRS representative at the ABA/AICPA Conference in June and subsequent statements by an IRS spokesman. The current confused state of the rules thus is diverting resources from gainful economic activity to needless and wasteful filings, in a manner Congress had "every confidence" Treasury would avoid.

The situation may be no more attractive from the government's perspective. Due to the recent focus on FBAR requirements (we believe largely as a result of a number of recent high-profile tax investigations, various resulting legislative proposals and the suggestion in June that foreign hedge funds might currently constitute foreign financial accounts), the government stands to receive a high volume of unnecessary paper from law-abiding filers. We have difficulty imagining that much of that information will be "highly useful" in criminal investigations, although these extra filings may well substantially increase the government's processing and data entry costs in light of this volume and the current paper-bound system.

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[202] *See* Government Accountability Office, *Tax Compliance*, *supra* note 161, at 5.

More important than these inefficiencies, however, as we discuss throughout this report, the current rulemaking process (or lack thereof) creates a risk of unenforceability. A successful challenge to the rules could undermine the credibility of the FBAR regime. We think the risk that an affected taxpayer might bring a challenge is a serious one if the rules applicable to that taxpayer have been changed apparently arbitrarily and without adequate notice. Where an agency properly promulgates a rule interpreting a statute within its institutional competencies according to an implicit or explicit delegation from Congress, with notice and opportunity for comment, that rule generally has the force of law and a reviewing court will afford the legislative rule substantial deference.[203] Where Congress itself has not addressed a specific issue,[204] Congress may be considered to have delegated power to the relevant agency to set policy in that regulated area.[205] Thus, the Supreme Court has explained that a reviewing court should generally defer to the agency's legislative rule interpreting a statute for which the agency has been delegated interpretive authority when the regulation is promulgated with notice and opportunity for comment and is within the agency's institutional competencies, so long as the legislative rule is not "arbitrary, capricious, or manifestly contrary to the statute."[206] Even if the reviewing court disagrees with the agency's action and would act differently if empowered to do so, the court must generally uphold the agency's procedurally proper legislative rule if it is a "permissible construction of the statute . . . ."[207]

Legislative rules that should have been but were not enacted pursuant to notice-and-comment rulemaking are known as "spurious" or "procedurally deficient" rules. While there is some debate regarding whether spurious rules are invalid or are merely not binding in the way the agency had intended,[208] commentators have concluded that these rules cannot provide the legal basis for assessing a violation of the underlying statute[209] and would not be entitled to

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[203] *See Chrysler Corp. v. Brown*, 441 U.S. 281, 295-96 (1979).

[204] If Congress has addressed the precise question at issue, then a reviewing court must "give effect to the unambiguously expressed intent of Congress." *Chevron U.S.A., Inc. v. NRDC*, 467 U.S. 837, 843 (1984).

[205] *See United States v. Mead Corp.*, 533 U.S. 218, 230 (2001) ("It is fair to assume generally that Congress contemplates administrative action with the effect of law when it provides for a relatively formal administrative procedure tending to foster the fairness and deliberation that should underlie a pronouncement of such force.").

[206] *Chevron*, 467 U.S. at 844. This standard is often referred to as *Chevron* deference.

[207] *Id.* at 843.

[208] *See* Jacob E. Gersen, *Legislative Rules Revisited*, 74 U. CHI. L. REV. 1705, 1711 n.44 (citing Judge Posner's discussion not of whether spurious rules are invalid, but rather whether they are not binding in the way the agency had intended in *Hoctor v. United States Dep't. of Ag.*, 82 F.3d 165 (7th Cir. 1996)).

[209] *See id*. at 1712.

Chevron deference if challenged in a court.[210] And the risk of unenforceability is likely to be higher in a criminal case.

Consider the proposition discussed in Part VII.A.2(a) that hedge funds, private equity funds or venture capital funds are financial accounts requiring FBAR filings. If this rule is promulgated using notice-and-comment rulemaking, we expect there would be little debate regarding Treasury's ability to make this determination within its institutional competency, and that the rule would be given some amount of *Chevron* deference. Without promulgation in this manner, some taxpayers might take the position that this rule is not enforceable. Treasury would have to argue that the statute and regulations require hedge fund reporting independent of interpretive statements to this effect, a position that may be difficult to sustain, in light of the fact that, as discussed above, Treasury considered and declined to expand the definition of a "financial institution" to include private investment vehicles for BSA purposes.

Moreover, and in any event, there are very real benefits in terms of the quality of the regime to the government adopting a formal notice-and-comment process. First, as discussed in Part V above, there is a very wide variety of affected classes of potential filers (many of whose issues, as we discussed in Part V and will illustrate further in Part VII.B, are unique and non-obvious, and can be quite technical and complex). In the trust area, for example, the current rules can result in a surprising amount of unnecessary and duplicative filing. For many filers, the meaning of the term "financial account" continues to be a source of great confusion, potentially resulting in both over- and under-filing. Comments also can help identify ways in which the quality of data collected can be improved, particularly if the FBAR is to be re-purposed to focus more specifically on tax crimes.

Courts and academics have observed that comments to proposed rules expose an agency to diverse perspectives and ensure that the agency considers issues that it may previously have only vaguely considered and/or may have little technical knowledge of, as well as new ideas and approaches that may make the relevant regime more efficient and/or useful.[211] Unlike informal methods of regulation, the notice-and-comment rulemaking process requires the agency to consider such comments and issue a more thoughtful, thorough final statement of the rule it is implementing. In the case of the FBAR regime, by giving filers the opportunity to comment on proposed rules, a higher concentration of useful information is likely to be gathered and preserved.

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[210] *See, e.g.*, *Mead*, 533 U.S at 230-33.

[211] *See id.* at 230 ("[T]he overwhelming number of cases applying *Chevron* deference have reviewed the fruits of notice-and-comment rulemaking or formal adjudication.").

Also, as discussed in Part IV.E, agency responsibility for the FBAR rules has shifted hands several times since the inception of the FBAR regime. We understand that some IRS officials believe that their authority to engage in formal rulemaking may be limited, and we believe this perceived limitation has contributed to the lack of timely and clear guidance on the FBAR rules. Whether or not there is in fact a lack of authority, we believe that potential FBAR filers are entitled to the same type of guidance on FBARs that they receive on other issues administered by the IRS. We urge Treasury to take such action as is necessary to ensure that formal authority for rulemaking is clear. People subject to, or potentially subject to, the FBAR requirements should be able to monitor changes in the FBAR rules and requirements and be given the opportunity for notice and comment on rule changes.

E. Electronic Filing

We strongly urge Treasury to allow electronic FBAR filing for all filers, and to mandate electronic filing for institutions that are currently required to file tax information returns and reports electronically. Though the IRS currently mandates electronic filing for corporations with assets of at least $10 million that must file at least 250 information returns of any type (for example, Forms W-2 and 1099),[212] electronic filing of FBARs is not permitted currently, regardless of the size of the filer, the number of accounts it must report or the number of FBARs it and its affiliated group (including subsidiaries, employees, etc.) are required to file.

In 2004, the IRS started a new electronic filing system for corporations that is web-based and accepts a standard format to facilitate and standardize the filing process.[213] The electronic filing rules developed by the IRS are reviewed and have been recently modified to "eliminate impediments to the electronic filing of Federal income tax returns,"[214] although there are still some forms that must be paper filed because the new system cannot yet process them.[215] The mandatory electronic tax return filing threshold and the new system would provide a solid basis for the development of an electronic FBAR filing system. In addition, the IRS and Treasury could specifically authorize FBAR filers to file

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[212] *See* Code Section 6011(e); Treas. Reg. Section 301.6011-5.

[213] *See* IRS, *e-file for Large and Mid-Size Corporations – Frequently Asked Questions* (June 2009), *available at* Hhttp://www.irs.gov/businesses/article/0,,id=177619,00.htmlH (last visited Oct. 23, 2009).

[214] Rev. Proc. 2006-21, 2006-1 C.B. 1050.

[215] *See* IRS, *e-file for Large and Mid-Size Corporations*, *supra* note 213. For example, Forms 1120-FSC (Foreign Sales Corporations), 1120-REIT (Real Estate Investment Trust) and 1120-RIC (Regulated Investment Companies), among others, cannot be filed electronically. *Id.*

their forms electronically under the Electronic Signatures in Global and National Commerce Act.[216]

The IRS has stated that it expected that roughly one million foreign financial accounts should be declared on FBAR forms. We are confident this estimate is far too low, at least for 2008. Electronic filing will save the IRS the time of sifting through millions of pages of reports and then uploading them to the Currency and Banking Retrieval System database. It will also be easier for filers to comply with the current rule that FBARs are considered filed upon receipt, as an electronic FBAR would generally be received on the day it was sent.

F. Exclude Offshore Investment Vehicles for Prior Years

As we will discuss in some detail in Part VII.A.2(a), we are doubtful of the merits of including interests in investment vehicles such as hedge funds, private equity funds, "collateralized debt obligation" and "collateralized loan obligation" vehicles, and even many mutual funds (collectively, "**offshore investment vehicles**") within the scope of "foreign financial accounts" subject to FBAR reporting. While, as we discuss there, it is permissible under the BSA to do so on a going-forward basis, we feel very strongly, in light of our analysis of the statutory framework and the history of the BSA, that it is inappropriate to do so for years prior to 2009.

The BSA authorizes Treasury to require reports when a person "makes a transaction or maintains a relation for any person with a foreign financial agency. "[217] A "foreign financial agency," according to the BSA, "appl[ies] to an action outside the United States of a financial agency or institution."[218] A "financial agency" is a "person acting for a person . . . as a financial institution, bailee, depository trustee, or agent, or acting in a similar way related to money, credit, securities, gold, or a transaction [therein]."[219] A "financial institution" is defined quite broadly, but finitely, as one of an enumerated list of entities that routinely engage in cash transactions:

> an insured bank . . . ; a commercial bank or trust company; a private banker; an agency or branch of a foreign bank in the United

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[216] *See Electronic Signatures in Global and National Commerce Act*, Pub. L. No. 106-229, 114 Stat. 464 (2000) (codified at 15 U.S.C. Section 7001 *et seq*.). The law permits agencies to continue to require paper forms for records to be filed with those agencies. Thus the Act would prohibit filers from filing documents with the IRS electronically except where specifically authorized by the IRS. But if electronic filing were specifically authorized, electronic signatures would be given full legal effect under the Act.

[217] 31 U.S.C. Section 5314(a).

[218] *Id.* Section 5312(b)(2).

[219] *Id.* Section 5312(a)(1).

> States; any credit union; a thrift institution; a broker or dealer registered with the [SEC]; a broker or dealer in securities or commodities; an investment banker or investment company; a currency exchange; an issuer, redeemer, or cashier of travelers' checks, checks, money orders, or similar instruments; an operator of a credit card system; an insurance company; a dealer in precious metals, stones, or jewels; a pawnbroker; a loan or finance company; a travel agency; [a funds transmission entity]; a telegraph company; a business engaged in vehicle sales . . . ; persons involved in real estate closings and settlements; the United States Postal Service; an agency of the United States Government or of a State or local government carrying out a duty or power of a business described in this paragraph; [or] a casino . . . or gaming establishment [if certain conditions are met];[220] [and] [a]ny futures commission merchant, commodity trading advisor, or commodity pool operator registered, or required to register, under the Commodity Exchange Act.[221]

The definition of a "financial institution" ends with several "catch-all" provisions, including "any business or agency which engages in any activity which the Secretary of the Treasury determines, *by regulation,* to be an activity which is similar to, related to, or a substitute for any activity in which any business described in this paragraph is authorized to engage" and "any other business designated by the Secretary whose *cash transactions* have a high degree of usefulness in criminal, tax or regulatory matters."[222]

The regulation requires reporting of a financial interest in or signature or other authority over "a bank, securities or other financial account."[223] We have no doubt that this requirement was – indeed, must have been – intended to encompass only transactions or relationships maintained with a "financial agency," as described in the statute.

The question, as it relates to equity interests in investment vehicles, is what constitutes a "securities or other financial account." The FBAR instructions say only that what is encompassed includes "securities, securities derivatives or other financial instruments accounts," adding that "[s]uch accounts generally also encompass any accounts in which the assets are held in a commingled fund, and

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[220] *Id.* Section 5312(a)(2).

[221] *Id.* Section 5312(c).

[222] *Id.* Section 5312(a)(2) (emphases added).

[223] 31 C.F.R. Section 103.24.

the account owner holds an equity interest in the fund (including mutual funds)."[224] The last parenthetical was added in October 2008.[225]

Under the FBAR Provision, a transaction or relationship can be reportable only if it is with a "financial agency" – *i.e.,* a financial institution, as defined in the FBAR Provision, a bailee, a depository trustee, or an agent, or a person acting in a similar way with respect to money, credit, securities, gold or a transaction therein. We have no doubt that these are broad concepts, and the definition of a "financial institution" is itself quite broad, but we think that this is all the more reason to ensure that what is asserted to be encompassed within these definitions in fact can fairly be so described.

We are skeptical that, absent regulations, a person can be said to "make[] a transaction or maintain[] a relation with a foreign financial agency" by purchasing an equity interest in an offshore investment vehicle. None of those arrangements typically constitutes a bailment, a depository arrangement or an agency in any legal or even layperson's sense of those terms, and we think it is unclear whether the typical entities in these categories of vehicles are currently within the definition of a "financial institution," reproduced above. We do believe these entities ***could be*** brought within the ambit of a "financial agency" by regulation, by a conclusion that they constitute "investment companies" within the meaning of the statute, that they engage in activity determined to be similar or related to activities engaged in by enumerated businesses or that they engage in "cash transactions" with a high degree of usefulness in criminal, tax or regulatory matters. But we do not believe that investments in equity interests in these types of entities are currently within the scope of the regime.

Indeed, again, we think recent history shows that Treasury agrees with our analysis – and in any event explains the inappropriateness of treating interests in these vehicles as financial accounts prior to regulatory action (*i.e.,* for at least years prior to 2009). As discussed in Part IV.C.1, Treasury considered and rejected a proposal to treat hedge funds, private equity funds and venture capital funds as "financial institutions" for purposes of the anti-money-laundering provisions of the BSA, promising to publish new proposals and allow for comment before doing so. We acknowledge that this action occurred in a context unrelated to the FBAR Provision, but it was directly related to the relevant BSA language – the definition of a "financial institution." It shows that Treasury does not believe these entities are currently subject to (at least some of) the rules governing financial institutions – if they were, there would obviously not have been need for the regulatory action in the first place. We think it would be highly inappropriate to reverse course in this regard and retroactively treat these types of

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[224] *See* 2008 FBAR Instructions.

[225] *See* 2000 FBAR Form; 2008 FBAR Form.

entities as foreign financial institutions for purposes of the FBAR Provision without regulatory action, given the clear indication that they would not do so, and we are skeptical that a court would entertain any such attempt.

In addition, we reiterate that, as discussed in Part IV.B, the clear original understanding of the terms "bank account," "securities account," and "other financial account," reflected in the Original FBAR, would not have come close to encompassing equity interests in offshore investment vehicles. The introduction of the concept of "a commingled fund . . . (including mutual funds)," was clearly intended to broaden the scope of the rule, but not in a way that we think could reasonably be understood to include interests in these types of entities.

More recently, Senator Carl Levin submitted a comment letter to the IRS and FinCEN stating his view, among other things, that offshore investment vehicles should be reportable financial accounts. Senator Levin explained that:

> These accounts function in a similar manner to foreign bank and securities accounts by tracking monies associated with a particular investor. These offshore financial accounts are precisely the types of accounts that should be disclosed on FBARs to help tax and law enforcement authorities discover and trace offshore funds involved in money laundering, tax evasion, or other misconduct.
>
> Some comment letters claim that offshore hedge fund investments should be exempt from the FBAR, because many are illiquid, explaining that most hedge funds "lock up" invested funds for a two-year period or longer and may use the money to purchase illiquid assets that can't be redeemed quickly. They reason that the FBAR was intended primarily to uncover money laundering, and illiquid investments are not typically used by money launderers who want quick access to their cash. But some money launderers are content to let their funds sit for an extended period. For example, Subcommittee investigations of foreign heads of state and their relatives who deposited suspect funds in U.S. and offshore financial accounts showed that they allowed their funds to be invested for years at a time at a single financial institution.
>
> In addition, FBARs are intended to help uncover, not only money laundering, but tax evasion, and it is not uncommon for tax dodgers to deposit funds offshore for substantial periods of time to allow a build-up of untaxed investment income. In the case of LGT Bank in Liechtenstein, for example, the Subcommittee uncovered a U.S. taxpayer . . . who made millions of dollars in cash deposits at the bank, used those funds to purchase foreign mutual funds and other investments, and allowed his invested

funds at the bank to remain essentially undisturbed for nearly 20 years. In the Subcommittee's 2006 investigation, two U.S. taxpayers . . . established two hedge funds . . . which operated with both U.S. master funds and Cayman Island feeder funds. [They] secretly directed millions of dollars from a network of offshore trusts and corporations they controlled to be deposited into the offshore hedge fund feeder accounts, and then caused those funds to be invested through the U.S. master funds in a variety of U.S. investments – without paying tax on either the transferred sums or the investment income later produced. [They too] allowed their investments to remain with the offshore hedge funds for years at a time. Also [they] have been investigated by the IRS for tax dodging. [These] case histories provide ample evidence that the extent to which offshore investments are illiquid is simply not a persuasive basis for exempting them from FBAR disclosure obligations.

The same analysis can be applied to other types of complex offshore investments as well, including money transferred to foreign private equity funds, special purpose investment vehicles, offshore partnerships, and PFICs. Investors in each of these offshore entities typically have offshore accounts that track their contributions, investment income, and distributions. Each such investor should file an FBAR disclosing that account.

Foreign financial products continue to evolve and proliferate as the barriers to international investment fall, and U.S. persons are increasingly able to access global markets. In addition, financial professionals continue to design complex offshore investments that take advantage of tax havens with strict secrecy laws that make it difficult for U.S. authorities to learn of the transactions. FBAR filing requirements are one of the few tools that U.S. tax and law enforcement authorities have to uncover, investigate, and punish instances of money laundering, tax evasion, and other illegal activity through offshore accounts. FinCEN and the IRS should continue to use an expansive definition of "financial account" to ensure that financial engineering does not succeed in weakening the FBAR disclosure obligation for complex offshore investments.[226]

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[226] Letter from Sen. Carl Levin to the Hon. Douglas Shulman, Commissioner of the IRS, and the Hon. James Freis, Director of FinCEN (Oct. 1, 2009), *reprinted at* 2009 TNT 192-26 (Oct. 7, 2009).

It is not entirely clear to us whether Senator Levin is asserting that investments in offshore investment vehicles currently are reportable financial accounts. To the extent that he is contending they are, we respectfully disagree, based on our review of the history of the issue discussed above. To the extent that Senator Levin is arguing that Treasury and the IRS should determine on a going-forward basis that these investments will be reportable, as we will discuss in Part VII.A.2(a), we also respectfully disagree, primarily based on our own sense that the number of tax crimes being committed or concealed through these entities pales in comparison to the avalanche of forms that will be necessitated by such an interpretation. Moreover, as discussed in that section, taxpayers are already required to report certain investments in such funds under current law, and we think that revising those rules where necessary is a more effective way of discovering tax crimes than FBAR filings. Of course, as we point out there, we do not have access to the data that Senator Levin has regarding the prevalence of the utilization of these vehicles in connection with money laundering and tax crimes, so our views in this regard may be based on less than full information.

In sum, we think it very unlikely that equity interests in these types of entities are ***currently*** within the scope of the FBAR Provision, and in any event we think it clear that as a matter of process, given the historical confusion surrounding this issue both in the context of the FBAR Provision and in other BSA contexts, any effort to encompass them should be made (if at all, as we discuss in Part VII.A.2(a)), only on a prospective basis.

G. Exclude Foreign Filers for Prior Years

As discussed in Part IV.B.2, there is very recent but significant confusion regarding whether or to what extent foreign corporations and partnerships that were "in and doing business in" the United States in 2008 and prior years were required to file FBARs with respect to their foreign accounts for those years. In particular, the Joint Committee in its recent description of the President's Budget Proposals, suggested that the revisions to the FBAR instructions' definition of a United States person to encompass person "in and doing business in" the United States might "arguably merely clarify what has long been required," notwithstanding the clear understanding that the instructions prior to this revision, referring only to "domestic corporations" and "domestic partnerships," were not intended to encompass foreign entities doing business in the United States. We assume that the Joint Committee's view is based on the BSA regulations, which provide that unless otherwise distinctly expressed or manifestly incompatible with the intent thereof, the use of the term "domestic" in the BSA and the forms "refer[s] to the doing of business within the United States . . . ."[227]

[227] 31 C.F.R. Section 103.11(k).

However, the regulation was proposed and adopted in 1971, whereas the FBAR instructions' definition of a "United States person" prior to 2008 is identical to the definition in the Original FBAR in 1970, and so its drafters could not have intended to conform it to the regulation's definition. Indeed, the pre-2008 FBAR instructions' definition of a "United States person" is virtually identical to the definition in Code Section 7701(a)(30), which we view as no coincidence, as it was drafted by the IRS. We thus think it very clear that the definition that was in the instructions until 2008 was intended not to include non-U.S. domiciled entities.

Moreover, the regulation actually defines a person required to file an FBAR not by reference to whether it is "domestic" but by reference to whether it is "subject to the jurisdiction of the United States." Thus, any argument that the instructions must be read "consistently" with the regulations would surely require consistency with ***this*** definition. And yet this definition is ***itself*** inconsistent with, and we think clearly broader than, the ***statute's*** definition of a filer as someone that is in relevant part "in and doing business in" the United States. (This point is discussed in more detail in Part VII.B.2(a) below.)

Further, the events leading to Announcement 2009-51 make clear that the IRS and Treasury intended by the phrases "domestic corporation" and "domestic partnership" to narrow the statutory ***and*** the regulatory definitions of who must file, and they are explicitly authorized to do that by the statute.[228]

Because so much rests on this issue, we ask that Treasury confirm the already clear understanding that persons required to file for 2008 and prior years did not include foreign entities "in and doing business in" the United States.

VII. Detailed Analysis of the Current Rules

This Part discusses in detail the key provisions of the current FBAR regime, including the definition of a financial account, who is required to file, and various procedural and other issues, and makes a number of recommendations and requests for guidance. Where appropriate, we will also discuss the requests for comment made by Treasury and the IRS in Notice 2009-62, to the extent that we have not already done so.

A. "Financial Account"

1. Background

As discussed in Part II.A, the BSA authorizes Treasury to require reports when a person "makes a transaction or maintains a relation for any person with a

[228] 31 U.S.C. Section 5314(b)(1).

foreign financial agency."[229] The Treasury regulation requires reporting of a financial interest in or signature or other authority over "a bank, securities or other financial account."[230] What constitutes a "securities or other financial account" for these purposes is fundamentally unclear. The FBAR instructions do not attempt to define these terms, instead specifying that what is encompassed includes "securities, securities derivatives or other financial instruments accounts," that "[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)," and that "[t]he term also means any savings, demand, checking, deposit, time deposit, or any other account (including debit card and prepaid credit card accounts) maintained with a financial institution or person engaged in the business of a financial institution."[231] The instructions further elaborate, unhelpfully, that "[i]ndividual 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."[232]

As we have previously described, the original FBAR, IRS Form 4683, required reporting of "a bank, securities or other financial account," and defined each of these terms.[233] A "bank account" meant "a savings, demand, checking, deposit, loan, or any other account maintained with a person engaged in the business of banking. It includes certificates of deposit."[234] A "securities account" meant "an account maintained with a person who buys, sells, holds, or trades stock or other securities for the benefit of another."[235] An "other financial account" meant "any other account maintained with any person who accepts deposits, exchanges or transmits funds, or acts as a broker or dealer for future transactions in any commodity on (or subject to the rules of) a commodity exchange or association."[236]

The only case of which we are aware that interpreted the term "financial account" arrived at an inclusive definition. In *United States v. Clines*, the Court of Appeals for the Fourth Circuit held that a bookkeeping entry on the ledger of a corporation constituted a "financial account" for FBAR purposes.[237] In that case,

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[229] *Id*. Section 5314(a).

[230] 31 C.F.R. Section 103.24.

[231] 2008 FBAR Instructions.

[232] *Id.*

[233] Instructions to the Original FBAR.

[234] *Id.*

[235] *Id.*

[236] *Id.*

[237] 958 F.2d 578, 582 (4th Cir. 1992).

the defendant was part of a covert operation to provide arms and ammunition to Nicaraguan Contras. A Swiss financial services company, Compagnie de Services Fiduciaries S.A. (CSF), helped form a corporation for the purpose of collecting money and financing the procurement of weapons. After funds were received and upon authorization from the defendant's supervisors, CSF debited from the corporation's ledger the defendant's share of the profit and credited the share to the "TC capital account" also maintained on the ledger. The defendant was able to transfer or withdraw TC capital account funds. He argued that the TC capital account was merely a bookkeeping entry, not a "financial account" for FBAR purposes. The court disagreed, holding that because CSF accepted credits to the TC capital account and transmitted sums from the TC capital account to Clines's other domestic and foreign accounts, the capital account fell within the definition of a financial account.[238]

2. Discussion and Proposals

(a) *Investment Funds*

As discussed in Part VI.G, we do not believe that equity interests in offshore investment vehicles are, in general, currently subject to subject to FBAR reporting. The following discussion analyzes whether these vehicles should be subject to FBAR reporting on a prospective basis (*i.e.,* for 2009 and subsequent years). On balance, we conclude that there is relatively little to be gained by requiring FBAR reporting with respect to equity interests in foreign investment vehicles, except if the interests are redeemable with a defined degree of frequency, and that the costs in terms of complexity and compliance burden outweigh any such benefits.

Investment funds include various types of pooled investment vehicles, which have different investment strategies, types of investors and liquidity features and are subject to significantly different levels of regulatory supervision. "Retail" funds offer interests to any investor, regardless of the investor's level of sophistication, income or net worth, and are typically regulated by governmental agencies in the jurisdictions in which they are organized. Interests in these funds are generally very liquid. In an "open-end" fund, commonly called a "mutual fund," investors have a right to cause the fund to redeem their interests, generally at the end of any business day. A "closed-end" fund does not issue redeemable interests, but its interests may be listed on a stock exchange and publicly traded.[239] Other investment funds, often referred to as "private funds," issue their interests in private placements, offer interests only to investors that meet certain requirements, are generally more lightly regulated than retail funds and provide

[238] *See id.*

[239] An exchange-traded fund is commonly called an "ETF."

their investors with less liquidity than retail funds. The "categories" of private funds, which are generally distinguished from one another by the nature of the underlying investment strategy, include private equity funds, venture capital funds, real estate funds, distressed debt funds, mezzanine funds and hedge funds.

A fund vehicle may be organized as a partnership, corporation or trust under relevant local law. The sponsor of a fund organizes the fund vehicles, and either the sponsor or one of its affiliates serves as the fund's investment manager, making investment decisions for the fund and otherwise running the fund. A fund vehicle typically pays certain fees to its investment manager.[240] In addition, a fund vehicle that is treated as a partnership for U.S. federal income tax purposes will typically grant its general partner or equivalent member – which will be the investment manager or one of its affiliates – a percentage interest in the partnership's profits that is larger than the percentage of the partnership's capital that is contributed by such partner.[241]

An investment manager that is based in the United States may organize fund vehicles outside the United States for various reasons, including facilitating investments in non-U.S. jurisdictions, protecting non-U.S. investors from the obligation to file U.S. federal income tax returns by interposing a foreign corporation that has that obligation between the investors and the underlying investment, and protecting U.S. tax-exempt investors from recognizing "unrelated business taxable income" as a consequence of borrowing at the fund level. Many funds have several separate investment vehicles, organized to accommodate different types of investors or different types of investments. For example, a private equity fund may consist of several parallel limited partnerships that co-invest in the underlying portfolio companies, each with investors that share certain characteristics (*e.g.,* U.S. taxable investors, U.S. tax-exempt investors that are not subject to ERISA, U.S. tax-exempt investors that are subject to ERISA, non-U.S. investors other than foreign governments and foreign governmental investors). Some of these partnerships may be organized in the United States, while others are organized outside the United States. A hedge fund typically consists of at least two investment vehicles: a vehicle that is organized in the United States and is treated as a partnership for U.S. federal income tax purposes and a vehicle that is organized outside the United States as is treated as a corporation for U.S. federal income tax purposes. These entities may invest in parallel in the underlying securities or may hold interests in a "master fund," often

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[240] In the past, managers of offshore fund vehicles often elected to defer the receipt of certain fees for several years after the date on which the fees would otherwise have been paid, and the amount of the deferred fee was indexed, generally to reflect the performance of the fund itself. The enactment of Code Section 457A in 2008 effectively eliminated this practice, but various fund managers are still entitled to receive payments of fees that were deferred in the past.

[241] This profits interest is referred to as a "carried interest" in funds other than hedge funds and as an "incentive allocation" or "performance allocation" in hedge funds.

organized outside the United States. In addition, investment funds, particularly private equity funds, frequently have the ability to form special-purpose vehicles (commonly called "alternative investment vehicles") through which some or all of the fund's investors will participate in certain investments. Use of an alternative investment vehicle may be appropriate, for example, to address regulatory or tax issues with respect to a particular investment.

Private funds other than hedge funds typically do not have redeemable interests and provide no liquidity to their investors prior to the time at which they distribute the proceeds derived from dispositions of their investments. These funds have invest-and-hold strategies, with the result that investors' capital contributions are tied up for significant periods of time. A private equity fund, for example, will generally purchase substantial positions, and often controlling interests, in portfolio companies, and may hold those positions for five to seven years or longer. It is standard for the term of a private equity fund to be ten years, subject to the possibility of extensions. Investors in private equity funds, venture capital funds, real estate funds, mezzanine funds and other similar private funds do not even control when they transfer money into the fund. Instead, they make commitments of stated dollar amounts at the outset of the fund, and their commitments are available to be "called" by the general partner (or its equivalent) at any time during a multi-year commitment period (for example, the first six years of the fund's term). Interests in private funds generally can be transferred only with the consent of the fund's general partner (or its equivalent). While the volume of transfers of interests in private funds has increased in recent years, particularly since the beginning of the recent economic upheavals, most transactions involving the sale of interests in a private fund are heavily negotiated and subject to a significant amount of due diligence and, as a result, take a substantial amount of time to complete.

Hedge funds typically hold a large number of liquid securities and are often active traders in those securities. Consistent with the greater liquidity of the underlying investments, hedge funds permit investors to redeem interests periodically, although much less frequently than mutual fund interests. Redemption dates are generally no more frequent than monthly, with quarterly redemptions being typical; some funds, however, permit redemptions only on a semiannual or annual basis. Redemptions are permitted only with significant advance notice, generally at least thirty days, but typically sixty days or longer. Virtually all hedge fund agreements provide that the fund may suspend the investors' right to redeem their interests under certain circumstances, such as a disruption in the markets on which the underlying investments are traded. Moreover, hedge fund agreements typically contain a variety of other limitations on investors' rights to redeem their interests in the fund. For example, many funds have initial "lock-up" periods during which an investor is not permitted to redeem its interest in the fund. Others permit redemptions (or redemptions at certain times or in certain amounts) only if the investor pays a substantial

redemption fee. Many hedge funds provide for redemption "gates," pursuant to which no more than a stated percentage of the fund's net asset value may be redeemed on any particular redemption date.

Mutual funds – that is, open-end retail funds that permit redemptions of their interests on a daily basis – have long been viewed with suspicion in the context of international money laundering and terrorism financing. In the preamble to the 2002 anti-money laundering regulations, Treasury discussed the possible connection between mutual funds and money laundering at length, noting that mutual funds may be a particularly attractive form of investment for money launderers by helping to distance "illegal transactions."[242] 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."[243] Consistent with these concerns, mutual funds have generally been subjected to a high degree of BSA regulation.[244]

Most private funds, including private equity funds and hedge funds, function very differently from mutual funds. As a consequence, the money-laundering concerns that Treasury has expressed with respect to investments in mutual funds have little application to investments in private funds. Treasury has acknowledged this point. For example, the 2002 proposed regulations that would have required certain domestic funds to establish anti-money laundering programs (discussed above in Part IV.C) specifically excluded any fund that imposed a lock-up of two years or longer.[245] In making this determination, Treasury reasoned that "[t]hese types of illiquid companies are not likely to be used by money launderers."[246]

We recognize that features like liquidity and engagement in "cash transactions" may be less significant factors when considering whether an equity investment in an investment vehicle could be used in or in connection with the commission of a ***tax*** crime. However, for the reasons discussed below, we do not believe that investments in offshore funds provide U.S. taxpayers with significant opportunities for committing tax crimes that would be prevented or discovered as a result of an FBAR filing requirement. Moreover, the limited benefit provided

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[242] 67 Fed. Reg. 21,117, 21,118 (Apr. 29, 2002).

[243] *Id.* at 21,118.

[244] *Id.* at 21,121.

[245] 67 Fed. Reg. 60,617 (Sept. 26, 2002).

[246] *Id.* at 60,619. Even for funds that fell within the scope of the proposed rule, Treasury withdrew the proposed regulations in 2008. *See* 73 Fed. Reg. 65,569, 65,570-71 (Nov. 4, 2008).

by additional FBAR reporting would come at the expense of a significant additional burden on taxpayers. Consequently, we think that investments in private investment funds generally should not be subject to FBAR reporting, although we suggest some factors that might justify reporting of limited classes of investment funds. These points are discussed in more detail below.

Information related to many investments in typical offshore investment vehicles is already subject to tax-related reporting (*e.g.,* Forms 8621, 8858, 8865, 5471, 3520 and 926).[247] For example, under Code Section 6038B, taxpayers generally must file a Form 926 (in the case of a foreign corporation) or 8865 (in the case of a foreign partnership) for transfers of cash to foreign investment vehicles. Section 6038B is an extremely bulky and, we think, unduly burdensome regime when it does apply, so we do not here recommend using it to this end without substantial revision. In any event, it incorporates a number of meaningful exceptions, which should perhaps be revisited (although we believe this would require legislation), and does not involve any "matching principle," which might also be revisited (although it too would require legislation). However, we believe a regime like this, properly structured, would be ***much*** more effective than the FBAR regime at uncovering and/or criminalizing conduct related to the concealment of taxable income via foreign investment vehicles. We recognize that the Section 6038B regime (like other tax information reporting regimes) is "wrapped" in the Section 6103 confidentiality restrictions, but because our understanding is that illiquid offshore investment vehicles are if anything effective in the commission of tax crimes (and not other crimes, like terrorism and money laundering), we are not sure there should be any significant concerns in this regard. We do not think that adding one more form to the list already required will prevent people intent on hiding income through investments in offshore funds from doing so, in view of the fact that they may well already be failing to comply with their tax filing obligations. The principal additional benefit of requiring FBAR reporting is that it permits the government to impose FBAR penalties.

However, FBARs in their current form are not a suitable instrument for identifying tax crimes. Indeed, we are troubled even by the thought that investments in all such entities should be subject to FBAR reporting. Clearly, the idea derives from a desire to mold the FBAR to better aid in the investigation of (and to add to the universe of) tax-related crimes, but nothing in the FBAR rules would tell filers to use tax concepts (including the tax concept of "income") in analyzing their obligations. More fundamentally, given the maze of reporting and

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[247] *E.g.,* Form 8621 (report by U.S. shareholder of PFIC or qualified electing fund); Form 8858 (information return for U.S. owners of foreign disregarded entities); Form 8865 (information return for U.S. partners in foreign partnerships); Form 5471 (information return of controlled foreign corporations); Form 3520-A (annual information return of foreign trust with U.S. owner); Form 926 (transfers of property to foreign corporations).

filing obligations described above, and of associated crimes, that already exists in connection with passive foreign investments, we are troubled by the thought of using so blunt and indirect a weapon as the FBAR to try to impose even further requirements along those lines. Thus, on balance we oppose expansion of FBARs to require reporting of investments in investment funds (subject to the exceptions discussed below), at least until the FBAR is itself revamped so that it more narrowly addresses tax-relevant information, including identifying and requiring reporting from the "beneficial owners" of accounts (for tax purposes), requiring reporting of (or at least fleshing out the meaning of) "taxable income," operating on the basis of "taxable years," etc.

Moreover, even if some U.S. taxpayers might be attempting to hide income through investments in offshore funds, the effort to uncover these malfeasors through the FBAR regime must be weighed against the enormous cost – to both the government and filers – of doing so. Making investment vehicles "foreign financial accounts" will cause an astonishing number of entities and individuals to be required to file FBARs, including:

- any U.S. person that owns an interest in an offshore investment fund (including a fund vehicle that is managed by a U.S-based investment manager);

- any U.S. person that owns more than 50% of any U.S. entity that is a direct investor in an offshore investment fund;

- any U.S. fund of funds or U.S. feeder fund that invests in an offshore investment fund, as well as potentially any U.S. investor therein, if the U.S. fund is treated as acting "on behalf of" all of its investors;

- any U.S. general partner or manager with a financial interest (presumably including an incentive or carried interest) in an offshore investment fund, as well as all of its employees who have signature or other authority over the offshore investment fund or any offshore investment vehicle formed by the offshore fund; and

- any U.S. financial institution or U.S. affiliate of a foreign financial institution that has invested in an offshore investment fund, holds an offshore investment fund interest as collateral or as a custodian, or has signature or other authority over the offshore investment

fund, as well as potentially all of its employees who have signature or other authority over the offshore investment fund interest.[248]

We turn now to the specific request made in item (iv) in Notice 2009-62, reproduced on pages 2-3, for comments on whether rules similar to the PFIC rules should be adopted to determine whether a foreign entity is a foreign financial account (that is, rules that would require FBAR reporting of all stock in corporations qualifying as PFICs under the asset and income tests in Code sections 1297[249] and 1298(b)[250] (or of all interests in entities that would be PFICs if they were foreign corporations for U.S. federal tax purposes, which we take to be the thinking behind request)). While we acknowledge that Treasury has stated that it views the term "investment company" – a subset of the definition of "financial institution" – as very broad, and considered it possible in 2002 to regulate domestic hedge funds and private equity funds under that rubric, we also consider it significant that Treasury ultimately decided that a rule covering all such funds would be too broad. We echo that determination. We see no sense in which all such entities even arguably engage in activities similar or related to those of the BSA's principal enumerated financial institutions or persons acting in a similar capacity (bailees, depository trustees, agents); the mere fact that most of an entity's assets or income can be characterized as "passive" in a given year simply implies nothing about its similarity to a financial institution or agency. Indeed, many such entities are active operating companies engaged in no business

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[248] *See, e.g.,* David Miller *et al.*, Memorandum, *FBAR Filing Requirements for Owners of Foreign Accounts, Hedge Fund Investors, Hedge Fund Managers, and Financial Institutions; June 30, 2009 Filing Deadline Extended Until September 23, 2009 for Certain Filers*, Cadwalader, Wickersham & Taft LLP (June 29, 2009), *available at H*http://www.cadwalader.com/assets/client_friend/062909FBAR_Filing_Requirements.pdfH (last visited Oct. 23, 2009). *See also* Simpson Thacher & Bartlett LLP, Memorandum, *The Controversy over FBAR Reporting* (June 24, 2009), *available at H*http://www.stblaw.com/content/publications/pub843.pdfH (last visited Oct. 23, 2009); Jeffrey T. Skinner *et al.*, Memorandum, *Recently Announced FBAR Reporting Requirements for Hedge Fund and Similar Investments – Due June 30, 2009 – Update: IRS Modifies FBAR Reporting Requirements for Hedge Fund and Similar*, Kilpatrick Stockton LLP (June 25, 2009), *available at H*http://www.kilpatrickstockton.com/publications/legal-alert.aspx?ID=357H (last visited Oct. 23, 2009).

[249] Code Section 1297(a) defines a passive foreign investment company as "any foreign corporation if— (1) 75 percent or more of the gross income of such corporation for the taxable year is passive income, or (2) the average percentage of assets (as determined in accordance with subsection (e)) held by such corporation during the taxable year which produce passive income or which are held for the production of passive income is at least 50 percent." Code Section 1297(b)(1) provides the general definition of passive income and Code Section 1297(b)(2) provides exceptions to the general rule. Under Code Section 1297(b)(1), "passive income" generally means income which would be foreign personal holding company income as defined in Code Section 954(c) (*e.g.,* dividends, interest, royalties, rents and annuities).

[250] Code Section 1298(b) provides special rules for determining the applicability of the PFIC rules.

remotely similar to any of those enumerated in the BSA's definition of a "financial institution" (*e.g.,* technology start-ups). In some cases, it is unclear whether the existing PFIC rules apply to the stock of certain banks, insurance companies, and other well regulated entities (which we assume are not intended to be brought within the scope of the FBAR rules), because the law in this regard is not clear, and the facts often are not either. Finally, it is often difficult even for tax experts with complete information to determine whether an entity is a PFIC; we do not favor introducing this kind of uncertainty into a broadly applicable regime with criminal penalties.

Accordingly, on balance we do not favor expanding the scope of FBAR reporting to include investments in foreign investment funds, and if FBAR reporting is required we do not consider the PFIC rules an appropriate way to determine which funds should be treated as financial institutions. There may, however, be some limited cases where reporting is appropriate. We suggest two alternatives below.

The first alternative would be a rule to the effect that an equity investment in a foreign investment vehicle is not treated as a "financial account," provided it is sufficiently illiquid that it is not the equivalent of a mutual fund. That is, under this alternative we would draft the rules such that interests in offshore mutual funds that allow investors to redeem interests on a frequent basis would be subject to FBAR reporting, while interests in offshore hedge funds, private funds or other PFICs that do not issue redeemable interests, or that permit redemptions only at substantial (say, monthly) intervals with substantial prior notice, would not be subject to FBAR reporting. We acknowledge that funds that allow investors ready access to their capital and allow frequent liquidation opportunities may closely resemble traditional bank accounts in substance and thus may permit potential criminals to engage in the types of crimes the BSA was intended to help uncover. By contrast, as we have discussed, we believe that typical investment vehicles do not enable investors to receive money and "wir[e] it quickly through several accounts" or to redeem fund shares purchased with illegal proceeds and then reinvest the proceeds in another fund without waiting for a relatively long period of time.[251]

We recognize that, given the broad purposes of the BSA, liquidity is not necessarily the key feature of suspect financial accounts, particularly in relation to tax evasion. However, a focus on liquidity is consistent with Congress's (original) focus on providing the government with information concerning cash and other highly liquid investments held by U.S. persons in accounts located in secrecy jurisdictions. Moreover, the FBAR rules must take into account the "need to avoid burdening unreasonably a person making a transaction with a foreign

[251] *See* 67 Fed Reg. 21,117, 21,118 (Apr. 29, 2002).

financial agency," and this approach would target FBAR reporting to a relatively narrow category of funds that appear most likely to be used for financial crimes.[252]

Another possibility would be to provide that equity interests in sufficiently illiquid vehicles are not foreign financial accounts ***unless*** a particular filer is ***in fact*** using the investment to commit a crime (*i.e.,* tax evasion), or knows or has reason to know a particular investment is being so used. This might be a narrow but effective way to address Senator Levin's concerns, discussed below.

As discussed in Part VI.F, we understand that Senator Levin has expressed skepticism that liquidity should determine whether an equity investment in an offshore investment vehicle is a reportable financial account. However, we think it important to emphasize that while we are aware that there are people who may use even illiquid investments for or for the concealment of nefarious purposes, we are also acutely aware that almost any asset can be used for or for the concealment of nefarious purposes, and Congress itself asked that this possibility be weighed against the costs of requiring recordkeeping and reporting in particular circumstances. In our minds, that requires an assessment of a balancing of (i) the likelihood that a type of asset might be involved in or in the concealment of crimes against (ii) the burdens of requiring investors in that asset to file reports and maintain records. From what we know of offshore investment vehicles, and acknowledging that we may not have access to data sufficient to determine how frequently they are used in or in the concealment of crimes, it is our sense that this balancing favors not requiring reporting when the asset is the equity of an illiquid offshore investment vehicle.

(b) *Securities accounts*

What is intended to constitute a "securities account" for purposes of the FBAR regime is unclear. The instructions to the Original FBAR provided that a "securities account" meant an account maintained with a person who buys, sells, holds or trades stock or other securities for the benefit of another," obviously a fairly narrow definition. The current instructions provide no affirmative statement of what securities accounts are, stating only that an individual bond or stock certificate is not a financial account. We assume the removal of the specific definition was intended to broaden the scope of the rule, although we are not aware of any reason having been given for the change and so can only speculate.

Most investors do not hold stock and securities in certificated form. The overwhelming majority of securities are held in accounts with brokers, clearinghouses, custodians, or other institutions. If the "exception" in the current instructions extends only to securities held by the filer in certificated form, it is

[252] 31 U.S.C. Section 5314(a).

irrelevant to the vast majority of investors. By contrast, we presume that it ***was*** intended that when securities are held through a foreign custodian that meets the definition of a "financial agency," the arrangement would constitute a "securities account." Therefore, we conclude that the purpose of the individual securities exception is simply to state that a person who holds shares or bonds issued by foreign corporations does not have a financial account "solely" by virtue of holding those securities.[253] For example, an investor who holds shares in a foreign corporation through a U.S. broker would not be subject to a filing requirement with respect to those shares.

This observation raises a number of questions that need clarification. First, we think it imperative that Treasury and the IRS provide guidance on whether arrangements with clearinghouses such as Euroclear and Clearstream constitute foreign financial accounts. We hope and expect that this result was not intended. These arrangements clearly did not constitute "securities accounts" under the Original FBAR, but in fact we are unsure of the technical ground for concluding that they don't constitute securities accounts currently. One could, of course, conclude that these organizations are not "financial institutions," but they ***do*** custody securities and act as bailees within the meaning of the BSA, much more clearly than, for example, private equity or hedge fund vehicles do. We think the intimation that interests in foreign investment funds constitute foreign financial accounts raises serious and potentially far-reaching questions regarding the possibility that arrangements with foreign clearinghouses do. We strongly recommend that it be clarified that arrangements with foreign clearinghouses do not constitute foreign financial accounts.

Second, it becomes critical to know whether non-deposit debt (*e.g.,* public bonds) of, or other securities issued by, a foreign financial institution are a reportable foreign financial account. We are concerned that the technical answer to this under current law might be yes, but we are confident this was not an intended consequence of the rules as drafted, and in any event we highly doubt that these types of interests are in practice being reported as such. Indeed, as a policy matter, it is difficult to understand why non-deposit debt of a foreign financial institution should be treated differently from debt of any other entity.

Coming back to the FBAR instructions, even the meaning of a "security" itself is unclear. Under the U.S. securities laws, the definition of "security" is quite broad, but the definition may exclude a number of potentially liquid and tradable assets, such as bank loans, that one might think ought to be included in

[253] This conclusion is, of course, impossible to reconcile with the position that equity interests in foreign hedge funds or foreign private equity funds (which are nothing more than stock certificates) constitute foreign financial accounts.

FBAR filings.[254] In the tax area, there are many different definitions of "securities," some of which clearly would seem inappropriate for FBAR purposes.[255] It is far from clear to us that either of these regimes would inform the concept of a "security" for FBAR purposes, or indeed what definition should be used. Potential filers would benefit from guidance on what the governing standard is for FBAR purposes.

As a final, technical point in this regard, the instructions' statement that "an unsecured loan to a foreign trade or business that is not a financial institution" is not a financial account raises what we assume was an unintended inference: Is a secured loan to a foreign non-financial institution a reportable financial account? We suggest clarifying this was not an intended result.

(c) *Securities derivatives accounts*

It is equally unclear to us what constitutes a "securities derivatives account." This term most naturally encompasses accounts the purpose of which is to hold derivatives linked to securities (for example, equity options trading accounts), but we are not sure why reporting should be restricted to accounts holding those derivatives linked to securities, as opposed to, say, commodities or currencies.

More fundamentally, this phrasing raises the issue of what an "account" really is. The instructions do not say that securities derivatives constitute financial accounts – indeed, the implication of the provision that stock and debt are not financial accounts is that something more than being a mere counterparty to a financial transaction is needed in order to have an "account." Nonetheless, it is not clear to us whether technically, a derivative entered into with, or acquired from, a foreign financial agency constitutes a financial account. For example, suppose that a United States person enters into an interest rate swap with a foreign financial institution or with the foreign branch of a U.S. financial institution. Or consider a United States person who purchases an option from, or enters into a futures contract with, an established foreign exchange, like the London International Financial Futures and Options Exchange. These positions are not

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[254] *See United Housing Found. v. Forman*, 421 U.S. 837 (1975) (holding that shares of stock purchased from a housing cooperative are not securities); *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946) (concluding that an offering of units of a citrus grove development was an offering of securities). *See also* 15 U.S.C. Section 80a-2(a)(36) (defining "security").

[255] 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. Commissioner*, 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). However, an account that held such instruments would generally be an "other financial account."

"accounts" in a traditional sense. However, the United States person has made a "transaction with" an organization that we presume is a foreign financial institution, and at any given time it may be the case that the financial institution owes (or would owe, if the contract were cancelled or offset on that day) the United States person a quantity of money (say by reference to the movement of the relevant rate or value of the underlying security in the U.S. person's favor). Furthermore, there is little doubt that, in the ordinary case, this set of rights and obligations would be reflected on the financial institution's books, which is in essence all that an "account" really is. We do not believe these results were intended, and we request that Treasury and the IRS confirm that derivatives entered into with foreign financial institutions are not for that reason alone reportable financial accounts.

An additional concern in this regard involves collateral arrangements with respect to derivatives. Many derivatives must be collateralized, and collateral arrangements are more easily characterized than derivatives themselves as traditional "financial accounts." Thus, even if a derivative itself is excluded from the scope of the FBAR rules, the associated collateral account conceivably could be either a "bank account," a "securities account" or something in the nature of a "securities derivative account" (*i.e.,* an account associated with a securities derivative). We think such a reading of the FBAR rules could have a materially harmful impact on international commerce, and that the trade-off would be little in the way of highly useful information. Accordingly, we recommend explicitly exempting at least exchange-traded derivatives and associated collateral arrangements from the scope of the rules, and we think serious consideration should be given to exempting all derivatives entered into with foreign financial institutions and associated collateral therefrom.

(d) *Compensation arrangements*

Given the ever-globalizing world economy, the variety of potential compensation programs is extremely broad. Examples of non-U.S. compensation arrangements include (i) options and stock appreciation rights, which confer upon the recipient a right to receive the value of the appreciation in underlying equity above a specified exercise or other strike price, and which are sometimes funded (particularly under certain local non-U.S. laws), (ii) restricted stock or other property (*i.e.,* stock or other property subject to vesting), which is forfeitable until vested and (iii) equity grant or purchase plans under which the equity is transferred for the benefit of the service provider but held in a central repository at least until the expiration of a lock-up period during which sales and other transfer restrictions apply. Some (but not necessarily all) of these programs are designed to satisfy non-U.S. tax rules, U.S. tax rules or both.

In the compensation context, we generally believe that otherwise-applicable FBAR filing requirements should be relaxed or eliminated. We suggest that the FBAR filing requirements specify that an "account" relating to

non-U.S. compensation arrangements will be considered to exist, if at all, only once income relating to such arrangement has been required to be reported for U.S. federal income tax purposes. We wish to note expressly that we do not believe that the fact that an account is used in the compensation context should ever be the basis for increased FBAR filing obligations.

However, we acknowledge that our proposed compensation-related FBAR reporting rule may allow for a U.S. person to hide income or assets if applied too broadly. If a compensation agreement may otherwise give rise to an "account" for FBAR purposes, we thus propose the adoption of an anti-abuse rule that overrides our proposed compensation-related rule if (i) the service provider does not participate in the plan on a basis that is consistent with that applicable to other similarly situated service providers under the arrangement or the program of which the arrangement is a part, or (ii) there is no clear and convincing evidence that the compensation arrangement is *bona fide* and is not intended to foster the secreting of assets in non-U.S. locations.[256] The exemption could be conditioned on the existence of procedures to ensure U.S. tax reporting of the compensation.

We believe these clarifications with respect to compensation arrangements are needed because, while perhaps not immediately apparent, a broad reading of the phrase "financial account" could encompass to certain common compensation arrangements. (For these purposes, a "compensation arrangement" is any arrangement under which the relevant property transfer gives rise to or will give rise to compensation income for U.S. federal income tax purposes.) One example would be a grant of restricted stock units. Instruments sometimes referred to as restricted stock (or other) units, which are also sometimes referred to as "phantom units," are generally an unfunded contractual promise made by an employer to a service provider to deliver employer stock, other equity, or the value thereof, in the future. In a customary arrangement, the employer tracks the obligation and delivers the stock, other equity, or the value thereof, to the service provider after vesting. For U.S. federal income tax purposes, a service provider who is granted restricted units is not required to recognize income until the time of actual or constructive receipt, or earlier if so required under Section 409A or 457A. If the arrangements are funded for U.S. federal income tax purposes, earlier taxation may arise.

For FBAR purposes, such an arrangement might be thought of as a financial "account" giving rise to a reporting obligation in several ways if the term "account" encompasses a mere bookkeeping entry (which we do not believe

[256] If an FBAR filing were to be required with respect to amounts that are subject to vesting, the proper method of valuing the assets of an "account" subject to a contingency would need to be clarified.

was the intent of that term).[257] The fact that a service provider has a contingent right to employer stock or other equity may cause the arrangement to be a "securities or other financial account" for FBAR purposes. The arrangement may also be an "other financial instrument account" because the value of the interest in the arrangement depends on the value of the underlying employer stock or other property. In addition, if units are granted pursuant to an employer plan maintained for the benefit of multiple service providers, the service provider could be considered to have "an equity interest" in the "assets of a commingled fund." Concerns about the potential FBAR filing requirements have been heightened because of IRS suggestions that interests in various investment entities, such as hedge funds, private equity funds and PFICs, might constitute foreign financial accounts, even when these investments do not involve transactions or relations with a foreign financial agency as defined in the FBAR Provision or the regulations.

As discussed above, individuals are often the persons least prepared to handle complex filing requirements. FBAR filing requirements should not create a trap for the unwary; imposing FBAR filing requirements on compensation arrangements that are not reportable for U.S. tax purposes risks creating just such a trap. While tax professionals may often take it for granted that individuals are savvy enough to understand and comply with reporting rules, the history of FBAR filing compliance suggests that this is not always the case.[258] Given that historically such noncompliance occurred with respect to accounts such as bank accounts and securities accounts that are more commonly associated with the word "account," it requires no great leap to surmise that individuals would have greater difficulty understanding that a compensation agreement that had yet to produce taxable income in the U.S. was an "account" requiring an FBAR filing. This is particularly true given that such an individual would receive no notice of his or her filing requirement comparable to the receipt of the Form W-2 or 1099 furnished in the U.S. federal income tax reporting context.

By defining "financial account" over broadly, Treasury and the IRS may subject many common non-U.S. compensation arrangements, including grants of restricted stock units, stock appreciation rights or stock options, and even deferred compensation agreements, to FBAR filing requirements. A broad definition may also subject interests in non-U.S. retirement plans to FBAR filing requirements. However, as discussed further below, doing so would have little if any impact on

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[257] We recommend that Treasury or the IRS should generally (*i.e.,* not only in the compensation context) clarify that a mere unfunded bookkeeping entry maintained to keep track of an obligation does not constitute a financial account for FBAR purposes.

[258] *See supra* note 161 (noting that a primary reason for low FBAR compliance is that potential filers have been unaware of or confused about the requirements).

combating tax fraud, while creating a trap for the unwary and raising the costs associated with certain arrangements that reward long-term success.

The special considerations informing FBAR reporting would not seem to apply in the case of compensation arrangements. No special FBAR requirements apply generally to current compensation paid to U.S. persons by foreign employers. The same considerations should apply in the case of deferred compensation. We recognize that this proposal is in some ways counterintuitive, as it requires FBAR reporting only after the time amounts have been included for tax purposes. We believe this result to be the appropriate one in the FBAR context, as FBAR reporting is targeted at capital accounts, not at compensation reporting, whether current or deferred.

We acknowledge that the considerations are quite different to the extent a U.S. person who is a party to a non-U.S. compensation arrangement has been required to report amounts for U.S. federal income tax purposes. This situation may arise, for example, if restricted stock units have vested under U.S. federal income tax principles but a "sales restriction period" has not yet lapsed and the shares continue to be held by the employer, or a capital trustee, broker or other custodian. (For this purpose, a "sales restriction period" means the period during which the stock cannot be sold or otherwise disposed of.) In such a case, and in similar circumstances, an FBAR filing may be appropriate if a foreign financial agency is the payor.[259]

We believe that our proposed rule encourages filings where appropriate while reasonably taking into account the nature of certain transfers as being in the compensatory context of a services relationship.

(e) *Foreign trusts*

If a trust is not a "person," as we discuss above, and perhaps even if it is, we believe there is a significant question whether a trust that holds securities and whose trustee is a foreign financial institution could itself be a foreign financial account that must be reported. In essence, as we have noted, a trust is similar to a custodial relationship in that the trustee holds record title to property that it is not free to use for its own benefit. Thus, if the trustee holds securities for the benefit

[259] On the other hand, we believe that there is an argument that, in the compensation context in particular, FBAR filing requirements should be minimized with respect to accounts from which a person has no current withdrawal rights. In this regard, for example, we note that IRS policy generally limits the IRS in levying a service provider's retirement income and interest in a tax-qualified retirement plan. *See* I.R.M. Section 5.11.6.1 (providing that the IRS should use discretion in levying retirement income); *id.* Section 5.11.6.2 (providing that a retirement account should be levied upon only in flagrant cases). We would have no objection to some measure of additional relief, possibly with an anti-abuse limitation, where a participant has no access to the compensation.

of a beneficiary, and does so in its capacity as a financial institution, we think that this arrangement may well amount to a foreign financial account under a technical reading of the relevant rules. We consider it a hard question whether these arrangements "should" (normatively) be viewed as foreign financial accounts, and we think careful consideration of this issue is warranted. We are in any event doubtful that many filers have historically made reports on the basis that such arrangements constitute foreign financial accounts. Indeed, as discussed in Part V.E, there are many situations in which beneficiaries will not be able to access the information necessary for FBAR filing or to determine whether a filing is necessary. And we note that a foreign trust that has a foreign financial institution as its trustee is likely to own foreign financial accounts itself, in which case the consequence of treating the trust itself as a foreign financial account is that United States beneficiaries, settlors and holders of appointment powers might have to report ***both*** the trust and its (or some of its) assets. See Part VII.C.2(b) for a discussion of the filing obligations of persons who may be considered to have financial interests in a trust that is itself considered a foreign account and/or in foreign financial accounts held by a trust. See Part VII.D.2(c) for a discussion of the filing obligations of persons who may be considered to have signature or other authority over a trust that is considered to be a foreign account and/or over foreign financial accounts held by a trust.

(f) *Time factor*

An ancillary question worth considering is whether an account needs to be reported if it is "transient." We realize some forms of criminal activity involve rapid flows of funds through various accounts and jurisdictions, so the mere fact that an account is short-lived is not an indicator that it is not suspect. However, we suspect that there are many transient accounts created for United States people for good commercial reasons. For example, imagine a United States person who sells foreign real estate and uses the proceeds to purchase new real estate. The proceeds of the first transaction might be deposited into a foreign bank account for only a moment in time before being transferred to the new seller. Clearly, this is an FBAR reportable transaction, but it seems obvious on these facts that it provides no useful information to the government.

B. "United States Person"

1. Background

The FBAR Provision applies to "a citizen or resident of the United States, or a person in and doing business in the United States," with a specified relationship to foreign financial agency. "Persons" are defined in the BSA to "include" (not to "mean") "corporations, companies, associations, firms, partnerships, societies, and joint stock companies, as well as individuals," and

also "a trustee, a representative of an estate and, when the Secretary prescribes, a governmental entity."[260]

The regulations make two significant departures from these criteria: They extend (we assume) the scope of the FBAR rules to any person "subject to the jurisdiction of the United States,"[261] and they define a "person" as "[a]n individual, a corporation, a partnership, a trust or estate, a joint stock company, an association, a syndicate, joint venture or other unincorporated organization or group, an Indian Tribe [as defined], and all entities cognizable as legal personalities."[262]

However, notwithstanding either the statute or the regulation, until late 2008, the FBAR instructions provided that "United States persons" required to file FBARs included only U.S. citizens and residents and domestic corporations, partnerships, estates and trusts. As discussed above, in October 2008, the IRS promulgated a new FBAR form with instructions that essentially returned the scope of the FBAR filing requirements to the statutory limit, defining a United States person to include citizens, residents and persons "in and doing business in" the United States, although the new instructions incorporate by reference the ***regulations'***, rather than the ***statute's***, definition of a "person." The new instructions specify that "[a] branch of a foreign entity that is doing business in the United States is required to file . . . even if not separately incorporated under U.S. law." After substantial protest from affected persons, however, the IRS allowed filers for calendar year 2008 to rely on the prior instructions' definition of persons required to file.

2. Discussion and proposals

Although the prior instructions' definition of who is required to file an FBAR was simple and administrable, we think there were very substantial questions as to its propriety. We think this definition was both over- and under-inclusive in material respects. First, as discussed below, we believe it was overinclusive to follow the regulation and define a United States person (indeed, any person) to include trusts (other than statutory business trusts) and estates. Second, we think it was underinclusive otherwise to enumerate the list of persons so narrowly, thereby excluding associations, joint ventures, unincorporated entities, etc. As a simple example, domestic LLCs are obviously not individuals, corporations, partnerships, estates or trusts, which are the only categories of filers enumerated in the instructions, and thus we think it clear that they were not

[260] 31 U.S.C. Section 5312(a)(5) (incorporating by reference 1 U.S.C. Section 1).

[261] 31 C.F.R. Section 103.24(a).

[262] *Id.* Section 103.11(z).

subject to the FBAR filing requirement for 2008 and prior years.[263] However, both the statute and the regulation are broad enough to encompass LLCs. And as we discuss further below, although certain LLCs might be exempt from FBAR filing obligations (because they are not "doing business in" the United States), we know of no reason why LLCs in general (indeed, why any "person," within the meaning of the BSA) should categorically be excluded from the FBAR filing requirements. Thus, we support the elimination of the pre-2008 FBAR instructions' definition of a United States person.

More fundamental, as we will discuss below, are questions surrounding the treatment of non-U.S. persons and U.S. trusts and estates. It was in fact the October 2008 revisions' impact on foreign entities that produced the protests that led to Announcement 2009-51's moratorium on the new definition of a United States person – prior to that time, the instructions had required only domestic persons to file FBARs. Bringing within the FBAR's grasp all persons in and doing business in the United States had the effect of requiring non-U.S. persons to determine what it means to be, and whether they are, in and doing business in the United States – questions to which they had not theretofore needed to know the answers (for FBAR purposes). As we discuss further below, while we generally support a very broad reading of who may be required to file FBARs, it is distinctly unclear to us whether the BSA was intended to impose filing requirements on non-U.S. persons, and there are obviously strong political and commercial considerations that should factor into the determination of whether and to what extent those persons should be required to do so.

As for trusts, as discussed below, it has always been unclear what reporting obligations apply to them and the various parties inevitably associated with them. In general, we recommend clarifying that trusts (other than statutory business trusts, which we think should be treated as persons) are not persons, as the BSA itself seems to recognize, but that their assets should be treated as owned by their trustee(s) for FBAR purposes.

(a) *"In and doing business in"*

What was intended by the phrase "in and doing business in" the United States is not clear. To summarize our views, we think it advisable to read this term very broadly as it applies to "true" United States persons (*i.e.,* domiciliaries),

[263] We understand that there is some disagreement within the IRS as to this conclusion, presumably based on the argument that LLCs are "sufficiently similar" to corporations as a state law matter to qualify as such for FBAR purposes. We are very dubious of this argument, although it does highlight the risk of permitting terms to go undefined – if this reasoning is correct, then whether an LLC is "close enough" to a corporation to so qualify must be decided case-by-case by reference to the particular state's law. In this way, a simple question would become potentially subject to the vagaries of more than fifty jurisdictions' interpretations, which is one of the reasons we are very doubtful that such an argument would persuade a court.

but different considerations apply to bringing non-United States persons within the scope of the filing regime, and strongly encourage Treasury and the IRS to consider carefully whether that was intended by Congress or is a desirable step.

Again, the statutory framework explicitly imposes filing obligations on U.S. citizens and residents and all other persons "in and doing business in" the United States. Thus we think it clear that this latter concept applies not only to foreign entities but U.S. entities as well (*i.e.,* all U.S. persons other than citizens and residents). The two statutory criteria for persons other than U.S. citizens and residents to be required to file are that the person be in the United States and that it be doing business here.

While it is not at all clear what law governs whether an entity is "in" the United States, we think for most "domestic" entities (corporations, LLCs, partnerships, associations, joint ventures, etc.), the question will typically be a straightforward one. Presumably, although acknowledging that the terminology is borrowed from the tax Code, an entity organized in or under the laws of the United States[264] or a state, territory or possession[265] is safely "in" the United States. Similarly, we think it will be clear when an individual who is neither a citizen nor a resident is "in" the United States – presumably, in that case, physical presence suffices.

However, from there, the answers get murky quickly. For starters, we do not know what it means for a foreign entity to be "in" the United States. The clear import of the statute is that it is insufficient to be "doing business in" the United States; the relevant "person" must ***also*** be "in" the country. Our speculation is that by the notion of being "in" the United States, Congress had in mind the idea of being "domiciled" here – *i.e.,* being established under the laws of the United States or a state or territory thereof. In any event, we think it should be made clear, perhaps by regulation, what Treasury's understanding of this language is – for example, by adopting a "domicile" standard, or perhaps that foreign entities with some level of ***permanent*** presence in the United States (that are also "doing business in" the United States), like the tax concepts of an "office" or "permanent establishment," can be subjected to the FBAR filing rules.

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[264] *See* Code Section 7701(a)(4).

[265] The "United States" is defined for purposes of the BSA more broadly than it is for U.S. tax purposes. *See* 31 C.F.R. Section 103.11(nn) (defining United States to be "[t]he States of the United States, the District of Columbia, the Indian lands [as defined], and the Territories and Insular Possessions of the United States"); *id.* Section 103.11(tt) (defining the "Territories and Insular Possessions of the United States" to be "[t]he Commonwealth of Puerto Rico, the United States Virgin Islands, Guam, the Commonwealth of the Northern Mariana Islands, and all other territories and possessions of the United States other than the Indian lands and the District of Columbia").

The regulations provide that an entity that is "doing business within" the United States is "domestic,"[266] notwithstanding the incremental statutory requirement to be "in" the United States as well. Also, the FBAR instructions are explicit that a foreign entity with a branch doing business in the United States is required to file, without explaining when and how such entities should be viewed as being "in" (as opposed to "doing business in") the United States.

There are a variety of other types of entities whose status as being "in" the United States is or will often be unclear. The best examples are trusts and estates, about which more below.

Interestingly, the statute seems clearly to contemplate that ***whether or not*** the relevant entity is "domestic" in a plain-meaning sense of the term, it must also be "doing business" in the United States in order to be potentially subject to the FBAR filing requirements. This raises a very serious question whether, for example, a grantor trust that is a U.S. business trust can be required to file an FBAR – almost by definition, such entities do no business at all, never mind doing so in the United States. More generally, it raises the question whether a variety of types of entities should be viewed as "doing business." Do investment partnerships "do business"? Trusts and estates – even if they are "persons"? "Mere" collateral or security arrangements? It is obviously critical to reach a consensus on what it means to be "doing business," and on what it means to be doing that business "in the United States." We are confident that the purpose of the statute is best served if "doing business" is read very broadly, for example to encompass things like trading and investing, which might be excluded from that classification under, for example, the tax laws.[267] However, we do think the statute requires that some business be done in order to impose the filing requirement.

Whatever determination is made as to what these concepts mean, we see no textual basis for applying them differently to foreign persons than to "true" U.S. persons (*i.e.,* domestic residents or domiciliaries). The only persons automatically subject to FBAR filing obligations (for years 2009 and later) are U.S. citizens and residents; everyone else is excluded unless they are both "in" ***and*** "doing business in" the United States.

However, while broadly speaking we believe it is desirable to bring as many U.S. persons into the FBAR regime as possible, as we have mentioned, different considerations may apply with respect to non-U.S. persons. The first observation here is that it is far from clear to us how likely it is that non-U.S.

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[266] *Id.* Section 103.11(k). *See* Part IV.B.2.

[267] *See* Code Section 864(b) (excluding "[t]rading in securities or commodities" from the definition of "trade or business within the United States").

persons subject to the jurisdictional reach of the United States are committing tax crimes against the United States (beyond the obvious facts that if they are engaged in a U.S. trade or business and, if relevant, if they have a "tax home" or permanent establishment here, then it is possible that they could be underreporting income subject to U.S. tax, like any U.S. taxpayer). While some foreign persons may facilitate tax crimes by U.S. taxpayers, those foreign persons are likely not to be "in" or "doing business in" the United States under any reasonable definition of those terms. We express no view on the likelihood that non-U.S. persons may commit other financial crimes against the United States. The second and more salient observation is that requiring non-U.S. persons to file FBARs merely because they have some colorable nexus with the United States could have material effects on capital inflows as well as political relations with other countries. We are not experts on such matters. However, we urge Treasury and the IRS to weigh carefully the advantages and disadvantages of imposing FBAR filing obligations on non-U.S. persons.

Coming back to our discussion of what it means to be "in" the United States, a way to make the regime apply to as many United States people as possible but not to foreign entities is to define being "in" the United States to mean being a domiciliary thereof (a different rule may be appropriate for foreign financial institutions with U.S. branches). As we have said, a domiciliary rule would be inconsistent with both the regulations and the instructions. On balance, we are inclined to think that a domiciliary rule would be advisable, but as we have said, we believe further consideration of this issue is needed.[268]

We turn finally to an important ancillary issue: what it means for an individual that is not a U.S. citizen or resident to be doing business in the United States. As we said above, for entities, we think some sense of permanency is needed, to distinguish their "in-ness" from their "doing business in" the United States. Individuals can be in the United States for very brief time periods, and as a matter of the plain meaning of the term, they might also be viewed as "doing business" in the United States for very brief periods of time. Take as an example tourists in the United States who participate in a conference call in connection with their employment, which is otherwise unconnected to the United States. We hope it is obvious that this does not constitute "doing business in" the United States, and yet the individuals are quite clearly in the United States and doing

[268] A note along these lines: We understand that it is fairly common (for reasons having nothing to do with U.S. tax, money laundering or other concerns) for non-U.S. persons to hold non-U.S. accounts through U.S. entities such as single-member LLCs. If, as we propose, the concept of being "in and doing business in" the United States is read broadly, these entities would be required to file FBARs even though they may have almost no nexus to the United States. This is not an ideal result. A possible way to avoid it is to exempt from filing entities that are wholly owned by non-U.S. persons and also, perhaps, that are doing no more than some specified minimal amount of business. We are unsure whether this would be an appropriate exemption as a technical matter.

business. Thus, we think it needs to be made clear that "doing business in the United States" means being involved in a United States business.

Relatedly, it is critical that Treasury and the IRS provide guidance on whether and when non-U.S. persons not actually in or doing business in the United States will be ***treated*** as being in and doing business in the United States. For example, are non-U.S. partners in a U.S. partnership, or in a foreign partnership that is doing business in the United States, "in and doing business in" the United States, so that the partners must file FBARs with respect to all of their foreign financial accounts? Under the tax law, the answer might well be "yes."[269] Nothing in the FBAR regime operates similarly, to our knowledge, and we think it clear as a matter of plain meaning that a foreign partner in a partnership with no other connection to the United States is not for that reason alone "in and doing business in" the United States. However, the simple statement in the instructions that an entity with a U.S. branch must file an FBAR for all of its foreign accounts (whether or not it is "in" the United States) leads inevitably to questions along these lines. Whether the FBAR regime ***should*** import the concept of an attributed business, as the tax law does, obviously depends in the first instance on whether it is determined that non-U.S. persons should be required to file FBARs. It is important to note that to attribute businesses through partnerships and other entities would dramatically expand the application of the FBAR regime to non-U.S. persons and (at least initially) increase the volume of filings.

(b) *Trusts and estates*

As discussed, the circumstance of trusts involves a substantial potential for duplicative filing obligations, including obligations of persons who do not have access to the information necessary to file. One source of the duplicative filing obligations is the fact that the BSA, on the one hand, and the FBAR regulations and Internal Revenue Code on the other, use differing concepts of what a trust is. Unlike the definition of "person" contained in the Code,[270] the BSA definition does not include either trusts or estates.[271] Instead, it includes trustees and representatives of an estate.[272] This definition is consistent with the traditional common law rule that trusts and estates are not juridical persons but simply arrangements under which property is managed by one or more persons for the

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[269] *See* Code Section 875.

[270] *See* Code Section 7701(a) (defining a "person" as an individual, a trust, estate, partnership, association, company or corporation).

[271] *See* 31 U.S.C. Section 5312(a)(5) (referencing the definition of "person" in 1 U.S.C. Section 1).

[272] *See id.*

benefit of one or more other persons.[273] Despite the relatively clear text of the Act, the regulations appear to apply the tax concept of a trust as a person.[274] The current version of the FBAR instructions follows the regulations by directing the reader to the regulations for a definition of "person."[275] The departure from the statute has given rise to the question whether a trustee has to file a minimum of two FBARs, one for the trustee itself under the statutory definition and another for the trust under the definition of the regulations. We recommend that it be clarified that trusts (other than statutory business trusts) and estates have no independent filing obligation but that their assets should be treated as owned by their trustees/executors for purposes of determining whether ***those persons*** have any filing obligations.

We note in this regard that in virtually any case in which a trust or estate has sufficient contact with the United States to be potentially considered a U.S. trust or estate that would be subject to the FBAR rules if the trust or estate were in fact a United States person, one or more of its trustees or executors will be a citizen or resident of the United States. As a result, the information the BSA seeks to make available to Treasury or to federal investigators of criminal or terrorist activities will be made available through the reports required to be filed by trustees and/or executors.[276]

This rule is consistent with the traditional common law rule that trusts and estates are not juridical persons. Under this proposal, a "United States person" would not include either a trust (other than a statutory business trust) or an estate but instead would include a trustee of a trust and a representative of an estate. Each trustee (or executor) who is a United States person would have a financial

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[273] Although it is not unusual today to see accounts titled in the name of a trust rather than the trust's trustees, as a technical matter, legal ownership of trust assets belongs to the trustees.

[274] *See* 31 C.F.R. Section 103.11(z) (defining "person" to include "all entities cognizable as legal personalities").

[275] Indeed, the 1983 version of the instructions also treated (U.S.) trusts as (U.S.) persons.

[276] The trust arrangement is generally not recognized under civil law. The role played by the trust arrangement under common law is assumed in civil law jurisdictions by foundations that are juridical persons such as stiftungs and anstalts. Although a foundation may have a governing body referred to as its trustees, if it does, the foundation's trustees have no ownership interest in its assets. A foundation's assets are held in the name of the foundation itself. We believe that a foundation is closer in nature to a corporation than to a trust and should, therefore, be subject to the same FBAR reporting obligations that apply to corporations. However, because the beneficiaries of a foundation are more like the beneficiaries of a trust than the shareholders of a corporation, their FBAR reporting obligations should be the same as the FBAR reporting obligations of trust beneficiaries. Similarly, a statutory business trust that is a business entity and is treated as a partnership or a corporation for federal tax purposes should be subject to the FBAR reporting obligations that apply to partnerships or corporations. The holders of interests in a statutory business trust should be subject to the FBAR reporting obligations that apply to shareholders of corporations or partners of partnerships.

interest in each account titled in either the name of the trust (or estate) or the name of the trustee (or the decedent's estate).[277] However, the FBAR filed by the U.S. trustee or executor could be required to provide information about beneficiaries and holders of presently exercisable powers of appointment who are United States persons.

If this recommendation is not adopted, there is an ancillary and difficult question ***which*** trusts and estates should file FBARs. The BSA applies to persons "in, and doing business in," the United States.[278] The FBAR instructions now contain similar language. It is particularly difficult to apply these concepts to trusts and estates. The concept of a trust's residence is neither obvious nor explained in the Act. Residence could mean the residence or place of business of the trustees or the jurisdiction under the laws of which the trust was organized or the laws of which apply to its administration and construction. And once one determines whether a trust is "in" the United States, it will often be equally difficult to determine whether it is "doing business" therein.[279]

We believe (again, if our recommendation not to treat trusts as persons is not adopted) that the characterization of a trust or an estate as domestic or foreign should be made with reference to the broad information-gathering objectives of the Bank Secrecy Act. We suggest, therefore, that such characterization be determined with reference to the residence of a trust's trustees or an estate's executors, the people who have control over the trust's or estate's assets and who are most likely to have the information necessary to satisfy the reporting requirement. Specifically, we believe that if one or more of a trust's trustees or an estate's executors are United States persons, the trust or the estate should be treated as a domestic trust for FBAR reporting purposes.[280]

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[277] We note that, as a technical property law matter, because estates and common law trusts are not separate juridical persons, it is often the case that property will be titled in the name of the juridical person (*e.g.,* the human being, bank or trust company) acting as executor or trustee, with a notation that such property is held in that person's fiduciary capacity as executor or trustee. For example, depending on a particular financial institution's account naming convention, an account statement may indicate (i) that the account owner is the "XYZ Trust" even though, as a technical property law matter, only the juridical person acting as trustee can hold title to the trust property, or (ii) that the account owner is "[Name of juridical person] in his/her/its capacity as trustee of the XYZ Trust." Irrespective of a particular financial institution's account naming convention, however, we suggest that a trustee be treated as the "record owner" of trust property.

[278] 31 U.S.C. Section 5314(a).

[279] This presumes a broad, non-tax concept of "doing business." A trust that engages in a trade or business for U.S. federal income tax purposes loses its status as a trust, again for tax purposes. *See* Treas. Reg. Section 301.7701-4.

[280] When in doubt as to how to define a term, tax lawyers are often tempted to turn to the definitional provisions of the Code. In the case of the FBAR reporting requirements as applied to the status of trusts, we believe this would be a mistake.

(…continued)

(c) *Tax-qualified plans and IRAs*

We believe that imposing FBAR filing requirements on plans, arrangements and fiduciaries that are already subject to substantial regulation and limitations strikes the wrong balance between the government's information-related interests and the interest of reducing duplicative administrative burdens. Tax-qualified plans and IRAs subject to ERISA, and non-participant-directed governmental and non-electing church plans, as well as their participants and beneficiaries, should be exempted from FBAR filing rules. Because of limitations on contributions and withdrawals, as well as existing regulatory, information reporting and public inspection regimes, these entities do not create the risk of criminal or secret activity that other accounts do. The IRS appears to agree that the FBAR requirements are not applicable to tax-qualified plans, because the annual reports for those entities, Forms 5500 and 5500-EZ, unlike those for individuals, trusts, exempt organizations, do not ask whether the entity has any foreign accounts subject to FBAR reporting.

Governmental plans subject to Code Section 457 are not subject to ERISA or Code Section 4975. Such plans are, however, often governed by analogous state law, and are subject to Code Section 457(g), relating to trustee requirements. In the case of participant-directed governmental plans, because participants control the investment of assets and because such plans are less heavily regulated, FBAR filings may be appropriate.

(continued…)

The Code treats a trust as a domestic trust if "a court within the United States is able to exercise primary supervision over the administration of the trust, and one or more United States persons have the authority to control all substantial decisions of the trust." Code Section 7701(a)(30)(E). This definition has the potential to exclude more trusts from the FBAR reporting requirements than is consistent with the purposes of the Bank Secrecy Act. For example, a trust that is organized under the laws of a state within the United States, all of whose trustees and beneficiaries are United States persons and all of whose assets are located in the United States, is not a U.S. person under this definition if the consent of a non-U.S. person has to be obtained for any particular substantial decision, such as a decision to remove or replace a trustee or to add a particular beneficiary.

There are similar issues with the Code's definition of a domestic estate. Code Section 7701(a)(30)(D) treats an estate as a United States person if it is not a foreign estate within the meaning of Code Section 7701(a)(31). A foreign estate within the meaning of Code Section 7701(a)(31)(A) is an "estate the income of which [comes] from sources without the United States which is not effectively connected with the conduct of a trade or business within the United States . . . ." This definition, which is nothing more than an explanation of the tax consequences of the foreign status of an estate, is obviously not particularly helpful. Judicial and administrative authority has partially filled the definitional void by establishing a test that required weighing of an estate's foreign contacts against its U.S. contacts. *See, e.g.,* Rev. Rul. 81-112, 1981-1 C.B. 598; Rev. Rul. 64-307, 1964-2 C.B. 163; Rev. Rul. 62-154, 1962-2 C.B. 148; *B.W. Jones Trust v. Comm'r*, 132 F.2d 914 (4th Cir. 1943). The guidance these authorities provide is of little help in determining the foreign or domestic status of estates with both foreign and domestic contacts.

As indicated above, a church plan that does not elect to be treated as other than a church plan under Code Section 410(d) will not be subject to ERISA or Code Section 4975. This result is a consequence of Congress's judgment that such plans should not be regulated by these extensive federal rules. Thus, similarly, we believe that Treasury and the IRS should consider not subjecting non-electing church plans to FBAR filing requirements on this basis, to the extent such plans are not participant-directed plans, if Treasury and the IRS believe proceeding in this manner would not unduly compromise the government's interests.

Non-ERISA plans that are not governmental or non-electing church plans, and non-ERISA IRAs, are subject to somewhat less regulation. We are thus recommending that such plans (other than participant-directed governmental and non-electing church plans) be exempt from FBAR obligations if they are administered by a qualified regulated entity and are in compliance with applicable federal reporting requirements.

If not eliminated altogether, FBAR filing requirements relating to investments through employer-sponsored plans (including all government and church plans) and IRAs should be minimized so as not to place duplicative burdens on arrangements that encourage retirement savings. To the extent FBAR filings are required with respect to employer-sponsored tax-qualified plans, IRAs, governmental plans and church plans, we recommend that FBARs may be filed by the employer (where applicable), a trustee or other custodian and that additional, duplicative filings not be required, *e.g.,* by plan participants, administrators, investment advisers or their employees.

(d) *Regulated entities*

Independent of our other recommendations, we believe that Treasury should consider exempting from the FBAR reporting regime certain classes of entities that might be determined to pose little or no risk of enabling financial crimes and terrorism, or that are already subject to sufficient reporting requirements. The argument would be that these entities need not file FBARs for their own account (as opposed to for the account of others, as in the case of a "qualified filer" regime, discussed in Part VI.A.1) because any information they report is unlikely to have a sufficiently "high degree of usefulness," on an incremental basis (either to other reports that the entity itself is already required to file, or to FBARs required to be filed by others) to justify the reporting burden. Generally, these entities would be those that are highly regulated and subject to government oversight.

However, we do not believe that this exemption, if granted, should cover accounts held in secrecy jurisdictions.[281] While we generally suspect that the benefit from FBAR reporting by highly regulated entities is minimal compared with the burden imposed by that reporting, we recognize that regardless of the level of governmental oversight, accounts in secrecy jurisdictions can be used for nefarious purposes. Thus, we recommend that Treasury consider exempting well regulated entities only with respect to those foreign financial accounts that are not located in secrecy jurisdictions.[282]

As discussed in Part V.B, domestic banks are subject to a complex regulatory system that involves numerous agencies at the both the federal and state levels that closely monitor their operations. Further, as discussed elsewhere, banks are required to implement sophisticated anti-money-laundering and anti-terrorism systems[283] and suspicious activity reporting systems.[284] Indeed, banks submit more than a million SARs to Treasury each year. Our view is that the rules should be structured to minimize duplicative reporting, both across FBARs and in parallel with other reports.[285] If Treasury and the IRS conclude that the regulatory mechanisms in operation in banks are likely to result in few opportunities for banks to commit financial crimes or further terrorist activities using foreign financial accounts, and that the information reported by banks on SARs is substantially more likely to have a "high degree of usefulness" than would the information reported on FBARs, then the need for banks also to provide FBAR reporting is not apparent. It appears that the information already reported by banks would be both more detailed and more comprehensive than what would be required by the FBAR. In that case, we believe that it would be appropriate to exempt banks from FBAR reporting for foreign accounts in non-secrecy jurisdictions.[286]

For similar reasons, we suggest that Treasury consider an exemption for domestic broker-dealers that are registered with the SEC. As discussed, broker-

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[281] As discussed above, we question whether reporting of accounts in non-secrecy jurisdictions is ever worthwhile. *See* Part VI.B. This section assumes that Treasury prefers not to exempt all non-secrecy accounts.

[282] In effect, therefore, this recommendation is relevant only if Treasury and the IRS do not adopt our proposal in Part VI.B to exempt from FBAR reporting ***all*** accounts located in some defined universe of "acceptable" jurisdictions.

[283] *See* Part V.B (discussing anti-money laundering rules as applied to banks).

[284] *See* Part II.B.2 (reviewing suspicious activity reporting rules).

[285] *See* Part VI.A.

[286] Note that this is ***not*** a proposal to exempt all filings with respect to accounts ***held through*** U.S. regulated banks; it is merely a proposal to consider whether a bank ***as a filer*** is providing material incremental information to the government by filing an FBAR with respect to accounts in which it has a financial interest or over which it has signature authority.

dealers are subject to anti-money laundering rules similar to those that apply to banks, to similar SAR rules and to detailed tax information reporting requirements.[287] Registered broker-dealers are subject to oversight, including record inspections, by the SEC and are also potentially subject to the requirements of an SRO. While we are in no position to determine whether these entities are sufficiently well regulated that their FBAR reports are likely to add little to what is already available to federal regulators, we ask that Treasury consider whether the reporting costs imposed on broker-dealers by the FBAR rules are outweighed by the benefit of the data that would be reported by registered broker-dealers on FBARs over and above what they already report.

We recommend that Treasury perform a similar evaluation with respect to other highly regulated entities, including insurance companies to determine whether they are already be subject to sufficient oversight to minimize the risk that they will enable financial crimes or terrorism.

Similarly, registered investment companies are subject to disclosure requirements that may be sufficiently expansive to render FBAR reporting by these entities unnecessary. In general, these entities are required to file Form N-SAR (Semi-Annual Report for Registered Investment Companies) with the SEC on a semiannual basis, reporting, *inter alia*, information with respect to each custodian and sub-custodian that holds assets on behalf of the fund, including whether the custodian or sub-custodian is foreign. In addition, a registered investment company is subject to inspection by the SEC at any time.

If any of these proposals is adopted, a more difficult question is whether FBAR reporting should be required of *employees* of exempted entities for accounts over which the employee has signature or other authority but no financial interest. As we discuss below, we believe that the concept of employee signature authority should be significantly pared back.[288] In situations where any misuse of a foreign financial account by a regulated entity is highly unlikely to go undiscovered, we believe that employees can be safely exempted. We lack sufficient insight into the utility of law enforcement of FBARs filed by regulated entities to express a definitive view on this question.

Obviously, an exemption for both an institution and its employees would create the possibility that no FBAR gets filed with respect to a particular account (for example, where the "indirect" or "beneficial" owner(s) of the account are not United States persons). As discussed in Part II.B.4 and elsewhere in this report, one might allow this result on the theory that the FBAR is not a useful tool in

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[287] *See* Part V.C.

[288] *See* Part VII.D.2 (proposing to exempt large classes of employees from FBAR filing obligations for accounts of their employers).

discovering misconduct, and based on the understanding that a well regulated financial institution will maintain adequate records to be able to assist in an investigation should federal enforcement agencies initiate one. As we mention in Parts II.B.4 and VI.A.1, if it is determined that this is not a valid assumption, Treasury and the IRS might consider conditioning this exemption on the institution actually filing one of the specified types of information reports.

(e) *Tax-Exempt Organizations*

We think tax-exempt organizations should be exempt from FBAR filing, at least if they report the relevant FBAR information (accounts and values) in their Forms 990, perhaps with an appropriate exception from public inspection. As discussed in detail in a report submitted by the NYSBA Tax Section on September 10 (the "**September 10 report**"), we recommend generally that taxpayers be required to file FBARs with their tax returns pursuant to all the procedural processes of the income tax rules, assuming that a legislative exception to Section 6103 confidentiality can be adopted.[289] In the case of tax-exempt organizations, however, no legislative action would be necessary for the IRS to share the FBAR information included on a Form 990 with FinCEN or other agencies, because the Code already requires that information to be made available to the public, and indeed Forms 990 are ultimately available to the public on the Internet.[290] If tax-exempt organizations are required to file FBARs, filing them as part of the Form 990 could reduce the overall filing burden. An FBAR or FBAR information filed as part of a Form 990 should be treated as an FBAR filing by the tax-exempt organization for purposes of any rules exempting employees from filing when an employer has done so.

We recommend that tax-exempt organizations be permitted an election to file the FBAR separately (or that there be appropriate safeguards against public inspection of the FBAR information), because some tax-exempt organizations reasonably may be reluctant to have the details regarding their foreign financial accounts made available to the general public on the Form 990.

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[289] *See* New York State Bar Association, Tax Section, *Report on Qualified Intermediary and Related Withholding and Information Reporting Legislation Proposed by the Administration*, at 45-51 (Report No. 1189, Sept. 10, 2009), *available on the NYSBA Tax Section website at* http://www.nysba.org/Content/ContentFolders20/TaxLawSection/TaxReports/1189Rpt.pdf (last visited Oct. 23, 2009).

[290] *See* Code Section 6104(b) (mandating public availability); Hhttp://www2.guidestar.org/rxg/about-us/history.aspxH (stating that in 2005, GuideStar expanded its public database by 340,000 nonprofits (including their Forms 990) to include all tax-exempt organizations registered with the IRS) (last visited Oct. 29, 2009).

C. "Financial Interest"

1. Background

The FBAR instructions provide that a United States person has a "financial interest" in a foreign financial account for which either (i) the United States 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 including non-United States persons" (which we will refer to as a "direct" financial interest) or (ii) the owner of record is (1) acting as "agent, nominee, attorney, or in some other capacity on behalf of" the United States person, (2) a corporation in which the United States person directly or indirectly owns more than 50% by vote or value of the shares, (3) a partnership of which the United States person owns more than 50% of the profits or capital or (4) a trust from which the United States person derives more than 50% of the income or of which the United States person has an interest in more than 50% of the assets (which we'll collectively refer to as "indirect" financial interests).

2. Discussion and proposals

(a) *General*

First, especially if our proposals to minimize duplicative filings (particularly our proposal regarding "qualified filers") in Part VI.A are not adopted, we urge Treasury and the IRS to provide guidance on whether a United States person with an interest in a foreign financial account held through a United States institution is or should be viewed as having a "financial interest" therein.

Several hypotheticals will help to illustrate the ways in which a United States person may have financial interests in foreign financial accounts, including, potentially, accounts over which the person has no meaningful control. Consider a person with a traditional money market account at a domestic bank, or a prime brokerage arrangement with a domestic broker-dealer, that in either case, unbeknownst to the United States person, sweeps positive balances into an offshore account each night. We understand that for regulatory capital reasons, this is a fairly common arrangement, and that indeed the offshore "sweep" account (or a subaccount thereof – raising again the question what "an account" is) may even be "coded" to match the U.S. account of the United States person. Thus, the person could be viewed as having a direct financial interest therein. In any event, however, it seems clear to us that the United States person would, under a literal reading of the current instructions, be viewed as having an ***indirect*** financial interest in the sweep account, because the bank or broker-dealer (or some affiliate of it) is holding the offshore account either as agent or "in some other capacity on behalf of" the United States person.

Similarly, imagine a United States person who directs a domestic bank to purchase and hold a quantity of gold. We understand that it is common for domestic banks to execute such an order but to store the gold overseas in the name of the United States customer(s). We also understand that when this occurs, it is often not easy for a United States person even to learn of the existence of this offshore account. As above, we think that this arrangement could be a direct financial interest but in any event would seem to be an indirect financial interest under a literal reading of the current instructions.

These hypotheticals raise several questions. First, we doubt that it is appropriate for a United States person to be required to file an FBAR with respect to foreign financial accounts that the United States person has not asked to be created, is not aware of, and/or or has little or no control over. One way to address these concerns, again if our proposals in Part VI.A are not adopted, would be to consider an exemption from filing with respect to foreign accounts created for the benefit of United States persons by domestic banks or other regulated entities (perhaps including broker-dealers and insurance companies) in the ordinary course of the financial institutions' business, such as "sweep" accounts, gold accounts, multi-currency accounts, etc.

Second, these hypotheticals highlight the extraordinary potential breadth of the phrase "as an agent, nominee, attorney, or in some other capacity on behalf of" a United States person. In particular, the meaning of "on behalf of" is ungrounded and potentially subject to overbroad or inconsistent interpretations. We assume that this language is intentionally quite broad in order to address persons who wish to ensure that their names not be associated with a foreign financial account. However, as worded, these concepts are imprecise and over-inclusive. Because the definition enumerates an agent, a nominee and an attorney, and then includes persons acting in "some other capacity," the latter category must be different from an agent, nominee or attorney. The IRS has offered no guidance on the meaning of this phrase. While we generally support giving very broad scope to the concept of a "financial interest" in order to maximize the number of potential filers, we think it self-evident that terms such as this, when undefined, risk being rendered unenforceable by virtue of being overly vague.

To provide some context for our concerns, we offer a number of additional hypotheticals that arguably implicate the concept of a person owning a financial account "in some other capacity [than an agent, nominee or attorney], on behalf of" a United States person. Given the severity of the potential FBAR penalties, United States persons confronted with these fact patterns under current law might conclude that they should report their interests in the accounts, which would lead to what we expect will be an avalanche of irrelevant data. Consider for example a United States person who:

- holds non-U.S. stock or bonds through a foreign clearing organization like Euroclear or Clearstream;

- has a deferred compensation arrangement with a foreign operating company that establishes an account with a foreign financial institution "in the name" or "for the account" of the employee to hedge its exposure to the arrangement;

- holds a minority interest in a domestic partnership or trust that invests in foreign financial accounts;

- has paid a security deposit to a foreign lessor which the lessor (with or without notifying the lessee) deposits into a bank account pending return to the United States person at lease-end;

- is the beneficiary of a domestic pension plan that invests in foreign financial accounts; or

- owns a "separate account" life insurance policy or annuity issued by a domestic insurance company, where the separate account is invested in one or more foreign financial accounts.

If the term "on behalf of" were broadly applied without regard to the purposes of the FBAR regime, we think it could fairly be argued that each of these arrangements involves someone holding an interest in a foreign financial account on behalf of a United States person. It may be that some of these fact patterns were intended to be encompassed by the FBAR regime, though we suspect most were not, and in any event we are confident that few United States persons have historically been filing FBARs on the basis of fact patterns similar to these (again, at the risk of potentially severe penalties). Moreover, as discussed elsewhere in this report, we believe that at least some of these fact patterns should not be subject to FBAR reporting. We in any event feel very strongly that a penalty regime like the FBAR rules needs to be drafted precisely so that persons subject to its penalties know what they must do to comply.

One additional observation before we turn to a discussion of issues specific to financial interests in trusts: The instructions' definitions of an indirect financial interest in a corporation or partnership (*i.e.,* ownership of 50% of vote or value, or capital or profits, respectively) is both over- and under-inclusive. It was presumably intended to represent a proxy for whether a United States person has the ability to control the subsidiary's investments. It is of course possible, however, that the majority shareholder of a public company has no such ability. Similarly, a majority partner may nonetheless be a limited and/or "silent" partner. By contrast, the owner of a relatively small interest in a corporation or partnership (*e.g.,* the general partner of a limited partnership, or the sponsor of an investment vehicle) or someone with the right to acquire a substantial portion of the entity's equity (*e.g.,* via an option) may well have the ability to control the entity's investments. We therefore think Treasury and the IRS should consider a rule specifying that any person determined to control another's investments, whether

via ownership, rights to acquire, managerial or other authority or otherwise, may be viewed as indirectly owning the latter's foreign financial accounts. Perhaps a rule to the effect that majority ownership is rebuttably presumed to meet this criterion would be appropriate.

(b) *Trusts*[291]

The FBAR instructions provide that a United States person has a financial interest in foreign financial accounts for which the owner of record or holder of legal title is a trust in which either a United States person 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.[292] Both of these tests give rise to considerable interpretative uncertainty under even the most common trust arrangements. As in many other areas, our concerns regarding these uncertainties are significantly ameliorated if our proposal to treat a trust's trustee as a qualified or designated filer is adopted. Nonetheless, in case that proposal is not adopted or not adopted in full, we here consider these issues in some depth.

(i) Determining who has an interest

For starters, it is not at all clear how to determine whether a person has a present beneficial interest in more than 50% of the assets of a trust or, for that matter, what is meant by the term "present beneficial interest." In the case of a typical discretionary trust, it would seem that no person has a greater than 50% present beneficial interest in the trust assets because no person has a right to or – in very many typical discretionary family trusts – even the expectation that the person will receive more than 50% of the assets of the trust. Indeed, in IRS General Counsel Memorandum 37,900, the only authority of which we are aware addressing this issue, the Chief Counsel, interpreting identical instructions to the first Form 90-22.1 to be issued and referring to foreign trusts that have family members as beneficiaries, stated that:

> If there is more than one such U.S. beneficiary, as is usually the case, it will almost always be true that no individual beneficiary "has a present beneficial interest in *more than 50 percent* of the assets" of the trust. Consequently, no Form 90-22.1 need be filed by *any* of those beneficiaries.[293]

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[291] The discussion does not pertain to trusts maintained in connection with retirement plans, which we discuss below.

[292] *See* 2008 FBAR Instructions.

[293] Gen. Couns. Mem. 37,900 (Mar. 29, 1979) (first emphasis added; second emphasis in original).

Even in the case of trusts that are not discretionary, it is quite commonly unclear who, if anyone, might have a present beneficial interest in more than 50% of the assets of a trust. For example, on what basis is a beneficiary's percentage interest in the assets of a trust measured if the beneficiary is legally entitled to distributions to the extent needed for "health, education, maintenance and support" but cannot receive distributions for any other purposes? The question becomes even more difficult if there is more than one beneficiary of such a trust.

The second test, requiring reporting by a United States person who "receives more than 50% of the current income" of the trust, although appearing at first to be clearer, also proves to be very difficult to interpret and apply in practice. The principal issue here is that the word "income" is not defined. Therefore, it is not clear whether the term should be interpreted by reference to U.S. tax concepts, by reference to "trust accounting income" (also called "fiduciary accounting income") as determined under the trust instrument and applicable law, or some other metric.[294] Importing the concept of "trust accounting income" makes little sense as a policy matter, because that would subject the FBAR filing requirements to local trust accounting rules and practices, among other things. In any event, it is not clear to us why the distinction between income and principal under trust accounting rules should be relevant for FBAR purposes.

On the other hand, defining the term "income" with reference to U.S. tax concepts, although perhaps more palatable from a policy perspective, also raises questions. For example, would trust income for FBAR purposes be the same as "distributable net income" ("**DNI**") as calculated for tax purposes?[295] If so, is there a reason to retain the distinction between the way DNI is computed for domestic trusts and foreign trusts for this purpose? Because capital gain is included in the DNI of "foreign trusts" but generally not "domestic trusts" (each as determined for U.S. tax purposes), it would be less likely that a beneficiary of a trust would reach the greater-than-50% threshold if the trust were foreign, because it would take a higher distribution amount to carry out more than 50% of the trust's DNI.

It is also unclear how the income determination in the FBAR instructions is made in certain cases. A person has a financial interest in a trust if the person has "a present beneficial interest, either directly or indirectly, in more than 50 percent of the assets or from which such person receives more than 50 percent of the current income." The application of this principle to discretionary

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[294] The calculation of trust accounting income is governed by a specialized set of rules bearing little or no relation to how income is calculated for tax purposes or under other financial accounting methods.

[295] Generally speaking, a trust's DNI is equivalent to its federal taxable income before any deduction for distributions to beneficiaries.

beneficiaries is uncertain. In a Q&A published from the IRS National Phone Forum, discussed in Part IV.C.2, the IRS addressed the determination of percentages of beneficial interest for wholly discretionary trusts by advising that if the "income of a trust that holds foreign financial accounts cannot be determined, the beneficiary should file an FBAR."[296] This guidance, which only serves to increase the number of FBARs filed without regards to whether or not they contain useful information, provides no indication on how to test a discretionary beneficiary's interest in a trust.[297]

We recommend defining a "present beneficial interest" in trust assets to exclude purely discretionary interests. Discretionary trust beneficiaries do not have rights or powers that implicate transfer of funds issues. Unlike holders of powers of appointment, discretionary beneficiaries cannot cause trust funds to be distributed to third parties. And unlike other types of income beneficiaries, such as holders of life interests (who can generally demand that trust assets be invested to produce current income), discretionary beneficiaries generally do not have the right to demand that trust assets be invested in any particular manner.

To be specific, we would not require FBAR reporting by beneficiaries who have (i) no access to trust information, (ii) no power to control disposition of trust assets, and (iii) no U.S. tax liability associated with their interest in the trust in the relevant year. On the other hand, comprehensive U.S. income tax reporting would be required from beneficiaries who receive distributions from discretionary trusts, and FBAR reporting would be required where the beneficiary receives distributions in excess of 50% of the trust's aggregate distributions during the calendar year.

More generally, we think that the current definition of financial interest could be modified to provide that a United States person has a financial interest in each foreign financial account for which the owner or record holder is the trustee of a trust in which the United States person has some requisite interest or connection. Our suggestions with respect to the nature of the requisite interest or connection that should result in the attribution of a financial interest in a trust account to a trust beneficiary are included below. The main principle behind the proposals below is that, with some exceptions, the determination of whether or not a beneficiary has a financial interest in a trust's foreign accounts should be based on the receipt of distributions. The benefits of this approach include

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[296] *See* Toscher & Stein, *FBAR Enforcement*, *supra* note 124, at 50.

[297] Issues can also arises as to timing: If the determination is supposed to be made annually and "income" is defined to mean fiduciary accounting income, would a distribution made after December 31 of a particular year be treated as having been made in the prior year if the trustee, for trust purposes, treats the distribution as being made from the prior year's income? Alternatively, if "income" is defined with reference to tax concepts, would a Code Section 663(b) election for distributions made within the first 65 days of the year affect the determination?

certainty and, when coupled with the proposals set out in the duplicative filing/designated filing discussion, a greater likelihood that the government will receive reports for a greater number of foreign accounts in a more comprehensive and organized fashion. This approach would also avoid the imposition of filing requirements on beneficiaries who, for good reason, have little or no information about the relevant trusts, *e.g.,* children and young adults.

In addition, it is well established and accepted that distributions to U.S. beneficiaries from both domestic and foreign trusts require the trustee to provide information to those beneficiaries in order to allow them to comply with their U.S. tax reporting obligations. Under our proposals, the additional information that would need to be reported in order to allow U.S. beneficiaries to comply with the FBAR reporting obligations would be able to "piggyback" onto those principles and procedures. By contrast, requiring reporting from beneficiaries who do not receive distributions would be novel, difficult to administer, and in many cases unfair. Moreover, if the proposals made herein are adopted, we believe requiring reporting from beneficiaries who do not receive distributions would be unnecessary because it would not result in the U.S. government receiving significantly more information than it would be receiving from the trustee(s) and beneficiaries who receive distributions.

(ii) Proposals

Note that the following proposals are all subject to the proposals in the duplicative filing/designated filing system discussion herein. Thus, for example, if a U.S. beneficiary of a domestic trust would be treated as having a financial interest in the trust's foreign accounts under the following proposals, in most cases it would be the trustee that would be required to file, although the trustee would be required to provide the U.S. beneficiary's name, address and social security number in its filing.

1) A United States person who has a purely discretionary interest in a trust should not be treated as having a financial interest in the trust's foreign accounts except for years in which he or she has received distributions sufficient to trigger reporting on that basis per paragraph 3 below.

2) A person who is only a contingent beneficiary or a remainder beneficiary of a trust should not be treated as having a financial interest in the trust's foreign accounts, because the person should not be considered as having a *present* beneficial interest in the trust. Moreover, these people quite often are not even aware of the existence of the trust.

3) A United States person who receives more than 50% of the total amount of distributions made from a trust during a calendar year

should be treated as having a financial interest in the trust's foreign accounts for the year, regardless of the amount of the trust's income for the year and regardless of whether the trustee treats the distributions as being made out of trust income or trust principal.

4) Potential and actual appointees under limited and general powers of appointment over trust property (described further below in Part VII.D.2(c)) should be treated the same as trust beneficiaries, *i.e.,* paragraphs 1 through 3 above should apply to beneficiaries of a trust and potential and actual appointees under powers of appointment in the same way. Moreover, amounts paid out of a trust to appointees pursuant to the exercise of a power of appointment should be treated as trust distributions in making the determination whether a United States person has received more than 50% of the total amount of trust distributions under paragraph 1 above.

5) A United States person who has a right of revocation or a presently exercisable general power of appointment over more than 50% of the trust fund (generally measured by value) should be treated as having a financial interest in the foreign accounts owned by the trust. However, if these powers can be exercised only over a portion of a trust and that portion does not contain interests in reportable foreign accounts, then the power holder should not be treated as having a financial interest in the trust's foreign accounts.

6) In the case of a foreign trust the trustee of which is not a United States person, the grantor of the trust, if he or she is then living, should be treated as having a financial interest in the trust's foreign accounts (and perhaps the trust itself, as discussed in Part VII.A.2(e)[298]). For this purpose, a "grantor" of a trust would be

[298] If, as discussed in Part VII.A.2(e), a determination is made to treat a trust with a foreign financial institution acting as its trustee as a foreign financial account, further consideration should also be given as to whether, in addition to or in lieu of the above generally applicable financial interest attribution proposals, a beneficiary or appointee receiving any distribution from such a trust during the year, or having the power to withdraw any property from that trust during the year, should be treated as having a financial interest in that trust for that year, with a corresponding requirement to report information regarding the trust (as opposed to information regarding the financial accounts held in the trust). If a determination were made to treat U.S. persons in this manner, we would suggest that the value of the financial interest for purposes of triggering any applicable reporting requirement be based on the amount received or which could be withdrawn by the U.S. person during the relevant reporting period.

defined as any person who created the trust or made a gratuitous transfer to the trust.[299]

Under our suggested approach, financial interests in accounts of corporations or partnerships held by a trust (*i.e.,* accounts of which the record owner is the corporation or partnership and not the trustee, which we refer to as "trust holding company accounts") could be attributed to United States persons who are trust beneficiaries under either (i) the current rule that treats a United States person as having a financial interest in a financial account of which a corporation or partnership is the record owner if the United States person "owns directly or indirectly" a sufficiently large interest in the corporation or partnership, with additional guidance as to the calculation of indirect ownership through a trust or (ii) a new rule attributing record ownership of trust holding company accounts to a trustee when a sufficiently large interest in the corporation or partnership is held in trust.

In this regard, if Treasury should conclude that it prefers the present definitional approach, which treats a trust as both a "person" and the "owner of record or holder of legal title" of trust property,[300] we respectfully request that additional guidance be issued clarifying (i) whether under such an approach a United States person acting as trustee has a financial interest in a trust account separate from the trust by reason of holding record ownership of the account as a matter of property law or by reason of a particular financial institution's account naming conventions, and (ii) the proper mechanism for attributing financial interests in trust holding company accounts to U.S. trust beneficiaries.[301]

(iii) Trust protectors

The October 2008 revisions to the FBAR instructions added the following paragraph to the definition of a "financial interest":

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[299] An exception for U.S. settlors of foreign trusts that are not grantor trusts for federal income tax purposes would seem warranted, because those trusts can have no U.S. beneficiaries or potential U.S. beneficiaries and very little control by the U.S. settlor.

[300] The 2008 FBAR Instructions refer to 31 C.F.R. Section 103.11(z) for a complete definition of "person." As indicated above, this definition includes a trust or estate. Moreover, part 2(d) of the definition of a financial interest in the 2008 FBAR Instructions provides, in part, that a United States person has a financial interest in financial accounts "for which the owner of record or holder of legal title is . . . a trust . . . ."

[301] Under the current approach, it would appear that, because a trust would never be the record owner of a trust holding company account, a United States person trust beneficiary could have an interest in such an account ***only*** by reason of the application of parts 2(b) and (c) of the 2008 FBAR Instructions definition of a "financial interest" (dealing with direct and indirect interests in corporations and partnerships) or part 3 thereof (dealing with a specific type of trust) as opposed to the more general trust rule set forth in part 2(d) thereof.

> A United States person has a financial interest in each bank, securities, or other financial account in a foreign country 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 United States person and for which a trust protector has been appointed. A trust protector is a person who is responsible for monitoring the activities of a trustee, with the authority to influence the decisions of the trustee or to replace, or recommend the replacement of, the trustee.

The reasons for this provision are unclear, and we submit that it would be unnecessary – and would thus add an unnecessary degree of uncertainty – if the proposals set forth above are adopted. If the trust in question has a U.S. trustee, then the trustee itself would be required to file FBARs with respect to its foreign accounts, and moreover, the identity of the settlor would be disclosed under the designated filer procedures discussed herein. If the trustee is foreign, the settlor would be required pursuant to paragraph 6 above to file FBARs to report the trust's foreign accounts, regardless of whether or not there is a trust protector.

If, however, it is determined to retain this provision, we recommend the following modifications. First, the provision should not apply if under applicable law the trust protector is considered to be a fiduciary. Second, the applicability of the provision should be conditioned on the trust protector having trustee removal powers. As it reads now, the provision applies if the trust protector has the authority to influence the decisions of the trustee, even if the trust protector does not have removal or replacement powers. That is too vague a standard, and it is not clear how a trust protector without such powers could wield enough influence on a trustee who is subject to legally binding fiduciary duties. Third, the terms "responsible for monitoring the activities of a trustee" and "authority to influence the decisions of the trustee" need clarification. Finally, the power to "recommend the replacement of" a trustee cannot have any relevance for FBAR reporting purposes and should be removed.

D. "Signature or Other Authority"

1. General scope

(a) *Background*

We start by observing that the concept of "signature authority" does not appear in the statute. The FBAR Provision refers only to persons who "maintain[] a relation *for any person* with a foreign financial agency." (emphasis added.) The regulation introduces the concept of "signature or other authority" over a bank, securities or other financial account in a foreign country, without explanation. The concept of "signature or other authority" is conventionally understood to embody the idea of a "signature card" – an instrument identifying for the benefit

of the relevant financial institution the signature(s) of anyone with authority to remove assets from a particular account. The signatories to an account are typically those with withdrawal or check-writing privileges, and would primarily include (other than the account's beneficial owner(s), who may or may not be signatories) any nominee, trustee, or agent so designated by or on behalf of the account's beneficial owner(s).

In the 2008 FBAR Instructions, the IRS sheds little light on the meaning of these terms: The instructions specify that a person has signature authority if the person "can control the disposition of money or other property in [the account] by delivery of a document containing his or her signature (or his or her signature and that of one or more other persons) to the bank or other person with whom the account is maintained."[302] "Other authority" is described as power that is comparable to signature authority by direct or direct communication, orally or otherwise.

At the same time, the instructions create some uncertainty by specifying that employees of banks or public companies with signature authority over but no financial interest in an account "maintained by the bank" (or "of the corporation") are excepted from FBAR filings under certain circumstances. To state the obvious, these exceptions "assume the conclusion" – that is, they assume the employee has signature authority, without explaining what in the view of the instructions' drafters causes them to have that status. However, the assumption is somewhat surprising, as it would seem to be only in unusual cases that bank or corporate employees would be considered "signatories" in the traditional sense discussed above (for example, an employee of a bank who is acting in an individual capacity as the trustee of a trust account "maintained by" the bank, or an officer of a public company that has been designated to a bank by the company as having authority to write checks on the company's account on the company's behalf).

However, it has recently become clear that representatives of the IRS do not view the concept of "signature or other authority" in the sense of its plain meaning. Indeed, it is clear that the IRS believes that a bank employee who performs a "back-office" or "compliance" function with respect to a foreign account (*i.e.,* who moves assets from the account upon the instructions of others) has signature authority over the account. This is a very surprising position,[303]

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[302] The parenthetical is presumably intended to get at the concept of "joint accounts," although typically assets in joint accounts can be disposed of by the instruction of ***any*** of the signatories rather than ***all*** of them.

[303] Indeed, in the case of a bank, there is an argument that this position is technically unsupportable, although the analysis becomes somewhat metaphysical. The exception applies only with respect to accounts "maintained by" the bank, which we think plainly means accounts at the bank, but in which only unrelated third parties (customers) have a financial interest. And the exception does not require that the bank itself file an FBAR with respect to the account (*i.e.,*
(…continued)

which we believe is not within the letter of the FBAR Provision. It is, however, overwhelmingly clear that this interpretation of the FBAR rules dramatically expands the volume of FBARs that potentially must be filed, and so we think careful consideration must be given to the likelihood that it is "worth the candle" – *i.e.,* whether it is worth the additional burdens, whether it is within the interpretive scope of the rules and whether as a policy matter it is a necessary or appropriate expansion of the rules.

(b) *Discussion and proposals*

The first observation about these filers is that they will in every instance we can imagine be in no better a position than their employers to have useful information regarding foreign financial accounts, including the name(s) of the beneficial owner(s) of the accounts. Thus, if there is a purpose served by requiring such a person to file an FBAR, it is that the employer might not be required (*e.g.,* because it is neither a U.S. person nor in and doing business in the United States), able (*e.g.,* because it is subject to secrecy laws) or willing (*e.g.,* because it is a malfeasor) to do so, so that the U.S. employee may be the only source that Treasury has for discovering information about such accounts (*i.e.,* the employee is the person of "last resort"). In each such case, however, we think it obvious that an attempt to deputize U.S. employees in this way and under these circumstances may incentivize the employer to take steps to ensure that U.S. employees have no such control of foreign accounts. And in all other cases, at least one other filer will have the same information, so there is no need whatsoever to consider employees to have signature authority under these circumstances. Thus, this expansive interpretation of "signature authority" is unlikely to be helpful as a labor matter, and in any event is unlikely to produce useful information.[304] Thus, we think consideration should be given to making

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(continued…)

unlike the public corporation exception, the bank employee exception is not conditioned upon the bank filing the form), which it would be required to do if the bank could be viewed as having signature authority over the account (by hypothesis, the bank has no financial interest in the account). Yet any authority an employee of the bank has over an account can be no greater than the authority the bank has, because the employee's authority in the case of back-office or compliance personnel has by hypothesis been given by the bank. Thus, concluding the employee has signature authority would seem to impel the conclusion that the bank does as well, meaning that the bank has signature authority over an account maintained at itself. This could be considered absurd.

[304] It is of course possible that one or more bank employee(s) will actually know the account owner or "beneficial owner" (for tax purposes) or be in possession of some material information regarding the account. Certainly, the IRS's apparent notion of "signature authority" makes no attempt to find such personnel; instead, the rules require reporting from a potentially very large number of compliance personnel who will in almost no case have any such information. One could imagine a regime in which employees with signature authority ***and*** some material knowledge of the accountholder or beneficial owner could be required to file notwithstanding any otherwise available exception.

clear that any employee with no financial interest in an account of or maintained by that person's employer and who is not acting on the instruction of anyone with a financial interest in the account (assuming for this purpose the bank itself has no financial interest in its accounts) is exempt from FBAR filing, at least where the employee knows or has reason to know the employer will file an FBAR and maintain appropriate records in the United States.

In any event, because the primary effect of this broad interpretation is to dramatically increase the chances of duplication of identical information, we think it lends very strong support to our proposal, discussed in Part VI.A.3., to expand significantly the universe of employers whose employees need not file FBARs with respect to accounts over which they have no financial interest if their employers have done so.

As an ancillary matter, there is some uncertainty regarding whether employees with managerial authority over employees determined to have "signature authority" are or should be viewed themselves as having signature authority. There has been some indication from IRS personnel that supervisors are not viewed as having signature authority, at least where the supervisor is not expected to exercise the authority to remove assets from an account personally, but this result is not at all clear (or logical) in light of the above discussion. If our recommendation to exclude employees in the course of their business generally is not adopted, it should be made clear that employees who do not ordinarily move assets out of foreign accounts do not have signature authority, even if they have the direct or indirect (by instructing their subordinates) ability to do so.

We now specifically respond to the request for comments regarding signature authority in Notice 2009-62. The first request was for comments regarding "when a person with signature authority over, but no financial interest in, a foreign financial account should be relieved of filing an FBAR for the account. For example, comments are requested regarding whether relief from filing would be appropriate if a person with a financial interest in the account has filed an FBAR." As discussed in Part VI.A and elsewhere in this report, we see no net benefit from collecting the same information more than once (other than from the "beneficial owner"). Thus, we have in Part VI.A made a variety of proposals intended to minimize the number of actual filers with respect to any account. On the other hand, we see no need to limit any exemption for persons with signature authority but no financial interest to cases where someone with a financial interest has filed an FBAR.[305] The exemption should extend to any

[305] Indeed, as we noted in Part II.B.4, in pure theory it could be argued that the FBAR rules should apply ***only*** to persons with no financial interest in an account, on the theory that those with a financial interest either will comply, in which case it seems likely they will be providing no information of interest to the Treasury, or they will not comply, in which case (unless an effective "matching" system is implemented) the FBAR regime, as applied to them, serves no informational purpose but acts only as an additional enforcement weapon.

person with signature authority but no financial interest over an account for which ***anyone*** else (other than the beneficial owner of the account) has filed an FBAR.

The second request was for circumstances in which the employee exceptions "might be expanded to all officers and employees with only signature authority over, and no financial interest in, an employer's foreign financial account, including circumstances in which an individual has been advised that an FBAR has been filed with respect to a foreign financial account for which that person has signature authority." First, a technical clarification: We think it clear that the current bank employee exception applies not only to "the employer's financial accounts" (*i.e.,* accounts "owned by" the bank), but all accounts maintained at the bank, whether or not "owned by" it. In any event, as discussed above in this Part VII.D.1(b), we are dubious as to whether employees should be viewed as *having* signature authority in the vast majority of the circumstances that the current rules seemingly contemplate. In any event, as discussed in Part VI.A.3, we conclude that there is no reason to require employees to file FBARs with respect to accounts over which they could be viewed as having signature authority in the course of their employment but in which they have no financial interest – ***any*** accounts, whether or not "of" or "maintained by" their employer – where they have been notified that their employer, any affiliate, any other entity with which any of them files a consolidated FBAR, or any employee of any of them has done so and maintains appropriate records in the United States.

Finally, the Notice requested comments regarding "how the bank and publicly-traded company exception (including the requirement of notification that an FBAR was filed by a U.S. person with a financial interest in the account) might apply to officers and employees with only signature authority over accounts owned by clients of their employer." As discussed above, we believe that the bank employee exception already clearly encompasses this set of fact patterns, and that exception does not require that there be any showing that anyone (including anyone with a financial interest) has filed a report. More generally, as we have said, we do not view it as critical to an employee (or any other) exception that there be a showing that someone *with a financial interest* has filed a report; all that is important is that *someone* have filed the report, ideally, we think, someone who is maximally likely to know the name(s) of the owner(s) of the account(s), to have adequate resources to organize, store and retain the relevant information, to file the report fully and accurately, and as discussed below, preferably to file the report electronically. With regard to accounts over which an employee has what is viewed as signature authority in the course of a business, we think it clear that the "ideal" filer will be the employer, whether or not the account is an account in which the employer has a financial interest, and thus that the employee should be exempted from filing obligations if the employee receives a statement to the effect that the employer or any of its affiliates has filed and will maintain appropriate records in the United States. And as discussed in Part VI.A.3, we recommend conditioning any such exemption on the employee not

having knowledge or reason to know that the employer will not file a full and complete report or maintain the relevant records.

2. Exceptions

(a) *Bank employees*

The bank employee exception, which originates in the FBAR instructions, provides that "[a]n officer or employee of a bank which is currently examined by Federal bank supervisory agencies for soundness and safety need not report that he has signature or other authority over a foreign bank, securities or other financial account maintained by the bank, if the officer or employee has NO personal financial interest in the account." There are several aspects of this exception that are unclear.

First, it is not clear what it means for a bank to be "currently examined by Federal bank supervisory agencies for soundness and safety." Most fundamentally, it is not clear whether this phrase encompasses non-U.S. banks that are doing business in and regulated to that extent by federal regulators. We understand that IRS personnel believe that the phrase does not encompass such entities, but it is not clear to us that this is literally correct, nor is it clear to us that it is an appropriate limitation on the exception as a policy matter. In order to analyze that question, however, we must first explore what the intended scope of the exception is.

The second key uncertainty regarding the bank employee exception involves what it means for an account to be "maintained by" the bank. As mentioned above in Part VII.D.1(a), we think it clear that this does not mean only accounts "owned by" or "of" the bank, but includes all accounts held "at" the bank by any person. However, also as discussed in Part VII.D.1(b) above, the drafters of Notice 2009-62 seem to have assumed that the exception involves only accounts in which the bank has a financial interest.[306]

A third uncertainty involves what it means for an employee to have no "personal" financial interest in an account. This phrase is used throughout the employee exceptions, but it is not clear to us whether it is intended to change the meaning of a "financial interest" (which as discussed in Part VII.C, above, is discussed in detail in the FBAR instructions, and does not use the word "personal").

[306] As discussed in Part VII.C.2(a), it is at least possible to interpret the concept of a "financial interest" in such a way that a bank will always have a financial interest in an account "at" the bank, even if owned by a third party, because the bank could be viewed as holding the account "on behalf of" that third party.

A fourth observation about the bank exception, mentioned in Part VII.D.1(a), above, is that it applies without regard to whether the bank (or any other person) is filing an FBAR with respect to the relevant account. It is unclear to us whether this reflects an expectation or understanding on the part of the FBAR instructions' drafters that domestic banks *would* file FBARs under these circumstances (either because they are viewed as having signature authority or because they are viewed as having a "financial interest" by virtue of holding "on behalf of" customers), or would *not* do so. More fundamentally, if the bank employee exception applies in cases where the bank does not file an FBAR, then it may reflect a broad understanding that U.S. employees of U.S.-regulated banks are unlikely to have relevant information for FBAR purposes, as discussed in Part VII.D.1. We are skeptical that was the purpose of the bank employee exception, and in any event are doubtful that such a broad assertion is warranted.

Nonetheless, we believe a resolution of this question is relevant to how broadly the phrase "currently examined by Federal bank supervisory agencies for soundness and safety" should be interpreted. In other words, in order to know which banks' employees should be exempt, it is important to know what was assumed about the conduct of the employer – was it important that the bank would be required to file SARs? Was it assumed the bank would be a "United States person" and would file FBARs? Was it important simply that all of the bank's customer data would be available to federal regulators if they wanted to review it?

In our view, starting the inquiry from scratch, we think it would make sense (for reasons we have already discussed in Parts VI.A and VII.D.1) for the bank employee exception (indeed, any employee exception) generally to apply where the bank, any of its affiliates or FBAR consolidated group members, or any of their employees, is filing an FBAR.[307] However, the limitation to employees of banks "currently examined by Federal bank supervisory agencies for soundness and safety" clearly was ***not*** dependent on whether the bank or anyone else would file the FBAR. Alternatively, the drafters of the exception may have assumed that the exception was appropriate because the bank could be assumed to be required to file ***SARs***. We are unsure whether the universe of banks required to file SARs is coextensive with the universe of banks "currently examined by Federal bank supervisory agencies for soundness and safety." If not, we are left to conclude that the drafters of the exception must have had in mind that employees of banks whose customer data would be available to federal regulators upon request need not file FBARs. In that event, however, we are unsure why the exemption should not extend to cover any accounts (whether or not of banks, and whether or not of domestic entities) the customer data with respect to which are subject to the

[307] To ensure adequate reporting, banks could file FBARs that list the employees who have signature or other authority over accounts because of their employment with the bank or its affiliates.

jurisdiction of federal – or even state – regulators (again, whether bank regulators or not). In any event, we think consideration should be given to identifying jurisdictions whose banks are sufficiently well regulated to qualify their employees for an exemption.

For completeness, although obviously not relevant to an understanding of why the current exception is drafted as it is, as we said in Part VII.D.1(b), we also think a case can be made that any employee with no financial interest in an account and who is not taking instructions from anyone with a financial interest in the account should be does not have signature authority in the first instance and so should be exempt from FBAR obligations, without regard to the status of the employer.

In addition, for reasons that are not clear to us, as discussed in the next section, the exception for employees of public corporations extends to employees of subsidiaries of those entities, but the bank exception does not extend to employees of subsidiaries of the bank. The distinction is irrelevant if the bank is also a public corporation. But for non-public banks (and domestic branches of foreign banks), we see no reason why employees of the bank's (or branch's) subsidiaries should not be covered provided that the customer data with respect to the accounts in question is within the jurisdictional reach of the United States. The types of subsidiaries that U.S.-regulated banks may own are very limited. These subsidiaries must engage in activities that are related to their core banking business and are subject to comprehensive regulation by state and federal authorities. Thus, much of the rationale that supports the bank exception also supports extending this exception to U.S. bank (or U.S. branch) subsidiaries.

In addition, we believe that the bank employee exception should be expanded to include employees of broker-dealers that are registered with the SEC. As described above, broker-dealers have record-keeping requirements under the BSA that are identical to the requirements imposed on banks, and are subject to supervision and examination by the SEC in a manner that is very similar to the supervision of banks by federal bank supervisory agencies, and are in general subject to the same tax reporting obligations as banks. And again, for the reasons discussed above, employees of broker-dealers will provide little or no incremental information, although requiring them to report many duplicative filings significantly increases the administrative burden on both filers and the government. We also think consideration should be given to whether other types of regulated entities' employees should be exempt from FBAR filing obligations. Different rules may apply, however, to employees of affiliates of these entities if those affiliates are not also subject to regulation and supervision.

(b) *Public company employees*

The second employee exception in the FBAR instructions exempts "[a]n officer or employee of a domestic corporation whose equity securities are listed

upon any United States national securities exchange or which has assets exceeding $10 million and has 500 or more shareholders of record" if the employee has signature or other authority over but "NO personal financial interest in the account and he has been advised in writing by the chief financial officer or similar responsible officer of the corporation that the corporation has filed a current report, which includes the account." The exception goes on to include officers or employees of "a domestic subsidiary of such a domestic corporation" if "the domestic parent meets the above requirements, he has no personal financial interest in the account, and he has been advised in writing by the responsible officer of the parent that the subsidiary has filed a current report which includes that account." Finally, the exception specifies that "[a]n officer or employee of a foreign subsidiary more than 50% owned by such a domestic corporation" is exempt if the officer or employee has no personal financial interest in the account and has been advised by the responsible officer of the parent that the parent has filed a current report which includes that account.

In Part VI.A.3, we propose that all employees of any entity be exempted from filing with respect to accounts over which they have only signature authority in the course of their business, if their employer or anyone else in the employer's group is filing a report and appropriate records are maintained in the United States. If that proposal is not adopted, we nonetheless recommend that Treasury and the IRS consider clarifying and expanding the public company employee exception.

As a starting point, as we have discussed in Parts IV.B.2 and VI.G, the definition of "domestic" as used in the FBAR form is somewhat unclear. As we have said, we believe that the term "domestic" as used in the instructions was intended to mean only those corporations that are formed under the laws of a domestic jurisdiction. In that event, the exception would not be currently available to a foreign corporation that does business in the United States and is listed on a U.S. national securities exchange. However, this is not entirely clear, and it perhaps less clear in the context of the public company exception, which was added to the instructions after the regulation that defines "domestic" to include entities doing business within the United States. In any event, as we have proposed a very broad exemption for employees of any entity filing an FBAR in Part VI.A.3, in the event that proposal is not adopted, we would not oppose a determination that going forward, the meaning of "domestic" as used in the context of the public corporation employee exemption encompasses foreign corporations (assuming it is determined that they must file FBARs if they are doing business in the United States, which we discuss in Part VII.B.2(a)).

The next observation regarding this exception is that it relates only to domestic *corporations,* and their subsidiaries. We see no reason why an exception for public companies (assuming there is an appropriate line-drawing) should be limited to public *corporations,* as opposed to LLCs, partnerships and

other entities, and we believe at a minimum that the exception should be expanded accordingly.

Also, as reflected by our proposal in Part VI.A.3, we do not see merit in limiting the employee exceptions to public-company employees. We surmise that the reason for limiting the exception to employees of companies that are exchange-listed or have a large number of shareholders was to ensure that the entity was not acting for the benefit of a small group of bad actors and was more likely to be subject to federal (*e.g.,* the SEC) regulation or at least some form of "public" scrutiny. We imagine the requirement that the company have at least $10,000,000 of assets[308] was to ensure it was not a "fly-by-night" operation that might not be accountable should it be determined that its statements to its employees were false. On the other hand, though, as we have said repeatedly, in general we think it better to collect information once and only once, and that ideally one would impose the burden on the person with the greatest resources and the highest likelihood of complying with the rules. In our view, this will in general be the employer rather than the employee, at least when the employee's potential filing obligation arises in the course of employment, and thus that the presumption should be that the employer will do the filing. And we think the risk that the employer might be a bad actor or falsely state that it filed the FBAR is better dealt with via a proviso to the effect that the employee is not exempt from filing if the employee knows or has reason to know that the employer will not do so fully and accurately. We do not think there should be a presumption (or even an inference) that a small or privately held employer will not file fully and accurately, but we do think it would be appropriate to take those facts into account in determining whether the employee appropriately relied on the employer's statement to the effect that it did so.

A third issue is that it is not clear what an account "of" the employer is. Our supposition is that this was intended (unlike the bank employee exception) to address only accounts owned by the employer (*i.e.,* in which it has a direct financial interest). We think this radically oversimplifies the multitude of scenarios where entities control or have access to bank accounts. Indeed, even under the rubric of the FBAR rules themselves, there are many ways that an entity might be viewed as having a financial interest in an account, for example, where it acts as a trustee, custodian or nominee. We believe that those accounts are

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[308] We note in any event that this number might appropriately be adjusted for inflation – as discussed in Part VI.C, $10,000,000 in assets in 1986 would be equivalent to approximately $20,000,000 in assets now. *See* Bureau of Labor Statistics, *Consumer Price Index*, *supra* note 200. We note also that it is not entirely clear whether this was intended to comprise gross or net assets; the most natural reading is that it means gross assets, but then we are unsure whether or how it serves the purpose for which it was intended.

accounts "of" the entity, if for no other reason than that the FBAR defines the entity as having a financial interest in the account.[309]

One aspect of this concept that we find interesting, discussed in Part VII.C.2(c), above, is whether a company's pension plan (or a foreign account held by the pension plan, if the plan itself is domestic) is an account "of the company" for this purpose. If the plan is a trust, as discussed in Part V.E, there is at least a strong argument that it is similar to a custodial relationship between the trustee and the trust's beneficiaries. We understand that under a typical pension plan, the company would be neither of these entities, although it could be viewed as having something like a power of appointment (via its ability to fire its employees). We certainly think that company employees responsible for pension accounts should be exempt from any related FBAR filing obligations, given the degree of regulation and supervision to which they are subject.

Another issue with the exception is that it is not clear what a "subsidiary" is. The foreign subsidiary employee prong of the exception explicitly applies only if "such a domestic corporation" (we presume, either the parent or any subsidiary described in the rest of the exception, though this is not clear) owns 50% of the subsidiary; the implication of this is that a domestic entity may be a subsidiary even if the parent doesn't own 50% of it, although we would have thought from the framework of the exception (in particular, from the focus placed on the parent "meet[ing] the above requirements [of public holding and substantial assets]" and a responsible officer of the parent stating in writing that filing was done) that it was important to the drafters that the parent control the relevant subsidiary. If our proposal to expand the employee exceptions significantly is not adopted, then we would recommend clarifying that it is intended that any "subsidiary" identified in the exception be controlled by the parent, which we would expect would at a minimum mean majority-owned.

It is also not clear whether the subsidiary employee prong of the exception applies only to accounts "of" the subsidiary or can encompass employees with signature authority over accounts of the parent or its affiliates. The implication of the domestic subsidiary employee prong's assumption that the subsidiary itself will have a filing obligation is that the exception was intended to apply with respect to accounts "of" the subsidiary, but the rule doesn't say that and we see no policy reason to so limit it. If the rule is retained in its current form, we recommend clarifying that a subsidiary's employee is exempt with respect to any account of the subsidiary, the parent or any other subsidiary over which the employee has signature authority but no financial interest if the parent states that an FBAR has been filed with respect to that account.

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[309] *See* 2008 FBAR Instructions.

Also interesting is that there is no requirement that a "subsidiary" be a corporation in order for its employees to obtain the benefit of the exception, as the exception is currently drafted. We doubt this was intended, but because we do not believe that limitation on the parent is an important one in any event, we would not recommend correcting it. However, if it is determined for some reason that it was important that the exception apply only to employees of corporations, the IRS and Treasury might want to clarify this point.

We also do not think it critical to the application of the employee exception that it be a condition to the availability of the exception that the CFO or another responsible officer of the parent state in writing that it is filing the FBAR. As discussed above, we think in general that if the parent (or anyone else) in fact files a full and accurate FBAR with respect to an account over which an employee has signature authority in the course of employment but in which the employee has no financial interest, the employee should be exempt from the requirement to file, regardless of whether/how the employee knew that the filing would be done. And we think that the question of the employee's reliance on the parent's assertions that it will file or has filed a full and complete FBAR (which should arise only if the filing was not in fact done) should be framed as a question of whether the employee knew or should have known that a full and accurate filing would not be done.

(c) *Holders of trust powers*

There is significant uncertainty as to whether a holder of a power of appointment over a trust is considered to have "signature or other authority" over a foreign financial account held by the trust. A power of appointment is a power, held by a person in a non-fiduciary capacity, to designate recipients of trust property. A power of appointment can be a so-called "general power of appointment," meaning that it may be exercised in favor of any person (including the holder of the power). Alternatively, a power of appointment can be a so-called "limited power of appointment," meaning that it may be exercised in favor of a specified class of persons. The class of persons who may be potential appointees in the case of a limited power may be very broad. For example, a common form of limited power of appointment allows a holder to exercise the power in favor of any person other than the holder, the holder's creditors, the holder's estate or the creditors of the holder's estate.

We believe that holders of powers of appointment over trusts with foreign financial accounts should be required to file FBARs reporting as described below:

(1) In the case of a power of appointment that is not presently exercisable (*e.g.,* the power is exercisable only upon the holder's death), the holder of the power should not be considered to have "signature or other authority" over a foreign financial account held by the trust. The holder has no present ability to direct distribution of property from the foreign account.

(2) In the case of a presently exercisable general power of appointment, the holder of the power should be treated as a beneficiary of the trust and subject to the FBAR rules that are applicable to trust beneficiaries (discussed above in Part VI.A.5). As described above, a holder of a general power of appointment has the ability to appoint the property in favor of the holder of the power. Accordingly, it is appropriate to think of the holder as a beneficiary of a trust for purposes of the FBAR rules.

(3) In the case of a presently exercisable limited power of appointment, it may be appropriate to treat the holder of the power as having "signature or other authority" over a foreign account held by the trust. If a United States person has a power to appoint funds held in a foreign financial account of the trust, and the trust has no other United States connection that would necessitate FBAR filings (*e.g.,* the trust is not a domestic trust and has no trustee, grantor or beneficiary who is required to file an FBAR), it is unlikely that an FBAR filing by a holder of a power of appointment would alert the IRS to unpaid U.S. federal income taxes of the trust.[310] However, an FBAR filing by a holder of a power of appointment would apprise the IRS that a United States person has the power to direct the distribution of funds from a foreign account, which may be important in view of the USA PATRIOT Act's anti-terrorism goals. Accordingly, we believe that it may be appropriate to treat a holder of a presently exercisable limited power of appointment as having "signature or other authority" over a foreign account held by a trust and to require such foreign person to file an FBAR on this basis. In many cases, however, requiring the holder of power of appointment to file an FBAR will result in duplicative filings. Procedures that can be implemented to avoid duplicative filings are addressed above in Part VI.A.5.

(d) *Governmental employees*

As we discussed in Part V.H, we think consideration should be given to whether employees of government agencies should benefit from an exception similar to that of domestic banks, *i.e.,* whether they should be exempt from filing FBARs for accounts over which they have only signature or other authority and no financial interest (regardless of whether they receive a notification that their employer has filed an FBAR).

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[310] If a trust is not a domestic trust, the trust will be subject to U.S. federal income tax only on (1) fixed or determinable, annual or periodical income and (2) income that is effectively connected with a U.S. trade or business. As for fixed or determinable, annual or periodical income, the U.S. tax obligations of a foreign trust are required to be satisfied through withholding by the payor. As for effectively connected income, it is rare for a trust to directly operate a business. If a trust has effectively connected income through a U.S. pass-through entity, its U.S. tax obligations in respect of that income are required to be satisfied through withholding by the entity.

E. "Foreign"

The FBAR instructions echo the Treasury regulations' definition of the United States, including the fifty states, the District of Columbia, and the territories and possessions of the United States. The instructions further indicate that the geographical location of an account, not the nationality of the relevant financial institution, determines whether it is an account in a foreign country.

Several observations follow from this. First, an account with a U.S. person (*e.g.,* a domestic bank) can be a foreign financial account if the account is maintained at a branch in a foreign country. And similarly, an account with the U.S. branch of a foreign institution is not a foreign account. The consequence of this is that the determination of whether an account is foreign is not necessarily a simple one.

For example, as we have discussed elsewhere, a person might deposit funds with a domestic financial institution, but the domestic institution might (*e.g.,* for regulatory capital or other reasons) hold those funds offshore. The owner of the funds would have a relationship with a domestic financial institution, but the funds themselves would be reflected on books held in a foreign country. In a world in which financial assets are usually held in book-entry form, where an "account" exists may amount to nothing more than a question where a ledger is maintained, and we are confident that there will be many fact patterns where the answer to this question is arbitrary, uncertain, and/or unknown to the prospective filer.

As another example, assume for the sake of argument that an interest in an offshore investment vehicle is a financial account that, if foreign, must be reported on an FBAR. What is the geographical location of the account? Assume that the vehicle is organized under non-U.S. law, but that, as is often the case, its investment manager is based in the United States and maintains all of the fund's books and records, including the statements of the investors' equity, in the United States. While the fund vehicle is a foreign person for U.S. federal income tax purposes, tax rules are not applicable to the FBAR analysis. Under the FBAR rules, we think that it is reasonably clear that ***if*** an interest in the fund is a financial account, that financial account is domestic.

Indeed, as we have discussed in Parts IV.B.2 and VII.B.2(a), it is at least possible that the entity itself (and therefore its status as a "financial agency," if it is one) is simply "domestic" for FBAR purposes under the regulations. Again, we do not think that is at all clearly the case under current law, but unlike the question of what is a "domestic corporation" or a "domestic partnership" that must file an FBAR, we know of nothing in the instructions that attempts to or manifestly does contradict the statement in the regulation that in this context (of what is a "foreign financial account"), "domestic" means "doing business within the United States." Indeed, more specifically, the regulation provides that a

"foreign financial agency" (again, assuming for this purpose that the investment fund is a financial agency) is "[a] person acting outside the United States for a person . . . ."[311] It is therefore not at all clear, technically, that the investment described above is a "foreign" account. We suspect the intent of Treasury and the IRS is that it is, but we think that intent needs to be "distinctly expressed" in order to override the regulation.[312]

We are inclined to think it would make sense to treat accounts as foreign when they are maintained at "foreign" (i.e., non-U.S.-domiciled) institutions, unless those accounts are ***both*** in the United States (*e.g.,* at a U.S. branch) ***and*** subject to U.S. regulatory oversight. This would, we think, exclude from filing obligations domestic accounts of foreign banks but not (***if*** they are determined to be financial accounts) equity interests in investment vehicles.

In any event, we believe it is important to ensure that accounts maintained by U.S. financial institutions ***in secrecy or anonymity jurisdictions*** be treated as foreign accounts.

F. Information To Be Reported

Generally, persons required to file FBARs must report their identities, including their TINs (or "official foreign government document" numbers, such as passport numbers) and, for each foreign account in which they have a financial interest or over which they have signature authority, the "maximum value" (discussed further below) of the account, the type of account and the institution where the account is held.[313] If a filer jointly holds a financial interest in the account, the name of the principal joint owner and the number of joint owners must also be reported.[314] In addition, for accounts in which a filer has no financial interest but only signature or other authority, the filer must disclose the identity of the record owner or legal title holder of the account,[315] even if the account owner is not a U.S. person.[316]

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[311] 31 C.F.R. Section 103.11(p).

[312] *Id.* Section 103.11.

[313] 2008 FBAR Form.

[314] *Id.* Part III.

[315] *Id.* FBAR Form, Part IV.

[316] Prior to 2008, a person filing based on signature or other authority did not need to disclose the identity of non-U.S. owners. 2000 FBAR Instructions, Item 26. In lieu of supplying information about the owner, the filer needed only to write "No U.S. person had any financial interest in the foreign account." *Id.* This exception for non-U.S. owners was removed in the 2008 revision of the FBAR and its instructions. *See* Part IV.B.2.

Companies that file consolidated FBARs must include the information described above, and must also report the identities of the accounts' owners.[317] Consolidated filers are not required to report the identities of the companies included in the consolidated filing if those companies are not financial account owners.

1. Maximum value

The maximum value of a financial account is the largest amount of currency or nonmonetary assets that appears on any quarterly or more frequent statement issued for a calendar year. If periodic statements are not issued, the maximum value is the largest amount of currency and non-monetary assets in the account at any time during year.[318] However, the value of stock, other securities or other non-monetary assets is their fair market value at the end of the calendar year, or if withdrawn from the account, at the time of withdrawal.[319] Thus, it is not clear how one should value a financial account containing securities (which are to be valued at calendar year end) and for which periodic statements of net asset value are not issued.

An alteration of the calculation of the maximum value of the assets in a financial account will provide the IRS with a more consistent and more accurate set of information. If the IRS is looking for data on the highest value of monetary assets in an account, it would make sense for the IRS to want to know the highest fair market value of nonmonetary assets during the reporting period, rather than the fair market value on an arbitrary date (*e.g.*, December 31). If periodic statements of value are issued, filers can as easily find and report the highest fair market value of nonmonetary assets based on those statements as they could report the value of monetary assets.

If periodic statements of value are not issued, then it becomes the filer's responsibility to know the value of the assets in the financial account. Valuation is simple for monetary assets, but it can be very complicated to determine the maximum fair market value of assets such as non-publicly traded securities. For relatively illiquid assets, one definite date on which valuation must be determined creates the most manageable valuation burden for filers. Though this will not provide the IRS with the most accurate maximum value of relatively illiquid assets, illiquid assets, by definition, cannot be quickly cashed in and used for illegal purposes. As discussed above, these are likely not the assets about which the government is worried, and thus a sacrifice in accuracy in favor of reducing the filing burden might be justified.

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[317] 2008 FBAR Form, Part V.

[318] *Id.* Item 15; I.R.M. Section 4.26.16.3.6.

[319] 2008 FBAR Form, Item 15.

2. TINs

There are many "United States persons" who do not have and may not be able to get a TIN. For example, U.S. citizens by virtue of birth who have never lived in the United States often cannot get social security numbers. Similarly, foreign entities (which until now had not been required to file FBARs) may not have or be able to provide official foreign government document numbers. We think it clear that a procedure must be implemented and made readily available by which "United States persons" with no other available identifying number can receive a U.S. identifying number, along the lines of the "individual TIN" or "ITIN" procedure available under the tax law for, *e.g.,* foreign persons claiming treaty benefits.[320]

3. 25 accounts

Filers with financial interests in or signature or other authority over 25 or more accounts are subject to abbreviated filing obligations. In this case, the filer need only check a box, enter the total number of financial accounts and retain records of the financial accounts for five years.[321] In addition, if the filer has no financial interest in the accounts, the filer must also identify the owners of the accounts.[322] The filer need not disclose any of the other information discussed above.

We recommend the elimination of these abbreviated filing rules. When this exception was first promulgated in the 1970s, it likely greatly reduced the burden on both FBAR filers and the IRS. Few filers had access to word processing equipment, and filling out large numbers of FBARs by typewriter would be onerous. The IRS would then have to sort, file and potentially read millions of physical pages of reports. If our other proposals were adopted (including in particular our proposals to minimize duplicative filings, increase the minimum value threshold and permit electronic filings), the burdens on filers and the IRS would be greatly diminished, so that we think the benefits of abbreviated filings would no longer outweigh the burdens associated with the loss of potentially important information regarding foreign financial accounts. Indeed, in this regard, it is not clear why filers with more than 25 accounts should categorically be presumed to be less suspicious than filers with fewer accounts.

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[320] *See* Form W-7. *See, e.g.,* Rev. Proc. 2006-10, 2006-1 C.B. 293.

[321] 2008 FBAR Form, Item 14.

[322] IRS, *FBAR Reporting by Persons with Only Signature Authority or Other Comparable Authority*, 265 Headliner (Apr. 2, 2009) *available at* *H*http://www.irs.gov/businesses/small/selfemployed/article/0,,id=206219,00.htmlH (last visited Oct. 23, 2009).

In fact, ***individuals*** – at least – with a financial interest in 25 or more foreign financial accounts would seem likely to be ***more*** suspicious than other filers.

4. Account values

We propose that the IRS restore the original requirement that taxpayers report the value range of their foreign accounts during the calendar year reported instead of the maximum value of the account. The Original FBAR required taxpayers to indicate the range in which the maximum value of their account fell, but did not require reporting of the exact value. That reporting method persisted through 2007; however, without notice, the 2008 FBAR Form required filers to disclose exact values.

Range reporting is clearly of use to law enforcement. The IRS currently uses range reporting in the voluntary disclosure program for undeclared offshore income, which allows taxpayers to voluntarily disclose their unreported taxable income, resolve their tax liabilities and minimize their chances of criminal prosecution.[323] Requiring a filer to disclose the maximum value of an account does not further the goal of gathering "highly useful" information for law enforcement officials, but can create a substantial burden on filers with multiple accounts. As discussed above, although the rules are unclear, if periodic statements are not issued, the maximum account asset value may be equal to the largest amount of currency and non-monetary assets in the account at any time during the year. [324] Very often, the filer does not have information as to the maximum value of an account on a daily basis. The reporting of value ranges would better balance the goals of information gathering against avoiding unreasonable burdens on filers.

5. Beneficial owner information

If the FBAR is to be used principally as a weapon in tax-crime investigation and enforcement, then the government might consider requiring disclosure of the identities of not only the legal owners of foreign financial accounts but also (when known) the beneficial owner(s) thereof for tax purposes. Requiring the reporting of beneficial owners of foreign financial accounts would allow the IRS to better enforce the FBAR requirements. As discussed in Parts II.B.3 and VI.A, we think this would be the most efficient way to permit "cross-checking" of foreign account information against the tax returns of any U.S. beneficial owners of those accounts' income, to make sure the beneficial owners are reporting income appropriately. However, it is important to note that the

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[323] *See* IRS, *Voluntary Disclosure: Questions and Answers*, A.6 (follow link to form letter), at Hhttp://www.irs.gov/newsroom/article/0,,id=210027,00.htmlH (last visited Oct. 23, 2009).

[324] I.R.M. Section 4.26.16.3.6.

determination of who owns an account, and more specifically its income, for U.S. tax purposes, can be an enormously complicated analysis. It would be inappropriate and indeed impossible to require FBAR filers to do more in this regard than state what they know, if they know anything at all, about the "true" owner(s) of an account. Anything beyond that, including any duty of inquiry and any liability if the information is inaccurate or incomplete, would be extraordinarily burdensome, expensive and inadministrable. Thus any efforts along these lines should be undertaken with a great deal of caution to ensure that FBAR filers are not unduly burdened.

G. Procedure

1. Background

The FBAR filing process is rather simple, but also fairly rigid. Filers must file their FBARs on paper, listing only three accounts per page, and either mail the FBARs early enough so that they arrive at Treasury's office in Detroit – or hand deliver the FBARs to an IRS office for forwarding to Detroit – on or before June 30 of the following years. Financial account information in the report is based on the previous calendar year.[325] Filing deadline extensions are not available, and, as discussed above, electronic filing is not an option.[326]

As discussed in Parts III and IV.F, the penalties for delinquent filing can be harsh, which highlights the need for accuracy in penalty assessment and appeals. The administrative appeals process is far from transparent, though internal IRS guidance sheds some light on the process.[327] If the IRS determines that a person has violated the FBAR requirements and proposes a penalty, the IRS sends to the delinquent filer Letter 3709, a letter proposing penalties, and Form 13449, the FBAR Agreement to Assessment and Collection.[328] If the person agrees to the penalties, the person signs and returns Form 13449 and pays the penalties.

A person who does not agree to the FBAR penalties proposed by the IRS may per the instructions in Letter 3709 appeal within 45 days of receiving the assessment by mailing a written protest to the examiner that includes the information requested.[329] If there is no related income tax investigation, or the proposed change arising from the related income tax investigation is agreed to,

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[325] *See* 2008 FBAR Form.

[326] *See id.*

[327] I.R.M. Section 4.26.17.4.3.

[328] *Id.* Section 4.26.17.4.3-7.

[329] *Id.* Section 4.26.17.4.6. Letter 3709 appears to be unavailable on the IRS website; thus it is unclear what information a protesting filer must include with hir written protest.

the appeals officer will then contact the Appeals FBAR Coordinator[330] and follow the procedures in "Foreign Bank and Financial Accounts Requirements Guidance for Appeals Officers."[331] These procedural instructions, like Letter 3709, are not available on the IRS Appeals website.

If the IRS assesses an FBAR penalty in spite of the filer's protest, it is not clear what recourse the filer has other than refusing to pay and risking being sued in a federal district court. The Tax Court has said that it does not have jurisdiction to review imposition of FBAR penalties, because its grant of power comes from Title 26, and the FBAR penalties in Title 31 have not been made subject to the procedural rules of Title 26.[332] Neither does the IRS believe that the administrative appeals process that applies to taxpayers may be relied on by people protesting FBAR penalties.[333] Thus the extent to which the administrative appeals process exists with regard to FBAR penalties is unclear.

2. Discussion and proposals

(a) *General*

As discussed in detail in our September 10 report, we recommend that taxpayers be required to file FBARs with their tax returns pursuant to all the procedural processes of the income tax rules but subject to a legislative FBAR exception to the Section 6103 tax return confidentiality requirements.[334] We make that recommendation because we think it would improve compliance with the regime (*i.e.,* assuming the regime as written "makes sense"). As we have discussed throughout this report, particularly in Parts II.B.4 and VI.A, we would prefer an approach that requires ***one*** person (in all likelihood, one who ***isn't*** the

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[330] *Id*. 4.26.17.4.7. FBAR cases are included in the Appeals Coordinated Issue Program. *See* IRS, *Appeals Coordinated Issues (ACI)*, *available at* Hhttp://www.irs.gov/individuals/article/0,,id=108652,00.htmlH (last visited Oct. 23, 2009).

[331] I.R.M. Section 4.26.17.4.7(5). "Foreign Bank and Financial Accounts Requirements Guidance for Appeal Officers" is not easily accessible from the IRS Appeals website, if it is accessible at all.

[332] *See Williams v. Commissioner*, 131 T.C. No. 6, at 12 (Oct. 2, 2008) ("The Tax Court has no jurisdiction to review the Secretary's determination as to petitioner's liability for FBAR penalties.").

[333] *See* I.R.M. Section 4.26.16.4.1(2) ("When [assessing FBAR penalties], the IRS is not acting under Title 26 but, instead, is acting under the authority of Title 31. Provisions of the Internal Revenue Code generally do not apply to FBARs.").

[334] *See* New York State Bar Association Tax Section, *Report on Qualified Intermediary and Related Withholding and Information Reporting Legislation Proposed by the Administration*, at 45-51 (Report No. 1189, Sept. 10, 2009), *available on the NYSBA Tax Section website at H*http://www.nysba.org/Content/ContentFolders20/TaxLawSection/TaxReports/1189Rpt.pdfH (last visited Oct. 23, 2009).

beneficial owner of an account for tax purposes) to file an FBAR with respect to that account, and that requires the person(s) with beneficial interests in the account to report the accounts on their tax returns (or, if they are not required to file tax returns, on FBARs).

Should the proposal to file FBARs with tax returns be rejected, or until a legislative FBAR exception to Code Section 6103 confidentiality is adopted, we propose adopting some, though preferably all, of the following specific procedural changes to the FBAR filing process. First, we recommend making the FBAR regime subject to procedures analogous to those in Title 26, including permissive electronic filing for all filers, with mandatory electronic filing for large institutions. We also urge the IRS to reconsider permitting reporting based on a fiscal rather than a calendar year. (To be clear, these recommendations address procedural issues only; under this approach, the FBAR would remain a Title 31 filing obligation, but a parallel set of procedures would be adopted for FBARs that mirror the Title 26 procedures to the extent permitted by statute.)

Including FBARs with (but not as part of) tax returns and making FBAR filing subject to the procedures of Title 26 will facilitate IRS's ability to enforce the FBAR regime. The IRS is obviously very familiar with the detailed enforcement procedures in Title 26, which means that the IRS will not need to create or adopt another set of procedural rules in order to enforce the FBAR requirements and handle FBAR penalty appeals. In addition, linking the FBAR filing system to tax return procedures will relieve some of the administrative burden on the IRS by allowing for electronic FBAR submissions, which are more easily processed than paper submissions.

Filing the FBAR with tax returns will also facilitate and encourage compliance with the filing process. Filers are very aware of their tax return filing obligations, and we think the mere fact of not having to remember to file another form at a different date will increase compliance significantly. Taxpayers and their advisers are also fairly familiar with the tax return filing, audit and appeals processes. The burden placed on FBAR filers would be greatly reduced by requiring filing according to the procedures in Title 26, including allowing filers to file electronically, to take advantage of the mailbox rule, to file based on their fiscal years and to extend the FBAR filing deadline.

We would also propose, again if our suggestion to adopt the procedural framework of Title 26 *in toto* is not accepted, that the IRS allow extensions for FBAR filing and adopt a mailbox rule. The IRS currently permits automatic six-month extensions of tax return filing deadlines for individuals.[335] There are

[335] Form 4868 (2008).

similar automatic extensions of time to file corporate and other tax returns.[336] The IRS could easily model its FBAR extension forms after its existing income tax extension forms.

There may be an argument that the information required by the FBAR is more time-sensitive than tax return information because part of the purpose of the FBAR is to discover and apprehend financial criminals and terrorists, whereas the purpose of tax return filing is to ensure that filers accurately pay their taxes. In addition, the income tax system discourages filing extensions by imposing interest on taxes due but not yet paid.[337] However, an FBAR filing extension could incorporate something like the income tax penalties to discourage filing deadline extensions.

Adopting a mailbox rule for FBAR filings would equalize the treatment of income tax return filers and FBAR filers while simplifying the filing rules. Code Section 7502(a)(1) prescribes the "mailbox rule," which considers a tax return filed as of, and the date of payment to be, the date of the U.S. postmark. No similar rule currently exists for FBAR filings. Adopting a mailbox rule for FBAR filings would likely increase compliance by FBAR filers who are already familiar with income tax filing requirements.

The proposal to file an FBAR based on the fiscal year, rather than on the calendar year, would also improve the FBAR regime. This proposal may be significantly more important if investment vehicles or other entities are determined to be treated as foreign financial accounts, because it is at least possible that those entities might be inclined to report financial information to their owners based on the owners' fiscal years. In any event, the requirement to report the maximum value of a financial account during a calendar year can be extremely burdensome for accounts containing non-monetary assets. For example, filers who receive no periodic statements of value for foreign financial accounts containing non-publicly traded securities may well, for a variety of reasons (accounting, regulatory capital, tax, other), need to engage in the complex process of valuing these securities based on their fiscal years. To require an additional valuation of these securities based on a calendar year could impose a substantial burden on these filers to engage in this complex process a second time. In addition, we simply find it arbitrary and confusing for FBAR filers who are also taxpayers (particularly if the FBAR is made part of the tax return, or if our proposal to report information regarding foreign accounts on tax returns is

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[336] *See, e.g.,* Form 7004 (rev. Dec. 2008) (providing that five-month and six-month extensions are available depending on the form required to be filed). There are additional extension forms for various types of taxpayers and situations. *See* IRS, *Extension of Time to File Your Tax Return*, at Hhttp://www.irs.gov/formspubs/article/0,,id=98155,00.htmlH (last visited Oct. 23, 2009).

[337] *See, e.g.,* Instructions to Form 4868 (2008).

adopted) to be required to calculate income on a fiscal-year basis but account values on a calendar-year basis.

We do not believe that adopting the procedural framework of Title 26 for FBAR filing and processing would require legislation, although it is evident that either legislation or regulation would be needed to permit the Tax Court to hear disputes regarding the FBAR.

We also recommend that the IRS reevaluate the Paperwork Reduction Act notice provided at the bottom of the first page of the FBAR form. The IRS suggests that "the estimated average burden associated with this collection of information is twenty minutes per respondent or record keeper . . . ."[338] This estimation is in many circumstances grossly inaccurate. In a comment letter discussing the issue, one accountant revealed that he spent an estimated total of three hours and twenty minutes ***per form*** for clients who had endowments with offshore investment partnerships.[339] Many filers face a burden of hundreds or thousands of hours to compile the necessary information, especially in the case of consolidated filers and filers who have signature authority over a large number of foreign accounts. In addition to filling out the form, evaluating the treatment of particular accounts under particular circumstances in the face of unclear instructions can significantly increase the total time spent filing. We propose revising the estimated average burden to reflect accurately the average amount of time filers can expect to spend in preparing the FBAR form.

(b) *Penalties*

The new FBAR penalty language, discussed in Part IV.F, presents several interpretational issues. First, there is some confusion regarding whether the statutory reasonable cause exception applies to both willful and non-willful violations. The statute clearly states that the reasonable cause exception does not apply to willful violations.[340] However, the IRS has published internal guidance stating that the willfulness penalty should not be asserted if the violation is due to reasonable cause.[341] We think the internal guidance should clarify that it is merely an expression of intent to use discretion in assessing the willfulness penalty.

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[338] 2008 FBAR Form.

[339] Letter from Peter S. Kennedy to IRS (June 30, 2009), reprinted in 2009 TNT 174-16 (Sept. 11, 2009).

[340] *See* 31 U.S.C. Section 5321(a)(5)(C)(ii) (providing that the reasonable cause exception "shall not apply" in the case of any person willfully violating the FBAR requirements). *See also* Toscher & Stein, *FBAR Enforcement – An Update*, *supra* note 149, at 59.

[341] *See* I.R.M. Section 4.26.16.4.5.3(4).

In addition, a possible reading of the statutory reasonable cause exception is that if a filer has a reasonable cause for not filing the FBAR, the filer will benefit from the reasonable cause exception only if the filer files an FBAR at some later date. That is because the statute requires both that the failure to file be due to reasonable cause, and that "the amount of the transaction or the balance in the account at the time of the transaction was properly reported."[342] Because the FBAR is used for non-tax enforcement purposes as well as for tax enforcement purposes, it is not clear whether the "proper reporting" means reporting for tax purposes; in any event, tax reporting would not necessarily report a transaction. In other words, the exception may apply only for late filings with reasonable cause for the lateness. However, neither the statute nor internal IRS guidance specifies whether the filer must file a late FBAR ***before*** the IRS recognizes that the FBAR is late, as would typically be the case in connection with tax penalties.[343] This raises the question whether a filer could benefit from the reasonable cause exception by filing an FBAR after the IRS has learned of the error.[344] If it was intended that the filer be required to file without prompting from the government in order to establish reasonable cause, this should be made clear.

Moreover, the statutory language does not clearly define whether a person who reasonably fails to file an FBAR with respect to an account but reports the *income* from the foreign account on some form other than an FBAR may benefit from the reasonable cause exception. Internal IRS guidance interprets the reporting prong of the reasonable cause exception merely to require the delinquent filer to file all missing FBARs with the IRS before the penalty will be waived.[345] However, we think consideration should be given to whether it is appropriate to take account of other types of voluntary reporting in determining whether the reasonable cause exception is available.

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[342] *See* 31 U.S.C. Section 5321(a)(5)(B)(ii)(II).

[343] *See generally* Hale E. Sheppard, *Evolution of the FBAR: Where We Were, Where We Are, and Why It Matters*, 7 HOUS. BUS. & TAX L.J. 1, 33-37 (2006).

[344] This result actually might make sense because the FBAR regime has no mailbox rule. Suppose an FBAR filer properly fills out the FBAR and mails it to the IRS, but the form gets lost *en route* and is never received. The filer has failed to file the FBAR, but would have no way of knowing that until the receipt of a notice of the failure from the IRS.

[345] I.R.M. Section 4.26.16.4.4(2)(b).

Form **4683**
(December 1970)
Department of the Treasury
Internal Revenue Service

U.S. Information Return on Foreign Bank, Securities, and Other Financial Accounts

▶ Attach to your tax return.

For the calendar year 19..... or other taxable year beginning ....., 19....., and ending ....., 19.....

Complete this form showing your relationship during the taxable year to one or more bank, securities or other financial accounts in foreign countries. Use additional sheets if necessary.

Name(s) as shown on return	Tax identifying number (Social security number or employer identification number if other than individual)	Check type of return
		☐ Individual ☐ Partnership ☐ Corporation ☐ Small business corporation ☐ Fiduciary

NOTE: Ownership of 50% or less of the stock of any corporation which owns one or more foreign accounts is not a "financial interest" in these accounts and need not be reported by the shareholder. Accounts in a U.S. military banking facility operated by a U.S. financial institution are not foreign accounts and need not be reported.

If you wish, you may also submit any other information or explanation not required by this form concerning your interest in or authority over an account.

Part I **Check all appropriate boxes. See instruction F for definition of "financial interest." Use additional sheets if necessary.**

1. ☐ I had signature authority or other authority over one or more foreign accounts, but I had no "financial interest" in such accounts (see instruction I). Indicate for these accounts:

   Name and tax identifying number (if any) of each owner

   Address of each owner

   (Do not complete Part II for these accounts.)

2. ☐ I had a "financial interest" in one or more foreign accounts, but the total maximum value of these accounts (see instruction H) did not exceed $10,000 at any time during the taxable year. (If you checked this box, do not complete Part II.)

3. ☐ I had a "financial interest" in 25 or more foreign accounts. (If you checked this box, do not complete Part II.)

4. ☐ I had a "financial interest" in one or more but less than 25 foreign accounts, and the total maximum value of these accounts (see instruction H) exceeded $10,000 during the taxable year. **(If you checked this box, complete Part II.)**

Part II **Complete this part ONLY if you checked item 4 and only for each account identified in item 4. Use a separate form for each account or your own schedule to provide the required information.** To avoid duplicate reporting with respect to accounts owned by a corporation, partnership or trust which is required to file this form, you may follow the procedure in instruction J by checking this box ☐ and completing the statement on the back of this form.

5. Name in which account is maintained	6. Name of bank or other person with whom account is maintained
7. Number and other account designation, if any	8. Address of office or branch where account is maintained

9. Type of account. (If not certain of English name for the type of account, give the foreign language name and describe the nature of the account. Attach additional sheets if necessary.)

   ☐ Savings, demand, or checking ☐ Securities ☐ Other (specify) .....

10. Maximum value of account (see instruction H)

   ☐ Under $50,000 ☐ $50,000 to $100,000 ☐ Over $100,000 ☐ Unable to determine (attach explanation)

Instructions

A. Who Must File a Return.—Each United States person who has a financial interest in or signature authority or other authority over a bank, securities, or other financial account in a foreign country at any time during a taxable year beginning on or after January 1, 1970, must report that relationship for each taxable year. Do this by checking the appropriate box on the Form 1040, 1041, 1065, 1120, 1120L, 1120M, or 1120S you file for the taxable year and by filing with that return an information return on Form 4683 for that year.

B. United States Person.—The term "United States person" means (1) a citizen or resident of the United States, (2) a domestic partnership, (3) a domestic corporation, and (4) a domestic estate or trust.

C. Account in a Foreign Country.—A "foreign country" includes all geographical areas located outside the United States, its possessions, and Puerto Rico.

Report any account maintained with a branch, agency, or other office of a bank (except a military banking facility as defined in instruction D) or broker or dealer in securities that is located in a foreign country, even if it is a part of a United States bank or other institution. Do not report any account maintained with a branch, agency, or other office of a foreign bank or other institution that is located in the United States, its possessions, or Puerto Rico.

D. Military Banking Facility.—Do not consider as an account in a foreign country an account in an institution known as a "United States military banking facility" (or "United States military finance facility") operated by a United States financial institution un-

(Continued on back)

der designation by the United States Treasury to serve U.S. Government installations abroad, even if the United States military banking facility is located in a foreign country.

E. Bank, Securities, or Other Financial Account.—The term "bank account" means a savings, demand, checking, deposit, loan, or any other account maintained with a person engaged in the business of banking. It includes certificates of deposit.

The term "securities account" means an account maintained with a person who buys, sells, holds, or trades stock or other securities for the benefit of another.

The term "other financial account" means any other account maintained with any person who accepts deposits, exchanges or transmits funds, or acts as a broker or dealer for future transactions in any commodity on (or subject to the rules of) a commodity exchange or association.

F. Financial Interest.—A financial interest in a bank, securities, or other financial account in a foreign country means an interest described in either of the following two paragraphs:

(1) A United States person has a financial interest in each account for which he is the owner of record or has legal title, whether the account is maintained for such person's own benefit or for the benefit of others including non-United States persons. If an account is maintained in the name of two persons jointly, or if several persons each own a partial interest in an account, each of those United States persons has a financial interest in that account.

(2) A United States person has a financial interest in each bank, securities, or other financial account in a foreign country for which the owner of record or holder of legal title is: (a) a person acting as an agent, nominee, attorney, or in some other capacity on behalf of the U.S. person; (b) a corporation in which the United States person owns directly or indirectly more than 50 percent of the voting stock or more than 50 percent of the total value of shares of stock; (c) a partnership in which the United States person owns an interest in more than 50 percent of the profits (distributive share of income); or (d) a trust in which the United States person either has a present beneficial interest in more than 50 percent of the assets, or from which such person receives more than 50 percent of the current income.

G. Signature or Other Authority Over an Account.—

Signature Authority.—A person has signature authority over an account if he can control the disposition of money or other property in it by delivery of a document containing his signature (or his signature and that of one or more other persons) to the bank or other person with whom the account is maintained.

Other authority exists in a person who can exercise comparable power over an account by direct communication to the bank or other person with whom the account is maintained, either orally or by some other means.

H. Account Valuation.—For items 2, 4, and 10, the maximum value of an account is the largest amount of currency and non-monetary assets that appears on any quarterly or more frequent account statement issued for the applicable taxable year. If periodic account statements are not so issued, the maximum account asset value is the largest amount of currency and non-monetary assets in the account at any time during the taxable year. Convert foreign currency by using the official exchange rate at the end of the taxable year. In valuing currency of a country that uses multiple exchange rates, use the rate which would apply if the currency in the account were converted into United States dollars at the close of the taxable year.

The value of stock, other securities or other non-monetary assets in an account reported on Form 4683 is the fair market value at the end of the taxable year, or if withdrawn from the account, at the time of withdrawal.

For purposes of items 2 and 4, if you had a financial interest in more than one account, each account is to be valued separately in accordance with the foregoing two paragraphs.

If you had a financial interest in one or more but less than 25 accounts, and you are unable to determine whether the maximum value of these accounts exceeded $10,000 at any time during the taxable year, check item 4 (do not check item 2) and complete Part II for each of these accounts.

I. United States Persons with Only Authority Over but No Interest in an Account.—Except as provided in the following paragraph, you must state the name, address, and tax identifying number (if any) of each owner of an account over which you had authority, but if you check item 1 for more than one account of the same owner, you need identify the owner only once.

If you check item 1 for one or more accounts in which no United States person had a financial interest, you may state on the first line of this item, in lieu of supplying information about the owner, "No U.S. person had any financial interest in the foreign accounts." This statement must be based upon the actual belief of the person filing this form after he has taken reasonable measures to ensure its correctness.

If you check item 1 for accounts owned by a domestic corporation and its domestic and/or foreign subsidiaries, you may treat them as one owner and write in the space provided, the name of the parent corporation, followed by "and related entities," and the tax identifying number and address of the parent corporation.

J. Avoiding Duplicate Reporting.—If you had a financial interest (as defined in instruction F(2)(b), (c) or (d)) in one or more accounts identified in item 4 which are owned by a domestic corporation, partnership or trust which is required to file Form 4683 with respect to these accounts, in lieu of completing items 5 through 10 for each such account you may check the box in the introduction to Part II and fill in the statement below.

K. Providing Additional Information.—Any person checking one or more boxes of Part I of this form, when requested by the Internal Revenue Service, shall provide information concerning each account reported in Part I that is necessary to determine such person's Federal income tax liability.

L. Penalties.—For criminal penalties for failure to file a return or to supply information, and for filing a false or fraudulent return, see sections 7203 and 7206 of the Internal Revenue Code.

Statement (Pursuant to Instruction J) Relating to a "Financial Interest" in Foreign Accounts Owned by a Domestic Corporation, Partnership or Trust

I had a "financial interest" in one or more foreign accounts owned by a domestic corporation, partnership or trust which is required to file Form 4683.

Name and tax identifying number of each such corporation, partnership or trust.....

Address of each such corporation, partnership or trust.....

(Do not complete items 5 through 10 on the front of this form for these accounts.)

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