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Client Alert

IRS Includes Foreign Fund Investors Among Those Required to File FBAR Returns

Each U.S. person who has a financial interest in or signature or other authority over any foreign financial account, where the aggregate value exceeds \$10,000 at any time during the calendar year, must report the financial account by filing a form with the Department of Treasury. This form, commonly known as an FBAR¹, generally must be filed on or before June 30th of the succeeding calendar year. The term ‘U.S. person’ includes, among others, U.S. citizens, U.S. residents and domestic business entities.

According to the instructions to the recently revised FBAR form,² a ‘financial account’ includes “any bank, securities, securities derivatives or other financial instruments accounts. Such accounts generally also encompass accounts in which the assets are held in a commingled fund, and the account owner holds an equity interest in the fund (including mutual funds). The 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 other person engaged in the business of a financial institution. Individual bonds, notes, or stock certificates held by the filer are not a financial account nor is an unsecured loan to a foreign trade or business that is not a financial institution.” The geographical location of the account and not the nationality of the financial institution determines whether the account is considered ‘foreign’. Accordingly, accounts held by foreign affiliates of U.S. banks are covered.

In recent teleconferences with practitioners, the IRS expressed the view that an offshore hedge fund was a foreign financial account for which FBAR reporting was required by any U.S. person with a greater than \$10,000 interest in that fund, or ‘signature authority’ in relation to the fund. The IRS has gone on to explain that, in the IRS’s view, hedge funds are much like mutual funds in that they are investment vehicles. Presumably, the IRS would also view an appropriate investment in a foreign private equity fund as a reportable financial account for the purposes of FBAR filing. The IRS has also recently stated that FBAR filing is required for any U.S. person who has an interest in a foreign retirement account similar to a 401(k) account in the U.S.

The IRS’s opinion that a foreign hedge fund falls within the definition of reportable financial account and the fact that private equity funds will probably also fall within the IRS’s definition will mean that U.S. investors, including tax exempt entities, that invest in offshore hedge funds and private equity funds will need to file the FBAR form for the 2008 tax year.

¹ Treasury Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts

² The form and instruction may be found on line at: <http://www.irs.gov/pub/irs-pdf/f90221.pdf>

The FBAR is generally required to be filed no later than June 30 of the year following the calendar year to which it relates. The instructions for this form do not make this clear, but the FBAR must be *received* by the Treasury Department by June 30th, instead of being postmarked by that date. However, the IRS has extended the deadline for the 2008 filing until September 23, 2009 for those taxpayers who have “only recently learned” of the FBAR filing requirement, have reported and paid all their taxes and do not have sufficient time before June 30 to gather the necessary information to complete the FBAR. September 23 is also the last date for taxpayers to participate in the IRS’s voluntary disclosure initiative relating to offshore financial accounts, which was discussed in our Client Alert dated June 4, 2009 (which can be viewed at our website: www.golenbock.com).

A U.S. person has ‘signature authority’ over a financial account if that person can control the disposition of money or other property in the financial account by delivering a document with his or her signature on it to the bank or other person who maintains the account. Alternatively, signature authority will exist if the U.S. person exercises comparable power over a financial account by directly or indirectly communicating with the bank or other person who maintains the account. This wide definition of signature authority means that corporate directors and officers, as well as partners and LLC members, may fall within this definition and therefore be required to file an FBAR. Exceptions are provided for officers of certain large or publicly traded corporations.

Although there is some question as to whether the IRS’s interpretation of ‘financial account’ is too broad, in light of the severe penalties for failure to file the FBAR form (up to \$10,000 for each violation without reasonable cause and the greater of \$100,000 or 50% of the balance of the account for willful violations), we recommend that U.S. investors make the FBAR filings. Specifically the following U.S. persons should consider filing:

- Investors (including tax exempt investors) in offshore hedge funds, including offshore feeder and master-feeder hedge funds;
- Feeder funds that invest in offshore master funds and U.S. investors that own more than 50% of such U.S. feeder funds;
- Direct investors in offshore master funds;
- Investors in offshore private equity funds;
- Investment managers with financial interests through so-called ‘profit’ or ‘carried’ interests in offshore hedge funds or private equity funds;
- Owners, of directly or indirectly, more than 50% of the stock (determined by voting power or value) of a corporation that owns a foreign financial account;
- Owners of more than 50% of the capital or profits interests of a partnership that owns a foreign financial account; and

- Beneficiaries of trusts in which the beneficiary has a present beneficial interest, either directly or indirectly, in more than 50 percent of the trust assets or from which the beneficiary receives more than 50 percent of the current income.

If you would like more information about the reporting of foreign bank and financial account or would like to discuss any particular set of facts, please contact:

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