FOREIGN BANK ACCOUNT REPORTS – 2011 REGULATIONS EXTEND RULES TO MANY UNAWARE PERSONS

By: Patrick W. Martin, Esq. and
Marta Guardia, Esq.

I. OVERVIEW

Treasury Form TD F 90-22.1 "***Report of Foreign Bank and Financial Accounts***"[1] the so-called "FBAR" must be filed by any "U.S. person" (now broadly defined by the new regulations) who has either (i) a "financial or other interest" in or (ii) "signature authority" over any financial account in a foreign country, if the aggregate value of the account or accounts exceed US$10,000 at any time during the calendar year. Accounts in U.S. banks in the U.S. are not included. The term financial account is broadly defined and includes any bank, securities, securities derivatives, or other financial instrument accounts. It also includes any savings, demand, checking, deposit, or other account maintained with a financial institution in addition to certain annuity and life insurance contracts, commodities and precious metals and safe deposit accounts. Importantly, only individuals can have "signature authority" over accounts. Individuals and entities can both have a "financial interest" in accounts.

The term "United States person" is defined as a citizen or resident of the U.S., a lawful permanent resident, any non-U.S. citizen who satisfies the so-called "substantial presence test" or any entity including but not limited to a corporation, partnership, trust or a limited liability company, created, organized or formed under the laws of the United States, any State, the District of Columbia, the Territories, an Insular possession of the United States or the Indian Tribes. In addition, certain beneficiaries of trusts and certain owners of companies or partnerships with foreign accounts also now have FBAR filing requirements. Further details regarding the newly expanded definitions are discussed later in this article along with various hypothetical scenarios that are used to demonstrate the law's very broad application.

Importantly, the FBARs must be filed by June 30th following the year in which the U.S. person has signature authority or a financial interest in the foreign account.

A. Harsh Penalties

Getting it right is important, since the penalties for not filing an FBAR are typically a minimum of US$10,000 for each account not reported (e.g., if there are 4 unreported accounts, that would be a US$40,000 penalty) to up to as much as 50% of the account balances in willful cases. Criminal penalties can also apply, which can include incarceration of up to 10 years. Further details regarding the penalties are discussed at the end of this article.

B. Overview of FBAR Reporting and Complexity

The next portion of this article provides some background of the FBAR law. The co-author had made various recommendations to the Treasury Department (which were largely not incorporated into the final regulations). See, Patrick W. Martin, ***State Bar Of California, Taxation Section International Tax Committee, Proposed Guidance On FBARs & Foreign Persons***.[2] The reader may skip over this portion to go directly to the latter portion that discusses hypothetical scenario of to whom the new FBAR reporting requirements now apply.

---

[1] www.irs.gov/pub/irs-pdf/f90221.pdf

[2] http://www.lacba.org/Files/Main%20Folder/Sections/Taxation/Files/2010%20Paper%20%28Martin%20Patrick%20re%20FBARs%29.pdf

Copyright @2011 Procopio, Cory, Hargreaves & Savitch LLP. All rights reserved.

Title 31 of the federal statutes is where the rules for FBAR filing requirements originated. Title 31 is not part of the federal tax laws which are found in Title 26, aka the "Internal Revenue Code" or "IRC".

Nevertheless, there are certain provisions of Title 31 that provide the statutory basis for the filing of the FBAR. The law is not new. It is part of the Bank Secrecy Act enacted in 1970. The regulations and scope of to whom FBAR reporting applies is new, since February 2011, applicable for years starting in 2010.

The government itself has been confused about the application of this law and not issued clear guidance until just this February, 2011. A 2002 report[3] to Congress from the U.S. Treasury that discussed the FBAR requirements, included the following key assertions from the government:

> *"Certainly there appear to be a number of taxpayers who fail to file because of lack of knowledge or confusion about the filing requirements. Education and outreach will go a long way toward reaching these people and improving their FBAR compliance."*

Update and Improve the FBAR Form and instructions

FinCEN will take responsibility for updating the FBAR form . . . and the accompanying instructions. Comments received from filers indicate to FinCEN that an updated form should:

- *eliminate duplication of information in the form;*
- *incorporate user-friendly instructions;*
- *use understandable definitions;*
- *develop a continuation sheet for use by multiple filers;*
- *address procedures for joint accounts with spouses and business partners; and*
- *include updated terminology and new types of financial transactions.*

Until updated regulations were issued on February 24, 2011, the law was not clear as to who needed to file this FBAR.

C. IRS Enforcement Efforts of FBARs

In April 2003, the Department of Treasury transferred authority to enforce the FBAR provisions from the Financial Crimes Enforcement Network (FinCEN) to the IRS.[5] Consequently, the IRS is now empowered to investigate potential violations, issue summonses, assess civil tax liabilities, issue administrative rulings, and take any other action reasonably necessary to enforce the FBAR rules.[6] Prior to this change, many very sophisticated employees and attorneys at the IRS were not even aware of these FBAR requirements in the law.[7]

Despite the unclearness as to whom is obligated to file the FBAR's, the chart below shows that after the enforcement of the FBAR provisions was transferred to the IRS, there has been a constant increase in the amount of people that have been filing FBAR's during the past years.

Year	**Number of filings**
2003	199,738
2004	218,667
2005	283,895
2006	287,356
2007	320,937
2008	344,967
2009	276,386
2010	594,488[4]

Confusion around the "FBAR law" was compounded by numerous notices and developments issued by the government as follows since the latter part of 2008:

---

[3] www.hsdl.org/?view&doc=14282&coll=limited
[4] FinCEN Annual Report Fiscal Years 2003, 2004, 2005, 2006, 2007, 2008, 2009, 2010.
[5] 68 Fed Reg. 26489 (5/16/03).
[6] 31 C.F.R. Section 103.56(g).
[7] 68 FR 26489 (May 16, 2003).

Copyright @2011 Procopio, Cory, Hargreaves & Savitch LLP. All rights reserved.

- **September 28, 2008:** IRS submitted new instructions to the FBAR form on its website expanding the application of the FBAR form to persons residing outside the U.S.;
- **October, 2008**: IRS publishes a revised FBAR form;
- **June 5, 2009:** 2009 IRS Announcement 2009-51 was issued, referring people to the definition of a "United States person" in the July 2000 FBAR instructions and effectively suspending the FBAR filings for certain foreign persons;
- **February 26, 2010**: IRS Announcement 2010-16 was issued, suspending the 2008 FBAR filing requirements for certain foreign persons;
- **February 26, 2010**: IRS Announcement 2010-23 was issued, clarifying various signature authority deadlines, etc;
- **February 26, 2010**: FinCEN announces proposed regulations regarding FBAR filing requirements;
- **February 24, 2011**: FinCEN issues final regulations;
- **March 21, 2011**: IRS posts revised FBAR instructions; and
- **March 26, 2011**: IRS publishes a revised FBAR form.
- **May 31, 2011**: FinCEN extends the filing date for the exceptions described in 31 CFR 1010.350(f)(2).

The point of the above analysis is to explain some of the extreme complexity for persons to even understand, if and when they might have an FBAR filing obligation. The regulations of February 24, 2011, now clarify many (but not all) of the open questions under the prior rules. The new regulations clarify that all U.S. citizens, including those who live exclusively outside the United States, must file and report their foreign bank accounts on an FBAR. There seems to be more than 4.1 million U.S. citizens residing overseas according to the most recent U.S. State Department estimates, which themselves are a bit outdated.[8]

II. FURTHER DETAIL REGARDING DEFINITIONS –

The 2011 FBAR regulations significantly expand the universe of persons who now have an FBAR filing requirement largely by expanding the definitions of (i) what is a "financial account"; (ii) who has "signature authority"; (iii) who has "a financial interest in"; and (iv) who is deemed to have a "financial interest in" the account of a legal entity. These are each discussed in more detail below.

A. "**Financial account**" is broadly defined and includes mutual funds, savings, demands, checking, 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. It also includes an account with a person who acts as a broker or dealer for futures or options transactions in any commodity on or subject to the rules of commodity exchange or association.[9]

B. "Foreign country" means any geographical areas located outside of the U.S.[10]

---

[8] In the mid-1990s, "The State Department estimates that there are approximately 3 million U.S. citizens living abroad, although thousands of these individuals may not even know that they are U.S. citizens." *See* Joint Committee on Taxation Report, J.C.S. 12-96: General Explanation of Tax Legislation Enacted in The 104th Congress (Expatriation Tax Provisions (Secs. 511-513)).
According to U.S. State Department data there were 4.1 million U.S. citizens living abroad in 1999 (see Table 1). Nearly one-quarter (1 million) of these people lived in Mexico, while 687,000 were in Canada. Other countries with large numbers of Americans included the United Kingdom (224,000), Germany (211,000), Israel (184,000), Italy (169,000), Philippines (105,000), Australia (103,000), France (102,000), and Spain (95,000). In fact, according to these State Department data, these ten countries contain about 70% of all U.S. citizens living abroad. Current estimates seem to be 4.1 million. See, **ESTIMATION OF EMIGRATION FROM THE UNITED STATES** by Jason P. Schachter, Ph.D. "There is currently no reliable estimate of the number of U.S. citizens living abroad. The U.S. State Department occasionally publishes data about U.S. nationals living abroad based on registrations at embassies and missions, but there are major questions concerning its validity."

[9] 31 C.F.R. Section 1010.350(c); *see also* FBAR instructions.

[10] 31 C.F.R. Section 1010.350(d).

Copyright @2011 Procopio, Cory, Hargreaves & Savitch LLP. All rights reserved.

C. **"Financial interest"** in a bank, securities or other financial account in a foreign country means any of the following:[11]

1. Owner of record or holder of legal title. A U.S. person has a financial interest in each bank, securities or other financial account in a foreign country for which he is the owner of record or has legal title whether the account is maintained for his own benefit or for the benefit of others. If an account is maintained in the name of more than one person, each U.S. person in whose name the account is maintained has a financial interest in that account.

2. Other financial interest. A U.S. 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 with respect to the account;

   b. A corporation in which the U.S. person owns directly or indirectly more than 50 percent of the voting power or the total value of the shares, a partnership in which the U.S. person owns directly or indirectly more than 50 percent of the interest in profits or capital, or any other entity (other than an entity in paragraphs (iii) and (iv) directly below) in which the U.S. person owns directly or indirectly more than 50 percent of the voting power, total value of the equity interest or assets, or interest in profits;

   c. A trust, if the U.S. person is the trust grantor and has an ownership interest in the trust for U.S. Federal tax purposes. *See* 26 U.S.C. 671-679 and the regulations hereunder to determine if a grantor has an ownership interest in the trust for the year; or

   d. A trust in which the U.S. person either have 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.

3. Anti-avoidance rule. A U.S. person that causes an entity, including but not limited to a corporation, partnership, or trust, to be created for a purpose of evading this section shall have a financial interest in any bank, securities, or other financial account in a foreign country for which the entity is the owner of record or holder of legal title.

4. Signature or other authority. Signature or other authority means the authority of an individual (alone or in conjunction with another) to control the disposition of money, funds or other assets held in a financial account by direct communication (whether in writing or otherwise) to the person with whom the financial account is maintained.[12]

5. No attribution rules. The attribution rules contained in the Internal Revenue Code (e.g., Sections 267 and 318) that create constructive ownership are not included or referenced in the FBAR regulations. As a consequence, in order to determine who has a reporting requirement in a corporation, partnership or trust, among others, the Internal Revenue Code rules of attribution should not be applied.[13]

---

[11] 31 C.F.R. Section 1010.350(e).
[12] 31 C.F.R. Section 1010.350(f).
[13] In general, IRC § 267 and 318 contain three attribution rules that are very broad and subject to specific rules and limitations within the rules: i) Stock owned directly or indirectly by a partnership, corporation, estate, or trust is deemed to be owned proportionately by the partners, shareholders, or beneficiaries thereof. ii) A person is deemed to own stock held by his family members iii) A person who is a partner in a partnership and who owns (directly or through application of rule i) stock in a corporation is deemed to own any stock held by his partners.

Copyright @2011 Procopio, Cory, Hargreaves & Savitch LLP. All rights reserved.

D. Scenarios of New Reporting Requirements

In order to understand the implication and the applicability of these new rules the remainder of this article explains various factual scenarios of when an FBAR will now be required to be filed.

1. U.S. Citizens:

There are various means by which someone may be a citizen of the United States. Under the 14th Amendment of the United States Constitution, "all persons born or naturalized in the United States … are citizens of the United States."[14] Also, persons born outside of the United States where parents are United States citizens may acquire U.S. citizenship at birth depending upon a number of factors.[15]

a. U.S. citizens living abroad:

Peter is a U.S. citizen that permanently lives in Canada where he was born and has lived all of his life. His U.S. citizenship was obtained via derivative citizenship since his mother was born in the U.S. and had lived a certain number of years prior to returning to her family's home town in Canada. Peter's father is a Canadian citizen who was born in India. He operates a hotel in Canada. Peter has no business in the U.S. and has not visited or done any business in the U.S. for the last 20 years, when he last took a vacation to New York City. Does Peter need to file an FBAR and report all his non-U.S. accounts in Canada? He also operates a small outsourcing business in Mumbai, the city of birth of his father. He travels to and from Canada and India regularly. Peter has individual accounts in Canada and India all of which, in the aggregate, exceed US$10,000 annually.

Peter will need to file an FBAR and report all of his accounts in Canada and India to the U.S. Treasury Department.[16]

b. Citizens acting as officers of a foreign corporation

Juan is a U.S. citizen who is an officer of a foreign subsidiary of a U.S. publicly traded company. Juan has signature authority over one of the foreign accounts of the foreign subsidiary. Does Juan have to file an FBAR?

A U.S. citizen or resident who as an officer or employee of a foreign subsidiary of a U.S. publicly traded company has signature authority over a foreign account, will be required to file an FBAR even if the account is reported in the consolidated FBAR filed by the U.S. parent company.[17] Therefore, even though Juan has no financial interest in the account, he still has the obligation to file an FBAR and report it.

Crystal is a U.S. citizen that owns 50% percent of the shares of a Costa Rican corporation. Manuel, citizen and resident of Mexico, is Crystal's business partner and owns the remaining 50% of shares of the Costa Rican corporation. The local laws in Costa Rica provide that the President of the company, unless restricted by the Articles of Incorporation, shall have full power of attorney to act on behalf of the company without any limitations. Crystal was appointed as the President of the company and the Articles of Incorporation were silent as to her powers. Neither Crystal nor Manuel reside in Costa Rica, thus they decided to appointed Carlos, a Costa Rican lawyer, as their agent and granted him full power of attorney to act on behalf of the company. Carlos opened a bank account in the Costa Rican National Bank in the name of the company and designed himself and Manuel as the only persons having signature authority over the account. Does Crystal, Manuel or Carlos have to file an FBAR?

---

[14] U.S. Cons. Amend. XIV; *See U.S. v. Wong Kim Ark,* 169 U.S. 649 (1898).
[15] INA § 301; 8 U.S.C. § 1401.
[16] 31 C.F.R. Section 1010.350(b)(1) and U.S. Cons. Amend. XIV; *See U.S. v. Wong Kim Ark,* 169 U.S. 649 (1898).
[17] See FinCEN comments to 31 C.F.R. Section 1010.350(f)(2)(iv) and 31 C.F.R. Section 1010.350(g)(3) (The special rule for consolidated FBAR reporting only applies to United States persons)

Copyright @2011 Procopio, Cory, Hargreaves & Savitch LLP. All rights reserved.

Here, because Crystal's ownership in the corporation is less than 51%, she is not deemed to have a financial interest in the Costa Rican account and as such, she will not be required to file an FBAR.[18]

However, a different conclusion follows based on the definition of "signature authority."[19] According to FinCEN comments, the test to determine if an individual has signature authority over an account is to determine whether the foreign financial institution will act upon a direct communication from that individual regarding the disposition of the assets in the account.[20]

Here, Crystal has not been designated as having signature authority over the account. However, because according to Costa Rican Laws, the President of the company has full power of attorney to act on behalf of the company, Crystal can make a disposition of the assets in the account by simply showing to the Bank in a direct communication that she is the President of the company, even if she was not originally designated as having signature authority by Carlos. Therefore, in this example, even though it seems that Crystal has no obligation to file an FBAR, her position as the President of the Company creates in her the obligation to file an FBAR.

This example evidences the importance to take into account the local laws of the country where the foreign company is incorporated. Local laws may grant powers to officers and managers of corporations that could be considered covered within the definition of having a signature authority.

Finally, because Carlos and Manuel are not US persons they are not obligated to file FBAR's.

c. Residents:

The FBAR regulations have adopted the definition of a resident contained in the Internal Revenue Code, specifically section 26 U.S.C. 7701(b). Within this section, two main categories of individuals are now included:

i. Substantial presence test

Charles, a New Zealand citizen, was physically present in the U.S. for 149, 179 and 98 days in each of the years 2008, 2009, and 2010, respectively.. He is not a U.S. income tax resident by application of the U.S-New Zealand Income Tax Treaty as his center of vital interests are in New Zealand and not in the U.S. Charles's father, Richard, owns a real estate development company in New Zealand. Richard, in connection with his business, owns several bank accounts, which he uses to carry on the day to day operation of his business. Richard would like his son to be able to manage his business in the event of an emergency, health problem, or incapacity. Accordingly, Richard gave Charles a power of attorney that entitles him to sign in some of his father's bank accounts. Does Charles need to report the bank accounts?

Charles satisfies the so called substantial presence test. i.e., he was in the U.S. during at least 31 days during the calendar year and a total of 183 by applying the substantial presence test.

He must count and sum the total of:

a) all the days present in the current year; plus

b) 1/3 of the days present in the first year before the current year, and,

Year	Days of Physical Presence	Factor	
2010	98	1.00	98
2009	179	1/3	60
2008	149	1/6	25
		Sum	**183**

[18] 31 C.F.R. Section 1010.350(e)(2)(ii).
[19] 31 C.F.R. Section 1010.350(f).
[20] FinCEN comments Section II.B

Copyright @2011 Procopio, Cory, Hargreaves & Savitch LLP. All rights reserved.

c) 1/6 of the days present in the second year before the current year.[21]

In this case, the sum equals 183 days and hence he will satisfy the substantial presence test.

Charles satisfies the substantial presence test, he will be required to file FBARs on all of his personal accounts. [22] In addition, the new regulations require that he must file an FBAR since the power of attorney from his father grants signature authority (or the ability to obtain signature authority) to his father's personal and company foreign accounts in New Zealand.[23] Thus, even though Charles might not be the owner of the funds, he has an FBAR filing obligation and must report the accounts.

ii. Lawful permanent residents.

John is a Belgian citizen that was granted a green card in 2000. John lived and worked in the U.S. for four years. John moved back to Belgium in 2005 and because he abandoned his domicile in the U.S., he has lost his right to re-enter and work in the United States for immigration law purposes as explained in more detail below. However, he never formally abandoned his green card and keeps the old card on his dresser in Belgian. In 2009, John was hired by a successful European company in Belgium. In order to deposit his salary and to keep his savings, he opened two bank accounts in a local Belgian bank. One of the accounts had a maximum value of $8,000 in May and a year end value of $2,000. The other account had a value of $1,000 in May, and a maximum value of $3,000 at year end. There has been no judicial or administrative resolution stating that John has abandoned his lawful permanent resident status. Does John have to file an FBAR?

The definition of lawful permanent residents ("LPR") contained in the Internal Revenue Code is based, in large part (but not exclusively), upon U.S. immigration law. The Immigration and Nationality Act (the "Act" or "INA") defines permanent resident status as being lawfully accorded the privilege of permanently residing in the United States as an immigrant.[24] Furthermore, for immigration law purposes, this lawful permanent residency status requires that the person physically reside in the territory of the United States in a permanent form.[25]

If a non-U.S. citizen permanently leaves the United States and takes up permanent residency in their home country, or any other country outside of the United States, they will apparently no longer have the lawful privilege (for immigration law purposes) of returning and residing permanently in the United States.[26] Nevertheless, Treasury Regulation Section 301.7701(b)-1(b) provides that these individuals retain their U.S. person status for U.S. income tax purposes and such status will be maintain until it has not been revoked (and has not been administratively or judicially determined to have been abandoned). The FBAR regulations now reference this IRC definition of "U.S. person."

In the present case, the first question is whether the $10,000 threshold is met in order for there to be an obligation to file an FBAR. Here, the $10,000 threshold is met by the aggregate value of

[21] 26 U.S.C. Sec. 7701(b)(3).
[22] 31 C.F.R. Section 1010.350(b)(2).
[23] See FinCEN comments to 31 C.F.R. Section 1010.350(f).
[24] INA sec. 101(a)(20); 8 U.S.C. sec. 1101(a)(20).
[25] The Act defines the term "lawfully admitted for permanent residence" as "the status of having been lawfully accorded the privilege of residing permanently in the United States as an immigrant in accordance with the immigration laws, such status not having changed." INA § 101(a)(20) [8 U.S.C. § 1101(a)(20)]. The Act defines a special immigrant "returning resident" as "an immigrant, lawfully admitted for permanent residence, who is returning from a temporary visit abroad." INA § 101(a)(27)(A) [8 U.S.C. § 1101(a)(27)(A)]. An immigrant, whether or not in possession of a valid entry document, may be permitted to enter the United States if he satisfies the definition of a special immigrant returning resident.
[26] The Act does not define "abandonment" or "a temporary visit abroad," and the Act does not otherwise address when an alien's lawful permanent resident ("LPR") status ceases to exist absent an Immigration Judge's finding of removability after the occurrence of removal proceedings.

Copyright @2011 Procopio, Cory, Hargreaves & Savitch LLP. All rights reserved.

the first account in May and the value of the second account at year end ($8,000 + $3,000 = $11,000).[27]

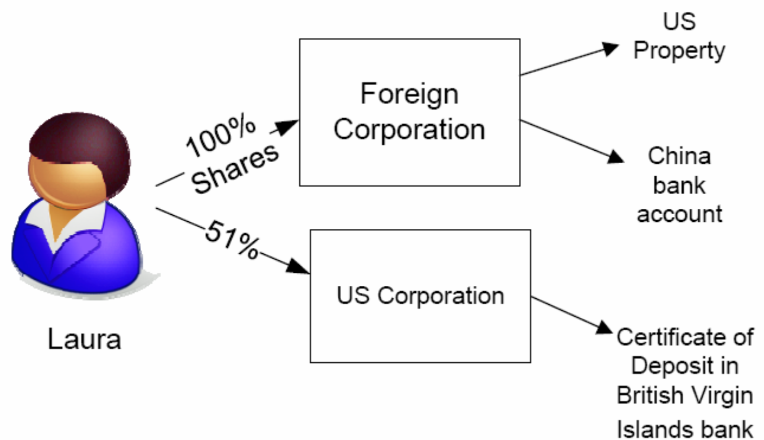
Next, is John still a LPR for purposes of the federal tax rules, and if so he will be considered a "U.S. person" pursuant to the new definition contained in the FBAR regulations. John permanently resides outside the United States and has no lawful right to live, work or return to the U.S. However, John will still be treated as a "U.S. person" under the FBAR regulations since he is so under Treas. Reg. Section 301.7701(b)-1(b)and is obligated to file an FBAR and report his Belgian Bank accounts. [28]

The next case is Carlos, who is a Mexican citizen that holds a LPR green card and resides mostly in Mexico. Carlos has bank accounts in two banks outside the U.S.: one in Mexico and one in Canada. Carlos under the current U.S. Mexico income tax treaty is a non-resident for U.S. income tax purposes. Does Carlos need to file an FBAR and report his foreign accounts?

Yes, the FBAR regulations establish that a legal permanent resident who elects, under a tax treaty, to be treated as a non-resident for tax purposes must nonetheless still file the FBAR.[29]

III. CORPORATION

Laura, a U.S. citizen, is the owner of 100% of the stock of a foreign corporation. The foreign corporation owns property in the U.S. and has elected to be treated as a U.S. corporation for U.S. income tax purposes for the limited purpose of IRC §897(b). The foreign corporation has a bank account in China and Laura has no signature authority over the account. Additionally, Laura is the owner of 51% of the shares of a U.S. corporation that owns a certificate of deposit in a bank in the British Virgin Islands. Does Laura or the foreign corporation have to report the account in China? Does Laura or the U.S. corporation need to file an FBAR for the certificate deposit in China?



The regulations state that for the purpose of the FBAR reporting, a corporation is a United States person only if it is created, organized or formed under the laws of the United States, any state, the District of Columbia, the Territories and Insular Possessions of the United States, or the Indian Tribes.[30] Thus, the Foreign Corporation will not have to make an FBAR filing even though it has made an election to be taxed as a U.S. domestic corporation for purposes of IRC §§897 and 1445. However Laura, as the owner of all of the shares of the foreign corporation, will have the obligation to file an FBAR and report the bank accounts that the foreign corporation owns and she will be treated as having a "financial interest" in those accounts, even though she has no "signature authority" over the account. [31]

Additionally, both the U.S. corporation and Laura have the obligation to file an FBAR for the certificate of deposit held in the British Virgin Islands Bank.[32] Laura's obligation arises from her being a U.S. citizen and owner of more than 50% of the stock of the U.S. Corporation.[33]

---

[27] 31 C.F.R. Section 1010.350(b)(2).
[28] 31 C.F.R. Section 1010.306
[29] See FinCEN comments to 31 C.F.R. Section 1010.350(b).
[30]See FinCEN comments to 31 C.F.R. Section 1010.350(b).
[31] 31 C.F.R. Section 1010.350(e)(2)(ii).
[32] 31 C.F.R. Section 1010.350(e)(1) and 31 C.F.R. Section 1010.350(e)(2)(ii).
[33] 31 C.F.R. Section 1010.350(e)(2)(ii).

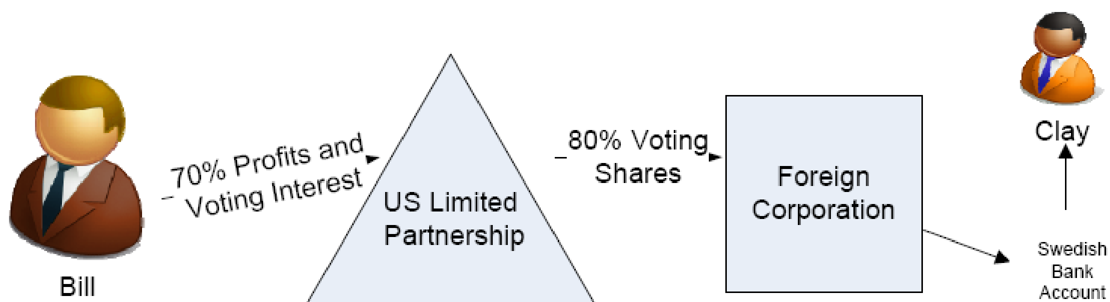
Copyright @2011 Procopio, Cory, Hargreaves & Savitch LLP. All rights reserved.

Paco, an Argentinean citizen and resident is the single owner of a U.S. domestic LLC formed in Delaware. The domestic LLC has a foreign financial account. Do any of the parties have a reporting requirement?

Here, even though Paco is a foreign person would not be personally required to file an FBAR, the domestic LLC that holds an interest in the foreign financial account will be required to file an FBAR as it has a "financial interest."[34] The Delaware LLC cannot have signature authority over an account (as it is not an individual), but does have a "financial interest in the account." Presumably, he is the manager of the LLC and hence will need to prepare the FBAR for filing on behalf of the Delaware LLC. Those rules obligate the filing of an FBAR, even though the Delaware LLC is disregarded and is not a U.S. taxpayer for federal tax purposes.

IV. PARTNERSHIPS:

Bill, a U.S. citizen from New York, is the only U.S. person owning 70% of a U.S. limited partnership. The U.S. limited partnership owns 80% of a foreign corporation. The foreign corporation and Sven, a U.S. and Swedish citizen who resides in Sweden, jointly own a Bank account in Sweden. Bill has no signature authority over the account. Who should file the FBAR, reporting the Bank account in Sweden?



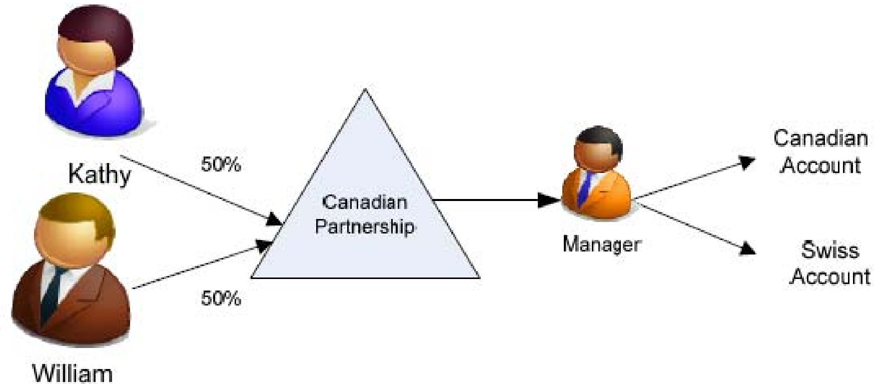
Bill will be required to file an FBAR because his indirect ownership (his interest in the U.S. limited partnership multiplied by the U.S. limited partnership's interest in Foreign Corporation) is greater than fifty percent (>50%).[35] Hence he has a "financial interest" in the Swedish bank account. Additionally, the U.S. limited partnership's interest in the Foreign Corporation is greater than 50%; therefore, the limited partnership also has an FBAR filing requirement as it too has a "financial interest" in the account.[36] The foreign corporation is not obligated to file an FBAR because it is not considered a U.S. person and only U.S. persons have the obligation to file an FBAR.[37] Finally, Sven qualifies as a U.S. person even though he lives in Sweden and is also a Swedish Citizen, and even though the account is reported by Bill and the U.S. limited partnership, he also has an obligation to file an FBAR since each U.S. person that has a financial interest in the account must file an FBAR, regardless of the fact that others have already filed.[38]

---

[34] 31 C.F.R. Section 1010.350(b)(3)
[35] 31 C.F.R. Section 1010.350(e)(2)(ii).
[36] Id.
[37] 31 C.F.R. Section 1010.350(a)_
[38] Id.

Copyright @2011 Procopio, Cory, Hargreaves & Savitch LLP. All rights reserved.

William and Katy, husband and wife, both U.S. citizens are the owners each of 50% of the voting and 50% profits interest of a Canadian limited Partnership. The Canadian Partnership has a Canadian Manager who has opened on behalf of the company two bank accounts. One of the accounts is held at HSBC Canada and the other account is held in HSBC Switzerland. Only the Manager of the company has signature authority over the accounts. Does William, Katy or the Manager have a reporting requirement?



Here, neither William's nor Kathy's indirect ownership over the accounts is greater than fifty percent (50%) of either voting or profits interests. Additionally, they do not have signature authority over the foreign financial accounts of the Canadian Partnership. Thus, because the Internal Revenue Code attribution rules do not apply, no constructive ownership can be imputed to them and as such they will apparently not have an FBAR reporting requirement.

However, take note that if the Canadian local laws grant the owners of the partnership interest, the type of power of attorney that will allow them to dispose of the assets of the account upon a direct communication to the financial institution, then a filing obligation arises due to a "financial interest."[39]

Also, even though the Manager of the partnership has signature authority over the foreign accounts, because the Manager of the foreign partnership is not a U.S. person, he would not have a reporting requirement.

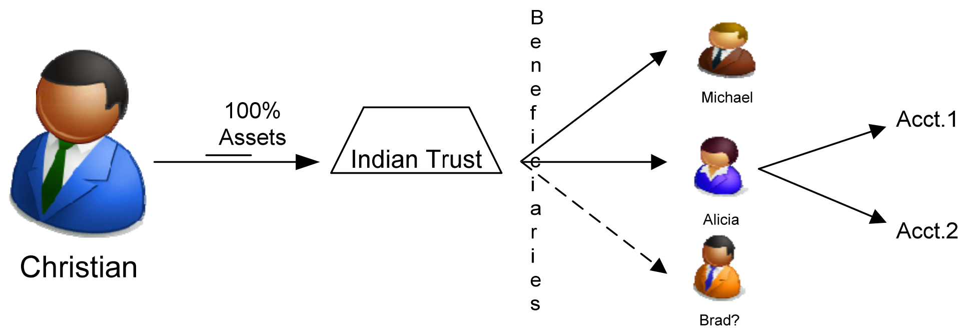
Finally, because the partnership is a foreign entity, and it is not considered a U.S. person, it would not have the obligation to file an FBAR.

V. TRUSTS

Navachakrangah, a US naturalized citizen (who sometimes goes by "Christian" so his U.S. resident colleagues and friends who can better pronounce and remember his name and not confuse him for a woman), created a Trust in India when he transferred a large portion of his estate of property to HBCS Trustee India, an Indian professional trustee, in order for such company to act as trustee. The trust contained the following instructions: a) 51% of the trust assets shall be held for the benefit of Navachakrangah's son Michael and b) 49% for the benefit of his daughter, Vrajabala AKA Alicia. In addition, Navachakrangah gave to the trustee the discretion to pay Navachakrangah's cousin Brad any trust income that might arise from the Trust assets for his maintenance and support. Michael, Alicia and Brad are all US citizens. The trust assets are composed of two bank accounts held by an Indian Bank, where the amount is more than US$10,000,000. Additionally, Alicia owns two bank accounts in an Indian Bank, which total amount equals $5,000. Who if any one has the obligation to file an FBAR?

[39] See the Costa Rican example.

Copyright @2011 Procopio, Cory, Hargreaves & Savitch LLP. All rights reserved.



Navachakrangah, as the grantor of the Trust, with no present beneficiary interest in it, may at first blush appear to have no obligation to file an FBAR and report the foreign accounts. However, since the "grantor trust" rules of the IRC are referenced in the FBAR February regulations, Navachakrangah is treated as the grantor since it is a foreign trust and he is a U.S. person, even though he has no rights to any of the trust assets or income.[40]

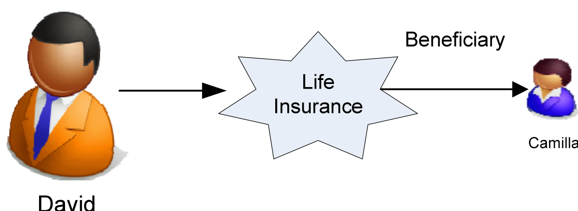
Michael, as U.S. beneficiary of a trust, in which he has a beneficial interest of more than 50 percent of the assets, will not be required to report the trust's foreign financial accounts, if the trust, trustee of the trust, or agent of the trust is a U.S. person that files an FBAR disclosing the trust's foreign financial accounts and provides any additional required information.[41] Here, because the trust is a foreign trust and the trustee is a foreign company that does not qualify as a U.S. person (and refuses to file an FBAR, in any event, as a violation of Indian law), Michael has an obligation to file an FBAR and report the foreign financial accounts held by the trust.[42]

Alicia, on the other hand, as a foreign trust beneficiary, does not fall within the scope of the FBAR filing requirements because her trust interest is less than 50 percent, but will be required to disclose her interest and file an FBAR because the value, together with the value of her Indian bank accounts, exceeds the aggregate value threshold.[43]

Brad is a discretionary beneficiary. The regulations establish that only present beneficial interest beneficiaries have an obligation to report and file an FBAR and have expressly excluded discretionary beneficiaries from the definition. [44]

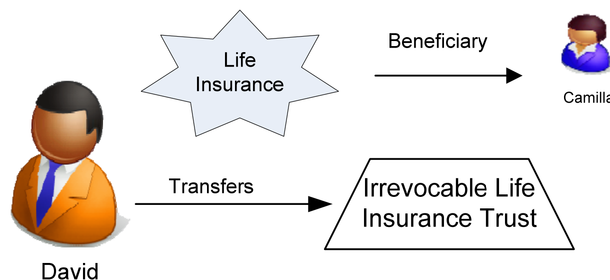
VI. LIFE INSURANCE:

David, a U.S. and Dutch citizen, who resides in France purchase a whole life insurance with a cash value of one hundred and thirty thousand dollars. He designated his wife Camilla, a French citizen, as the beneficiary of the life insurance. One year after David acquired the life insurance contract, he learned about the potential tax benefits of transferring it to an irrevocable life insurance trust. David hired an international tax planning firm in Europe and he was advised to constitute the trust in Luxembourg. Are their any FBAR filing obligations derived from these transactions?



[40] See IRC Section 679(a)(1)
[41] 31 C.F.R. Section 1010.350(g)(5)
[42] 31 C.F.R. Section 1010.350(e)(2)(iv).
[43] 31 C.F.R. Section 1010.350(e)(2)(ii) and See form TD-F90-22.1
[44] See FinCEN comments to 31 C.F.R. Section 1010.350(e)(2)(iv).

Copyright @2011 Procopio, Cory, Hargreaves & Savitch LLP. All rights reserved.



Here, according to the regulations, the definition of other financial accounts includes life insurance contracts with a cash surrender value.[45] Furthermore, the FBAR regulations clarify that in this cases the person responsible for filing an FBAR is the policy holder and not the beneficiary.[46] Thus, during the first year David was the policy owner, he is required to file the FBAR and Camilla as the beneficiary of the policy has no filing obligations.

During the second year, the policy holder of the life insurance is a foreign Luxembourg irrevocable trust. Thus, on its face it might appear that David does not have a reporting obligation. However, just as discussed above in the Trust example with Navachakrangah, the "grantor trust" rules of the IRC apply and David will be treated as the grantor and as such shall be obligated to file FBARs as long as the life insurance contract has a cash surrender value.[47]

VII. ANNUITY CONTRACTS:

Victor, who just turned 21, is a resident and citizen of Mexico. Victor was born in the U.S. but has never lived in the U.S. other than the first week of his newborn life. Victor does not own any significant assets of value nor has any bank accounts. However, recently his parents purchased for him an annuity in Mexico that is guaranteed to pay him $1000 per month for the rest of his life. He can cancel the contract and receive $200,000. Does Victor have any reporting requirements?

Annuity contracts are also included in the definition of other financial accounts and as such are subject to the FBAR reporting rules.[48] Additionally, even though Victor has never lived in the U.S., because he was born in the United States he will be considered a U.S. citizen.[49] Thus, because his parents purchased an annuity contract, which they gave to him which has a cash surrender value, it qualifies as a financial account and he has an FBAR filing obligation.

These are just but a few of the many different examples that illustrate how the new FBAR regulations expand who is now subject to the informational reporting requirements regarding foreign bank accounts.

VIII. PENALTIES FOR FAILURE TO FILE FBAR'S:

The potential FBAR penalties which can be assessed against a U.S. person are very significant.

A. **Non-Willful Penalty.** For a non-willful violation, the penalty shall not exceed $10,000 per violation.[50] In the case of a non-willful violation, no penalty should be imposed if the failure is due to reasonable cause and the account was properly reported.[51]

---

[45] 31 C.F.R. Section 1010.350(c)(3)(ii)
[46] See FinCEN comments to 31 C.F.R. Section 1010.350(c)(3).
[47] See IRC Section 679(a)(1).
[48] 31 C.F.R. Section 1010.350(c)(3)(ii).
[49] U.S. Cons. Amend. XIV; *See U.S. v. Wong Kim Ark,* 169 U.S. 649 (1898).
[50] 31 U.S.C. Section 5321(a)(5)(B). This penalty applies only to violations occurring after 10/22/04 (i.e., FBARs due on or after 6/30/05).
[51] 31 U.S.C. Section 5321(a)(5)(B)(ii). The second condition has been interpreted to mean that the taxpayer agrees to file delinquent FBARs with the Revenue Agent as part of the audit. I.R.M. 4.26.16.4.4 (7/1/08).

Copyright @2011 Procopio, Cory, Hargreaves & Savitch LLP. All rights reserved.

B. Willful Violation – Civil Penalty. For each willful violation, the maximum penalty that may be imposed is the greater of $100,000 or 50% of the value of the account at the time of the violation.[52] The violation is deemed to occur on the due date for filing the FBAR.[53] Since the penalties can be so significant, it is important for persons who may be subject to the filing requirements be aware of how and when the penalties may apply. Also, it is worthwhile to understand how these penalties are procedurally assessed. These penalties are not assessed under Title 26, the Internal Revenue Code the same way the IRS might assess an income tax or any income tax penalties under Title 26.[54] A mere letter of proposed income tax assessment can not just be sent to the "U.S. person" to enforce the collection of the penalty.

In contrast, an FBAR penalty must be brought, not through a mere letter, but by the U.S. government filing a claim in U.S. District Court.[55] The statute provides that the government must commence a civil action to collect within two years after assessing. *See,* 31 USC Section 5321(b)(2). In Joseph B. Williams, III v. Commissioner, 131 TC 54 (2008), the Tax Court dismissed the FBAR case for lack of jurisdiction. Hence, penalties assessed must be proven by the U.S. government under the standards set forth in the statute and discussed below. The practical effect is the government has the burden of proof in virtually all FBAR penalty cases they bring against "U.S. persons."

1. **FBAR – "Willfulness" in Civil Cases.** In the context of civil cases, the government can prove willfulness if they can demonstrate that the U.S. person had knowledge of the FBAR reporting requirement. It is the IRS's position that the term "willfulness" can be established by a showing of willful blindness (or intentional ignorance). For example, willfulness may be attributed to a person who has made a conscious effort to avoid learning about the FBAR reporting and recordkeeping requirements.[56]

   In *U.S. v. Williams*, 106 AFTR.2d 2010-6150 (E.D. Va. 2010) (September 1, 2010), the District Court had to decide whether Mr. Williams, who had admitted he evaded income tax for failing to report income earned from a Swiss account, had willfully failed to file an FBAR with respect to his Swiss accounts for purposes of the FBAR civil penalty.[57] In order to prove willfulness, the government pointed toward Mr. Williams' overall course of conduct, focusing on this guilty plea to tax evasion and conspiracy to defraud, his actions to conceal the unreported income, and his willful ignorance (i.e., his conscious effort to avoid learning about the FBAR reporting requirements).

   In *Williams*, the court noted that it is well established that "[w]here willfulness is a statutory condition of civil liability, it is generally taken to cover not only knowing violations of a standard, but reckless ones as well."[58] The court further stated that "a single, or even a few, inadvertent errors would not amount to a 'willful' violation. At some point, however, a repeated failure to comply with known regulations can move a [defendant's] conduct from inadvertent neglect into reckless or deliberate disregard (and thus willfulness). . . ."[59]

Nevertheless, the district court ultimately ruled that Mr. Williams did not act willfully as it related to the FBAR willfulness penalty. In rendering its decision, the court noted that the case was one of first impression regarding the proper legal standard to be applied in reviewing FBAR penalty issues. The court noted that the government failed to adequately differentiate between "simply failing" and "willfully failing" to disclose an interest in foreign accounts. Ultimately, the court held that there was not enough evidence that Mr. Williams was lying about his ignorance of the law (i.e., that an FBAR filing requirement existed). The court acknowledged that the box on Schedule B of the taxpayer's Form 1040 was marked "no" in response to the foreign account question. The court underscored, however, this action or inaction occurred after Mr. Williams learned that the U.S. authorities knew about his foreign financial accounts (and thus lacked any motivation to willfully conceal the accounts from the authorities after that point).

---

[52] 31 U.S.C. Section 5321(a)(5)(C). Prior to 10/24/04, the maximum civil penalty for willful violations was the greater of $25,000 or the balance in the account at the time of violation, up to a maximum of $100,000.
[53] IRM 4.26.16.4.5.5.
[54] IRM 4.26.17.5
[55] See, *U.S. v. Williams*, 106 AFTR.2d 2010-6150 (E.D. Va. 2010) (September 1, 2010).
[56] IRM 4.26.16.4.5.3(6).
[57] 31 U.S.C. Section 5321(a)(5)(C)
[58] *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47 (2007)*(emphasis added)*
[59] *Am. Arms Int'l v. Herbert*, 563 F.3d 78 (4th Cir. 2009)

Copyright @2011 Procopio, Cory, Hargreaves & Savitch LLP. All rights reserved.

2. **Willful Violation – Criminal Penalty.** A person who willfully fails to file an FBAR is also subject to up to five years in prison and/or maximum fine of $250,000.[60] If a willful failure is part of a pattern of illegal activity involving more than $100,000 over a 12-month period, or is committed while violating another law of the U.S., the failure may subject the taxpayer to a fine of not more than $500,000 and/or imprisonment for not more than ten years.[61]

3. **FBAR – "Willfulness" in Criminal Cases.** In *Cheek v. U.S.,* 498 U.S. 192 (1991), the Supreme Court held that a good faith misunderstanding of the law or good faith belief that one is not violating the law negates the willfulness element of a tax evasion charge, regardless of whether the claimed misunderstanding or belief is objectively reasonable. Thus, if a taxpayer truly believes that a law does not apply to him, his violation of that law cannot be willful because the element of knowledge, which is required to prove willfulness, is absent. Furthermore, a showing that the defendant acted with careless disregard (i.e., reckless) is not adequate in establishing "willfulness" for a criminal penalty.[62]

In summary, in the context of a criminal prosecution, the jury must find based on the evidence, direct or indirect, that the defendant was aware (had knowledge) of the FBAR reporting obligations.[63] In accordance with *Cheek*, it appears that an honest and good faith mistake regarding the FBAR laws, no matter how unreasonable, is a defense for failing to file the FBAR.

IX. CONCLUSION AND OBSERVATIONS

The 2011 FBAR regulations are expansive in their scope and now include many persons who previously did not need to file. The application of when the new FBAR regulations can apply can be extremely complex and confusing as the examples demonstrate. The penalties for not filing an FBAR can be devastating, especially if the failure to file was willful on the part of the person with the filing requirement. Many practical, policy and key legal questions remain for the government as the enforcement and implementation of the new FBAR regulations take affect. Some of these questions include the following:

- Does the cost and burdens imposed by FBAR filers (with the expanded scope under the new regulations) provide any real and tangible benefits for U.S. law enforcement efforts?
- Does the expanded application of the FBAR regulations serve the purpose of the statute to assist in identifying criminal activity, including money laundering, tax crimes and terrorism?
- Will organized criminals, including terrorists and money launders be filing their FBARs timely on the June 30 due date annually?
- Will a wave of new FBAR filings be manageably by FinCEN for the purposes of the statute?
- Is the willfulness penalty measured by 50% of the balance of the foreign account an excessive penalty under the 8th Amendment of the Constitution?
- Does the requirement that the revised regulations impose on non-U.S. citizens who reside principally in their home country (e.g., 220 days in Paris and 140 days in New York City annually) go beyond the scope of the statute?
- Will non-U.S. citizens residing principally overseas, but who have (i) lawful permanent residency status or (ii) meet the substantial presence test going to know they need to report their home county financial accounts to the U.S. Treasury?
- If they know, will most such non-U.S. citizens comply?
- Will there be a significant increase in filings of FBARs over the 594,488 filings in 2010?

---

[60] 31 U.S.C. Section 5322(a).

[61] 31 U.S.C. Section 5322(b).

[62] *United States v. Griffin*, 524 F.3d 71 (1st Cir. 2008).

[63] Note that the criminal willfulness standard only includes knowing violations and does not include reckless violations like the civil standard seems to include.

Copyright @2011 Procopio, Cory, Hargreaves & Savitch LLP. All rights reserved.

Only time will tell what answers evolve out of the above questions. In the meantime, a careful understanding of the FBAR rules and the 2011 FBAR regulations are important to try to avoid what can be very harsh penalties for someone who is now required to file an FBAR.

Copyright @2011 Procopio, Cory, Hargreaves & Savitch LLP. All rights reserved.

Mr. Patrick W. Martin *is a U.S. lawyer licensed in California and Washington, D.C. and specializes in international tax and related international law matters. Mr. Martin is the partner in charge of the international practice group of the Tax Team with the San Diego based law firm of Procopio, Cory, Hargreaves & Savitch LLP. He received his J.D. from the University of San Diego School of Law, has passed the Certified Public Accountant's exam, previously worked for the Internal Revenue Service, and studied postgraduate law studies in international business transactions at the Escuela Libre de Derecho, in Mexico City. He received the Judson V. Klein award from the Taxation Section of the State Bar of California. Reach him at* *patrick.martin@procopio.com* *or 619.515.3230.*

Ms. Marta Guardia *is a Costa Rican licensed lawyer who is also licensed in California and obtained her LLM in masters in comparative international law from the University of San Diego School of Law.*

Copyright @2011 Procopio, Cory, Hargreaves & Savitch LLP. All rights reserved.