STATE BAR OF CALIFORNIA
TAXATION SECTION INTERNATIONAL TAX COMMITTEE[1]

PROPOSED GUIDANCE ON FBARS & FOREIGN PERSONS

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EXECUTIVE SUMMARY[3]

Section 5314(a) of Title 31 of the United States Code provides the statutory basis for the filing of Treasury Form TD F 90-22.1 "Report of Foreign Bank and Financial Accounts" (the so-called "FBAR"). The law is not new. It is part of the Bank Secrecy Act enacted in 1970, nearly forty years ago.

Only on September 30, 2008, some 38 years after the enactment of the statute, did the government expand the FBAR form to apply to non-U.S. persons. The expansion of this FBAR to non-U.S. persons was not submitted for comment or discussion, but rather announced on the IRS website. This created much confusion among practitioners and non-U.S. persons in an attempt to try to understand when the FBAR could apply to them. That expansion was then temporarily suspended by IRS Announcement 2009-51.[4]

The lack of definitions and guidance for non-U.S. persons is stark. For instance, there are no applicable cross-referenced definitions in Title 31 and 26, yet the instructions to the FBAR frequently references concepts and definitions found in Title 26, but not Title 31. The newly proposed regulations (RIN 1506-AB08, amending 31 CFR Part 103) attempt to address and provide a more clear line of who is a "United States person" for purposes of filing FBARs.

The law is particularly unclear as to when a non-U.S. persons might have FBAR filing requirements, as the statute refers only to "doing business in the United States," without any further definition or explanation of what that means and when it might apply. Specifically the statute provides that "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 [or] file reports".[5] While IRS Announcement 2010-16 provides some relief for this issue, it apparently is only temporary as it seems to

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[1] The comments contained in this paper are the individual views of the author who prepared them and do not represent the position of the State Bar of California or the Los Angeles County Bar Association.

[2] Although the participant on the project might have clients affected by the rules applicable to the subject matter of this paper and have advised such clients on applicable law, no such participant has been specifically engaged by a client to participate on this project.

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[4] 2009-25 I.R.B. 1105.

[5] 31 U.S.C. § 5314(a).

only suspend the filing requirement for non-U.S. persons for "the 2009 and earlier calendar years." Accordingly, this language implies (if not expressly contemplates) that there will be FBAR reporting requirements for non-U.S. persons beginning for the year 2010 (*i.e.,* June 2011).

DISCUSSION

I. CURRENT LAW & REASON FOR PROPOSED CHANGE

The U.S. has an important interest in fighting international terrorists and identifying criminal acts committed and generally being able to investigate tax compliance and crimes. Indeed, Section 5311 of Title 31 of the United States Code explains the purpose of the Bank Secrecy Act:

> It is the purpose of this subchapter (except section 5315) to require certain reports or records where they have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism.

Much of the reporting requirements throughout the Bank Secrecy Act relate to banks and financial institutions themselves.

Section 5314(a) of Title 31 provides the statutory basis for the creation of the reporting form known as the FBAR and provides in relevant part as follows:

> (a) Considering 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, 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. (Emphasis added)

There is no further definition in the regulations of what is "doing business in, the United States." Is someone doing business in the U.S. if they are calling to customers or clients who are physically located in the U.S.? Are they doing business in the U.S. if they solicit potential customers through the internet, whereby the U.S. customer can access the internet and the non-U.S. person's website?

The operative regulations (prior to the recently proposed Section 103.24 regulations) provide little guidance as to when a non-U.S. person might have a filing obligation, as it merely refers to "each person subject to the Jurisdiction of the United States." See the relevant provisions of the current operative regulations below:

> (a) 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 the 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. Persons having a financial interest in 25 or more foreign financial accounts need only note that fact on the form. Such persons will be required to provide detailed information concerning each account when so requested by the Secretary or his delegate."[6]

These regulatory rules provide no real guidance as to when a foreign person is deemed to be subject to the jurisdiction of the United States. What standards are to be applied (*e.g.*, state law standards of personal jurisdiction)?

[6] *See* 31 C.F.R. §103.24.

This is a serious problem for practitioners who advise non-U.S. persons and for non-U.S. persons generally, particularly since the penalties for failure to comply with the FBAR are a minimum of $10,000 for each violation and up to $100,000 for willful violations. Does a non-U.S. person who has 10 bank accounts in their home country and 5 bank accounts in an adjacent country where they do business have 15 violations if they have an FBAR filing requirement (*e.g.*, a penalty of $150,000 – that is $10,000 multiplied by 15 accounts)? What if these accounts are unrelated to the business in the United States? Why would a non-U.S. person be required to file detailed information regarding their foreign bank accounts if they have no relevance to any U.S. tax liability or other compliance with U.S. law? Would the U.S. even have jurisdiction over a non-U.S. person requiring them to file detailed information regarding their foreign bank accounts?

The current FBAR form also seems to indicate that any non-U.S. person who might have a filing requirement (which has been suspended for the years 2008 and 2009) must file and report *all* foreign bank accounts, with detailed information about each, even if there is no bearing or relationship to the tax liability arising to that non-U.S. person.[7] There are numerous questions raised by the current FBAR form and how it might apply to non-U.S. persons.

The Treasury Department is aware of at least many of these issues when the IRS recently issued IRS Announcement 2010-16 suspending the FBAR filing requirement for certain person. Announcement 2010-16 was issued in conjunction with the issuance of proposed regulations (RIN 1506-AB08, amending 31 CFR Part 103) which would define persons required to file an FBAR as a U.S. citizen, resident alien or an entity, including a corporation, partnership, trust or limited liability company, created, organized, or formed under the laws of the United States.

These proposed regulations, however, raise additional issues tied to the question of foreign persons and filing of FBARs which are discussed in this paper.

While the proposed regulations do provide more clear guidance about the filing requirements of FBARs and non-U.S. persons, it still leaves a number of important questions unanswered. Written comments are to be provided by April 27, 2010 and these comments regarding the proposed guidance on FBARs & Foreign Persons are written comments that will be submitted to the FinCEN, P.O. Box 39, Vienna, Virginia 22183 (RIN 1506-AB08).

II. PROBLEMS AND ISSUES RAISED BY THE PROPOSED REGULATIONS

The proposed regulations address the prior lack of definitional terms to determine when a non-U.S. person has an FBAR filing requirement. The proposed regulations help clarify when a person is a "U.S. person" for purposes of FBAR filing requirements. However, many questions remain and are as follows:

A. When does a person who is not a resident alien or a U.S. citizen generally have an FBAR filing requirement after the calendar year 2009 (i.e., commencing June 30th, 2011)?

B. ***Does the temporary suspension for non-U.S. persons apply just for 2009?*** What will happen for the year 2010 – will non-U.S. persons have FBAR filing requirements for the calendar year 2010 after Announcement 2010-16 expires (and if so, when and under what circumstances?

C. When is a non-U.S. person deemed to be "doing business in the Untied States"? Does holding and owning passive investments with a U.S. broker or U.S. bank rise to the level of "doing business in the United States"? Is a non-U.S. partner, who is a partner in a U.S. partnership a non-U.S. person "doing business in the United States" even though the non-U.S. person never engages in business directly?

D. Is someone passing through the U.S. (and maybe even holding a meeting or two) give rise to an FBAR filing requirement as a person "doing business in the United States"?

[7] Incidentally, it is often times nearly impossible for persons to obtain information from their bank as to the highest balance on any given day, particularly for company accounts which might have millions of dollars of transactions monthly effected by deposits from sales, expenses, etc. The actual balances can vary dramatically from day to day and bank statements are usually issued with balances only at the end of each month.

E. Are non-U.S. persons deemed to have a filing requirement if they sell their products from their home country through the country through the internet, whereby they have U.S. buyers of their products?

F. ***Only individuals can have "signature authority" – so how can a U.S. entity with a non-U.S. person with "signature authority" ever have an FBAR filing requirement?*** IRS Announcement 2010-16 suspends the FBAR filing requirements, at least for the time being, for non-U.S. persons. However, "signature authority" is defined as "the authority (alone or in conjunction with any other individual) to control the disposition of money, funds, or other assets held in a financial account by delivery of instructions (whether communicated in writing or otherwise) directly to the financial institution[.]" By definition, this requires an individual have this authority and not an entity. If so, when does a U.S. entity that is controlled and managed by a non-U.S. person individual who is the only person who has "signature authority" over the U.S. entity's foreign accounts ever have an FBAR filing requirement for the U.S. entity's foreign financial accounts? Presumably, the requirement arises from the U.S. entity having a "financial interest" in the foreign account, irrespective of non U.S. individual having signature authority?

G. ***Is a non-resident under an income tax treaty still have an FBAR filing requirement if they are a "resident alien" under IRC Section 7701(b)(1)(A)?*** The proposed regulations defines "United States person" to include a resident alien of the United States under Section 7701(b). Will a resident alien (as defined by Section 7701(b)(1)(A)) be a U.S. person for purposes of the FBAR filing requirement if they are not a resident under an applicable income tax treaty (*e.g.*, by application of the "tie breaker" rules under an applicable income tax treaty – typically Article 4)?

H. ***Will a trust subject to U.S. law that has only a non-U.S. person settlor and where the majority of beneficiaries are non-U.S. persons ever have an FBAR filing requirement?*** The proposed regulations define "United States person" to include " [a]n entity, including but not limited to a . . . trust . . . created, organized, or formed under the laws of the United States[.]" IRC Section 7701(a)(31) and Treas. Regs. Sec. 301.7701-7(a)(2) provide that a trust is not a United States person and hence a foreign trust unless both the "court" and "control tests" are satisfied.[8] Do the proposed regulations purport to extend an FBAR filing requirement to a foreign trust as defined by the IRC and regulations? Is there an FBAR filing requirement if such a foreign trust for purposes of the IRC has no U.S. beneficiaries, no U.S. or no U.S. settlor/owner? The proposed FBAR regulations define "other financial interest" to include the following trusts only –

(iii) A trust, if the United States person is the trust settlor and has an ownership interest in the account for United States federal tax purposes. See 26 U.S.C. 671–679 and the regulations thereunder to determine if a settlor has an ownership interest in a trust's financial account for a year; (iv) A trust in which the United States person either has a beneficial interest in more than 50 percent of the assets or from which such person receives more than 50 percent of the income; or (v) A trust that was established by the United States person and for which the United States person has appointed a trust protector that is subject to such person's direct or indirect instruction.

Do the proposed regulations intend to require FBAR reporting by a foreign trust under IRC Section 7701(a)(31) with no U.S. beneficiaries and/or no U.S. settlors/owners and/or no United States persons who have established a trust?

I. ***Does a non-U.S. person who sells its products to U.S. persons have a filing requirement* (i.e., *because it is "doing business" in the U.S.)?***[9]

J. ***Must a non-U.S. person report all foreign bank account information* (e.g., *of all banks, in all countries,* etc.*)?*** Will persons residing overseas generally know of these filing requirements, let alone spend the time, money and expense to complete these FBARs?

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[8] *See also* Priv. Ltr Ruling 200243031 for a more detailed discussion of when a trust subject to U.S. law is a foreign trust for purposes of the IRC.

[9] Currently, the U.S. import of goods and services was approximately US $1,843 billion from foreign persons. See U.S. Census Bureau http://www.census.gov/foreign-trade/statistics/highlights/annual.html. Does a seller who sells its products FOB, U.S. port have an FBAR filing requirement?

The proposed regulatory rules, similar to the existing regulations, provide no real guidance as to when a foreign person is deemed to be subject to the jurisdiction of the United States. What standards are to be applied (*e.g.*, state law standards of personal jurisdiction)? How are the above questions to be answered?

The factual scenarios set out below help demonstrate the complexities of determining when non-U.S. persons might have an FBAR filing requirement:

> Elina Swenson ("Elina") is a Swedish national, with lawful permanent residency ("green card") in the U.S. She obtained her green card after marrying a U.S. citizen who is a famous professional golfer, Lion Lumbers ("LL"). She maintains various bank accounts in Sweden. Elina's mother Birgitta ("Mother"), is also a Swedish citizen but resides in Sweden and visits her daughter in the U.S. on major holidays. Mother is a land use expert in Sweden and a major land developer where she has several projects, including development projects in Denmark. Mother has several bank accounts or signature authority over various business accounts in Sweden and Denmark to help manage these real estate projects. Elina has co-signing authority over some of these accounts. Mother also invested in a U.S. real estate development partnership, as a limited partner on the suggestion of Elina.
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> Elina also has a cousin, Sven Swenson (Sven) who has a Swedish company that makes Viking Adventure products largely manufactured in China. Sven markets his products to retail buyers through much of Europe. He also sells directly to buyers around the world through an internet website he maintains and operates from Stockholm. He recently has been selling about 20 percent of his total sales (approximately US$20M annually) to individual U.S. buyers after an interview he held with a famous Swedish morning talk show host made its way to YouTube.
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> Finally, Elina has an uncle Hjalmar who has invested heavily in the U.S. stock market through his U.S. broker based in New York at the Bank of Americaz ("BAZ"). Hjalmar resides in Stockholm, but visits his New York stock broker at BAZ at least 3-4 times annually and likes vacationing in New York and Florida where he regularly meets Elina and Lion on their private yacht. He typically spends 3 months each year in the U.S. vacationing and taking cell phone calls and sending e-mails regarding his U.S. stock investments and business interests in Europe.

The author recognizes that a number of different approaches could be taken to address the above questions and respectively requests that the Treasury Department consider the following in any particular proposal:

A. Will the requirement to report more information lead to more and better compliance and enforcement (both in tax and money laundering matters)?

B. Will these additional filing requirements discourage foreign investment in the U.S. by imposing greater burdens on foreign investment?

C. Will additional filing requirements for non-U.S. persons create even greater noncompliance (particularly considering many foreign persons are not aware they might have specific filing requirements under U.S. law)?

The need for guidance in this area is still present (since Announcement 2010-16 only applies to 2009 calendar years and before) and the FBAR must be filed annually by June 30th of each year following the year in which the foreign accounts existed.

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