# Final FBAR Rules – Some Retirement Plan Relief But Reporting Obligations Remain

## *Background*

To assist the federal government in its efforts to deter criminal tax, money laundering and terrorist activities, the United States Treasury Department, through its Financial Crimes Enforcement Network, has issued final regulations (the "FBAR Regulations") under the Bank Secrecy Act concerning reports of foreign financial accounts. The final FBAR Regulations were issued on February 24, 2011 and can be found in the Federal Register through the following link http://www.gpo.gov/fdsys/pkg/FR-2011-02-24/html/2011-4048.htm. The form used to file the required report is the Report of Foreign Bank and Financial Accounts – Form TD-F 90-22.1, commonly known as the "FBAR" report. In addition, if an individual has an FBAR reporting requirement, he or she will generally be required to indicate such fact on his or her individual federal income tax return for the year to which the FBAR report relates.

The general FBAR reporting requirement applies with respect to a calendar year for each United States ("U.S.") person[1] that has a financial interest in, or signature or other authority over, a foreign financial account (an "FFA") if the aggregate value of all such accounts exceeds $10,000 at any time during the calendar year. The FBAR report must be filed with, and received by, the Internal Revenue Service on or before June 30 of the calendar year following the calendar year to which the FBAR report relates.

Significant questions and comments have been raised regarding the extent to which FBAR reporting applies to retirement plans (through, generally, the plan's trust) and the scope of the types of foreign investments by retirement plans which could give rise to a reporting obligation on the part of the plan, the plan's participants, and the fiduciaries and other persons who provide investment-related services to the plan (collectively, "plan service providers"). While the FBAR Regulations do not offer a complete exemption from FBAR reporting with respect to FFAs maintained by or on behalf of retirement plans, the FBAR Regulations do provide some helpful relief for retirement plans and their plan participants, as well as for plan service providers. The following describes certain key aspects of the FBAR Regulations which impact the reporting obligations of retirement plans and their participants and plan service providers.

## Foreign Financial Account

An FFA is a bank, securities or other financial account[2] that is not maintained with a financial institution located in the U.S. The FBAR Regulations provide two important clarifications of the term financial account. First, the FBAR Regulations currently do not require FBAR filings with respect to interests in foreign hedge funds, foreign private equity funds and other foreign commingled investment funds. However, interests in funds that constitute foreign mutual funds or similar pooled funds are subject to FBAR reporting. For these purposes, a mutual fund or similar pooled fund offering financial accounts that may be subject to FBAR reporting is a fund which issues shares available to the general public, has a regular net asset value determination, and offers regular redemptions. Accordingly, unless and until additional guidance is issued, a retirement plan's investment in an offshore hedge fund or private equity fund (e.g., a fund whose interests

are not available to the general public, but are offered to investors in private transactions) will not be subject to FBAR reporting. This is certainly welcome relief for both plans that invest in offshore hedge and private equity funds and the plan fiduciaries with authority over such investments as well as for the managers of such funds.

Second, the Preamble discussion to the FBAR Regulations clarifies that in the case of a retirement plan that maintains an account at a U.S. bank or other financial institution, the assets of which are pooled in an omnibus custodial account maintained outside the United States by the U.S. bank or other financial institution as a global custodian, the plan would not have to file an FBAR report with respect to the assets in the omnibus account so long as the plan does not have any legal rights in the omnibus account and can only access the plan's holdings in the omnibus account located outside the U.S. through the U.S. global custodian. If, however, the plan is permitted under the custodial arrangement to directly access its foreign holdings in the omnibus account, the plan's interest in the account would constitute a reportable FFA. This clarification should help retirement plans avoid FBAR reporting obligations with respect to certain pooled custodial accounts maintained outside the U.S. by a U.S. bank.

## Financial Interest

For purposes of FBAR reporting, a retirement plan will have a financial interest in an FFA if it is the owner of record of, or has legal title to, the account. In addition, in situations where another person is the record owner of, or holder of legal title to, the FFA, a plan will have a financial interest in an FFA if such other person is (i) acting as an agent, nominee, attorney or in some other capacity on behalf of the plan with respect to the account, (ii) a corporation in which the plan owns directly or indirectly more than 50 percent of the voting power or total value of the shares of the corporation, a partnership in which the plan owns directly or indirectly more than 50 percent of the profits or capital interests of the partnership, or any other entity in which the plan has the same more than 50 percent requisite ownership, (iii) a trust that is a "grantor trust" under federal tax rules, with respect to which the plan is the grantor, or (iv) a trust in which the plan either has a present beneficial interest in more than 50 percent of the assets or from which the plan receives more than 50 percent of the current income. Further, the FBAR Regulations provide an anti-avoidance rule whereby if a U.S. person creates an entity for a purpose of evading the rules governing the existence of a financial interest, the person will be treated as having a financial interest in any FFA for which the entity is the record owner or holder of legal title.

The final FBAR Regulations make a favorable change benefiting the sponsors of retirement plans by eliminating a provision that could have resulted in the plan sponsor having a reportable financial interest in an FFA maintained by the plan's trust where the plan sponsor has the authority, directly or indirectly (such as through a committee designated by the plan sponsor), to appoint, monitor and remove the plan trustee (referred to in the proposed FBAR regulations as a "trust protector"). The Treasury Department believes that the FBAR purposes purportedly served by the proposed trust protector provision are adequately covered by the anti-avoidance rule that continues to apply under the final FBAR Regulations.

## Signature or Other Authority

Under the proposed FBAR regulations, there was some uncertainty as to the scope of the signature or other authority ("signature authority") requirement that would trigger an FBAR reporting obligation.

The final FBAR Regulations provide some clarification of this requirement by defining "signature authority" as the authority of an individual (alone or in conjunction with another) to control the disposition of money, funds or other assets held in an FFA ***by direct communication*** (whether in writing or otherwise) to the person with whom the FFA is maintained. Thus, the test for determining the existence of signature authority over an FFA is whether the foreign financial institution will act upon a direct communication from the individual regarding the disposition of assets in the account. Accordingly, it can be expected that where a retirement plan's pension or investment committee is authorized to directly communicate only with the plan's U.S. trustee or a U.S.-based investment manager and not directly with the person with whom an FFA is maintained, then such committee members should not have signature authority and thus no FBAR reporting requirement should apply to them on that basis.

The FBAR Regulations confirm that the signature authority reporting requirement only applies to individuals. Further, officers or employees who file FBAR reports because they have only signature authority over an FFA of their employer are not required to personally maintain the records regarding such FFA of their employer.

Notwithstanding the general FBAR reporting requirements applicable to individuals who have signature authority over an FFA, officers or employees of (i) a bank that is subject to federal regulatory oversight, (ii) a financial institution that is registered with and examined by the Securities and Exchange Commission ("SEC") or Commodity Futures Trading Commission, (iii) an entity whose equity securities are listed on a U.S. national securities exchange, (iv) an entity whose equity securities are registered under the Securities Exchange Act of 1934 (i.e., entities with more than $10 million in assets and more than 500 shareholders), or (v) an entity that is registered with and examined by the SEC and that provides services to an investment company registered under the Investment Company Act of 1940 are not required to file an FBAR report due to having signature authority over an FFA maintained by any of the foregoing entities provided the officer or employee has no financial interest in the FFA.

## Plan Participants and Beneficiaries and Trust Beneficiaries

Many commenters to the proposed FBAR regulations had requested a broad exemption from FBAR reporting for pension and welfare benefit plans, arguing that the regulation and oversight already applicable to such plans under ERISA will result in unduly burdensome and duplicative reporting obligations. Notwithstanding such request, the Treasury Department determined not to grant a blanket exemption for plans.

However, in addition to the clarifications and relief described above, the FBAR Regulations provide that participants and beneficiaries in retirement plans described in Internal Revenue Code section 401(a) (qualified plans), 403(a) (qualified annuity plans), or 403(b) (tax-deferred annuities), as well as owners and beneficiaries under IRAs or Roth IRAs, shall not be required to file FBAR reports with respect to FFAs held by or on behalf of the retirement plan or IRA. In addition, the beneficiary of a trust in which the beneficiary has a financial interest based on the beneficiary having a present beneficial interest in more than 50 percent of the trust's assets or receiving more than 50 percent of the current income of the trust need not file an FBAR report with respect to the trust's FFAs if the trust, trustee of the trust or agent of the trust is a U.S. person that files an FBAR report with respect to such FFAs.

## Effective Date

The final FBAR Regulations apply to FBAR reports required to be filed by June 30, 2011 with respect to FFAs maintained during calendar year 2010 and for reports required to be filed for subsequent calendar years. In addition, the FBAR Regulations (and the favorable clarifications provided thereunder) may be applied in determining FBAR filing requirements for reports due by June 30, 2011 with respect to FFAs maintained in calendar years prior to 2010. ◆

### Endnotes

1 Under the FBAR Regulations, a United States person means a U.S. citizen, U.S. resident and any entity (including a corporation, partnership, limited liability company and trust) that is created, organized or formed under the laws of the U.S., any State, the District of Columbia, U.S. Territory and Insular Possession, or Indian Tribe.

2 Other financial accounts mean (i) an account with a person that is in the business of accepting deposits as a financial agency, (ii) an account that is an insurance or annuity policy with a cash value, (iii) an account with a person that acts as a broker or dealer for futures or options transactions in any commodity on or subject to the rules of a commodity exchange or association, or (iv) an account with a mutual fund or similar pooled fund which issues shares available to the general public that have a regular net asset value determination and regular redemptions.

**If you would like more information about this alert, please contact one of the following attorneys or call your regular Patterson contact.**

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