GROOM LAW GROUP

June 25, 2009

MEMORANDUM TO CLIENTS

RE: Plans May Be Required to Report Offshore Investments by September 23, 2009

Under current rules, U.S. persons (including employee benefit trusts) with a "financial interest in or signature or other authority over" certain "foreign financial accounts" must file a "Report of Foreign Bank and Financial Accounts" (Form TD F 90-22.1, or "FBAR") with the Internal Revenue Service ("IRS"). While the deadline for the annual filing is June 30, the IRS announced that filers have until September 23, 2009, to file FBAR for the 2008 calendar year if they have (i) only recently learned of their obligation to file FBAR, (ii) insufficient time to gather the necessary information, and (iii) reported and paid all 2008 taxable income, if any. FBAR filings made after June 30 will still be considered delinquent and should be filed with a statement explaining the delinquency, but the IRS will not impose penalties for a failure to file.

Although this filing requirement has been in existence for a number of years, plan fiduciaries have rarely considered it necessary to file FBAR with respect to most foreign investments. However, recent changes to the FBAR filing instructions and, we understand, informal guidance from an IRS official, indicate that fiduciaries must file FBAR with respect to, among other things, a plan's investments in certain types of offshore entities, such as offshore hedge funds. The civil penalties for a failure to file FBAR can range from $500 per violation up to the greater of $100,000 or 50 percent of the account balance, and in some circumstances, criminal penalties may apply.

Below, we discuss how the FBAR filing requirements might apply to plan investments. Significantly, FBAR's filing requirements may be relevant to all types of plan fiduciaries, including plan investment and administrative committee members, and financial institutions that act as trustees for plan trusts. Plan fiduciaries should also be aware that the IRS is currently taking comments on the FBAR form and instructions. As discussed below, the comment period ends on August 31, 2009.

I. FBAR

FBAR must be filed by "each United States person who has a financial interest in or signature or other authority over any foreign accounts, including bank, securities, or other types of financial accounts, in a foreign country, if the aggregate value of these financial accounts exceeds $10,000 at any time during the calendar year." Therefore, in order to comply with the filing requirements, plans and plan fiduciaries must determine (a) whether the plan holds any "foreign financial accounts" and (b) who must file.

A. Foreign Financial Accounts

To trigger an FBAR filing requirement, an account must be located outside of the United States. We note that for FBAR purposes, the United States is defined to include Puerto Rico and certain other territories. In addition, the account must be one of the following types of financial accounts:

- any bank, securities, securities derivatives or other financial account;
- any savings, demand, deposit, time deposit, or 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; or

- any account in which the assets are held in a commingled fund and the account owner holds an equity interest in the fund (including mutual funds).

Individual bonds, notes, or stock certificates held by a person or unsecured loans to a foreign trades or businesses (other than financial institutions) are generally not "financial accounts."

Thus, an FBAR filing could be required where an employee benefit plan trust makes an equity investment in an offshore hedge fund or other commingled investment vehicle if the offshore vehicle itself is considered the "foreign financial account" and the equity investment causes the plan to have the requisite interest in or authority over the foreign financial account. Similarly, the plan's directed trustee may have a requisite interest in the same account by reason of the directed trustee's status as the record owner of the investment. In this case, both the trust and the trustee may have to file with respect to the same account.

During a June 12, 2009 teleconference sponsored by the American Bar Association and the American Institute of Certified Public Accountants, an IRS official took the position that an offshore hedge fund would be a "foreign financial account." This informal guidance has brought to the attention of fund managers, financial institutions, and plan sponsors the potential application of FBAR filing requirements to plan investments. However, there is still much confusion as to the scope of foreign financial accounts for which an FBAR filing must be made. For instance, some have argued an offshore feeder fund, such as the type frequently used by fund managers to "block" unrelated business income tax ("UBIT"), should not be considered a foreign financial account to the extent the offshore feeder fund invests solely and directly in a domestic "master" fund.

Persons with foreign financial accounts that have an aggregate value of $10,000 or less need not file FBAR. For purposes of applying this filing threshold, one should determine the maximum value of each account, as it appears on account statements (or if no statements are provided, at any time in the calendar year), in a calendar year, converted to U.S. dollars using the foreign exchange rates available at the end of the year. Although valuing foreign accounts raises a number of difficult issues, we suspect that the vast majority of benefit plans that have foreign accounts will exceed the $10,000 filing threshold.

B. Parties Responsible for Filing

Generally, FBAR filings must be made by U.S. persons (including employee benefit trusts) with a covered relationship to a foreign financial account. Specifically, a U.S. Person with a "financial interest in" or "signature or other authority over" any foreign financial account must file FBAR with respect to that account.

A person has a "financial interest" in an account where that person is the owner of record or holds legal title to that account, regardless of whether the account is maintained for his or her own benefit. A financial interest may arise by virtue of a person's role as agent, nominee, attorney, or in some other capacity with respect to a financial account on behalf of a U.S. person. A 50 percent interest in a corporation, partnership or trust that holds legal title to or is the owner of record for a foreign financial account also qualifies as a "financial interest" in such account.

"Signature authority" over an account exists where a person can control the disposition of money or other property by delivery of a document containing his or her signature (or his or her signature and that of one or more other person) to the bank or other person with whom the account is maintained. Similarly, a person will have "other authority" where that person can exercise power over an account by communicating oral instructions to the bank or person with whom the account is maintained.

As noted above, because more than one person may have a financial interest in or signature or other authority over a foreign financial account, multiple FBAR filings may have to be made for the same account. In some instances, persons required to file FBAR may make a simplified filing. Specifically, persons required to report 25 or more foreign financial accounts need not provide information regarding every account, provided they retain detailed records about the accounts for five years. Additionally, corporations may consolidate FBAR filings with any 50 percent-owned companies that must also report.

II. Comments

Direct investment by plans in offshore vehicles is relatively common, and the use of offshore feeder funds to block UBIT by plans is also common, so if the recent statements by an IRS official are correct and an offshore hedge fund and, by extension, other offshore commingled funds (*e.g.*, private equity feeder funds) are "foreign financial accounts," FBAR must be filed with respect to those accounts. In this regard, the IRS could take the position that plan investment-related FBAR filings from prior years are delinquent and impose penalties. Consequently, plan fiduciaries concerned about potential FBAR-related liability should ensure that FBAR is filed for 2008 and may wish to consider filing under the voluntary correction program.

However, FBAR filing presents numerous challenges to plan fiduciaries. There is no certainty regarding the proper scope of the foreign financial account definition, nor with respect to who is required to make the filing for a plan's foreign accounts. The limited IRS guidance available explicitly contemplates multiple filings for the same account. Thus, IRS could take the position that the trust itself and each member of an investment committee must file FBAR with respect to the plan's foreign financial accounts. Moreover, FBAR filings may be required by directed trustees (including trustees of individual retirement accounts), investment managers, and certain plan administrators. In addition, FBAR's substantive filing requirements, while not extensive, will be burdensome and confusing for most filers.

In an announcement released on June 5, 2009, the IRS acknowledged the widespread confusion regarding FBAR and requested comments on the FBAR form and instructions. Those interested in submitting comments should do so on or before August 31, 2009.

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If you would like to discuss the FBAR filing requirements or are interested in submitting comments, please contact Jennifer Eller ((202) 861-6604, jee@groom.com), Michael Kreps ((202) 861-0182, mpk@groom.com), or your regular Groom attorney.