Foreign Bank Account Reporting for Employee Benefit Plan Investments

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Are you a trustee, custodian, investment committee member, fiduciary, or sponsor of an employee benefit plan that invests through one or more offshore "feeder" funds? Does the plan have other types of foreign investments? How about foreign securities accounts or sub-custody arrangements?

If you answered yes to any of these questions, you may be required to file a Report of Foreign Bank and Financial Accounts (Form TD F 90-22.1, or FBAR). And you are not alone. While most financial institutions have established procedures for assisting individual and corporate clients with FBAR filings, the application of the FBAR requirement to employee benefit plans and plan-related investments is still not settled. However, developments since June 2009 have caused plans and their trustees and custodians to take a fresh look at the FBAR requirement. Many institutions have struggled to provide information to plans in advance of shifting deadlines, and the uncertainty is not yet over. We expect that new FBAR rules will be issued before June 30, 2010—the next FBAR filing deadline—but until then, the application of FBAR to plans continues to be uncertain. Below, we explain why.

FBAR Basics

As a general rule, an FBAR must be filed by June 30 by every U.S. person (i.e., citizens, residents, trusts, and other legal entities) who has a "financial interest in" (i.e., is the owner of record or holder of legal title) or "signature or other authority over" (i.e., the ability to control the disposition of money or other property) any foreign "financial accounts" at any time during the previous calendar year, provided the aggregate value of the accounts exceeds $10,000.[1] Financial accounts include the following:

- 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
- 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)

The IRS has indicated informally that offshore hedge funds and offshore feeder funds exempt investors are foreign financial accounts. However, individual bonds, notes, or stock certificates held by a person or unsecured loans to a foreign trade or business (other than financial institutions) generally are not. Notably, plan fiduciaries might not even be aware that their plans have foreign financial accounts. For example, a plan may have hundreds of foreign financial accounts where its custodian has established a foreign custody network on the plan's behalf, even if some of the accounts do not contain any assets.

Because retirement plans are typically managed and administered by a large number of people, dozens of people could be required to file FBARs with respect to a plan-related foreign financial account. For the typical plan with a foreign financial account, the following parties may need to file FBARs: (a) the trust under the plan; (b) the plan's trustee(s); (c) members of an investment or administrative committee; (d) investment managers; (e) custodians; (f) the company or union that established and maintains the plan and trust; (g) various officers, employees, or members of the plan sponsor; and (h) participants in certain individual account plans [e.g., 401(k) plans].

Civil penalties for failing to file an FBAR range from $500 per violation up to the greater of $100,000 or 50 percent of the account balance, and criminal penalties may also be imposed.[2] However, the maximum penalty for nonwillful violations is $10,000, and the IRS will not impose the maximum penalty if the violation was due to "reasonable cause" and the amount of the account (or the balance of the transaction) was properly reported.

FBAR—Not on the Radar

The FBAR filing requirement has existed since the 1970s, but the retirement plan community was largely oblivious to it until fairly recently. Reasons for this include the following:

- When the Treasury instituted the FBAR rules, plans were largely invested in domestic bonds, and it was not until recently that plans began to invest directly in foreign markets.
- FBAR is a banking law requirement and not a tax or pension law requirement.
- Prior informal guidance from the IRS indicated that at least some plan fiduciaries were not required to file FBARs with respect to plan-related foreign investments.
- Requiring plan-related filings does little to further FBAR's purpose because plans are tax-exempt and pose little to no risk of engaging in criminal activity.
- There exists a general atmosphere of noncompliance with the FBAR requirement.[3]
- Enforcement of the FBAR requirement has been limited until fairly recently.

After September 11, 2001, Congress, the Treasury, and the IRS began to breathe new life into the FBAR requirement in an effort to combat terrorism and tax evasion. The IRS instituted a voluntary compliance program to incentivize FBAR and tax reporting compliance and began actively enforcing the FBAR and tax reporting rules for those failing to comply voluntarily. There have also been a number of high-profile tax evasion prosecutions, the most notable of which is the prosecution of Swiss banking giant UBS.[4] However, it was not until approximately two weeks before the June 30, 2009, FBAR filing deadline that many in the retirement plan community first learned of a potential filing obligation.

Plans Left Scrambling

On June 12, 2009, an IRS official taking part in a teleconference on the FBAR took the position that certain offshore, commingled investment vehicles would be considered foreign financial accounts. Previously, many practitioners had taken the position that such investments were not financial accounts for FBAR purposes. Word of the IRS official's position spread quickly through the retirement plan community as offshore fund managers alerted plan investors that they may be required to file FBARs. Confronting this "new" reporting requirement only days before the June 30 deadline, the retirement plan community was gripped by widespread confusion and the IRS was flooded with calls and e-mail messages.

In response, the IRS issued a hodgepodge of formal and informal guidance that extended the FBAR filing deadline to either October 15, 2009 (extended from September 23, 2009), or June 30, 2010, depending on the nature of the filer's relationship with a foreign financial account and the type of account at issue. Specifically, the following three deadlines apply:

- The FBAR filing deadline for 2008 and prior years was extended to June 30, 2010, for U.S. persons with (a) signature or other authority over a foreign financial account or (b) a financial interest in a commingled account.[5]
- U.S. persons not eligible for the June 30, 2010, deadline were permitted to file delinquent FBARs for the 2008 calendar year by October 15, 2009, without incurring a penalty if they had (a) only recently learned of their obligation to file FBAR, (b) insufficient time to gather the necessary information, and (c) reported and paid all 2008 taxable income, if any.[6]
- All other filings not eligible for either of the two extensions were still subject to the June 30, 2009, deadline.

Notably, trustees, custodians, trusts, and plan sponsors—any of which may be deemed to have a financial interest in plan investments—did not appear to be eligible for the June 30, 2010, deadline for their interests in foreign financial accounts that were not "commingled funds." Consequently, many of them were required to report their interest in noncommingled accounts, such as foreign securities or custody accounts, by October 15, 2009, while being able to delay reporting their interests in commingled funds, such as offshore hedge funds, until June 30, 2010. This likely resulted in numerous partial filings, which undoubtedly provided the IRS with information that is at best of little value and at worst misleading. In the authors' experience, different financial institutions hold accounts in different ways, with some institutions favoring "omnibus" accounts in all but a few jurisdictions, and others holding virtually every account in any foreign jurisdiction in the name of the plan or trust. Thus, two plans with identical investments but different trustees could (and did) make very different FBAR filings.

Looking Ahead
Those responsible for creating the FBAR requirement likely did not contemplate the substantial burden that the filing requirement would one day place on the retirement plan community. A single plan investment in a foreign financial account could trigger literally dozens of FBAR filings from people who have no actual, personal interest in the account. For example, a plan's directed trustee (and, in some cases, employees of the directed trustee) may be required to file an FBAR with respect to a plan's investment in a foreign financial account despite the fact that the directed trustee has no personal financial interest in the account and acts only on instructions from plan fiduciaries. Although compliance with the FBAR filing requirement is extremely burdensome, it serves no meaningful policy goal because plan-related filings provide the IRS with virtually no information that could prevent tax evasion, money laundering, or other crimes.

Thus, it is difficult to say what the FBAR filing requirement will look like in the future. However, the retirement plan community is working with the IRS to lessen the burden on plans, and we have already begun to see signs of progress. Specifically, the IRS recently requested comments on the current FBAR form and instructions and indicated that the Treasury is considering issuing FBAR-related regulations. This is an extremely positive development that will, we hope, result in much-needed clarification regarding the filing obligation of U.S. persons with a financial interest in or signature or other authority over a plan's foreign financial account. In particular, it provides the Treasury the opportunity to exempt retirement plans from the FBAR filing requirement or, at the very least, to limit the substantial burden the requirement places on plans and plan fiduciaries.

The comment period closed on October 6, 2009. We hope that new regulations specifically addressing plan-related investments will be issued before the next filing deadline of June 30, 2010.

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Endnotes

[1]Unless otherwise noted, the rules discussed below are found in the FBAR instructions.
[2]31 C.F.R. §§ 103.59, 5321(a)(5).
[3]U.S. Treasury Department, Report to Congress in Accordance Act Sec. 361(b) of P.L. 107-56 of the USA PATRIOT Act (April 26, 2002) (estimating FBAR compliance at around 20 percent).
[4]See, e.g., "IRS to Receive Unprecedented Amount of Information in UBS Agreement" (Aug. 19, 2009), available at www.irs.gov/newsroom/article/0,,id=212124,00.html.
[5]Notice 2009-62, I.R.B 2009-35 (Aug. 31, 2009).
[6]Voluntary Disclosure Questions and Answers [May 6, 2009 (revised June 24, 2009)], Question 43, available at www.irs.gov/pub/irs-utl/faqs-revised_6_24.pdf; IRS press release re deadline extension (Sept. 21, 2009), available at www.irs.gov/newsroom/article/0,,id=213463,00.html and www.irs.gov/newsroom/article/0,,id=210027,00.html).