Foreign Account Reporting for Retirement Plans

By Jennifer E. Eller and Michael P. Kreps

The authors discuss the filing requirements of the Bank Secrecy Act that may apply to retirement plans if funds are held in foreign bank accounts.

Since the 1970s, the Department of Treasury (Treasury) has required U.S. persons to file a Report of Foreign Bank and Financial Accounts (Form TD F 90-22.1, or FBAR) with respect to their "foreign financial accounts." Despite the longstanding existence of the FBAR form, the extent of its application to employee benefit plans is not well settled, for two primary reasons. First, foreign investment by plans was simply not widespread in the 1970s. As plan investments broadened to include more foreign and alternative investments, there seems to have been a general understanding on the part of plan fiduciaries, practitioners, and the Internal Revenue Service (IRS) that it was not necessary to file FBAR with respect to plan-related foreign investments. This understanding was likely derived from the fact that FBAR's purpose—to prevent taxpayers from hiding assets offshore to either evade paying income taxes or launder money—seems to have little relevance in the context of plan investments. Second, enforcement of the FBAR reporting requirement has been limited until fairly recently.

Recently, however, the IRS, began active enforcement of the FBAR filing requirements through a number of high-profile prosecutions and media initiatives. In addition, recent changes to the FBAR filing instructions and informal guidance from the IRS 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. This "new" filing requirement presents a number of practical difficulties to plan fiduciaries and service providers. Fortunately, the IRS granted some relief by extending until June 30, 2010 the deadline to file for 2008 and prior calendar years for many plan-related filings.

This article explores the FBAR filing requirement as it relates to retirement plans by first looking at the history of the current FBAR filing rules and then discussing how the filing requirements are relevant to retirement plans and plan fiduciaries (*e.g.*, plan investment and administrative committee members, and financial institutions that act as trustees for plan trusts). This article also analyzes recent filing relief issued by the IRS and discusses the future of the filing requirement.

History of FBAR and Recent Enforcement

The obligation to report foreign accounts to Treasury originated with the passage of the Bank Secrecy Act of 1970 (BSA), which was intended to, among other things, prevent financial crimes. Specifically, the BSA provides that:

> [T]he 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.[1]

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Congress intended such reports to include information concerning (i) the identity and address of participants in a transaction or relationship; (ii) the legal capacity in which a participant is acting; (iii) the identity of real parties in interest; and (iv) a description of the transaction.[2]

Soon after passage of the BSA, Treasury promulgated regulations requiring every "person subject to the jurisdiction of the United States" that has "a financial interest in, or signature or other authority over, a bank, securities or other financial account in a foreign country" to report the "relationship" to the IRS annually. As a result, FBAR was developed in order to facilitate such reporting.[3] Treasury also added foreign financial account reporting questions to individual, corporate and partnership tax returns.[4]

Enforcement and administration of the filing requirements have traditionally been divided within Treasury between the Financial Crimes Enforcement Network (FinCen) and the IRS. However, in April, 2003, IRS and FinCen agreed that the IRS would have primary responsibility for administration and enforcement of the FBAR rules.[5] FinCen retained some limited authority tointerpret the Treasury regulation on which FBAR is based, among other things.

Historically, compliance with the FBAR reporting requirements has been low, and the IRS has estimated that only 20 percent of those required to file FBAR actually do file.[6] The IRS has rarely enforced the FBAR filing requirements. Further, when it brought enforcement actions (usually along with) the Department of Justice), the IRS sought to impose FBAR penalties in conjunction with tax evasion charges.

However, since the attacks on September 11, 2001, FBAR reporting has taken on renewed significance as a crime fighting tool. In particular, the FBAR reporting requirements play an important role in preventing money laundering and abusive foreign tax schemes. These requirements "provide leads to investigators that facilitate the identification and tracking of illicit funds or unreported income, as well as providing additional prosecutorial tools to combat money laundering and other crimes."[7] In order to increase compliance with the foreign account reporting rules, and to entice people to pay taxes on foreign income, the IRS has instituted a new carrot-and-stick approach that rewards voluntary compliance and punishes scoff-laws.

The IRS has encouraged compliance with the FBAR and tax reporting requirements by implementing a voluntary compliance program for certain taxpayers with foreign income.[8] Taxpayers taking part in the voluntary compliance program were required to pay taxes owed but were subject to significantly reduced penalties. The program ran from March 23, 2009, through September 23, 2009 and was largely successful in encouraging voluntary reporting.

The IRS has also begun actively enforcing the FBAR and tax reporting rules for those failing to comply voluntarily. This stepped up enforcement has resulted in a number of high-profile tax evasion prosecutions, the most notable of which is certainly the IRS's case against Swiss banking giant UBS.[9] After months of diplomatic tussling, the IRS (with the Department of Justice) and UBS entered into a settlement agreement in which UBS agreed to turn over the names of approximately 4,500 U.S. persons who had foreign financial accounts with the bank.

[T]he FBAR reporting requirements play an important role in preventing money laundering and abusive foreign tax schemes.

FBAR

Under the current rules, 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."[10] "U.S. person" is defined broadly for FBAR purposes to include citizens, residents, trusts, and any legally cognizable person (or their associated trusts) to the extent prescribed by Treasury, a government entity is also considered a U.S. person.[11]

As a preliminary matter, there is nothing in either the Treasury regulations or the FBAR instructions that would explicitly exclude employee benefit plans (or their associated trusts) from the FBAR filing requirements.[12] Consequently, without further guidance or clarification, FBAR (or their associated trusts) seems to squarely apply to plan-related foreign financial accounts. One possible exception, however, may be governmental plans—typically considered instrumentalities of state and/or local governments—because

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Treasury has not explicitly included governmental entities in the definition of "U.S. person," as appears to be required by the BSA.[13]

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. These determinations are made based on careful reading of the FBAR's instructions.[14]

Parties Responsible for Filing

Generally, FBAR filings must be made by U.S. persons (including employee benefit trusts) who have 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.

Financial interest. A person has a "financial interest" in an account when that person is the owner of record or holds legal title to the account—regardless of whether the account is maintained for his or her own benefit. A financial interest may also arise by virtue of a person's role as an agent, nominee, attorney or some other capacity with respect to a financial account that belongs to a U.S. person. For example, a trustee of an employee benefit plan trust may have a "financial interest" in a foreign financial account where it is the owner of record of a plan's investment.

A U.S. person may also have an indirect "financial interest" in a foreign financial account if that person has 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. This would apply, for instance, when a pension plan trust owns more than 50 percent of the interests in a foreign corporation set up to make investments.

Another way a U.S. person can have an indirect financial interest is by being the person who established a trust, for which a "trust protector" has been appointed. In this case, such U.S. person may have a financial interest in an account where the trust, or a person acting on behalf of the trust, is the record owner or holder of legal title of the foreign financial account. "Trust protector," which is a term of art for trust lawyers, has been defined by the FBAR instructions as "a person who is responsible for monitoring the activities of the trustee with the authority to influence the decisions of the trustee or to replace, or recommend replacement, of the trustee." This may result in a plan sponsor having a financial interest in a plan's foreign financial accounts because (i) the trust is established by the plan sponsor as "settlor" and (ii) the named fiduciary (or other plan fiduciary) may meet the broad definition of "trust protector."

Signature or other authority. "Signature authority" over an account exists when a person can control the disposition of money or other property by delivering a document containing his or her signature (or his or her signature and that of at least one other person) to the bank or other person maintaining the account. An individual will have "other authority" when that person can exercise power over an account by communicating oral instructions to the bank or person maintaining the account.

In informal conversations, IRS personnel have stated that a person without the power to disburse an account does not have "other authority." Specifically, that a person who has power to direct how an account is invested, but cannot make disbursements from the account, is not required to file FBAR. The reasoning behind its position is that the person has no power to dispose of money or other property in the account. This statement appeared to have been an attempt on the part of IRS to limit the scope of the FBAR filing requirement for investment managers. However, the relief actually provided to investment managers is illusory. This is because there are virtually no circumstances under which a plan's investment manager lacks the power to make dispositions from an account. For example, a hedge fund manager will virtually always have the authority to compel redemptions.

Foreign Financial Accounts

To trigger an FBAR filing requirement, an account must be located outside of the United States. 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
- 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)

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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."

Retirement plan fiduciaries frequently make foreign investments that may trigger the FBAR reporting requirements. For example, it is relatively common for retirement plans, and other tax-exempt investors, to invest in offshore hedge funds or private equity funds. 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 brought to the attention of fund managers, financial institutions, and plan sponsors the potential application of FBAR filing requirements to plan investments.

The IRS has since reiterated its position with respect to offshore funds, but 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.

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Plans may also have foreign brokerage, securities, or custodial accounts that plan fiduciaries, including investment managers, use to purchase, sell and hold foreign securities. All such accounts are likely foreign financial accounts under the FBAR instructions. In some cases, a plan may even unknowingly hold a foreign financial account indirectly where it is a majority interest holder in a partnership and that partnership holds a foreign financial account.

An individual who has a foreign financial account that has 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 in a calendar year (or if no statements are provided, at any time in the calendar year), The maximum value should be 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.

Simplified or Limited Filings

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. However, under the following circumstances, certain persons otherwise required to file FBAR are excepted from the reporting rules:

- *Employees of U.S. corporations.* Where the U.S. person required to file an FBAR is a public U.S. corporation with shares traded on a national exchange, more than $10M in assets and more than 500 shareholders, an employee or officer of the corporation need not file a separate FBAR by reason of his or her signature or other authority over the corporation's foreign financial accounts, if (i) the officer or employee has no independent financial interest in the account and (ii) the chief financial officer has informed the officer or employee that the corporation has filed a report for the account.
- *Bank employees.* Bank officers and employees need not file FBAR with respect to accounts maintained by the bank where the bank is examined by a federal supervisory agency, provided the officer or employee has no financial interest in the account.

Further, a simplified reporting requirement applies where a U.S. person has a covered relationship with 25 or more financial accounts. In this case, an FBAR filing can be made without listing all of the foreign financial accounts. However, the filer must maintain records with respect to all of the accounts and turn the records over to IRS upon request. The FBAR and its instructions seem to indicate that the simplified filing requirement applies only when someone has a "financial interest" in more than 25 accounts and not when a person has "signature or other authority" over more than 25 accounts. However, the IRS stated on its website that the simplified filing does apply to signature or other authority.[15]

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Deadlines and Penalties

FBAR must be filed no later than June 30 for the previous calendar year. Because the filing requirement originates from the Bank Secrecy Act and not the Code, FBAR must be received by the IRS on June 30, not mailed. As discussed in more detail below, the IRS has granted a partial filing extension, so some filers may have until June 30, 2010, to file for 2008 and prior calendar years.

The IRS has discretion to impose penalties for failure to file FBAR, incorrect FBAR filings, and a failure to maintain appropriate records. Civil penalties 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.[16] However, the maximum penalty for non-willful violations is $10,000, and the IRS cannot 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. Although IRS generally has discretion to set penalties, it lacks the power to collect on its own and must turn to the Department of Justice to aid in enforcement.

Typical Plan-Related Filers

If an employee benefit plan holds a foreign financial account, any number of persons could have an FBAR reporting obligation as a result of their "financial interest in" or "signature or other authority over" the account. Under a typical plan structure, one or more of the following U.S. persons may be required to file FBAR:

- The trust(s) associated with the plan
- The plan's trustees, which in some cases may be financial institutions and in other cases may be corporate employees, union members, or government officials
- The fiduciary named in a plan's governing document, which in many cases may require filings by each member of an investment committee
- Other investment fiduciaries, such as investment managers
- Custodians and/or subcustodians, that hold plan assets and may facilitate foreign investment
- The plan sponsor, which may be a company, union, or governmental entity
- Officers and employees of the plan sponsor
- Participants in individual account plans, where, for example, the participant has invested in foreign financial accounts through a self-directed brokerage account

Needless to say, coordinating FBAR filings among all of the parties listed above raises difficult practical issues for plan fiduciaries and service providers, particularly for plans that experience numerous personnel and/or service provider changes during each calendar year. Unfortunately, plan fiduciaries will frequently be unable to determine conclusively whether a filing needs to be made with respect to a particular investment because there is limited formal guidance with regard to the FBAR filing requirements. Therefore, although FBAR's substantive filing requirements are not extensive, they will be burdensome and confusing for most filers.

Moreover, the penalties for failing to file FBAR may serve as a significant disincentive to corporate employees, government officials and union members who might serve on plan committees. This disincentive is exacerbated by the fact that the relationship must also be disclosed on individual income tax returns, including Form 1040. The burden associated with FBAR filings, therefore, goes far beyond that which may have been reasonably expected by current or future plan fiduciaries and service providers when agreeing to act in connection with plan investments.

Widespread Confusion and the IRS Response

It was not until after the June 12, 2009 teleconference (at which an IRS official opined that certain offshore funds were foreign financial accounts) that plan fiduciaries first began to learn about their FBAR filing requirements. Many plans were alerted to their potential filing obligations by fund managers and investment service providers.

Having learned about their "new" reporting requirement mere days before the deadline, the retirement plan community was gripped by widespread confusion and consternation regarding the legal and practical issues raised by FBAR. In response, the IRS issued revised Frequently Asked Questions (FAQs), posted on its Web site six days before the 2008 calendar year filing deadline, which provided, among other things, that certain filers would have until September 23, 2009 (the final day of the voluntary disclosure program), to file FBAR for the 2008 calendar year without penalty, provided certain conditions were met.[17] Specifically, a penalty-free delinquent filing was permitted if the U.S. person had (i) only recently learned of his or her obligation to file FBAR, (ii) insufficient time to gather the necessary information,

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and (iii) reported and paid all 2008 taxable income, if any. FBAR filings made after June 30 are considered delinquent and be filed with a statement explaining the delinquency, but the IRS will not impose penalties for a failure to file.

However, the relief provided by the IRS's FAQs was, at best, incomplete and, at worst, unreliable. The penalty-free filing period appeared to apply only to the 2008 calendar year, so the vast majority of plan fiduciaries with an FBAR filing obligation remained exposed to liability for prior year filings. Additionally, many plan fiduciaries quickly learned that, if an institutional trust was involved, the trustee was submitting its own FBAR filings with respect to the plan's foreign financial accounts (sometimes as trustee and other times on behalf of the trust). Consequently, it was difficult for fiduciaries to be sure that the IRS would deem them to have "only recently learned of their obligation." Further, the FAQs did not clarify what "tax return" should be filed with the delinquent FBAR, and it was not clear whether every person associated with a covered relationship to a plan's foreign financial account(s) would have to submit a personal tax return or if a plan's Form 5500 or Form 990 would suffice. Even putting aside those practical difficulties, many fiduciaries were generally skeptical of relying on informal guidance posted with little fanfare on the IRS Web site.

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Even after the release of the FAQs, confusion and discontent over the FBAR filing requirements continued to simmer in the retirement plan community. The IRS received a number of comments requesting a suspension of the FBAR filing requirement. In addition, requests were made for clarification regarding many of the difficult filing issues. As a result, the IRS issued a temporary suspension of the FBAR filing requirements for certain filers.

On August 10, 2009, the IRS issued Notice 2009-62, which extended the FBAR filing deadline until June 30, 2010, for persons whose only relationship with a foreign financial account is by reason of having signature or other authority over the account.[18] Thus, regardless of the type of foreign financial account, a plan fiduciary, such as an investment committee member, typically need not file FBAR for 2008 or prior years until June 30, 2010. The IRS noted that such persons may need to make filings for 2008 and prior years on or before June 30, 2010, to the extent required by future guidance.

Notice 2009-62 also applies in a more limited fashion to persons deemed to have a "financial interest" in a foreign financial account—such as trustees, custodians, trusts and plan sponsors—if the account is a "commingled fund." The term "commingled fund" is defined by the FBAR instructions as 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)." Trustees, custodians, trusts and plan sponsors may need to differentiate between foreign financial accounts that are "commingled funds" and foreign financial accounts that are not in order to determine which accounts are eligible for the extended June 30, 2010 filing deadline. This could result in partial FBAR filings. Consider the following example:

> In 2008, an employee benefit plan trust (i) invested in an offshore commingled fund and (ii) held foreign securities in a foreign custody account. Both the commingled fund and the foreign securities account are arguably foreign financial accounts. While the trust could be deemed to have a "financial interest in" each of the foreign financial accounts, the relief provided by Notice 2009-62 may be available to the trust only with respect to the commingled fund. An FBAR filing with respect to the foreign securities account would not be eligible for the extended deadline and would, in fact, already be considered delinquent (but potentially eligible to file by September 23, 2009, without incurring penalties).

A similar situation arises in the individual retirement account (IRA) context where, for example, an IRA custodian may have to first identify which of its IRA clients invested in foreign accounts at any time during the calendar year and then determine which of those foreign financial accounts are "commingled funds" in order to determine the extent to which the June 30, 2010 FBAR filing deadline applies.

Although it does not provide complete relief, Notice 2009-62 was helpful to numerous U.S. persons

that may have otherwise been required to file FBAR in connection with retirement plans. The extended filing deadline is a particularly positive development for investment fiduciaries of retirement plans, many of whom will likely be eligible for a complete reprieve from any FBAR filing obligation until June 30, 2010. The extension is similarly helpful in connection with plans and IRAs where foreign investments are limited to commingled funds.

Outlook

It is difficult to say what the FBAR filing requirements will look like in the future. The benefit plan community is actively working with the IRS to lessen the burden on plans, and we have already begun to see signs of progress. Specifically, Notice 2009-62 requests comments on the current FBAR form and instructions and indicates that Treasury is considering issuing FBAR-related regulations. This is an extremely positive development and will hopefully 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 Treasury the opportunity to except retirement plans from the FBAR filing requirements or, at the very least, to limit the substantial burden FBAR places on plans and plan fiduciaries.

Endnotes

1 Pub. L. No. 91-508 (1970); 31 U.S.C. § 5314(a).

2 31 U.S.C. § 5314(a).

3 31 C.F.R. § 103.24.

4 *See, e.g.,*Form 1040, Schedule B, Line 7.

5 68 FR 26,468 (May 16, 2003)(codified at 31 CFR §103.56(g)).

6 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).

7 IRS Workbook on FBAR (February 19, 2009), available online at *www.irs.gov/businesses/small/article/0,,id=159757,00.html.*

8 September 23 Deadline for Some FBAR Filers, available online at *www.irs.gov/newsroom/article/0,,id=210174,00.html*; Voluntary Disclosure Questions and Answers (May 6, 2009 (revised June 24, 2009)), Question 43, available online at *www.irs.gov/pub/irs-utl/faqs-revised_6_24.pdf.*

9 *See, e.g.,* IRS to Receive Unprecedented Amount of Information in UBS Agreement (Aug. 19, 2009), available online at *www.irs.gov/newsroom/article/0,,id=212124,00.html.*

10 Unless otherwise noted, the rules discussed are found in the FBAR Instructions.

11 FBAR Instructions; 31 C.F.R. § 103.11(z).

12 31 U.S.C. § 5312(a)(5).

13 Treasury issued the FBAR reporting requirement under 31 U.S.C § 5314, which states that Treasury may prescribe "a reasonable classification of persons subject to or exempt from a requirement under this section or a regulation under this section … ." For purposes of 31 U.S.C. § 5314, "person" is defined to include "a trustee, a representative of an estate and, *where the Secretary prescribes*, a government entity." 31 U.S.C. § 5312(a)(5) (emphasis added). Neither Treasury regulations nor IRS guidance prescribe that government entities, such as governmental plans, are "persons" subject to the FBAR filing requirement.

14 *Supra* note 11.

15 FAQs Regarding Report of Foreign Financial Accounts (FBAR) – Financial Accounts (revised June 29, 2009), available online at *www.irs.gov/businesses/small/article/0,,id=210249,00.html#FA10.*

16 31 C.F.R. §§ 103.59, 5321(a)(5).

17 Voluntary Disclosure Questions and Answers (May 6, 2009 (revised June 24, 2009)), Question 43, available online at *www.irs.gov/pub/irs-utl/faqs-revised_6_24.pdf.* The authors note that on September 21, 2009, the IRS announced a further delay of the filing deadline initially announced in Question 43. The announcement (available online at *www.irs.gov/newsroom/article/0,,id=213463,00.html* and *www.irs.gov/newsroom/article/0,,id=210027,00.html*) provides that those otherwise required to file FBAR by September 23, 2009, are now permitted to file delinquent FBARs by October 15, 2009, without penalty.

18 Notice 2009-62, I.R.B 2009-35 (Aug. 31, 2009).

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