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Further Guidance Needed for the Required Reporting of Foreign Bank And Financial Accounts

by Fred Feingold

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SPECIAL REPORTS

Further Guidance Needed for the Required Reporting Of Foreign Bank and Financial Accounts

by Fred Feingold

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Although there has been a requirement for U.S. persons to report interests in foreign financial accounts for more than 30 years, compliance with this requirement has been less than stellar. In some cases, the lack of compliance is attributable to a desire not to report and pay tax on income earned on accounts required to be disclosed. Indeed, there has been much publicity of late regarding the failure of as many as 50,000 account holders at one non-U.S. financial institution alone to properly report the existence of such accounts. Most observers assume that in many cases the lack of reporting was motivated by a desire of the account holders to improperly exclude the income from such accounts, and the admission in a deferred prosecution agreement that the foreign institution in question facilitated these failures to report suggests that this may be the case.[1] The IRS has made it clear that it intends to vigorously pursue those who have not complied with their obligations to report interests in foreign financial accounts[2] and to be more lenient with those who voluntarily come forward and report the existence of such accounts and pay any taxes, interest, and penalties that may be due.[3]

One cannot tell this from a casual reading of this recent press coverage, but not every case involving a

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[1]*See, e.g.*, Lynnley Browning, ''A Swiss Bank Is Set to Open Its Secret Files,'' *N.Y. Times*, Feb. 18, 2009, *available at* http://www.nytimes.com/2009/02/19/business/worldbusiness/19ubs.html?scp=1&sq=UBS%20irs%20deferred%20prosecution&st=cse; David D. Stewart, ''U.S., Swiss Dispute Over UBS Intensifies,'' *Tax Notes Int'l*, Mar. 2, 2009, p. 735, *Doc 2009-3716*, or *2009 WTD 32-1*; Carrick Mollenkamp, ''UBS Customers Shielded by Swiss Law, Bank Says,'' *Wall St. J.*, Feb. 23, 2009, *available at* http://online.wsj.com/article/SB123531487617042081.html. *See also* Press Release, U.S. Department of Justice, ''UBS Enters Into Deferred Prosecution Agreement'' (Feb. 18, 2009), *available at* http://www.usdoj.gov/opa/pr/2009/February/09-tax-136.html. The deferred prosecution agreement is available at http://www.usdoj.gov/tax/UBS_Signed_Deferred_Prosecution_Agreement.pdf.

[2]*See, e.g.*, Press Release, U.S. Department of Justice, ''United States Asks Court to Enforce Summons for UBS Swiss Bank Account Records'' (Feb. 19, 2009), *available at* http://www.usdoj.gov/tax/txdv09139.htm. The petition to enforce the summons is available at http://www.usdoj.gov/tax/UBS_Petition_to_Enforce_John_Doe_Summons.pdf. *See also* Press Release, U.S. Department of Justice, ''Federal Judge Approves IRS Summons for UBS Swiss Bank Account Records'' (July 1, 2008), *available at* http://www.usdoj.gov/tax/txdv08584.htm. The court order is available at http://www.usdoj.gov/tax/UBS_Order.pdf. *See also* ''Brief of UBS AG in Opposition to the Petition to Enforce the John Doe Summons,'' *Doc 2009-9956* or *2009 WTD 83-25*; ''Amicus Brief of Government of Switzerland,'' *Doc 2009-9958* or *2009 WTD 83-26*; Press Release, The White House, ''Leveling the Playing Field: Curbing Tax Havens and Removing Tax Incentives For Shifting Jobs Overseas'' (May 4, 2009), *available at* http://www.whitehouse.gov/the_press_office/leveling-the-playing-field-curbing-tax-havens-and-removing-tax-incentives-for-shifting-jobs-overseas/.

[3]The IRS recently published a series of memoranda and a statement from the Commissioner of Internal Revenue outlining their initiative to encourage voluntary compliance by imposing a smaller penalty in lieu of penalties otherwise applicable, which are available at http://www.irs.gov/newsroom/article/0,,id=206012,00.html. To provide further information about this voluntary compliance initiative, the IRS published a series of Frequently Asked Questions on May 6, 2009, which are available at http://www.irs.gov/pub/irs-news/faqs.pdf.

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failure to comply with the reporting requirements is attributable to a desire to hide income. Indeed, in many cases, the lack of compliance with the reporting requirements has more to do with ignorance by taxpayers and their advisers concerning the application of the requirements to a particular situation than any willful attempt to hide income.[4] For example, a U.S. person may understand that income earned on a non-U.S. account must, like all other income, appear as income subject to tax on his or her U.S. tax returns and in fact report such income, but that person may nevertheless fail to file the required reports not realizing the reports are due or believing that the reporting of any income on such accounts on U.S. tax returns fulfills his obligations. U.S. persons living abroad who report income on their accounts to the country in which they reside may fail to report the existence of and income regarding a foreign financial account to the United States out of a belief that they have paid all taxes that are due, and therefore have met their obligations.[5]

While common sense indicates that the failures in the above cases are not all attributable to an intention to illegally avoid the payment of taxes that are due, there appears to be a presumption, at least in the newspaper accounts, that a failure to comply has an illegal purpose. And if the failure to comply with the reporting of an interest in a foreign financial account is coupled with a corresponding omission of income, however inadvertent,[6] there may be cause for concern given the present climate, at least in circumstances when the application of the reporting requirements is clear. Yet, as will be seen below, the application of the reporting requirements to a particular circumstance is not always clear and, even when clear, can lead to astounding results.

Whatever ''official'' guidance that exists can be found only in instructions to the forms required to be filed and in various ''Q's and A's'' of which most taxpayers and their advisers might not even be aware. Moreover, certain rules contained in the recently published revised instructions described in this article would seem to add yet other categories of persons who could unwittingly fail to be in compliance with the reporting requirements without having any liability for income tax on income earned on an offshore financial account. Given the severe penalties imposed for not complying with this requirement, discussed below, further formal guidance on the application of these reporting requirements may be needed.

The IRS published a new version of Form TD F 90-22.1 (Rev. October 2008), ''Report of Foreign Bank and Financial Accounts'' (FBAR), on its Web site on September 30, 2008, to be used for any filing after December 31, 2008.[7] The new version of the form includes revised instructions and definitions concerning who is required to file the FBAR. The new definitions potentially expand the group of persons required to file, but the extent of this group is unclear, as some of the key requirements and definitions contain undefined terms.

This year, the Service made a number of updates to pages on its Web site regarding the filing of the FBAR. These pages included the ''FAQs Regarding Report of Foreign Bank and Financial Accounts (FBAR)'' (the FAQs); the ''Workbook on the Report of Foreign Bank and Financial Accounts (FBAR)'' (the workbook); the ''Report of Foreign Bank and Financial Accounts'' (the FBAR page); and ''Headliner Volume 262,'' which defines ''in and doing business in'' for FBAR purposes (the headliner).[8] These pages on the Service's Web site provide the only interpretation of the instructions to the FBAR. This article outlines the extent to which the FAQs, the workbook, the FBAR page, and the headliner have provided clarification on the requirements and definitions, and what remains ambiguous despite this guidance. Finally, a number of examples, which would clarify the definitions in the FBAR instructions if they were to be included as part of formal published guidance on this issue, are suggested.

The Applicable Provision

31 U.S.C. section 5314 (the applicable provision) provides that:

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[4]*See* Martin A. Sullivan, ''Proposals to Fight Offshore Tax Evasion, Part 2,'' *Tax Notes Int'l*, May 4, 2009, p. 353, *Doc 2009-9130*, or *2009 WTD 85-4* (discussing the proposal of Sen. Max Baucus, D-Mont., to require tax preparers to ask due diligence questions to determine whether the FBAR should be filed).

[5]Strangely enough, in some cases these taxpayers may be correct when foreign tax credits are taken into account.

[6]Who among us has never inadvertently omitted interest income regarding a domestic bank account, possibly because of a misplaced Form 1099, and, when reminded of the failure, paid any balance due?

[7]Filings for interests in foreign accounts held in 2008 are required to be made by June 30, 2009. The FBAR is not currently filed with the tax return. *See* Sullivan, *supra* note 4 (discussing the proposal of Sen. Max Baucus, D-Mont., to require FBARs to be filed with the income tax return).

[8]These are available at http://www.irs.gov/businesses/small/article/0,,id=148845,00.html (updated Mar. 13, 2009); http://www.irs.gov/businesses/small/article/0,,id=159757,00.html (updated Feb. 19, 2009); http://www.irs.gov/businesses/small/article/0,,id=148849,00.html (updated Feb. 23, 2009); and http://www.irs.gov/businesses/small/article/0,,id=204798,00.html (updated Feb. 27, 2009). Also, the IRS recently published Headliner Volume 265, ''FBAR Reporting by Persons with Only Signature Authority or Other Comparable Authority,'' *available at* http://www.irs.gov/businesses/small/selfemployed/article/0,,id=206219,00.html (updated Apr. 8, 2009).

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> 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.][9]

The statute also states that records and reports shall contain information ''in the way and to the extent the Secretary prescribes.'' This information includes the identity and address of participants in a transaction or relationship, the legal capacity in which a participant is acting, the identity of real parties in interest, and a description of the transaction.[10]

Subsection (b) of the applicable provision provides that the Secretary:

> may prescribe — a *reasonable*[11] classification of persons subject to or exempt from a requirement under this section or a regulation under this section; a foreign country to which a requirement or a regulation under this section applies if the Secretary decides applying the requirement or regulation to all foreign countries is unnecessary or undesirable; the magnitude of transactions subject to a requirement or a regulation under this section; the kind of transaction subject to or exempt from a requirement or a regulation under this section; and other matters the Secretary considers necessary to carry out this section or a regulation under this section. [Emphasis added.][12]

The statute does not specify the manner in which the Secretary may prescribe these various items. Finally, subsection (c) states that ''[a] person shall be required to disclose a record required to be kept under this section or under a regulation under this section only as required by law.''[13]

Persons Required to File

The applicable provision requires ''a resident or citizen of the United States or a person in, and doing business in, the United States'' to comply with the provisions of the statute. While the meaning of the term ''U.S. citizen'' may be clear (but see below), the meaning of the term ''resident'' as used under the applicable provision is not entirely clear from the context. Indeed, there appear to be several possible definitions of that term. Resident may be defined as an individual lawfully permitted to reside permanently in the United States under immigration and nationality provisions,[14] possibly as an individual considered to be a U.S. resident for U.S. federal income tax purposes[15] (which includes some individuals who are lawful permanent residents[16]), or an individual who, although not a U.S. citizen, is domiciled in the United States and therefore considered resident in the United States for U.S. federal gift or estate tax purposes.[17] Although neither the applicable provision nor the regulations that appear to interpret the provision specifically define the term ''resident,'' reg. section 103.24, which relates to reporting requirements, appears to sensibly indicate at least an intention of limiting the application of the reporting requirements to a ''person subject to the jurisdiction of the United States'' (but not a foreign subsidiary of a U.S. corporation).[18]

> **While the meaning of 'U.S. citizen' may be clear, the meaning of 'resident' as used under the applicable provision is not entirely clear from the context.**

Although obviously being subject to the jurisdiction of the United States is intended to be a prerequisite for the application of this section, it is unclear what the term ''jurisdiction'' is intended to mean in this context.

[9] 31 U.S.C. section 5314. All references to sections of the United States Code, the IRC, and regulations refer to the current version of such statutes and regulations at the time of the writing of this article.

[10] 31 U.S.C. section 5314(a)(1)-(4).

[11] While rules requiring U.S. persons to be subject to the reporting requirements would no doubt be considered reasonable, as will be discussed below, extending the classification to non-U.S. persons raises a threshold question of whether the reasonable limitation has been breached.

[12] 31 U.S.C. section 5314.

[13] *Id.*

[14] 8 U.S.C. section 1101(a)(20).

[15] IRC section 7701(b).

[16] *Cf.* Treas. reg. section 301.7701(b)-7(a) (relating to dual residents treated as nonresident aliens for certain purposes of the IRC). Consider, for example, the situation of an individual who under this section is treated as a nonresident alien for purposes of computing his tax liability but as a U.S. resident under the IRC for purposes other than determining his tax liability.

[17] Treas. reg. section 20.0-1(b); Treas. reg. section 25.2501-1(b).

[18] 31 C.F.R. section 103.24.

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One possible reading of this limitation is that for the purposes of the applicable provision, the term ''jurisdiction'' is intended to mean the authority of a U.S. court over the person such as in personam jurisdiction or possibly subject matter jurisdiction. But, read that way, all persons actually in the United States (perhaps with rare exceptions) would be subject to U.S. jurisdiction (at least when they are physically in the United States) including persons such as foreign tourists that no one could conceivably have intended to cover (nor would it have been reasonable to do so), and therefore in personam jurisdiction could not be an appropriate standard. It is possible for a person not physically within a state to be subject to the jurisdiction of the courts of that state under a long-arm jurisdiction statute because that person was regularly doing business within the jurisdiction.[19] Whether being subject to jurisdiction under a long-arm jurisdiction statute is an appropriate standard is somewhat questionable. On the one hand, the ''in and doing business in'' language (discussed below) in the applicable provision suggests the possibility; on the other, long-arm jurisdiction statutes are generally matters of state, not federal, law without necessarily a uniform standard apart from the outer constitutional limits of long-arm jurisdictions.

A more appealing interpretation is that the U.S. jurisdiction to which one must be subject under the regulations is the ''taxing jurisdiction'' of the United States. That the enforcement of these provisions falls to the IRS lends some credence to this rationale.[20] Read in this manner, an individual who is considered to be a resident of the United States for U.S. federal income tax purposes or a U.S. citizen would clearly be subject to the provision.

Consistent with this approach, U.S. federal income tax returns of U.S. citizens and individuals considered to be U.S. residents require the filer to answer whether the filer has a covered financial interest and, if he does, instruct that he must file the FBAR. By contrast, an individual who is neither considered to be a U.S. citizen nor a resident for U.S. federal income tax purposes may or may not be required to file a U.S. federal income tax return. A U.S. federal income tax return is required for such a taxpayer if the person is engaged in a U.S. trade or business or has U.S.-source income subject to withholding and the proper amount of withholding has not been deducted (and in other cases in order to file elections).[21] Such returns that may be required to be filed are a Form 1040NR (in the case of a nonresident alien) or Form 1120F (in the case of a foreign corporation). Neither of these forms has heretofore asked any question concerning non-U.S. financial interests, and the conventional wisdom has been that such persons were not subject to the FBAR filing requirements even though a U.S. income tax return might be required to be filed by the person. Such a person is subject only to a limited U.S. tax jurisdiction relating generally to U.S. business income and some types of U.S.-source passive income. Not requiring such a person to file the FBAR (and, as noted, heretofore there did not appear to be any such requirement) is consistent with an interpretation that the U.S. jurisdiction to which a person must be subject for the FBAR requirement to be applicable is tax jurisdiction of the widest sort, and this indeed has been the way most observers have viewed the breadth of the provision. As so viewed, a nonresident alien or a foreign corporation generally would not be subject to the FBAR requirements.

In and Doing Business In

Literally, the applicable provision, and for the first time the new instructions to the FBAR form, are also made applicable to a person (whether or not a citizen or resident of the United States) who is *in and doing business in the United States.*

The applicable provision and the new instructions to the FBAR form are made applicable to a person who is in and doing business in the U.S.

The term ''person'' is defined broadly in reg. section 103.11 as including ''an individual, a corporation, a partnership, a trust or estate . . . and all entities cognizable as legal personalities.''[22] Literally, therefore, if any person as so defined was either a U.S. citizen or resident or was ''in'' the United States and was ''doing business'' in the United States, such person would be subject to the FBAR requirements. Indeed, the new instructions provide that the form is applicable to a United States person, a term defined in those instructions as ''a citizen or resident of the United States, or a

[19] *See, e.g.*, N.Y. C.P.L.R. section 302(a).

[20] *See* 31 C.F.R. section 103.56(g). But tax enforcement is not the only purpose of the provisions. *See* S. Rep. 91-1139, at 1 (1970). And, therefore, one may have to look at the jurisdictional prerequisite to the application of the money laundering provisions to determine the intended breadth of the application of the provision.

[21] Treas. reg. section 1.6012-1(b).

[22] 31 C.F.R. section 103.11(z).

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person in and doing business in the United States.'' There does not appear to be any definition, either in the applicable provision or the regulations, that defines either the terms ''in'' or ''doing business in.'' Turning first to the term ''in,'' it appears that the context of the applicable provision requires that the term relate to persons (other than U.S. citizens or individuals considered resident for U.S. federal income tax purposes already covered) that have a legal existence governed by the laws of any state or the United States. As so viewed, the term would have no meaningful application to individuals and indeed for the reasons already stated the context of the applicable provision strongly suggests there is no reason to interpret the term as being applicable to individuals. The term ''in'' as it relates to persons other than individuals could properly mean those persons deriving their existence from U.S. law, such as U.S. corporations and U.S. limited liability companies that are cognizable as entities. Other persons cognizable as entities, such as trusts, estates, and partnerships, should also likely be considered ''in'' the United States if they are created under and in some cases governed by U.S. law.[23] Indeed, such persons would be considered U.S. persons for U.S. federal income tax purposes. Such an interpretation would be consistent with what most observers already assume to be the case: A person considered a U.S. person for U.S. federal income tax purposes is subject to reporting under these provisions. Despite this, the new instructions define the term ''U.S. person'' in a manner that could include persons that are neither U.S. citizens nor U.S. residents who draw their legal existence from U.S. law, but who are in and doing business in the United States. By doing so, the applicable provision appears to turn the definition of U.S. person on its head.

A person, cognizable for legal purposes, deriving its existence under U.S. law and that would otherwise be considered a U.S. person for tax purposes but for the fact that such person is disregarded for U.S. federal income tax purposes (such as a single member LLC) should probably also be disregarded for purposes of reporting requirements: No harm would be done by so doing. The taxpayer, regarding that disregarded entity, would be the person who would be required to report depending on whether such person meets the requirement for filing the FBAR. Moreover, were the rule otherwise, the required filing by such a person disregarded for tax purposes would in some cases require duplicate filings and in still other cases eliminate filing by the person subject to tax on the income earned on the foreign account.[24] Nevertheless, the rule does appear to be otherwise: A disregarded LLC is required to file with respect to interests in non-U.S. accounts it may have an interest in, but in certain circumstances a person required to include the income of that LLC may have no requirement to file.

Of course, even this proposed rule (which again seems to fit the conventional wisdom) may pose issues in the case of a partially disregarded entity such as a trust, only a portion of which is a grantor trust. It seems that the portion that is so treated should similarly not be required to file, but regarding that portion the grantor/owner should file if otherwise a covered person under the filing requirements. In certain circumstances, this may require both a trust and an individual grantor to file regarding a portion of an interest, but that does not appear to be so difficult.

The above analysis would suggest that the term ''in'' in the applicable provision, if interpreted in the manner indicated, would provide a rationale for FBAR requirements regarding persons other than individuals. However, such an interpretation without more would read out of the applicable provision the term ''and doing business in.'' The question arises as to whether the ''and doing business in'' requirement modifies the term ''in.'' If so, then only those persons ''in'' (perhaps under the interpretation set out above) the United States that are also doing business in the United States need report. A nondisregarded U.S. entity that did not do business in the United States would, under such a reading, be absolved from reporting, and it does not appear that most observers would view such an interpretation as having been intended (although a literal reading of the applicable provision does seem to suggest the possibility); an interpretation that always includes an entity that derives its existence from the United States as a U.S. person required to file reports would prevent the exclusion of such U.S. entity. Indeed, it would seem that to the extent anyone has thought of the issue, the ''in and doing business in'' language was probably meant to define that class of persons, other than U.S. citizens and residents, that have two qualities: a legal presence in the United States (that is, ''in'') and doing business in the United States, and for this purpose the term ''U.S. citizen'' was meant to include not only individuals who are U.S. citizens, but also entities that are considered to have derived their legal existence from the United States. Under this reading, the only class of persons to whom the ''in and doing business in'' requirement could apply would be to non-U.S. entities that had a sufficient presence in the United States to be considered ''in'' the United States and who were ''doing business in'' the United States. It would not ordinarily apply to nonresident alien individuals (and as indicated above the provision has never been applied to nonresident alien individuals) whether or not such individuals were engaged in a U.S. trade or business within the United States.

[23]*Cf.* Treas. reg. section 20.0-1(b); Treas. reg. section 301.7701-5(a); Treas. reg. section 301.7701-7(a).

[24]Consider the case of a disregarded entity such as a single member LLC owned by a grantor trust and in respect of which the grantor does not have a more than 50 percent interest.

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This would leave the ''in and doing business in'' requirement as being applicable to non-U.S. persons that have a sufficient cognizable legal presence in the United States to be considered ''in and [obviously] doing business in'' the United States. Indeed, the new instructions provide that a U.S. branch of a foreign entity that is doing business in the United States is required to file even if not separately incorporated under U.S. law,[25] implying (a) that a non-U.S. entity that did not have a U.S. branch doing business in the United States would not be required to report; and (b) that in the case of a non-U.S. entity with a U.S. branch, there would be required reporting but whether such reporting would be required only for non-U.S. accounts of that branch and not for the non-U.S. accounts of that entity that are not connected to its U.S. branch is by no means clear. Thus, for example, a non-U.S. corporation that regularly conducted U.S. business activities through a U.S. branch (as such term is commonly understood internationally[26]) should be included, but a non-U.S. corporation that was technically engaged in a U.S. trade or business but did not operate such trade or business through some U.S. office or other fixed place of business generally considered to constitute a branch under international standards should not be considered sufficiently in the United States to be subject to the reporting rules, notwithstanding that such a company might be subject to a branch profits tax under IRC section 884. But a non-U.S. partnership that had a formal U.S. branch and regularly conducted U.S. business activities from that branch should be subject to the reporting rules at least for the non-U.S. accounts of that branch, even though the branch profits tax provisions do not apply to such entities.

Thus, in a case when a non-U.S. entity is subject to the reporting rules, it is because it has a legal presence in the United States (that is, an actual branch from which it conducts business in the United States). It would seem logical to limit the reporting requirements of such a person to any interests in non-U.S. accounts that were an integral part of those U.S. branch activities because non-U.S. accounts of such a person that were not attributable to the branch would have no tax significance. Logic would dictate that a non-U.S. corporation with both a cognizable U.S. branch and activities unrelated to such U.S. branch activities, such as activities relating to business conducted outside the United States, should only be required to report interests in accounts that are an integral part of its U.S. branch activities. Yet there is no clear statement to this effect.

[25]*See* new instructions at p. 6 (''General Definitions'').

[26]*Cf.* Commentary on Article 5, OECD Commentaries on the Articles of the Model Tax Conventions (July 2008).

Financial Interest

The term ''financial interest'' is not used in 31 U.S.C. section 5314 but is used in regulation section 103.24, which states that ''[e]ach person subject to the jurisdiction of the United States . . . 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.''[27] However, financial interest is not defined in the statute or any of the relevant regulations.

The new instructions define a financial interest as an interest a U.S. person has in each foreign financial account for which that person is the owner of record or has legal title.[28] The new instructions also contain a series of look-through rules, first attributing ownership of an account to a U.S. person when the owner of record or holder of legal title is acting on behalf of the U.S. person.[29] When a corporation or partnership is the owner of record or holder of legal title, the new instructions attribute the foreign accounts held by such corporation or partnership to a shareholder or partner of such corporation or partnership meeting certain ownership requirements. This look-through rule applies to any U.S. person owning, directly or indirectly, more than 50 percent of the total value of shares of stock or more than 50 percent of the voting power for all shares of stock of a corporation or a more than 50 percent interest in the profits or the capital of a partnership. There is also a look-through rule for a trust owning a foreign account in which a U.S. person either has an indirect or direct present beneficial interest in more than 50 percent of the assets or from which such person receives more than 50 percent of the current income. Finally, a U.S. person has a financial interest in each financial account in a foreign country for which the owner of record or holder of legal title is a trust, or a person acting on behalf of a trust, that was established by such U.S. person and for which a trust protector, defined in the instructions, has been appointed.[30] These look-through rules do not appear in the statute or any of the relevant regulations.

While this definition is largely the same as the definition on the instructions to the previous version of the FBAR,[31] there remain questions about its application. First, with nothing limiting the look-through rule to

[27]31 C.F.R. section 103.24.

[28]New instructions at p. 6 (''Financial Interest'').

[29]*Id.*

[30]A U.S. person who is considered a grantor of a non-U.S. resident trust solely by reason of IRC section 679 and therefore subject to U.S. federal income tax on the income of the trust would not fall under this rule if the trust did not have a protector.

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foreign entities, the new instructions appear to require redundant filings of the FBAR. For example, for a U.S. citizen that owns 51 percent of the capital of a U.S. partnership that holds legal title to a foreign financial account, both the U.S. citizen and the partnership would be required to file duplicative information under the instructions.[32]

Second, there does not appear to be any rule attributing ownership among co-owners applied to the definition of financial interest, which could allow taxpayers to easily circumvent the filing requirements by falling just under the percentage threshold. If attribution rules were to apply in this context, however, it is unclear which rules would apply.[33]

Finally, the look-through rule regarding beneficiaries of a trust presents a number of practical problems. While presumably a shareholder or partner in control of such entity has access to information about the entity that would enable the shareholder or partner to determine whether a covered financial interest exists, the same may not be true for a beneficiary of a trust, who may not have information regarding the total value of the assets, the current income, or whether the trust has foreign accounts.

The Service's Guidance

As described above, the new instructions leave many questions unanswered. Presumably, the publication of the FAQs, the workbook, the FBAR page, and the headliner was an attempt to clarify many of these issues. However, many of the definitions in the new instructions remain unclear.

The headliner provides the same definition of ''United States person'' as the new instructions, but also states that ''[e]ntities that are disregarded for tax purposes (such as [LLCs] that are owned by one individual and that do not elect to be treated as corporations for tax purposes) are not disregarded for FBAR reporting purposes.'' The inclusion of disregarded entities in the class of entities required to file would seem unnecessary. As discussed above, no harm would be done by not requiring disregarded entities to file the FBAR, because the owners of such entity may be required to file the FBAR with the same information on the same accounts that the entity would have provided.

The headliner also provides a definition of ''in and doing business in,'' starting with the general statement, repeated in the FAQs and on the FBAR page, that:

> [w]hether a person is considered, for FBAR purposes, to be in and doing business in the United States is based on an analysis of the facts and circumstances of each case. Generally, for these purposes, a person is not considered to be in and doing business in the United States unless that person is conducting business within the United States on a regular and continuous basis.

The headliner continues, defining two classes of persons who are not considered to be ''in and doing business in'' the United States for FBAR purposes and, thus, are not required to file the FBAR: persons who are ''merely visiting'' the United States and persons who ''sporadically conduct business'' in the United States. The headliner also provides examples of those not required to file the FBAR, including individuals who are not U.S. citizens or residents and who are engaged in a business but who ''only occasionally'' visit the United States to meet customers or business associates, and persons who are not U.S. citizens or residents who visit the United States only to manage their ''personal investments,'' such as rental property, and conduct no other business. Also included as an example of those not required to file the FBAR are artists, athletes, and entertainers who are not U.S. citizens or residents and who ''only occasionally'' come to the United States to participate in exhibits, sporting events, or performances. The FAQs, specifically numbers 4 and 26, also address these examples.

While this information from the Service's Web site indicates that a tourist, ''merely visiting'' the United States, does not need to file an FBAR, that seemed to be clear under the FBAR instructions alone because it is unlikely anyone could have determined that a tourist was ''in and doing business in'' the United States for FBAR purposes. Similarly, it is unlikely anyone could have decided that a nonresident alien not conducting business and with only personal investments in the United States was required to file the FBAR, even without the illustrative FAQ.

As noted, the headliner and the FAQs also suggest that a person who is not a citizen or resident of the United States who comes just once or twice (as that would certainly be ''only occasionally'') to the United States to meet with clients or a nonresident alien artist, athlete, or entertainer who comes to the United States just once or twice to participate in an exhibit, a sporting event, or a performance would not be subject to the requirement to file the FBAR. Arguably, this was also clear from the instructions themselves, as one or two visits to the United States would not seem to rise to the level of being ''in and doing business in'' this country.

On the other end of the spectrum, a nonresident alien could ''occasionally'' come to the United States to such an extent that such person could be a resident alien under the ''substantial presence'' test in IRC section 7701(b)(3) and, as such, be a U.S. person for purposes of the FBAR. That also seemed clear before the information was published on the Service's Web site.

[31] Form TD F 90-22.1 (Rev. 7/00).

[32] *Cf.* new instructions at p. 6 (''Exceptions'').

[33] *Compare* IRC section 267(c) *with* IRC section 318(a).

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Whatever the intentions of this ''guidance,'' nothing in it attempts to provide any definite terms that would be helpful in interpreting the requirements. There are no concrete definitions distinguishing a person who ''sporadically conduct[s] business in the U.S.'' or who ''only occasionally'' visits or comes to the United States from one who conducts business ''on a regular and continuous basis.'' There are many situations that fall between ''only occasionally'' visiting and having a ''substantial presence'' that may be sufficient to subject a nonresident alien to the requirement to file the FBAR, but the new instructions and the Service's Web site do not attempt to define these situations. It is unclear how the Service intends to enforce these vague requirements. Nor is it clear how advisers are supposed to advise in this area.

While the above addresses, if only partially, what is considered to be ''doing business in'' the United States, the various information on the Service's Web site also fails to define or describe what constitutes being ''in'' the United States for purposes of the FBAR. The Service does not attempt to apply a term to define a presence ''in'' the United States for an entity, such as a branch or permanent establishment. It is unclear whether only those entities both ''in'' and ''doing business in'' the United States would be subject to such filing requirement or whether simply ''doing business in'' the United States without such fixed place of business would be sufficient to subject such entities to the requirement, which would effectively read the term ''in'' out of the statute and the definition of ''U.S. person.''

Along these lines, the Service does not attempt to address the situation of a non-U.S. interest holder of a U.S. disregarded entity when the entity conducts business in the United States but does not maintain a branch or a fixed place of business and when the interest-holder never sets foot in the United States. While the headliner indicates that the disregarded entity is required to file, it is unclear whether this interest holder would be considered to be ''in and doing business in'' the United States through this entity and therefore required to file the FBAR.

Further, even when the ''in and doing business'' test is applied, there is nothing in any of the information on the Service's Web site limiting which accounts must be disclosed. Without such limitation, a nonresident alien conducting business in the United States, making him a ''U.S. person,'' is required to disclose all of his non-U.S. financial accounts if they have an aggregate value over $10,000, whether or not related to his U.S. business.

Both the workbook and the FAQs provide examples of the application of the look-through rules under the definition of ''financial interest'' in the new instructions. FAQ 24 makes clear that even when a U.S. corporation has filed the FBAR regarding its foreign accounts, a shareholder of that corporation who is a U.S. person owning more than 50 percent of the value of shares of stock must file the FBAR as well. A similar example appears in the workbook. Both of these apply the look-through rules to require both the U.S. corporation owning a foreign company with a foreign financial account and the shareholders of such U.S. corporation to file, if any of them own more than 50 percent of the total value or the voting power of the shares of stock. However, none of the information on the Service's Web site addresses whether any attribution rules apply to the definition of ''financial interest.''

The Effect of the Guidance

31 U.S.C. sections 5321 and 5322 impose civil and criminal penalties for violations of 31 U.S.C. section 5314 and the provisions of that subchapter.[34] The civil penalties, which can be imposed in addition to any criminal penalties imposed on the same transaction,[35] can be as high as $10,000 for nonwillful violations and the greater of $100,000 or 50 percent of the balance in the account not reported at the time of the violation for willful violations.[36] The criminal penalties can result in a fine of up to $250,000, a sentence of up to five years, or both, or a fine of up to $500,000, a sentence of up to 10 years, or both, in some situations.[37] The severity of these penalties makes compliance with the FBAR requirements, and, thus, deciphering what is required in order to comply with such requirements, particularly important.[38]

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[34]31 U.S.C. section 5321; 31 U.S.C. section 5322.

[35]31 U.S.C. section 5321(d).

[36]31 U.S.C. section 5321(a)(5)(A); 31 U.S.C. section 5321(a)(5)(C). The IRS memorandum describing its initiative for voluntary disclosure of offshore accounts imposes, in lieu of all other penalties that may apply, a penalty equal to 20 percent of the amount in foreign bank accounts in the year with the highest aggregate account value. The memorandum is available at http://www.irs.gov/pub/newsroom/memorandum_authorizing_penalty_framework.pdf. The statute clearly states that the civil penalty for willful violations cannot exceed $100,000 or 50 percent of the balance in the account at the time of the violation, so the voluntary disclosure initiative can only impose a penalty amount less than or up to the amount that the statute would impose. Compare this also with the bill introduced by Sen. Carl Levin, D-Mich., on March 2, 2009, which would change this provision of the statute to impose a penalty of the greater of $100,000 or 50 percent of ''the highest balance in the account during the reporting period to which the violation relates.'' Stop Tax Haven Abuse Act, S. 506, 111th Cong, section 205 (2009).

[37]31 U.S.C. section 5322(b); 31 C.F.R. 103.59.

[38]*Cf.* Kristen A. Parillo and Jeremiah Coder, ''IRS Reduces Penalties on Voluntarily Disclosed Offshore Accounts,'' *Tax Notes*, Mar. 30, 2009, p. 1561, *Doc 2009-6771*, or *2009 WTD 57-1*. The IRS memoranda and a statement from the Commissioner of Internal Revenue outlining their initiative to encourage voluntary compliance by imposing a smaller penalty in lieu of penalties otherwise applicable are available at http://www.irs.gov/newsroom/article/0,,id=206012,00.html.

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The new instructions provide the most explicit statement of the requirements to file the FBAR and the definitions relating to these requirements. While some of these requirements come from the statute, others, particularly the definitions, do not have any basis in the statute or regulations. The new instructions themselves, the FAQs, the workbook, the FBAR page, and the headliner are the only documents providing interpretations of these definitions. The legal effect of these types of materials is unclear.[39] It is unlikely a person could be penalized on the strength of the information provided on the Service's Web site that is not formalized elsewhere.

31 U.S.C. section 5314 gives broad authority to the Secretary to determine the classification of persons and the kind of transactions subject to the requirements of 31 U.S.C. section 5314, but does not state in what form such determinations must be issued. 31 U.S.C. section 321, which describes the general authority of the Secretary of the Treasury under Title 31, states that the Secretary may ''prescribe regulations to carry out the duties and powers of the Secretary.''[40] No other section of the Bank Secrecy Act, under which 31 U.S.C. section 5314 falls, has a provision relating to the issuance of regulations or rules.

The Administrative Procedure Act (the Act) generally requires public notice in the *Federal Register* and a comment period when an agency creates rules other than ''interpretive rules, general statements of policy, or rules of agency organization, procedure, or practice.''[41] The classification of persons and the kind of transactions subject to reporting requirements (and penalties) would arguably be substantive, rather than simply ''interpretative.'' In promulgating regulations under the Bank Secrecy Act, the Treasury properly published the regulations in the *Federal Register* and solicited comments on such regulations.[42] It would seem appropriate that the Service should issue any guidance on the FBAR filing requirements under this procedure provided in the Act, rather than in an unannounced, informal update to its Web site.

All cases in which a taxpayer has been convicted under the penalty provisions of 31 U.S.C. sections 5321 and 5322 have involved individuals whose category as a U.S. person for purposes of the FBAR was not at issue in the case. This may be because the previous definition of U.S. person in the FBAR instructions included only U.S. citizens, U.S. residents, and domestic corporations, partnerships, estates, and trusts, which was a clearer rule with which to comply (although, as discussed above, ''U.S. resident'' is not defined). The new definition of U.S. person in the new instructions including those ''in and doing business in the U.S.'' leads to considerably more uncertainty as to who is required to file, and could lead to more cases concerning whether some individuals and entities are required to file. The extent of the ambiguity inherent in the statute and the lack of guidance on such statute raises the question of whether this statute could be found to be unconstitutionally vague.[43]

Possible Ambiguities

The sum of the information available on the new FBAR, including the statute, the regulations, the instructions, and the Service's Web site, simply do not provide enough clarity to permit taxpayers and their advisers to understand their obligations, much less encourage compliance with the filing requirements. In these circumstances, it is suggested that additional published guidance of a formal nature is needed on the requirements of the FBAR.

Several illustrations of possible ambiguities are set out below.

Example 1

N, a nonresident alien individual, is a partner in a U.K. limited liability partnership (UKLP) generally engaged in the practice of law from offices in London. From time to time partners of UKLP come to the United States to provide services to their clients. UKLP does not maintain an office or other fixed place of business in the United States. A, a U.S. citizen residing in the United Kingdom, is also a partner in UKLP. He does not have a more than 50 percent profits or capital interest in UKLP. However, he has signatory authority over one or more UKLP bank accounts in the United Kingdom.

Although UKLP would be considered to be engaged in a trade or business within the United States by virtue of its provision of services in the United States, it

[39]The page on the Service's Web site with a table of contents for the ''IRS Stakeholder Partners' Headliners,'' which is available at http://www.irs.gov/businesses/small/article/0,,id=102669,00.html, states that ''IRS Stakeholder Headliners are intended to provide alerts or reminders to taxpayers and tax professionals about tax matters and issues. For more authoritative information, readers are encouraged to review the materials cited or referenced in the Headliners.'' However, the headliner providing the definition for ''in and doing business in'' does not cite or refer to any material or ''authoritative information'' other than the FAQs and the FBAR page.

[40]31 U.S.C. section 321.

[41]5 U.S.C. section 553.

[42]*See, e.g.,* Amendments to Implementing Regulations; the Bank Secrecy Act, 51 *Fed. Reg.* 30233 (Aug. 25, 1986) (codified at 31 C.F.R. pt. 103).

[43]*Cf. City of Chicago v. Morales*, 527 U.S. 41, 56 (1999) (''[v]agueness may invalidate a criminal law for either of two independent reasons. First, it may fail to provide the kind of notice that will enable ordinary people to understand what conduct it prohibits; second, it may authorize and even encourage arbitrary and discriminatory enforcement'').

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does not appear that it should be considered ''in and doing business in'' the United States since it does not maintain a PE in the United States under the applicable provisions of the U.K.-U.S. tax treaty. As such, it should not be considered to maintain a branch in the United States.

In these circumstances, regardless of whether UKLP has any non-U.S. bank accounts related to its U.S. business, it should not be required to file the FBAR, but absent further guidance on this issue, this result is not absolutely clear. A is subject to FBAR reporting for the UKLP bank accounts on which he has signatory authority.

Example 2

Assume the same facts as in Example 1 except that UKLP maintains a U.S. office or branch through which it conducts business in the United States. Also, assume that UKLP's U.S. office maintains bank accounts only in the United States. Finally, assume that several partners of UKLP (U.S. resident partners) who work in the U.S. office are considered U.S. residents for U.S. federal income tax purposes but that none of them has a more than 50 percent interest in UKLP.

Under the prior instructions, UKLP would not have been required to file the FBAR because it is not a U.S. person as the term was understood. By contrast, under the new instructions, it appears UKLP is sufficiently within the United States, maintaining a U.S. branch through which it conducts its U.S. business, to be considered a U.S. person and therefore subject to FBAR reporting. Since its U.S. branch does not have any interest in or maintain any authority over UKLP's non-U.S. bank accounts, it would seem logical to exempt UKLP from being subject to FBAR reporting, but there does not appear to be any limitation in the existing ''guidance.'' Because they are resident in the United States for U.S. federal income tax purposes, the U.S. resident partners of UKLP will be required to file FBAR reports regarding any non-U.S. accounts in which they have an interest. Since none of them has a more than 50 percent interest in UKLP, the non-U.S. bank accounts of UKLP cannot be attributed to them.

Example 3

N, a nonresident alien as to the United States, is a partner in a U.S. partnership (USP) that is engaged in a U.S. trade or business of owning and operating U.S. real estate. USP does not maintain any financial accounts outside the United States. USP has no FBAR requirement. N is not regularly in the United States; rather, his U.S. presence is only occasional. Although N is considered engaged in a trade or business within the United States, because N is a partner in a partnership that is so engaged, it is unclear why N should be required to file FBAR reports regarding any of his own non-U.S. financial accounts that are unrelated to USP's U.S. business. Yet under the new instructions this would be true if N were only occasionally in the United States. Moreover, as noted above, there is no definition of ''occasional.'' Rather, whether one is in the United States occasionally is left to a facts and circumstances test. Which facts and circumstances are relevant to a determination of whether the occasional limitation has been breached is not described.

Example 4

Assume the same facts as in Example 3 except that N also is the sole member of a U.S. LLC that has investment activities both within and without the United States and maintains financial accounts both within and without the United States.

Although LLC is a disregarded entity for U.S. federal income tax purposes, LLC is still required to file an FBAR report. Yet it is not clear how it would do so or how its filing could be relevant for U.S. federal income tax purposes.

N, as the owner of more than 50 percent of LLC, would be required to file an FBAR report regarding the accounts of LLC outside the United States if N were in and doing business in the United States, but there is nothing to suggest he would be so considered simply because he is the owner of all of the interests of a U.S. LLC.

Example 5

Also assume the same facts as in Example 4, except that N also is the sole member of another domestic LLC (LLC2) that operates a business in the United States through a branch that manufactures products that it sells outside the United States through unrelated sales agents. The unrelated sales agents collect the sales proceeds for LLC2, depositing the proceeds in accounts over which LLC2 does not have any legal ownership or signatory authority, and upon such deposit are immediately required to transmit such funds, less their commission, to LLC2's U.S. bank accounts.

While it would seem that the non-U.S. account of LLC2's unrelated sales agent should not be deemed an account of LLC2 and as a result N should not be required to file an FBAR regarding that account, this result is not entirely clear, particularly if LLC2 requires that its sales agents collect funds through a separate account and ''occasionally'' funds are retained in such account through inadvertence.

Example 6

N, a nonresident alien individual, performs a series of concerts in the United States during a particular year but does not maintain a fixed base or PE in the United States. The proceeds of those concerts, after proper deduction of U.S. withholding tax, are deposited in a non-U.S. bank account maintained by N in his country of residence and the expenses of the concerts are paid out of that non-U.S. bank account.

Although N is considered to be engaged in a U.S. trade or business within the United States, N would

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not be required to file an FBAR regarding the accounts if his appearances were occasional, but it is not clear when a series of concerts is considered to be occasional.[44]

Example 7

H, a U.S. citizen, is married to W, also a U.S. citizen. Each separately owns 50 percent of FC, a foreign corporation, which is engaged in business in a foreign country and has financial accounts in its country of incorporation. Independent directors of FC have signatory authority over the accounts of FC. The independent directors of FC are not required to take instructions from H or W regarding the accounts of FC. Neither H nor W has signatory authority over such accounts and neither is the owner of record or has legal title to such accounts and it is assumed that neither FC nor its independent directors are nominees for either H or W.

Since neither H nor W owns more than 50 percent of FC and since there do not appear to be any constructive ownership rules that apply for the purposes of the FBAR like the provisions of IRC sections 318 or 267(c), it would seem that neither H nor W has a reporting requirement regarding the foreign accounts of FC. Of course, if H or W was a nominee for the other regarding the ownership of FC, then it would seem that the look-through rules would apply to the one who is not a nominee. Whether such a nominee relationship should be presumed, at least in the absence of a community of ownership, such as may be the case in a community property state, is another story.

Conclusion

The above illustrations are by no means an exhaustive list of areas in which further guidance would appear to be needed to avoid extending the potential application of the reporting requirements to situations where such reporting is unlikely to be warranted and beyond the reasonable limitation contained in the applicable provision, but they do present a number of the more obvious instances when this would be the case. And while in many cases the suggested answers to the questions posed seem logical, absent further guidance no assurance can be given that the applicable provision would be interpreted consistently with the limitations suggested, however logical they may appear. ◆

[44] *See* Rev. Rul 67-321, 1967-2 C.B. 470.

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