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## Recent IRS Notices and Actions Regarding FBAR and Other Reporting

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Increasingly, professionals advising international families whose members include US citizens and residents can bring added value to their services if they can highlight US tax reporting requirements and timely compliance procedures. The Internal Revenue Service (IRS) is making offshore tax matters a top priority. The assumption is wrongdoing and a web of reporting requirements has been woven to catch the 'bad guys', while casting a shadow on legitimate tax planning.

#### **Automatic Penalty on Late Filing of Certain Information Returns**

##### ***US citizens and residents subject to tax information reporting***

Professionals advising international families must identify those members who are US citizens (relatively easy if they hold a US passport; not so easy if they were born in the United States but have lived abroad without relinquishing their US citizenship), and those who are US resident (again,

relatively easy if they hold a US green card, but not so easy if they are often visiting or working in the United States). (For details of income tax residency and transfer tax domicile, please see the Overview (March 2008).) It may be just a couple of tax forms; it may be several; but those US citizens and residents will have US tax reporting requirements. Keeping up-to-date books and records, and identifying which forms need to be filed and when, have become crucial aspects of modern legitimate tax planning, especially given that in some cases the IRS will automatically assess late filing penalties.

### ***Automatic penalty for late filing of return regarding foreign corporations***

For example, effective January 1 2009, the IRS has begun automatically to assess a \$10,000 penalty for each late filed Form 5471, Information Return of US Persons with Respect to Certain Foreign Corporations. This form must be attached to the annual tax return of a US citizen or resident who is an officer, director or shareholder in certain foreign corporations. Because of attribution rules, taxpayers who are related to parties holding significant interests in foreign corporations may also be required to file. Since foreign corporations are often used in an international family's succession planning, identifying the involvement of US persons and filing the necessary information returns can save the family a hefty penalty. Although the Internal Revenue Code includes provisions abating a late filing penalty for reasonable cause, it appears that the IRS's automatic assessment will result in the taxpayer having to make a case for reasonable cause post-assessment and potentially require the taxpayer to go through the full IRS administrative appeal process.

### **No Penalty on Certain Late FBAR Filings**

#### ***Filing after June 30 deadline but before September 23 2009***

If family members who are US citizens or residents have not done so already, there is an opportunity to file the 2008 Report of Foreign Bank and Financial Accounts, Form TD F 90-22.1 (commonly referred to as FBAR) without being assessed a late filing penalty. Many commentators have reported that the IRS extended the report's June 30 filing deadline. More accurately, what the IRS did was state in its answer to Frequently Asked Question #43, posted on June 24 2009, that it would not impose a late

filing penalty in a specified situation where the late filing was made by September 23 2009.

***All income timely reported and tax paid but FBAR not filed***

This situation is where the taxpayer has reported and paid tax on all 2008 taxable income, but only recently learned of an FBAR filing obligation and did not have sufficient time to gather the necessary information to complete Form TD F 90-22.1 by the June 30 2009 deadline. In this situation, the taxpayer should file the delinquent form, according to the instructions, with the Department of the Treasury, Detroit, Michigan and attach a statement explaining why the form is late. The taxpayer must also send a copy of the delinquent form, together with a copy of the 2008 tax return (unless that return is not due until after September 23) to the Philadelphia Offshore Identification Unit by September 23 2009.

Thus, the deadline was not technically extended, but in the above situation the IRS will not impose a penalty on the late filing of the FBAR after June 30 2009, but prior to September 23 2009. Alternatively, certain taxpayers instead will be permitted to file the FBAR for the 2008 and earlier calendar years by June 30 2010 (see below).

**Extended FBAR Filing Date for Certain Persons**

On August 7 2009 the IRS issued Notice 2009-62, supplementing the September 23 2009 filing extension discussed above by extending the FBAR filing date for: (i) persons with signature authority over, but no financial interest in, a foreign financial account; and (ii) persons with a financial interest in, or signature authority over, a foreign commingled fund.

These persons have until June 30 2010 to file an FBAR for the 2008 and earlier calendar years with respect to those foreign accounts. The IRS intends to provide future guidance. The IRS has also requested comments on most of the problem areas raised by the new form.

**Non-US Persons Not Required to File 2008 FBAR**

***New FBAR definition of 'US person'***

When the IRS released the new Form TD F 90-22.1, it expanded the definition of 'US person' to include "a person in and doing business in the

United States" (for further details please see "IRS Releases Revised Foreign Bank Account Reporting Form"). This definition has, potentially, a very broad scope. For example, an individual who is not a US citizen or resident, but who owns an interest as a limited partner in a US partnership, may be considered to be "in and doing business in" the United States and thus be required to report all of his or her non-US financial accounts.

### ***Previous definition to be used for 2008 FBAR filings***

In Announcement 2008-51, issued on June 22 2009, the IRS temporarily suspended the FBAR reporting requirement for those persons who are not citizens, residents or domestic entities. The definition of the term 'US person' from the instructions for the prior version of the form may be relied upon for the purpose of determining who must file for tax year 2008. In the prior version, 'US person' means:

- a citizen or resident of the United States;
- a domestic partnership;
- a domestic corporation; or
- a domestic estate or trust.

All other requirements of the current version of the form and instructions (revised October 2008) are still in effect. The current version of the form must be used when filing for tax year 2008.

The substitution of the definition of 'US person' " from the prior Form TD F 90-22.1 applies only with respect to the 2008 reports. The IRS has said that additional guidance will be issued with respect to FBARs due in subsequent years.

### **FBAR Definition of 'Financial Account'**

#### ***Mutual funds***

In addition to changing the definition of 'US person', the new Form TD F 90-22.1 added to the definition of a 'financial account'. The new form says that a financial account:

*"includes any bank, securities, securities derivatives or other financial instruments account. Such accounts generally also encompass any accounts 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 parenthetical '(including mutual funds)' was added as clarification in the new version of the form; otherwise, the above definition is identical to that which has been in place since at least the 2000 version of the form.

### ***Foreign hedge and private equity funds***

Representatives of the IRS have, in informal guidance, stated that they believe that US persons who own an equity interest in foreign mutual funds, as well as foreign hedge and private equity funds, are required to disclose their equity interest on Form TD F 90-22.1 as if the equity interest itself were a 'financial account', regardless of whether the fund itself holds any foreign bank or other financial accounts. While the language of the form seems clearly to treat a foreign mutual fund as a 'financial account', extending that characterization to foreign hedge and private equity funds was a surprise to many. The basis for the IRS's informal interpretation and guidance appears to be the belief that holding an interest in such a foreign hedge or private equity fund is similar to holding an interest in a foreign mutual fund.

In theory, even a non-US investment partnership owned by members of a single family might be such a 'financial account' and therefore family member-partners who are US persons would be required to file Form TD F 90-22.1 to report the existence of the partnership (even if the partnership held no foreign bank or other financial accounts).

### **Quiet Disclosure Not Sufficient**

Details of the IRS voluntary disclosure programme for US persons who have not properly reported their non-US bank and other financial accounts and offshore structures, such as foreign trusts and companies controlled by US persons, were reported in "IRS Increases Focus on Offshore Tax

Matters". The programme will end on September 23 2009.

The family may ask about the situation where a US citizen or resident family member has filed amended income tax returns and paid any related tax and interest for previously unreported offshore income or is considering doing so. This is sometimes referred to as 'quiet disclosure'. The US taxpayer has not otherwise notified the IRS by filing an information form such as TD F 90-22.1 or Form 5471. The family member may then question whether the IRS will really prosecute someone who filed an amended return and correctly reported all income. Advisers to international families need to be aware, if they are not already, that the IRS is serious about enforcement.

In the quiet disclosure situation, the IRS strongly encourages taxpayers to come forward under the voluntary disclosure programme and make timely, accurate and complete disclosures by September 23 2009. Making only a quiet disclosure leaves the taxpayer open to the risk of being examined and potentially criminally prosecuted for all applicable years.

The IRS points out, in responses to frequently asked questions posted on May 6 2000 and June 24 2009, that it has identified and will continue to identify amended tax returns reporting increases in income, and that it will be closely reviewing these returns. If a return is selected for examination, the penalty framework of the volunteer disclosure programme will not be available. When criminal behaviour is evident and the disclosure does not meet the requirements of a voluntary disclosure, the IRS may recommend criminal prosecution to the Department of Justice.

## **Comment**

While much of the media focus is on US citizens accused of sheltering income from US tax in foreign accounts, the web of reporting requirements spun by the IRS to catch wrongdoers extends to international families where, for example, non-US children married to US citizens live outside the United States - working, investing, raising their families, buying homes and opening financial accounts, all in the ordinary course of their lives. In today's environment, innocent non-compliance is becoming expensive.

There is increasing value in family advisers who advocate keeping proper books and records, and full and frank disclosure.

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