

# FOREIGN ACCOUNT REPORTING REQUIREMENTS

Selected provisions of the FBAR rules and U.S. income tax informational reporting that may be relevant to U.S. holders of foreign accounts

If you are a U.S. person, you may need to file an FBAR (as defined below) to report a financial interest in, or signature or other authority over, a foreign financial account. Substantial penalties may apply for failure to report foreign accounts.

## FBAR BASICS

An increased emphasis by U.S. authorities on enforcement of the FBAR rules, together with a global trend toward greater financial transparency, has resulted in many recent inquiries from clients as to the FBAR reporting requirements. In response to these inquiries, we have prepared the following summary of the types of situations about which our clients have inquired, along with a description of certain aspects of the rules.<sup>1</sup>

### What is an FBAR?

A U.S. person is required to file a Report of Foreign Bank and Financial Accounts, FinCEN Form 114 (an “FBAR”) with the U.S. Treasury for a calendar year if the person has a financial interest in, or signature or other authority over, one or more foreign financial accounts during that calendar year. A *de minimis* filing exception applies if the aggregate balance of all reportable accounts did not exceed \$10,000 at any time during the calendar year. FBAR is an informational

filing that is separate from tax filings (though additional information may be required on a U.S. taxpayer’s Forms 1040 and 8938 filed with the IRS). The FBAR for any year is due June 30 of the following year, and no extensions are available. The FBAR is an annual form and must be filed electronically for each calendar year in which the requirements are met.

The FBAR requirements have their roots in the Bank Secrecy Act of 1970. Although all of the essential elements of the FBAR rules, as described below, have been in effect since the 1970s, U.S. authorities have clarified their scope. The Financial Crimes Enforcement Network (“FinCEN”), the arm of U.S. Treasury with primary rulemaking authority over the FBAR, has issued FBAR regulations, which became effective on March 28, 2011. These changes have since been supplemented by the IRS with a series of clarifying notices and guidelines.

### Who is required to file an FBAR?

The FBAR filing obligations apply to:

- U.S. citizens;
- Individuals who are residents of the United States for U.S. federal income tax purposes (e.g., “green card” holders) or who would be treated as U.S. residents if the

<sup>1</sup> This summary does not contain all information that may be relevant to a filer, nor does it aim to provide comprehensive guidance as to whether an FBAR is required in a given situation. Moreover, J.P. Morgan does not undertake to inform you of any other applicable reporting requirements. Persons who may have FBAR filing obligations are urged to consult their advisors as to the extent of those obligations.

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FBAR definition of “United States” applied for U.S. federal income tax purposes; and

- Entities, including, but not limited to, corporations, limited liability companies, partnerships and trusts, that are created, organized or formed under the laws of the United States.

A limited liability company that is a “disregarded entity” for U.S. federal income tax purposes is a U.S. person for FBAR purposes and is therefore required to file an FBAR. For FBAR purposes, “United States” includes any state, the District of Columbia and any U.S. territory or possession.

A U.S. person has an FBAR filing obligation if the person has a financial interest in, or signature or other authority over, a foreign financial account.<sup>2</sup> A “financial account” includes:

- A savings deposit, demand deposit, checking or other account at a bank or other financial institution;
- A securities account with a securities brokerage firm;
- A commodity futures or options account with a commodities brokerage firm;
- An insurance or annuity policy with a cash value; and
- An interest in a mutual fund or similar pooled fund that issues to the general public shares that have a regular net asset value determination and regular redemptions.

FBAR reporting is not currently required for interests in private investment funds, such as hedge funds, private equity funds and venture capital funds.

A financial account is treated as foreign for FBAR purposes if it is located outside of the United States. An account maintained at a foreign branch of a U.S. financial institution is a foreign account for FBAR purposes.

## INDIRECT FINANCIAL INTERESTS

A U.S. person has an indirect financial interest in a foreign financial account if the owner of record or holder of legal title of the account is:

- A person acting as an agent, nominee or otherwise on behalf of the U.S. person;
- A corporation in which the U.S. person owns, directly or indirectly, more than 50% of the voting power or value of the shares;
- A partnership in which the U.S. person owns, directly or indirectly, a greater than 50% interest in the capital or profits;
- A grantor trust, if the U.S. person is the grantor and has an ownership interest in the trust for U.S. federal income tax purposes;
- A trust, if the U.S. person has a greater than 50% present beneficial interest in the trust’s assets or receives more than 50% of the trust’s current income; or
- An entity other than a corporation, partnership or trust described above in which the U.S. person owns directly or indirectly more than 50% of the voting power, value of the equity interest or assets, or interest in profits.

For FBAR purposes, a “financial interest” in a foreign financial account can be either direct or indirect. A U.S. person has a direct financial interest in an account if the U.S. person is the owner of record or holder of legal title of the account. A U.S. person has an indirect financial interest in a foreign financial account under a specific set of rules (see sidebar, “Indirect Financial Interests”).

<sup>2</sup> Each year the IRS has extended the filing deadline (currently June 30, 2016) for officers of companies with signatory authority over, but no financial interest in, foreign financial accounts.

A beneficiary of a trust who is not a grantor of the trust is not required to report foreign financial accounts owned by the trust if the trust, the trustee of the trust or an agent of the trust is a U.S. person and files an FBAR disclosing the accounts.

A U.S. person has “signature or other authority” over a foreign financial account if, with certain exceptions, the person (alone or together with another person) has the authority to control the disposition of assets held in the foreign financial account by direct communication (whether in writing or otherwise) to the bank or other financial institution that maintains the financial account. Thus, a U.S. person may be required to report a foreign financial account on an FBAR even if the person does not have a financial interest in the account. Only an individual can have signature authority over a foreign financial account.

#### **What other requirements may apply?**

In general, a U.S. person required to file an FBAR is also required to maintain records relating to the account for five years.

### **EXAMPLES**

**Here are some situations, based on questions we have received, in which FBAR filings may be required:<sup>3</sup>**

**Example 1:** A U.S. citizen purchased a vacation house in Bermuda. To pay local staff and expenses, he opened and maintains a local Bermudian account denominated in Bermuda dollars. Because he is a U.S. person with a financial interest in a foreign financial account, he is required to file an FBAR.

**Example 2:** A person born in Japan moves to the United States and obtains a green card. She maintains a sizeable financial account in Japan because much of her extended

family lives there, and she may one day decide to return. As a U.S. resident with a financial interest in a foreign account, she is required to file an FBAR.

**Example 3:** A Swiss family employs a U.S. citizen living in Switzerland as a key employee of its family office. The U.S. person has no financial interest in, but has signature authority over, the family’s Swiss financial accounts. As a U.S. citizen with signature authority over a foreign account, she is required to file an FBAR.

**Example 4:** Brazilian parents set up a Bahamian trust for their son when he was born. The trustee of the trust is a non-U.S. person. The son came to the United States to attend a university and has remained here since. He is now in his early 30s and receives income from the trust. As a U.S. resident entitled to more than 50% of the income from the trust, he is required to file an FBAR to report any foreign financial account in which the trust has a financial interest.

**Example 5:** A California resident owns a U.S. company formed to acquire an Asian art collection. The company has a financial account in Hong Kong that it uses to facilitate the acquisition of works by emerging Chinese artists. The company is required to file an FBAR to report its foreign account. In addition, the California resident, as a U.S. person who owns more than 50% of the company, is required to file an FBAR to report the account.

**Example 6:** A U.S. private foundation based in Texas does charitable work in Mexico. It maintains a local Mexican account funded with pesos to facilitate its charitable distributions. The foundation is required to file an FBAR for the foreign peso account. In addition, any U.S. officers or employees of the foundation who have signature authority over the account are required to file FBARs to report the account.

<sup>3</sup> A *de minimis* filing exception applies if the aggregate balance of all reportable accounts did not exceed \$10,000 at any time during the calendar year.

**Example 7:** The same foundation has an interest in an offshore hedge fund as a component of its investment portfolio. The foundation's interest in the foreign hedge fund does not create an FBAR filing requirement because interests in hedge funds and private equity funds are currently not considered foreign financial accounts.

**Example 8:** A Florida resident owns foreign securities through an account she maintains at a Florida branch of a U.S. bank. The U.S. bank custodies those foreign assets in an omnibus account maintained with a foreign financial institution. The resident has no access to the omnibus account and can access the securities only through the account she maintains in the United States. The Florida resident is not required to file an FBAR with respect to the omnibus account.

### INCREASED INCOME TAX REPORTING: FORM 8938

In tandem with the increased emphasis on the disclosure of foreign accounts, an additional informational filing was introduced for the 2011 tax year—Form 8938. This is attached to an individual's annual income tax return—Form 1040 or 1040-NR. A comparison of the FBAR and Form 8938 is illustrated in the chart on the right.

### ADDITIONAL INFORMATION

*Which accounts are subject to reporting:*

- An account is not considered “foreign” for FBAR purposes if it is maintained in the United States, even if the financial institution that maintains the account is a U.S. branch of a foreign bank. However, an account is considered “foreign” for FBAR purposes if it is maintained outside the United States, even if the financial institution that maintains the account is a foreign branch of a U.S. bank. Thus, for example, an account that a U.S. person has at the London branch of a U.S. bank is a foreign financial account.

	Form 8938	FinCEN Form 114 (FBAR)
Who must file:	U.S. citizens, resident aliens and NRAs that exceed reporting threshold	U.S. citizens, resident aliens, trusts, estates and domestic entities that exceed reporting threshold
Reporting threshold (total asset value):	\$50,000 on last day or \$75,000 at any time during tax year	\$10,000 at any time during the calendar year
When you have a reportable interest:	Income, gains, losses, deductions, distributions, or other filing positions otherwise reported on income tax return	Financial interest (account owner) or signature authority (authorizing power)
What is reported:	Maximum account value (determined at FMV in USD using end of year spot rate)	Maximum account value using periodic statements (using end of year USD spot rate)
Where to file:	With individual income tax return	Electronically through FinCEN's BSA e-filing system
When due:	By tax return due date (April 15), including extension (October 15)	June 30 (generally, no extensions)
Penalties:	Up to \$10,000 for failure to disclose, and an additional \$10,000 for each 30 days of non-filing after IRS notice (maximum penalty of \$60,000); also potential criminal penalties	If non-willful, up to \$10,000, but if willful, then up to greater of \$100,000 or 50% of account balances; also potential criminal penalties
Examples of foreign assets requiring reporting		
Financial account at a foreign institution	Yes, unless maintained at a “U.S. payor” such as J.P. Morgan	Yes
Financial account at a foreign branch of a U.S. institution	No	Yes
Foreign account for which you have signature authority	No, unless have an interest resulting in a tax return filing	Yes
Foreign partnership interests	Yes, unless assets are held in an account that is already reported	No
Foreign hedge funds and private equity funds	Yes, unless assets are held in an account that is already reported	No

Source: Internal Revenue Service

- As discussed previously, shares of mutual funds that are available to the general public are generally treated as financial accounts, but interests in private funds, such as hedge funds, private equity funds and venture capital funds, are not currently treated as financial accounts for FBAR purposes. FinCEN may issue additional guidance on this issue at a later date.

*Who is required to report:*

- “Green card” holders are subject to the FBAR reporting requirements even if they have elected under a tax treaty to be treated as non-residents for U.S. federal income tax purposes.
- A trust that is created under U.S. law is subject to FBAR reporting requirements even if it has no U.S. settlors, beneficiaries, fiduciaries or assets, and derives no income that is subject to U.S. income tax.
- Filers reporting a financial interest in, or signature authority over, 25 or more foreign financial accounts are subject to simplified reporting rules. They need report only the number of financial accounts and certain other basic information, but are required to maintain records and provide detailed information about each account upon request.
- Certain exceptions apply, including in some circumstances for employees of certain regulated entities and of publicly traded companies with regard to signature authority over foreign financial accounts of their employer.

## PENALTIES FOR NONCOMPLIANCE

There are significant penalties for failure to comply with FBAR requirements. A person who fails to file an FBAR may be subject to a civil penalty of up to \$10,000. A willful failure to report a foreign financial account properly may result in a penalty equal to the greater of \$100,000 or

50% of the account balance at the time of the violation, as well as criminal penalties (including substantial fines and imprisonment). The statute of limitations for civil penalties on FBAR violations is six years. No penalty will be imposed if there is reasonable cause for the failure to file an FBAR, and the balance in the account is properly reported.

## HOW TO PROCEED

Although the FBAR rules have been in effect since the 1970s, the new emphasis on enforcement of these rules is indicative of the global trend toward greater financial transparency. For many persons, the rules create significant compliance burdens and recordkeeping requirements. **Individuals with potential FBAR filing obligations should consult their legal or tax advisors to determine the extent of those obligations.** Steps that may be helpful in ascertaining these obligations include:

- Gathering foreign account information (e.g., name of account owner, taxpayer EIN, address of account owner, type of account, name and address of financial institution, account number, maximum value of account during the year, those with signature authority over the account, etc.).
- Identifying who owns and controls each foreign account.
- Identifying which persons have signature authority over those accounts and whether those persons are U.S. persons.
- Determining the foreign accounts for which FBARs must be filed.
- Communicating filing responsibilities with those required to file (e.g., employees or trust beneficiaries).

**Persons who may have FBAR filing obligations are urged to consult their legal or tax advisors as to the extent of those obligations.**

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