March 21, 2011

FBAR Update for Employee Benefit Plans: FinCEN Publishes Final Rule Addressing Reports of Foreign Financial Accounts

The Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN") recently released final regulations (the "Final Regulations") under the Bank Secrecy Act concerning the Report of Foreign Bank and Financial Accounts (or "FBAR") that is required to be filed with the Treasury by June 30 of each year. Although there are relatively few substantive changes from the proposed regulations issued on February 26, 2010, the final regulations do clarify the proposed rules in a number of respects. This update will focus on those provisions in the Final Regulations that are applicable to employee benefit plans, plan sponsors, plan fiduciaries, and plan participants and beneficiaries. The Final Regulations generally address the scope of the persons that are required to file the FBAR, and they further specify the types of accounts that are reportable. The Final Regulations also provide filing relief in the form of exemptions for certain persons with signature or other authority over foreign financial accounts and adopt provisions intended to prevent persons subject to the filing requirements from avoiding their obligations. Finally, while the Final Regulations make reference to revised instructions for Form TD-F 90-22.1 (Report of Foreign Bank and Financial Accounts), these instructions have yet to be released. The Final Regulations are effective March 28, 2011, and apply to FBARs that are required to be filed by June 30, 2011, for financial accounts maintained in calendar year 2010, and to FBARs for all subsequent filing years. In brief, the FBAR must be filed for each calendar year by a U.S. person having a financial interest in, or signature or other authority over, any foreign financial accounts if the value of the accounts exceeds $10,000 in the aggregate. As noted above, the FBAR must be received by the Department of the Treasury no later than June 30 of the year following the year being reported (e.g., for the 2010 reporting year, the FBAR must be received no later than June 30, 2011), and the civil penalties for failing to file can range from $500 for each violation to the greater of $100,000 or fifty percent of the account balance. Criminal penalties can also be imposed in certain circumstances. For benefit plans, plan sponsors and plan fiduciaries, the primary concerns related to the FBAR requirements have generally been (i) what does "signature or other authority" mean as applied to plan fiduciaries such as investment committee members (and do such individuals also have a disclosure obligation on their personal Form 1040, Schedule B), (ii) whether private equity funds and hedge funds constitute "foreign financial accounts" subject to the FBAR requirements, and (iii) the extent to which individual trustees with respect to a plan can be considered to have a financial interest in accounts established on behalf of the plan. Our review of the Final Regulations has identified certain provisions that appear particularly relevant to the benefit plan community. As a preliminary observation, FinCEN has refused to exempt benefit plans from the FBAR requirement despite repeated (and well-reasoned) arguments that such plans are already subject to numerous reporting and disclosure requirements. *Clarifications Addressing When an Account Is a "Foreign Financial Account"*:

- As a general matter, an account is not a foreign account under the FBAR if it is maintained with a financial institution located in the United States. The Final Regulations clarify that an account maintained by such a financial institution is not rendered "foreign" simply because the account may contain holdings or assets of foreign entities.
- The Final Regulations provide that where a U.S. bank acts as a global custodian with respect to pooled cash and/or securities accounts held outside the U.S. for the benefit of multiple investors (commonly called "omnibus accounts"), a U.S. person invested therein who does not have any legal rights in the account and can only access their holdings through the U.S. global custodian bank would not have to file an FBAR with respect to the assets held in such omnibus account. *Note that this would not be the case if the U.S. investor was permitted direct access to the foreign holdings in the account*.

Relief for Plan Sponsors: Elimination of the "Trust Protector" Provision: Under the proposed regulations, a U.S. person was deemed to have a financial interest in a trust that was established by such person and for which a "trust protector" (such as a fiduciary committee responsible for monitoring the trustee) had been appointed. The Final Regulations eliminate the "trust protector" provision. Thus, plan sponsors who establish a trust to hold plan assets and appoint a fiduciary committee with the authority to monitor and, if necessary, replace (or recommend replacement of) the trustee will not be deemed to have a financial interest in the plan's foreign financial accounts merely as a result of its appointing such committee. *Revised Definition of "Signature or Other Authority"*: The Final Regulations incorporate a change to the definition of "signature or other authority" to clarify that it is intended to encompass only those individuals having the authority (alone or in conjunction with another) to control the disposition of money, funds or other assets held in a financial account *by direct communication (whether in writing or otherwise) to the person with whom the financial account is maintained*. The test recited in the Final Regulations is whether the foreign financial institution will act upon a direct communication from that individual regarding the disposition of assets in the account. FinCEN's clarification of this definition is also beneficial in determining those individuals who will need to comply with the foreign account disclosure requirement on Schedule B of their individual Form 1040 - to the extent a fiduciary committee member or other similar individual is deemed to have "signature or other authority" because he or she meets the above test, such person will be required to check the appropriate box on his or her individual tax return. Those individuals not meeting the test will not be required to complete such disclosure. *Clarifications Relating to the Definition of "Other Financial Accounts"*:

- The proposed regulations confirmed that an account with a mutual fund or similar pooled fund would constitute an "other financial account" subject to the FBAR. The preamble to the Final Regulations simply reiterates that the definition of "mutual fund" (or a similar pooled fund) includes a requirement that the shares be available to the *general public* in addition to having a regular net asset value determination and regular redemption feature.
- The Final Regulations continue to reserve treatment of "investment companies other than mutual funds and similar pooled funds"?- including hedge funds and private equity funds?- and thus there is no requirement that interests in commingled funds other than mutual funds and similar pooled funds be reported in filings for 2010 (unless they otherwise constitute foreign financial accounts).
- An account that is an insurance policy with a cash value or an annuity policy may also constitute an "other financial account." The Final Regulations amend the definition with respect to life insurance and annuities to clarify that only those policies with a cash value are covered. The FBAR requirement is not, however, limited to situations in which there is payment of an income stream.

Broad Exception for Plan Participants and Beneficiaries: The Final Regulations clarify that participants and beneficiaries in retirement plans under Sections 401(a), 403(a) or 403(b) of the Internal Revenue Code as well as owners of and beneficiaries of IRAs under Section 408 of the Code and Roth IRAs under 408A of the Code will not be required to file an FBAR with respect to a foreign financial account held by or on behalf of the retirement plan or IRA. *Account Valuation*: The Preamble to the Final Regulations clarifies that it is possible for reporting persons to rely on periodic account statements that provide the value in the account at the end of an applicable statement period where such statements are *bona fide* and prepared in the ordinary course of business. As mentioned above, the Final Regulations apply to FBARs required to be filed by June 30, 2011, for financial accounts maintained in calendar year 2010, and to FBARs for all subsequent calendar years. Thus, it is important that plan sponsors and fiduciaries become familiar with the Final Regulations and their application very soon.