

## Employee Benefits & Executive Compensation Client Service Group

To: Our Clients and Friends

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### Pension Plan Investors in Foreign Hedge Funds May Need to File a Report of Foreign Bank and Financial Account by June 30th

Each entity that possessed a financial interest in, or signatory or other authority over, any foreign financial accounts valued at more than \$10,000 in 2008 must report that relationship to the IRS by filing a Report of Foreign Bank and Financial Account ("FBAR") ([Form TD F 90-22.1](#)) by June 30th, 2009. As more fully explained below, IRS representatives recently stated that this filing requirement may extend to pension plans and other investors which have an interest in foreign hedge funds.

#### Background

Originally a creation of the Bank Secrecy Act of 1970, FBAR compliance has often been overlooked due to a lack of enforcement by the IRS. However, following the enactment of the PATRIOT Act of 2001, which required Treasury to find ways to improve FBAR compliance, the number of FBAR forms received by the IRS has steadily increased. This increased filing activity has been due in part to a renewed IRS focus along with the implementation of severe penalties for non-compliance with the FBAR rules under the American Jobs Creation Act of 2004.

#### FBAR Compliance

A FBAR must be filed by any "United States person," which includes a pension fund, who has a financial interest in, or signatory or other authority over, any foreign "financial accounts" if the value of those accounts exceeds \$10,000 at any time during the calendar year. This report must be filed by June 30th of the calendar year succeeding the year in which the \$10,000 threshold is broken. Failure to file a FBAR can result in significant civil and criminal penalties—particularly where the failure is deemed willful. Civil penalties can reach the greater of \$100,000 or 50 percent of the amount in the account at the time of violation. Criminal penalties can include up to a \$500,000 fine and 10 years imprisonment.

According to the Instructions accompanying the FBAR Form, the term "financial account" includes any bank securities, securities derivatives or other financial instruments account. The Instructions continue, "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).” Although the IRS had offered very little formal guidance on the subject, until recently, based on informal IRS guidance, it was generally thought that the definition of “financial account” for purposes of a FBAR did not include an equity interest in a foreign, or off-shore, hedge fund, or similar private equity fund, unless the investor had authority over the hedge fund’s underlying financial accounts.

Earlier this month, however, in a teleconference hosted by the American Bar Association and the American Institute of Certified Public Accountants, IRS representatives explained that the term “financial account” in the context of a FBAR did include interests in foreign hedge funds where the foreign hedge fund was serving a function similar to a mutual fund. Therefore, absent IRS guidance to the contrary, this position suggests that any investor in foreign hedge funds or private equity funds that had previously not filed a FBAR due to the belief that it was immune from those requirements should now file the Form by June 30th.

During the teleconference mentioned above, the IRS also advised that individuals and entities subject to the FBAR reporting requirement who may have failed to properly file FBARs over the past six years, but who did properly include income attributable to such foreign accounts, should file those delinquent FBARs for the applicable years accompanied by an explanation as to why the reports were filed late. The IRS advised that these delinquent FBAR filings should be made by September 23, 2009.

## **Conclusion**

Because the IRS seems to have taken the position that an offshore hedge fund is a foreign financial account for purposes of the FBAR rules, and given the relative simplicity of completing and filing a FBAR, any U.S. investor in an offshore hedge fund, including a pension plan, should consider filing a FBAR prior to June 30, 2009.

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