

Solari Report - Foreign Investment Filing Requirements for Individual Investors - FBAR, FATCA and PFIC - 2011 Calendar Year

By Carolyn A. Betts

Given the flurry of regulatory activity in 2010 and 2011 surrounding filing requirements for US holders of foreign investments, we thought a review of the current US Treasury and IRS filing requirements would be useful. As always, we stress that this summary is generalized, does not cover all situations in which you may find yourself and is no substitute for consultation with your personal tax preparer.

FBAR

On February 24, 2011, FinCEN (the Financial Crimes Enforcement Network, which is an agency within the U.S. Treasury) issued revisions to Bank Secrecy Act regulations (31 CFR 103) requiring US persons to keep records and file reports regarding foreign financial accounts. This is commonly referred to as the “FBAR” filing requirement. Authority for the FBAR filing requirement is found in the Bank Secrecy Act provisions that authorize FinCEN to issue regulations requiring persons to keep records and file reports that are determined to have “a high degree of usefulness in criminal, tax, regulatory and counter-terrorism matters.” The following is a summary of the current regulations as they relate to individual investors.¹ The new regulations were effective starting with reports required to be filed by June 30, 2011 for holdings during calendar year 2010.

Statutory Provisions (31 USC 5314)

Who is covered: Anyone who is a US citizen, US resident or person in and doing business in the US.

What circumstances are covered: The making of any transaction or maintaining of a relation for any person with a “foreign financial agency.”

What is a foreign financial agency: One who acts for the holder of the asset as a financial institution, bailee², depository trustee or agent or in a similar way with relation to the covered assets. Excepted from the definition is any person acting for a country, a monetary or financial authority acting as a monetary or financial authority or an international financial institution of which the US government is a member (31 USC 5312(a)(1)).

What size of transaction or holding is covered: Aggregate holdings of more than \$10,000 US during the tax year.

What assets are covered: Money, credit, securities, gold or any transactions in them.

Regulatory and IRS Interpretations of Statutory Provisions

Reportable Accounts Generally

Financial interests in, or signature authority over, foreign financial accounts held by foreign financial institutions are reportable by a US person if at any time during the calendar year the aggregate value of the accounts exceeds \$10,000. If such a foreign financial account is jointly owned, each joint owner must report the full value of the account.

Solari Report - Foreign Investment Filing Requirements for Individual Investors - FBAR, FATCA and PFIC - 2011 Calendar Year

Ownership is determined by legal or record title, whether or not the account is maintained for the benefit of others. Ownership exists as well in situations in which the US person's ownership or control over the owner of record or holder of legal title rises to such a level that the US person should be deemed to have a financial interest in the account. It is not clear whether such a control situation could apply in the case of an individual, as opposed to an entity, account. A US person also is deemed to have control over a foreign financial interest if he or she is acting as an attorney, agent or nominee with respect to the account. Finally, in an anti-avoidance provision, a US person that causes an entity (including a trust) to be formed for the purposes of evading the FBAR requirement is deemed to have a reportable financial interest in the foreign financial account.

Accounts are not foreign (and therefore not reportable) if maintained at a financial institution located in the US (for example, interests in foreign companies purchased through a broker dealer located in the US). Assets held offshore in an omnibus (pooled) account outside the US are not subject to FBAR where US customers can only access their holdings through the US global custodian bank. However, if the custodial arrangement permits the US person to directly access the foreign holdings maintained at the foreign institution, then the US person has a reportable foreign financial account.

There is no exemption for US citizens living abroad, for entities that qualify for exempt recipient status for purposes of reporting on IRS form 1099 or generally for employee benefit or ERISA pension and welfare benefit plans, even though they are tax-exempt. There also is no exemption for legal permanent residents of the US who elect under a tax treaty to be treated as non-residents for tax purposes.

Each foreign financial account up to 25 must be listed on the FBAR form. If a US person has 25 or more accounts, he or she is required only to provide the number of accounts and certain other basic information and to be prepared to provide detailed information concerning each account when requested to do so.

Who is Not Required to File an FBAR

Participants, owners and beneficiaries in IRAs and tax qualified retirement plans are not required to report financial interests in foreign financial accounts held in such plans. Trust beneficiaries likewise are not required to report trust financial interests in foreign financial accounts, but only if the trust, trustee or agent of the trust is a US person and files an FBAR report disclosing foreign financial accounts held by the trust. In the case of a reportable annuity or life insurance policy, it is the policy holder, not the beneficiary, who is required to report. The instructions to the FBAR form state that the following also are exempt from FBAR filing requirements:

- (i) Certain foreign financial accounts jointly owned by spouses;
- (ii) United States persons included in a consolidated FBAR;
- (iii) Correspondent/nostro accounts;
- (iv) Foreign financial accounts owned by a governmental entity;
- (v) Foreign financial accounts owned by an international financial institution;
- (vi) Certain individuals with signature authority over but no financial interest in a foreign financial account; and
- (vii) Foreign financial accounts maintained on a United States military banking facility.

Solari Report - Foreign Investment Filing Requirements for Individual Investors - FBAR, FATCA and PFIC - 2011 Calendar Year

Determining Value of the Account

Bona fide periodic account statements provided in the ordinary course of business that reflect the value of the account at the end of each statement period may be relied upon in determining maximum value of the account during the taxable year.

Process of Filing FBAR

The FBAR form [TD F 90-22.1](#) is currently available on the FinCEN and IRS websites, allowing users to complete the form electronically and print a PDF for mailing to the address on the form. FinCEN plans an electronic filing option at some point in the future as part of its process of modernizing its IT system.

The FBAR form is due June 30 of the year following each calendar year during which the reportable accounts are held. There are no extensions, even if the US person has been granted an IRS filing extension.

Note that the FBAR is filed with the US Treasury in Detroit, not the IRS, although it may be hand delivered to a local IRS office or the IRS tax attaché located at an American embassy for forwarding to the US Treasury.

Clarification of Specific Definitions

A resident alien is one who satisfies any one of the following criteria:

- (i) The individual is a lawful permanent resident of the US at any time during the calendar year.
- (ii) The individual meets the substantial presence test under Section 7701(b)(3).
- (iii) The individual was not a resident during the previous year, was a resident the following year, and for the year at issue was present in the US for the period provided in Section 7701(b)(4) and makes an election to be treated as a resident for the year.

For purposes of determining residency, the US includes Puerto Rico, the US Virgin Islands, Guam, the Northern Mariana Islands and all other US territories and possessions.

A “bank account” is defined as a savings deposit, demand deposit, checking or any other account with a person engaged in the business of banking. A “securities account” is defined as an account maintained with a person in the business of buying, selling, holding or trading stock or other securities. The term “other financial account” is defined to include the following:

- (i) Accounts that are life insurance and annuity policies with cash value satisfying the size of account requirements;
- (ii) Accounts with any person in the business of accepting deposits as a financial agency;
- (iii) Accounts with persons that act as broker or dealer for futures or options transactions in commodities on or subject to the rules of a commodities exchange or association; and
- (iv) Accounts with a mutual fund or similar pooled fund that issues shares available to

Solari Report - Foreign Investment Filing Requirements for Individual Investors - FBAR, FATCA and PFIC - 2011 Calendar Year

the general public and that have regular net asset value determinations and regular redemptions.

Note that FinCEN, in the final regulations, expressly reserves the treatment of investment companies other than mutual funds or similar pooled funds.

PASSIVE FOREIGN INVESTMENT COMPANY REPORTING

On 21 June 2011, the Internal Revenue Service (IRS) released [Notice 2011-55](#) temporarily suspending information reporting requirements for passive foreign investment company/qualified electing fund interests under IRC Section 1298(f) pending release of a new revised IRS form reflecting law changes adopted during 2010. The revised form has now been released and the filing requirements are reinstated, although regulations have yet to be issued. Revised Form 8621, Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund can be found [here](#) and separate instructions can be found [here](#).

Information reported on Form 8621 reflects the various actions a taxpayer can take with respect to his or her holdings of PFIC stock, that is:

- (i) do nothing (in which case capital gain income may be converted to ordinary income),
- (ii) make a QEF election by the deadline for the first year during which the PFIC stock was held,
- (iii) make a QEF election in a subsequent year (in which case the taxpayer bears some of the adverse consequences of failure to make the election in the first year) or
- (iv) make a mark-to-market election (where the taxpayer has elected to pay capital gains and losses on shares annually as the value of the PFIC stock changes in value).

Part I of Form 8621 is the actual election to treat a Passive Foreign Investment Company as a Qualifying Electing Fund (“QEF Election”), to make various elections in subsequent years thereafter, or to make a mark-to-market election. Part II is used to report the shareholder’s pro rata share of ordinary income and net capital gains of a qualifying electing fund. Part III is used to report gain or loss from a mark-to-market election. Part IV is used to report distributions from and dispositions of stock from a “1291 fund.” A 1291 fund is a PFIC (a) for which the taxpayer has made no QEF election or mark-to-market election or (b) that is an “unpedigreed QEF,” (i.e., a PFIC for which the taxpayer has made a QEF election for some but not all years in the taxpayer’s holding period for the PFIC shares). Finally, Part V is used by taxpayers who have made a 1294 election to extend the time for payment of tax on undistributed PFIC earnings and is used to report the status of the election from year to year or terminate the election.

FATCA

The Foreign Account Tax Compliance Act was enacted in 2010 as part of the “HIRE” jobs legislation. Our original article on the adoption of FATCA can be found [here](#). Most of FATCA relates to requirements for foreign financial institutions, but it is relevant to individual US investors because it also requires US persons who hold foreign financial assets valued at \$50,000 or more to report these assets to the Internal Revenue Service on Form 8938 Statement of Specified Foreign Financial Assets, which is filed as an attachment to the annual federal income tax return (as the deadline for the return may be extended). Penalties of from \$10,000 to \$50,000 can be assessed for

Solari Report - Foreign Investment Filing Requirements for Individual Investors - FBAR, FATCA and PFIC - 2011 Calendar Year

failure to file Form 8938. In addition, if failure to report foreign assets results in an underpayment of tax a 40% understatement penalty on the shortfall applies. The nine-page instructions for completing Form 8938 can be found [here](#).

Proposed Treasury regulations issued in December under FATCA provide guidance on reporting and withholding requirements for foreign financial institutions (“FFIs”) and non-financial foreign entities (“NFFEs”). Foreign financial institutions were required to enter into disclosure compliance agreements with the US Treasury, and non-financial entities covered by the law must report or certify ownership of US assets in foreign accounts, or become subject to the 30% withholding requirement. The proposed regulations become effective in 2013.

Also relevant to individuals subject to the new reporting regime is the requirement that foreign financial institutions and foreign non-financial entities take steps to identify “specified US persons” whose assets must be reported. If a US person subject to the reporting requirements refuses to provide the requested financial information to the FFI or NFFE, he or she becomes categorized as a “recalcitrant” and subject to the 30% FATCA tax. A “specified US person” required to file Form 8938 is someone who:

- (i) is a US citizen, a resident alien for any part of the year, a nonresident alien who makes an election to be treated as a resident alien for purposes of filing a joint tax return or a nonresident alien who is a bona fide resident of American Samoa or Puerto Rico; and
- (ii) has an interest in a specified foreign financial asset, defined as:
 - (a) a financial account maintained at a foreign financial institution and
 - (b) the following foreign financial assets if held for investment and not in an account maintained at a foreign financial institution:
 - i. stock or securities issued by anyone other than a US person,
 - ii. an interest in a foreign entity and
 - iii. any financial instrument or contract that has as an issuer or counterparty someone other than a US person;and
- (iii) has specified foreign financial asset(s) that has/have a value in the aggregate exceeding the one of the following reporting thresholds that applies:
 - (a) *Unmarried taxpayers living in the US*: the total value of the specified foreign financial assets is more than \$50,000 on the last day of the tax year or more than \$75,000 at any time during the tax year.
 - (b) *Married taxpayers filing a joint income tax return and living in the US*: The total value of the specified foreign financial assets is more than \$100,000 on the last day of the tax year or more than \$150,000 at any time during the tax year
 - (c) *Married taxpayers filing separate income tax returns and living in the US*: The total value of the specified foreign financial assets is more than \$50,000 on the last day of the tax year or more than \$75,000 at any time during the tax year.
 - (d) *Taxpayers living abroad*³:

Solari Report - Foreign Investment Filing Requirements for Individual Investors - FBAR, FATCA and PFIC - 2011 Calendar Year

- i. *If filing a return other than a joint return* and the total value of the specified foreign assets is more than \$200,000 on the last day of the tax year or more than \$300,000 at any time during the year; or
- ii. *If filing a joint return* and the value of the specified foreign asset is more than \$400,000 on the last day of the tax year or more than \$600,000 at any time during the year.

Links

[Ernst & Young summary of the Foreign Account Tax Compliance Act](#)

[PFIC section of Central Fund of Canada](#)

See [The availability of a retroactive QEF election for a passive foreign investment company](#)

Author

Carolyn Betts is an attorney in private practice in Ohio who serves as general counsel to Solari, Inc. and Solari Investment Advisory Services, LLC.

Solari Report - Foreign Investment Filing Requirements for Individual Investors - FBAR, FATCA and PFIC - 2011 Calendar Year

¹ Additional guidance (not covered here) deals with exemptions to the reporting requirements for those with signatory or other authority over corporate and other entity accounts.

² A definition of “[bailee](#)” that suffices for this purpose is:

[B]ailee (custodian) n. a person with whom some article is left, usually pursuant to a contract (called a "contract of bailment"), who is responsible for the safe return of the article to the owner when the contract is fulfilled. These can include banks holding bonds, storage companies where furniture or files are deposited, a parking garage, or a kennel or horse ranch where an animal is boarded. Leaving goods in a sealed rented box like a safe deposit box, is not a bailment, and the holder is not a bailee since he cannot handle or control the goods.

³ [IRS guidance](#) advises taxpayers that for purposes of Form 8938:

“You are a taxpayer living abroad if:

- (a) You are a U.S. citizen whose tax home is in a foreign country and you are either a bona fide resident of a foreign country or countries for an uninterrupted period that includes the entire tax year, or
- (b) You are a US citizen or resident, who during a period of 12 consecutive months ending in the tax year is physically present in a foreign country or countries at least 330 days.”