Understanding FBAR Disclosure Responsibilities

When Must an Entity or Connected Individual File?

By Ian Weinstock

The Treasury Department's Financial Crimes Enforcement Network (FinCEN) Form 114, the Report of Foreign Bank and Financial Accounts—colloquially known as FBAR—has become famous due to the huge potential penalties imposed on taxpayers whose failure to file is deemed to be willful. As a result, tax preparers know to ask whether individual clients own foreign accounts before preparing those clients' income tax returns. But not all foreign accounts are owned by individuals. If an entity (i.e., a nonnatural person) owns a foreign account, when does the entity itself need to file an FBAR, and when does an FBAR need to be filed by someone connected to the entity?

When Does an Entity Itself Need to File?

Under the FBAR regulations—31 CFR 1010.350—an FBAR must be filed by a United States person with a financial interest in, or signature authority over, a bank, securities, or other financial account in a foreign country. (It is worth noting that a foreign insurance policy or annuity falls within the definition of "other financial account," as does an interest in a foreign mutual fund.) A United States person will be deemed to have a financial interest in an account when, among other things, the United States person is the owner of record or holder of legal title of the account.

Thus, an entity will itself need to file an FBAR whenever the entity 1) owns a foreign account and 2) is a United States person. Unfortunately, what constitutes a United States person is not necessarily intuitive, because there is a meaningful difference between the definition in the FBAR regulations and the standard definition under Internal Revenue Code (IRC) section 7701(a)(30). Specifically, although both definitions refer to U.S. citizens and U.S. resident individuals, and both refer to corporations and partnerships organized or formed in the United States, an estate or trust is a United States person for FBAR purposes if it is organized or formed in the United States, even if the estate or trust would be foreign for purposes of the IRC.

That difference will rarely be an issue for estates; the IRC definition of a foreign estate provides a facts-and-circumstances test, and if an estate is organized or formed in the United States, it should also be treated as a U.S. estate under said test. But for trusts, the difference has real, practical significance. The IRC treats a trust as foreign unless a court in the United States exercises primary supervision over the administration of the trust *and* one or more U.S. persons control all substantial decisions of the trust. Many trusts are organized in the United States because it has excellent substantive (i.e., nontax) trust law but are nonetheless foreign trusts under the IRC because a non–U.S. person controls a substantial decision of the trust. Those trusts are not U.S. taxpayers, but they do have FBAR filing obligations.

Who Else Needs to File on Account of an Entity?

As indicated above, a United States person with a financial interest in a foreign account is required to report the account on an FBAR. An entity that itself owns a foreign account has a financial interest in the account. In addition, the FBAR regulations specify the circumstances under which a United States person will be deemed to have a financial interest in a foreign account owned by a different person. Specifically, a United States person has a financial interest in a foreign account for which the owner of record or holder of legal title is—

- a corporation in which the United States person owns, directly or indirectly, more than 50% of the voting power or value of the shares;
- a partnership in which the United States person owns, directly or indirectly, more than 50% of the interest in profits or capital;
- a grantor trust of which the United States person is the grantor and has an ownership interest in the trust;
- a trust 1) in which the United States person has a present beneficial interest in more than 50% of the assets or 2) from which the U.S. person receives more than 50% of the current income; or
- any other entity in which the United States person owns, directly or indirectly, more than 50% of the 1) voting power, 2) total value of the equity interests or assets, or 3) interest in profits.

A few things are worth noting about these rules. First, a United States person does not report the actual interest in the entity on the FBAR. Rather, the United States person reports the foreign account owned by the entity. These are, in some sense, attribution rules, pursuant to which the account of an entity is attributed to the United States person. This is a critical difference between the FBAR and IRS Form 8938, Statement of Specified Foreign Financial Assets, where the taxpayer is required to report interests in foreign entities, but not any accounts owned by the entities.

Second, a foreign account may need to be reported by more than one United States person. For example, if a domestic corporation with a sole U.S. citizen shareholder owns a foreign account, the domestic corporation would need to report the foreign account because it owns the account, and the shareholder would need to report the account because she owns more than 50% of the shares of the corporation. There is an exception to the multiple-reporting requirement, however; a trust beneficiary need not report a foreign account owned by a trust if the trust or the trustee is a United States person and reports the account.

Third, the phrase "directly or indirectly" does not appear in the trust-related rules described above. Therefore, if a trust does not directly own a foreign account, it seems that the grantor or beneficiary of the trust would not have to report the account.

Fourth, there is no express mention of estates among the entities through which a financial interest in a foreign account is attributed. An estate would fall into the catchall "any other entity," but a beneficiary of an estate would not generally be deemed to hold voting power over, equity interest or assets of, or interest in profits of, an estate.

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So, is the sole beneficiary of an estate that owns a foreign account required to report the account on the beneficiary's FBAR? A good argument can be made that the beneficiary is not required to report the foreign account. That said, there is no penalty for overreporting, and since the cost of not reporting a foreign account that has to be reported will generally far outweigh the cost of reporting a foreign account that does not, the safest choice is to report such an account.

Examples

The examples below illustrate the rules described above.

Example 1. Jane, a U.S. citizen, owns 100% of the membership interest in a New York LLC that is a disregarded entity for U.S. income tax purposes. The sole asset of the New York LLC is 100% of the stock of a Cayman Islands corporation. The Cayman Islands corporation holds an account at a Swiss bank. Who must report the Swiss account on an FBAR?

The Cayman Islands corporation is not a United States person, so it has no FBAR reporting obligation.

The New York LLC is a United States person because it is organized in the United States. It has a financial interest in the Swiss account because it owns more than 50% of the stock of the Cayman Islands corporation that owns the account, so it must report the account on its FBAR, even though it is a disregarded entity for income tax purposes.

Jane is a United States person because she is a U.S. citizen. She has a financial interest in the Swiss account because she owns 100% of the New York LLC and, therefore, indirectly owns the Cayman Islands corporation that owns the account. Thus, she must also report the account on her FBAR.

Example 2. Marlon, a U.S. citizen, is the settlor and sole current beneficiary of a California revocable trust. The trust is treated as a grantor trust with respect to him, and all of the trust's income is reported directly on his personal income tax return because the trust has no separate Employer Identification Number (EIN). (It supplies the grantor's Social Security number as its Taxpayer Identification Number instead.) The trust holds an account at a Swiss bank. Who must report the Swiss account on an FBAR?

The trust is a United States person because it is organized under California law. It has a financial interest in the Swiss account because it owns the account. The trust must therefore report the account on its FBAR, even though it does not have its own EIN and does not have any obligation to file its own income tax return.

Marlon is a United States person because he is a U.S. citizen. He has a financial interest in the Swiss account because he is the grantor of the grantor trust that owns the account. Thus, he must also report the account on his FBAR.

Example 3. Maria and Elena, both U.S. citizens, each own 50% of the stock of a

British Virgin Islands (BVI) corporation. The BVI corporation holds an account at a Swiss bank. Who must report the Swiss account on an FBAR?

The BVI corporation is not a United States person, so it has no FBAR reporting obligation.

Maria and Elena are both United States persons because each is a U.S. citizen; however, neither has a financial interest in the Swiss account because neither owns more than 50% of the stock of the BVI corporation. Thus, neither has an FBAR reporting obligation.

Example 4. Howard, a U.S. citizen, is the settlor of a Wisconsin irrevocable trust that is treated as a nongrantor simple trust. The sole trustee and current beneficiary of the trust is his U.S. citizen son, Richard, who is entitled to all of the income from the trust during his life. The sole remainder beneficiary of the trust is a U.S. private foundation organized under the laws of Texas. The trust holds an account at a Swiss bank. Who must report the Swiss account on an FBAR?

The trust is a United States person because it is organized under Wisconsin law. It has a financial interest in the Swiss account because it owns the account. The trust must report the account on its FBAR.

The private foundation is a United States person because it is organized in the United States; however, it has no financial interest in the Swiss account because it has no present beneficial interest in the trust and does not receive any of the trust's income. It therefore has no FBAR filing obligation.

Richard is a United States person because he is a U.S. citizen. He has a financial interest in the Swiss account because he receives more than 50% of the income from the trust that owns the account. Nevertheless, he has no FBAR filing obligation because the trust reports the account on the trust's FBAR, which relieves him of the obligation to report the account on his own FBAR.

Howard is a United States person because he is a U.S. citizen; however, he has no financial interest in the Swiss account because he is not the beneficiary of the trust and the trust is a nongrantor trust. He therefore has no FBAR filing obligation.

Example 5. Reshma, a U.S. citizen, is the sole trustee of a trust formed under the laws of Delaware. The trust is treated for U.S. income tax purposes as a foreign grantor trust owned by Alan, the nonresident, noncitizen settlor of the trust who created it, funded it, and has the unilateral right to revoke it. The sole beneficiary of the trust is David, the settlor's U.S. citizen brother. The trust's sole asset is a 100% membership interest in a Florida LLC that has made an entity classification (i.e., check-the-box) election to be taxed as a corporation. The sole asset of the Florida LLC is 100% of the stock of a Cayman Islands corporation, whose sole director/officer is Reshma. The Cayman Islands corporation holds an account at a Swiss bank. Who must report the Swiss account on an FBAR?

> Whenever foreign accounts are involved, a return preparer must peel back the layers of the onion and analyze each one to determine whether an entity or connected individual might have a filing obligation.

The Cayman Islands corporation is not a United States person, so it has no FBAR reporting obligation.

The Florida LLC is a United States person because it is organized in the United States. It has a financial interest in the Swiss account because it owns more than 50% of the stock of the Cayman Islands corporation that owns the account. Thus, the Florida LLC must report the account on its FBAR.

The trust is a United States person because it is organized in the United States, even though it is a foreign grantor trust for U.S. income tax purposes. It has a financial interest in the Swiss account because it owns 100% of the Florida LLC and therefore indirectly owns the Cayman Islands corporation that owns the account. Thus, the trust must also report the account on its FBAR.

David is a United States person because he is a U.S. citizen. He has no financial interest in the Swiss account, however, because even though he is the sole current beneficiary of the trust, the trust is not the owner of record or holder of legal title to the account. He therefore has no FBAR reporting obligation. (Moreover, even if David had a financial interest in the account, he would not have to report it on his FBAR because the trust must, and that relieves the beneficiary of the reporting obligation.)

Alan, the settlor of the trust, is not a United States person, so he has no FBAR reporting obligation.

Reshma, the trustee of the trust, is a United States person because she is a U.S. citizen. She has no financial interest in the Swiss account. Nonetheless, she must report the account on her FBAR because, as the sole director/officer of the Cayman corporation that owns the account, she has signature authority over the account.

Peeling the Onion

Entity ownership structures can be multitiered and complicated; the above examples barely scratch the surface of the variety of arrangements one might encounter. Fortunately, the attribution rules described above involving foreign accounts and entities are actually reasonably clear, as long as one does not make assumptions based on income tax treatment. Whenever foreign accounts are involved, a return preparer must peel back the layers of the onion and analyze each one to determine whether an entity or connected individual might have a filing obligation. ❑

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