

NONPROFIT ALERT: UNITED STATES INVESTORS IN OFFSHORE HEDGE FUNDS SHOULD CONSIDER FILING THE REPORT OF FOREIGN BANK AND FINANCIAL ACCOUNTS (FBAR)

INTRODUCTION

TD F 90-22.1 is required to be filed for all accounts where a U.S. person or entity has a financial interest or signature authority in foreign financial accounts if the aggregate value of these accounts exceeds \$10,000 at any time during the calendar year. These relationships are reported on the calendar year by filing Form TD F 90-22.1 with the Department of the Treasury on or before June 30, of the succeeding year.

FORM TD F 90-22.1

The rules are fairly straight forward but the definitions can be somewhat cumbersome. Simply put, every United States person (Code section 7701(a)(1) includes corporations in the definition of persons), who has a financial interest in or signature or other authority over any foreign financial accounts, including bank, securities, or other types of financial accounts, in a foreign country, if the aggregate value of these financial accounts exceeds \$10,000 **at any time** during the calendar year, has to report that relationship each **calendar year** by filing TDF 90-22.1. In some cases this could mean both the organization and those with signature authority over the accounts are both responsible for filing the forms. In the case of a corporate officer, for securities that are listed on a national exchange over which there is no direct financial interest on the part of the officer, there is not an individual filing requirement. This exception is only if the organization has filed the Form and notified the officer in writing that they are not required to file.

For this purpose a financial account is defined as any bank, securities, derivatives or other financial instrument t account. This includes any account in which the assets are held in a commingled fund, and the account owner holds any equity interest in the fund. The term also refers to savings, demand, checking, deposit, time deposit or any other account maintained with a financial institution.

Financial interest fall within one of three categories:

1. Those accounts where the organization is the owner of record or has legal title without regard to whose benefit the account is set up for;
2. Those financial and securities accounts where the organization is the holder of record with legal title and, (a) is a person acting as an agent, nominee, attorney, or in some other capacity on behalf of a U.S. "person"; (b) a corporation in which the organization owns directly or indirectly more than 50 percent of the total value of shares of stock or more than 50 percent of the voting power for all shares of stock; (c) a partnership in which the organization owns an interest in more than 50% of the profits or more than 50% of the capital of the partnership; or, (d) a trust in which the organization either has a present beneficial interest, either directly or indirectly in more than 50 percent of the assets or from which the person receives more than 50% of the assets or from which an organization receives more than 50% of the current income.
3. In cases where there is a trust protector involved as in rare cases.

Signature authority is present where a person can control the disposition of money or other property in it by delivery of a document containing his or her signature to the bank or other person with whom the account is maintained.

OFFSHORE HEDGE FUNDS MAY BE CONSIDERED FOREIGN FINANCIAL ACCOUNTS

On June 12, three IRS personnel participated in a teleconference with a law firm that was designed to address open questions regarding the TDF 90-22.1 filing for calendar year 2008 that must be filed by June 30. It was their position (not official IRS position at this point) that an offshore hedge fund is a “foreign financial account” for this purposes and that, therefore, every U.S. investor in an offshore hedge fund should file a TDF 90-22.1 Form, whether or not the fund has any offshore bank or securities accounts.

The instructions to TDF 90-22.1 provide that foreign financial accounts include “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).” In the teleconference, the IRS personnel took the position that offshore hedge funds are foreign financial accounts for this purpose.

Based on the instructions to TDF 90-22.1 and the insight from IRS personnel, until further guidance is issued by the IRS, we recommend that the Form should be filed by the following persons or entities with respect to offshore funds:

- Every U.S. investor, including ***U.S. tax-exempt entities***, in an offshore hedge fund (this includes both stand-alone offshore hedge funds and the offshore feeder in master/feeder hedge fund structure)
- U.S. feeder funds that invest in offshore master funds, and any U.S. investor that owns more than 50% of the U.S. feeder
- Any direct U.S. investor in an offshore master fund
- Investment managers that have a financial interest (for example, through their carry) in any offshore hedge funds (whether stand-alone, feeder or master)

One final note. In the event that you should acquire or create another controlled entity, an organization which owns directly or indirectly more than a 50 percent interest in one or more other entities will be permitted to file a consolidated report on TDF 90-22.1 on behalf of itself and such other entities as might be included.

CONCLUSION

The principal purpose for collecting the information is to assure maintenance of reports where such reports or records have a high degree of usefulness in criminal tax cases. This has become more apparent in recent months with the amount of news media attention foreign accounts are receiving in the current economy. This form has gone from a report that was often ignored to one that carries, under certain circumstances, a fine of not more than \$500,000 and imprisonment of not more than five years, for failure to file the report or to prepare a false report. ***While the IRS’s position on hedge funds is not official, it does carry substantial weight and should be considered.***

FOR FURTHER INFORMATION

Additional information about the Report of Foreign Bank and Financial Accounts (FBAR) can be found on the IRS website or by contacting Robert Lyons in our firm’s Nonprofit and Government Services Group.