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USA Reporting Requirements with Respect to Certain Financial Accounts Held Outside of the USA

(Including Those Applicable to Non-USA People and Institutions)

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The United States of America ("USA") requires certain filings with the US Department of Treasury with respect to financial accounts held by Americans outside of the USA.[1] There has been much confusion concerning when these filings are or are not required and by whom. Thus, the purpose of this memo is to explain the current circumstance and requirements as well as offer some thoughts with respect to limiting the cost of compliance.

Notably, these filing requirements can easily impact businesses which are wholly outside of the USA with no business connection to the USA.

In addition to individuals and businesses, these filing requirements could easily apply to a person who is the trustee or receiver with respect to an insolvency. They could apply to the executor or administrator of an estate. They could apply to the trustee of a trust. The insolvent, the estate or the rust could be wholly within the USA, wholly outside of the USA or both. Further, the obligation to file could attach to the insolvent, the estate or the trust as well as their individual managers.

This has to be one of the most boring and tedious subjects I have ever had to write about. The length and detail is also way beyond reason albeit necessary given the subject matter. If you need a motivating force to read this, please skip to the heading "Penalties" commencing at page 18. That certainly motivated me.

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[1] Throughout this memo, unless otherwise indicated, the term "foreign" or "foreign country" means all geographical areas **not** located in the USA. The USA, for this purpose includes its states, territories and possessions. There are other issues but typically of limited consequence. There is a more detailed discussion of this issue in later parts of this memo.

The filing in question is Form TD F 90-22.1 Report of Foreign Bank and Financial Accounts. This form is often referred to as the "FBAR". One can see this form at the web site for the US Internal Revenue Service ("IRS") at http://www.irs.gov/app/picklist/list/formsInstructions.html?value=90-22.1&criteria=formNumber .[2]

The general rule is:

> Each United States person 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, must report that relationship…[by filing Form TD F 90-22.1 Report of Foreign Bank and Financial Accounts]…before June 30 of the succeeding year.[3]

We can break the requirement to file down into the following parts:

1. There must be a United States person.

2. That United States person must have a financial interest in or signature or other authority over the accounts in question.

3. The accounts must be financial accounts.

4. The accounts must be in a foreign country.

5. The accounts in question must exceed US$10,000.

Bear in mind, one must meet all of these conditions before this reporting is required. Below, we will address each one of these five elements.

[2] Please be cautious when accessing the IRS web site. There is a web site www.irs.com. That is a private commercial web site of dubious integrity. The IRS web site is ".gov". Should you choose to use the IRS' active pdf version of the FBAR, please be sure to save it to your computer before commencing data entry. If you do not, there is a high probability of losing all of your data input work. Finally, never send anything to the taxing authorities without also retaining a copy in paper form in your files.

[3] General Instructions to Treasury Form TD F 90-22.1, p. 6, hereinafter referenced as the "Instructions" or the "FBAR", as appropriate. Instructions to forms are not binding law in the USA. Binding law is found in the statutes such as the Internal Revenue Code, the regulations such as the Treasury Regulations and cases tried before courts.

United States Person

A United States person is, generally, a citizen or resident of the USA regardless of where that person actually physically maintains his home and business. Further, any citizenship or residency in addition to that of the USA is not relevant in this determination. Thus, a person who is a citizen of both the USA and another country is a United States person. A USA resident includes a so-called "green card" holder but it is not limited to that visa status. It also includes a person who is physically in the USA or doing business in the USA.[4]

There are no age limitations or requirements. Thus, a baby who is otherwise a United States person may be required to file this form. It is not uncommon for children of even modestly wealthy families to have some meaningful wealth and, thus, "financial accounts" registered in their names or trusts for their benefit. This is, perhaps, more common in jurisdictions like the USA with estate, inheritance and gift tax regimes.

We should also note here that children of a United States citizen and a non-United States citizen even when the children are born outside of the USA may be United States persons as defined for this purpose as well as for USA income tax purposes. However, one may need to consult counsel who specialize in this area.

A "person" can be corporal or non-corporal. Thus, a corporation organized under the laws of the USA is a United States person for this purpose.[5]

A foreign subsidiary of a United States person is not required to file the FBAR.[6] Its USA parent, however, is required to file and would have to include the foreign bank accounts owned or controlled by its foreign subsidiary.

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[4] 31 CFR 103.11(z). *See also*, 31 CFR 103.11(nn).

[5] In the USA, non-corporal persons or legal entities are typically organized under the laws of one of its several states, territories or possessions. This is true of corporations, partnerships, limited liability companies, limited liability partnerships and trusts. In limited circumstances, certain legal entities are organized under the laws of the USA's national government. National banks would be an example.

[6] The words "United States person" clearly include corporeal and non-corporal persons. This provision on its face implies that a corporeal person could have a "subsidiary". On the other hand, we can think of no circumstance where a corporeal person could, in fact, have a "subsidiary". Even Black's Law Dictionary defines "subsidiary" in the context of a "corporation". Black's Law Dictionary (Revised Fourth Edition) at p. 1596 (West Publishing 1968). Given the age of our version, we would expand that to include limited liability companies, limited liability partnerships and partnerships but, never, a corporeal person. Thus, it is unclear as to what precisely the US Department of Treasury has in mind at least with respect to corporeal persons.

A Financial Interest in or Signature or Other Authority Over the Accounts

This is what we call a two part disjunctive test. One must have **either** a financial interest in **or** the ability to access an account through signature or other authority even if one does not have a financial interest in the account. Possessing one of these attributes is one more step down the road to being required to file with the US Department of Treasury. Of course, one could also have both an interest in an account and signature or other authority over that same account.

A Financial Interest

In one circumstance, one must have a financial interest in the account. A United States person has a financial interest in an account if:[7]

1. The United States person is the actual owner of the account. An actual owner is where one has dominion over or title to the account. The easy example is where one opens a personal checking account using it for day to day needs. However, a trustee takes legal title to a bank account while the beneficial ownership belongs to another. In this case, assuming both the trustee and the beneficiary of the trust are United States persons, both the trustee and the beneficiary would have to file the FBAR.

2. A United States person also has a financial interest where:

    a. The United States person is beneficiary of an account where legal title is held by another person acting as agent, as a nominee, an attorney or by someone in a similar capacity under local law. Thus, for example, a United States person would need to include in his FBAR the account held by his Costa Rican attorney in a Costa Rican bank in escrow in connection with a real estate closing. While unusual, a corporation or other legal entity can be a beneficiary of a trust as well as trustee.

    b. The foreign financial accounts of a foreign or USA corporation[8] in which the United States corporeal or non-corporeal person has a

[7] Instructions at p. 6.

[8] For this purpose, it should be highlighted that it makes no difference whether a non-corporeal legal entity is organized under the laws of the USA or not. It is the location of the financial account which controls.

It should also be highlighted that the US Department of Treasury and the IRS consistently refer to "corporations" and "partnerships". However, these non-corporeal legal entities do not exist in many foreign jurisdictions. Indeed, they are generally unique to jurisdictions founded in Common Law. The US Department of Treasury does have explicit regulations controlling this issue for USA income tax purposes where nearly all foreign non-corporeal legal entities are defined as direct or indirect ownership interest in excess of 50% are includable.[9] In this case, the United States corporeal or natural person has to include the corporation's foreign financial accounts in his FBAR.

c. The foreign financial accounts of a foreign or USA partnership in which the United States person has a direct or indirect ownership interest in excess of 50% are includable.[10] In this case, the United States corporeal or natural person has to include the partnership's foreign financial accounts in his FBAR.

d. The foreign financial accounts of a foreign or USA trust in which the United States person has either a **present** beneficial interest or actually receives current income in excess of 50% are includable.[11]

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either a "partnership" or a "corporation". Those rules can be found at IRC §7701(a) and Treas. Reg. §301.7701 as revised effective after 31 December 1996. For most foreign non-corporeal legal entities, there is a definitive list. *See*, Treas. Reg. §301.7701. With respect to Costa Rica, a *sociedad anomina* is, *per se*, a corporation for USA income tax purposes. A *sociedad de responsibilidad limitada* or *limitada* may be either a corporation or a partnership or a pure disregarded entity (sole proprietorship) for USA income tax purposes.

The FBAR is not explicit in this definitional context. But, once one goes through the entire process, it makes little or no difference as to outcome. We also observe that the Instructions do make explicit reference to the US Department of Treasury income tax regulations for certain other definitional matters. Thus, following the US Department of Treasury definitions of "corporation" and "partnership" for USA income tax purposes is probably intended or implicit.

[9] The greater than 50% ownership requirement is determined by either the voting rights or by the true or market value of all equity interests. The voting rights and true or market value would be determined by the law under which the "corporation" is organized but using USA valuation methodology. One would also "look through" tiers of legal entities.

[10] The greater than 50% ownership requirement is determined by either the rights to income or the rights to capital. This determination is controlled by the law under which the "partnership" is organized or governed. One would "look through" tiers of legal entities.

[11] As with other non-corporeal legal entities, trusts are creatures generally unique to jurisdictions founded in Common Law. There are definitional provisions of what constitutes a "trust" in the USA income tax law both statutory and regulatory. They are more nuanced than those with respect to "corporations" and "partnerships" and, thus, are beyond the scope of this memo.

Costa Rica is unique in the author's experience. Its law is founded in Civil Law but it does, in fact, have a legal concept of a trust which is substantively indistinguishable from the USA concept. These are frequently used as the mechanism for Costa Rica's financial institutions to secure title to real estate supporting a loan. They are also frequently used in Costa Rica with respect to certain titling issues surrounding "concession land". Thus, this issue does arise with some frequency in Costa Rica.

The use of the term "present interest" warrants some discussion. A present interest in a trust is a very nuanced area of USA common and statutory law not limited to taxation. It is also beyond the scope of this memo. Suffice it to say, if you are currently receiving a distribution from a trust it is

In this case, the United States corporeal or natural person has to include the trust's foreign financial accounts in his FBAR.

3. A financial interest arises where the legal title of the account is a trust or a person acting as trustee where the trust was established by the United States person where a "trust protector" has been appointed. A trust protector is a person responsible for monitoring the account and may have authority to influence the decisions of the trustee or even replace the trustee. This appears to source, at least in part, in some prior attempts to remove the technical side of "ownership" especially in some schemes sometimes referred to as "asset protection" trusts. In order to effectively implement a limitation on the ability of one's creditors to access assets, one has to remove "dominion and control". This is sometimes attempted through crafty draftsmanship of trust agreements. This provision is intended to remove the opportunity to circumvent the otherwise required disclosure of foreign financial accounts where the beneficial interest is really intended to reside in the United States person who is a "possible" beneficiary.

Signature or Other Authority

Even if one does not have a financial interest in a foreign financial account as defined above, the mere "signature or other authority" over a foreign financial account is sufficient to require the United States person to include the foreign account or accounts in his FBAR.[12] One has signature or other authority over an account if one can control the disposition of its content regardless of its nature (cash or securities). Controlling its disposition includes:

1. Signature authority exercised alone whether independently or in tandem with one or more others. The application of a "signature" includes, but is not limited to, what would commonly be required when using a check or draft.

2. By any other means of communication with the financial institution or other person who maintains the accounts. The easy example is via debit or credit card with access to the PIN but it is certainly not limited to this circumstance.

3. There is a catchall as the paragraph ends with the phrase "…or by other means" with respect to authority over an account. We are confident this will be very broadly applied by the US Department of Treasury.

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likely a "present interest" but there are many other factual circumstances where an interest in a trust would be a present interest despite the fact one may not actually be receiving distributions.

[12] Instructions at p. 6.

Inserting agency or similar relationships or requirements does not circumvent this provision. For example, an account where the United States person's foreign attorney has "signature" authority over the account but the United States person does not must still be included in the United States person's FBAR.

Rather than the nefarious, the most common example we see is a United States person who is married to a foreign person. The foreign spouse has a wholly separate bank account where the foreign spouse is the sole signatory. The foreign spouse gives the United States person spouse a debit card and the PIN. The United States person spouse has to include this account in his FBAR.[13]

Signature or other authority over the financial account is broadly defined. The definition and scope has expanded over the years as banking has shifted into the electronic age. We would expect it to continue down this path including by means of broad and liberal interpretation.

It is a bit disconcerting. However, after one contemplates the foregoing, it is entirely possible for the same foreign financial account to be included in more than one FBAR.

Financial Accounts

In order to be reportable, the accounts must be "financial accounts". This may seem silly but the reportable accounts go beyond what most of us think of as a checking account. So, here are the words:

> [A reportable account]…includes any bank, securities, securities derivatives or other financial instruments accounts. [These]…encompass any accounts in which assets are held in a commingled fund, and the account owner holds an equity interest in the fund (including mutual funds). [A reportable account]…also means any savings, demand, checking, deposit, time deposit, or any other account (including debit card and prepaid credit card accounts) maintained with a financial institution or other person engaged in the business of a financial institution.[14]

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[13] This is a good place to make an observation. Spouses are, in fact, separate people. Thus, only spouses who are also United States persons file the FBAR. But please remember that an otherwise foreign spouse who is a United States person solely by means of USA residency including a so-called green card, must also file an FBAR.

A spouse can join in a single FBAR filing where there are joint accounts and both spouses are United States persons. However, should both spouses have separate foreign financial accounts, each spouse would need to file a separate FBAR.

Generally, as a practical matter, the author recommends that spouses file separately.

[14] Instructions at p. 6.

The language is very broad and all inclusive. We can list some of the more common in plain American English:

1. Checking accounts in a bank.

2. Savings accounts in a bank.

3. Brokerage accounts.

4. Mutual funds.

5. What are commonly called hedge funds.

There are other “accounts” not so familiar to Americans. One might be what we in Latin America call a “*fondo*”. It is somewhat similar to a mutual fund. There are others.

There is an interesting catch in here. Many of our non-USA investment advisors might well counsel the holding of USA securities including US Treasury bills, bonds and notes but in a brokerage account outside of the USA. This gets to the rather curious result where the value of US government bonds could easily end up included in this report where a United States person held those bonds through a brokerage account in, for example, Switzerland.

There is an interesting exclusion or exception implicit in the above language. The value of the Costa Rican sovereign bonds held in our brokerage account in Costa Rica is, indeed, included in the reporting of that financial account. However, should we actually take physical delivery of those bonds, the Costa Rican sovereign bonds themselves are not a reportable account. Further, should one take actual physical delivery of the stock certificates of, for example, RWE (a German utility) rather than hold them in a French brokerage account, their value is not reportable. Those RWE stock certificates are not a reportable account.[15]

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[15] We find this curious. We really do not know anyone today who actually takes delivery of the certificates of publicly traded companies. It is generally still possible. On the other hand, it is no longer possible to do so with respect to US Treasury bills, notes and bonds. We have no idea with respect to Costa Rican sovereign bonds or others. But, in the not too distant past, we used to actually take delivery of the physical certificates representing equity holdings. There are legitimate and proper reasons to do so especially in troubled times. However, there are “costs” to taking delivery of the certificates like collecting and depositing each and every dividend check; physically securing the certificates including protecting them from theft, fire or other risks of physical loss; delivering the physical certificates to a broker dealer to sell them; etc.

There is another circumstance out there in the investing world. Some publicly traded companies including some organized outside of the USA will actually hold one’s shares in notional form instead of actually sending the stock certificate. This arrangement is actually quite common as it

There is another point above which specifically sweeps in “accounts” with a “person” who conducts the business of a financial institution.[16] Firstly, a “person” can be either corporeal or non-corporeal. Most real people see the word “person” and think of a real human being. As used here, it includes a real human being but it also includes other non-corporeal legal entities.

It is unclear to us what precisely the US Department of Treasury is addressing other than being as all inclusive as possible. On the other hand, we do see here in our little part of planet earth a couple of circumstances which would seem to get swept into this regulatory regime:

1. On occasion, attorneys or others in Panama[17] maintain escrow-like accounts on behalf of certain clients over periods of many years. While these individuals and firms are certainly not financial institutions, these escrow-like accounts function in every way like savings accounts or even brokerage accounts. It is our view that these “accounts” are included as “financial accounts”.[18]

2. Also on occasion and again often in Panama in our part of the world, we see “investment advisors” maintain arrangements similar to those described in Item 1 above. The distinguishing factor appears to be a more explicit promise on the part of the investment advisor to actually invest the funds often quite explicitly as to the form of the investment.[19]

3. Finally, we have the nefarious. In Costa Rica’s past, they were known as “the Brothers”. These guys suggested that one make a loan to them. They then promised (not kidding) to pay 3% per month on these “loans”.

is the means by which most dividend reinvestment programs are administered. These rules with respect to the FBAR seem to be silent as to whether this arrangement is an “account”.

[16] There is a large body of both USA and other nation states’ law defining a financial institution. There is also a large body of law defining what one might call a “real bank” (the one you and I think of where we have our checking account). Some of the better definitions are actually in the US Internal Revenue Code and Treasury Regulations. Thus, the term “financial institution” used in this context is a well defined term of legal art well beyond the scope of this memo.

[17] We do not intend to unjustly single out Panama. There are many fine professionals and institutions centered in Panama. Indeed, we count some amongst our clients. However, there is another side which cannot be denied or swept discretely under the rug. This is certainly not limited to Panama. There are more than a few others.

[18] These accounts or arrangements are not *per se* wrong or nefarious or evil. There are right, proper and legitimate purposes for these arrangements. They are, however, less formal or structured than we typically see in the USA and certainly more private.

[19] These accounts or arrangements are also not *per se* wrong or nefarious or evil.

> After something in excess of ten years, this Ponzi scheme imploded leaving many American expatriates with substantial losses. Needless to say, many of these American expatriates failed to include the 3% per month of interest income in their USA income tax returns. In any event, this scam or similar would be swept into this portion of the definition of a reportable account. As an aside, anyone promising a fixed rate of return of 3% per month in the context of the era is either lying or in a business most would not want to fund.

Finally, the US Department of Treasury did explicitly pick up credit cards albeit limited to “prepaid” credit cards. We actually recognize at least one source of this issue. Quite a number of years ago, American Express[20] solicited more than a few Americans to deposit funds in their bank in one of the Caribbean islands. Of course, the source of those funds was not necessarily from income previously taxed. These Americans were then given American Express cards which were usable throughout the world including on Rodeo Drive and the better shops in Manhattan. In any event, these arrangements are also reportable accounts.

The Accounts Must Be in a Foreign Country

To be included in the disclosure, the accounts must be held in a foreign country. At first blush, this seems rather obvious and straight forward. A foreign country relative to the USA is a geographical location which is not one of the several states, territories or possessions of the USA. But therein lays the rub especially in this modern era. The account must be **geographically** located outside of the USA irrespective of the nationality of the financial institution.[21]

This is best explained by example. Literally downstairs from our office in Escazú, Costa Rica is CitiBank. There is the sign on the building here including the stylized red umbrella as the last vestige of the old Travelers Group. We have clients with accounts there. Some of those same clients have accounts with CitiBank in New York. We are told that one can actually link the CitiBank New York and CitiBank Costa Rica accounts so one can do on-screen electronic banking as if these are simply separate accounts within the same institution. Nonetheless, the account in CitiBank Costa Rica must be disclosed on the FBAR while the accounts in CitiBank New York are not includable.

On the other hand, we maintain personal and business checking accounts at BAC San José. BAC San José was originally locally owned. Today, General Electric Corp. owns a meaningful interest. BAC San José has operations throughout Central America with one lonely office in Coral Gables, Florida. BAC San José, except that sole office in Florida, is a foreign bank. Unless our

[20] Again, we do not intend to pick on American Express alone. We are sure there were others. We just happen to have rather clear recollection of this “event”.

[21] Instructions at p. 6. *See also*, 31 CFR 103.11(nn).

accounts are physically issued by the Florida branch, our accounts in BAC San José are foreign and must be included in the FBAR.

A final example should cover most of the remaining circumstances. We are a USA citizen, lawful permanent resident of Costa Rica and physically reside in Costa Rica. We have no property or personal presence in the USA. We have brokerage accounts with UBS – UBS Financial Services, Inc. which is the USA operation of UBS AG the Swiss parent. UBS sends the statements to us at our address in Escazú. Our accounts with UBS Financial Services, Inc. are USA accounts and, thus, not includable in the FBAR. Our citizenship, residency and physical location make no difference. It is the location of the account which controls.

The second point in the final example above is a foreign institution operating in the USA is **not** foreign to the extent the accounts are maintained in the USA operations of that foreign financial institution. Hence, our accounts with UBS are not foreign financial accounts.

So far, as a practical matter, we have had no difficulty in making these determinations. We can, however, easily envision a circumstance especially with electronic banking where the determination could become complex. On the other hand, with the current crises within these institutions, there is likely to be a greater need for ring fencing of the various parts of these institutions within nation state boundaries. Thus, perhaps, that day of pure multi-national integration may be indefinitely postponed.

The Accounts Must Exceed US$10,000[22]

This one is tricky.

First, one has to determine the highest value of **each** applicable foreign financial account during the calendar year. One also has to capture that value for possible disclosure. This includes all of the financial accounts the United States person owns as well as those in which he has an interest or over which he has signature or other authority.

Next, one aggregates or sums these highest balances with disparate dates to determine whether one meets the more than US$10,000.00 threshold for filing. If one exceeds the US$10,000.00 threshold for filing, then **all** foreign financial accounts, regardless of the highest balance within each account, must be included in the FBAR. Thus, do not overlook that old savings account in Banco de Costa Rica with the US$26.39 balance. It also must be included in the FBAR

[22] Instructions at p. 6.

once the aggregate values of all foreign financial accounts exceed US$10,000.00.

Let's assume Maria is a manager at Sigma Alimentos SA de CV ("Sigma")[23] here in Costa Rica. Maria is a Costa Rican citizen but holds a USA green card. She physically resides in Costa Rica having lived in the USA only as a young child. Maria has a checking account at Banco Nacional. The highest balance in that account throughout the year is her monthly wage of US$2,000.00 automatically deposited in her checking account by Sigma. Maria has no other foreign financial accounts. She does not have to file the FBAR, right? Possibly wrong.

If Maria is the payroll supervisor at Sigma here in Costa Rica with "signature or other authority" over Sigma's local payroll disbursing checking account, one can be virtually certain that Maria meets the US$10,000.00 threshold. Thus, she has to file the FBAR because she has to include the highest balance of Sigma's payroll disbursing checking account during the calendar year which, we can assure you, will have balances greater than US$8,000.01 (that is not a typo – the sum of the highest balances of Maria's checking account and Sigma's account must be **more than** US$10,000.00). Also, please remember the definition of United States person. It is not limited to USA citizens. Maria is a United States person by reason of her green card.

There are some other practical problems with true bank checking accounts and savings accounts. We will simply list a few but by no means a comprehensive list without too much commentary:

1. On any given day, does one first book deposits or withdrawals? It is customary for banks to book withdrawals and checks first before booking deposits. We notice Quicken also books withdrawals first for internal bookkeeping purposes.

2. Clearing times become problematic. For example, the author recalls sending a client check drafted on Costa Rica's version of the Federal Reserve Bank to UBS Financial Services, Inc. in the USA for deposit. It took more than six months to clear. We cite this circumstance as it could as easily have been a check drafted on our BAC San José account to transfer funds internally. In the reverse, typically a check drafted on a non-Costa Rican bank deposited in a Costa Rican checking account takes three weeks to clear. When does one count these deposits or transfers in making the highest account balance determination?

[23] Sigma is Mexico's largest producer of refrigerated and frozen food. They have a large presence in Costa Rica. We chose this with a reason which will become apparent later in the exceptions. In any event, Sigma is a large multinational but not a USA multinational like Proctor & Gamble or others with large operations here in Costa Rica.

3. Accruing interest could be problematic. For example, banks typically credit the interest to an account on a particular day on a monthly basis. But the standard or test here is highest **value** during the calendar year. Thus, if the bank credits interest on the 15th of each month but would be contractually required to pay interest through the date of withdrawal or deposit if the funds were withdrawn on a day other than the 15th, one would have to add the accrued but unpaid interest to the **value** of the account.

Brokerage accounts provide an additional problem. It is the value of the brokerage account in its entirety which is used to determine its highest value during the calendar year. Let's use the easy example of our Costa Rican brokerage account. It is easy because it consists solely of Costa Rican sovereign bonds denominated in colones and, on occasion, some amount of cash. The value of those bonds varies daily; arguably, these days, by the minute.[24] We honestly do not know but truly hope the Costa Rican brokerage house does not value these bonds any more frequently than monthly which is reflected on the monthly statement. But, the plain language says we should value this account daily. That would be a serious burden.

The US Department of Treasury has addressed many of these issues. The maximum value for determining the US$10,000.00 filing threshold as well as the amount to be disclosed is the highest value shown on the periodic statements at the end of the reporting period **so long as one receives statements quarterly or more frequently**. In short, one can look at the end of month value on the monthly statements from a financial institution to determine the highest value of that account during a calendar year.[25]

If one receives either no statements or receives statements on less than a quarterly basis, one must look at the values in the bank or securities account on a daily basis.

Planning point: Make sure one does business with financial institutions which provide quarterly or more frequent statements. That is a pretty good policy regardless of tax and other reporting obligations.

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[24] The truth with respect to this issue of valuation especially with respect to bonds is the values are anything but certain until a bond is sold or matures. Despite the nano second trading of securities by the largest investment banks, the bond markets and others are often thinly traded. Thus, there may, in fact, not be a comparable trade of any given bond at any particular moment including month end as shown on brokerage statements. Indeed, the author recalls participating in the sale of a bond broker-dealer in New York. That broker-dealer had an inventory of USA sovereign bonds. A portion of the sales price was bench marked to the true or fare value of that bond portfolio. Two very large independent institutions were hired to value that bond portfolio. The two experts arrived at three materially different valuations.

[25] Instructions at p. 7.

The next issue of account valuation is the relevant foreign currency exchange rate. There are three possible exchange rates:

1. The exchange rate on the date of highest value.

2. The exchange rate at 31 December of the reporting year.

3. The average exchange rate during the relevant reporting year.

The Instructions are explicit on this point. One uses the exchange rate on 31 December of the relevant reporting year. [26]

This is a good place to interject some sense of practicality. It is entirely unclear as to whether the US Department of Treasury has actually considered all of the practical issues surrounding the compliance and data gathering with respect to

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[26] Instructions at p. 7.

In the bad old days, my mentor Miss Lillian Call and I had to use the paper Wall Street Journal to locate the various currency exchange rates. I distinctly recall our collective vast libraries (including Lillian's garage) of every Wall Street Journal published on the first business day of every month going back decades. Our secretaries had the horrible job of maintaining green ledger sheets of those month end values for the currencies Lillian and I most frequently encountered in the practice.

Our methodology violated the plain language of the law then and today. We should have been maintaining those records on a daily basis. I do not recall a single instance of a taxing authority quibbling with our more practical month end methodology. Indeed, I do recall a couple of telephone calls from the taxing authorities asking if they could use that data base especially the older portions.

Today is a new era and, on occasion, thankfully so. For the Costa Rican colon/US dollar exchange rate, our central bank Banco Central de Costa Rica ("BCCR") maintains a fabulous Excel exportable daily data base. One can find it at http://www.bccr.fi.cr/flat/bccr_flat.htm. One can also convert that web site from Spanish to English. For many other currency exchange rates, the best source of which we are aware is http://fx.sauder.ubc.ca/data.html. This web site does not include every currency. For example, the colon is not included. It does, however, include gold? This web site is maintained by the University of British Columbia. It also has Excel exportable data. There is no charge for its use.

Finally, we need to consider a technical fine point in this area. Many institutions publish exchange rates. One sees them posted in every public and private bank in Costa Rica. These are not typically the official exchange rates. The exchange rates we typically see posted vary in time and by institution. The web sites above contain the correct official exchange rates for tax reporting purposes.

Further, there are always two exchange rates at any point in time – the buy rate and the sell rate. The USA tax law, without exception, requires that one use the average of those two rates. Thus, and this cannot be avoided, one must use this average of the official buy and sell exchange rates to convert other currencies into US dollar for US tax purposes.

this issue including valuation. However, the issue of these valuations is three fold:

1. They quantify the US$10,000.00 threshold amount determining whether one must file the FBAR.

2. If one must file, the amounts or values of each account must be disclosed on the form.

3. There is no fee or tax generated by the FBAR process. Its sole and exclusive purpose is disclosure.

Recognizing these three observations, the actual precise “value” of these accounts is of little or no practical consequence unless one was very near the US$10,000.00 threshold. In thirty-three years of practice, we have never seen a circumstance where a very narrow valuation issue would tip a person into or out of filing the FBAR. People are either so far under the US$10,000.00 threshold or over it so as to render any nuance of valuation moot. In the unlikely event of a close call, the author would “round up” and advise the client to file.[27]

Obviously, this practical view is not to suggest one should be less than appropriately diligent in the valuation process.

The only time valuation would become cash meaningful is, as we will see, in calculating the penalty for failing to file at all or failing to include a foreign financial account. Thus, some issues may have been addressed from time to time within the US Department of Treasury with respect to enforcement. But, as a practical matter, there would seldom be a material consequence with respect to small differences in valuation.

Exceptions

There are very few exceptions. They are fairly straight forward and very narrow.

1. An officer or employee of a bank under the current supervision of the USA national bank regulatory agencies does not need to consider any foreign account over which he has signature or other authority so long as he has no financial interest in the account. Please note carefully. This does not apply to a United States person who is an officer or employee of a **foreign** bank.

2. An officer or employee of a USA based company where its stock or equity (not just its bonds) trades on a USA national bourse or stock exchange

[27] *See* discussion below concerning penalties and statutes of limitation. Rounding up and filing is the correct answer as an advocate of the client.

like the New York Stock Exchange. The company must have more than US$10 million in assets and 500 or more stockholders. This officer or employee need not consider the foreign financial accounts of his employer over which he has signature or other authority if he has no financial interest in the account **and** he has received a letter from the chief financial officer of that company attesting that the company has filed the requisite FBAR. This written attestation must be received by the employee annually.[28]

3. The same result as Item 2 above would occur where the United States person is an officer or employee of a USA subsidiary of that USA publicly traded parent as defined in Item 2 above. This exception is predicated on the fact that the USA parent company has complied, the officer or employee has no financial interest in the account **and** he has received the requisite annual attestation from the chief financial officer of the USA parent.

4. The same result as Item 2 above would occur with respect to the United States person who is an officer or employee of a more than 50% owned foreign subsidiary of a USA parent otherwise described in Item 2 above. This exception is predicated on the fact that the USA parent company has complied, the officer or employee has no financial interest in the account **and** he has received the requisite annual attestation from the chief financial officer of the USA parent.

5. Correspondent or “nostro” accounts maintained by banks are, generally, not reported on the FBAR. There are other reporting requirements with respect to these accounts.[29]

6. While it is not really an exception *per se*, certain commonly controlled groups with a USA parent company can file a consolidated FBAR.

7. An account in a United States military banking facility, even if that facility is in a foreign country, is not a foreign financial account.

This is the sum total of the exceptions.

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[28] Exceptions 2, 3 and 4 above speak in terms of “corporations” and their subsidiaries. In some cases, the US Department of Treasury is ambiguous. The vast majority of USA publicly traded companies are USA corporations. However, an ever growing number of their USA and foreign subsidiaries are organized as limited liability companies and their foreign equivalents. It is unclear whether a noncorporate legal entity would qualify here albeit we can think of no policy reason preventing such a result.

[29] Correspondent or “nostro” accounts are used for certain multi-national interbank transfers.

Record Keeping Requirements

An interesting twist here is the record retention period is five years; not three years more typically seen with respect to many USA tax matters. The Instructions are silent but, generally, records retention periods commence with the due date of the form or, if later, the date the form is actually filed.[30]

Another observation is in order here. A United States person whose foreign financial accounts fall below the US$10,000.00 threshold is not required to file the FBAR. However, where a taxing authority has no "notice" or reason to query based solely upon the taxing authority's records on file, a statute of limitations never commences and never tolls.[31] Thus, even many years from now, the US Department of Treasury could, for whatever reason, assert that one should have filed the FBAR but failed to do so. One would then have to prove that one did not, in fact, have foreign financial accounts with balances in excess of US$10,000.00 at that time. Thus, one needs to be even more careful to preserve proof that one falls short of the US$10,000.00 threshold. That proof needs to be retained **indefinitely**.

This is not farfetched. We can think of two similar circumstances where we had to prove ten or fifteen years later that a tax had been paid but where the taxing authority had lost the tax returns. The taxing authorities asserted the statute of limitations had not tolled because they had no notice. Yet it was clear the taxing authorities had lost the actual tax returns which had, in fact, been filed. Thankfully, in the larger case, our client had taken our prior advice to heart. They had retained all of the records to prove they had, in fact, both filed and paid – the monetary amount was in six figures.

[30] As a practical matter, one really cannot rely on these record retention dates. In the event the regulatory authorities loose the form in their records, one has to have the records to prove that one did, in fact, file and file timely. Thus, one should retain these records on a permanent basis.

[31] USA income tax returns do have some questions on them asking about foreign financial accounts. Where those are properly answered "yes" even where the foreign financial accounts do not meet the threshold, one could argue the US Department of Treasury is "on notice" with respect to this issue. However, those income tax returns go to an entirely different sub set of the US Department of Treasury than the FBAR. Thus, we suspect, the US Department of Treasury would argue there is not sufficient notice.

Further, with respect to corporeal persons (real people), the questions are on a sub form not always required to be included with a person's annual income tax return. In this case, there clearly would be no notice.

Due Date for Filing

The due date for filing is 30 June of the succeeding year. Thus, reports for the year ended 31 December 2009 are due 30 June 2010. There is no ability to extend this filing deadline.

There is an explicit provision and process for amending previously filed FBARs in the event an error is subsequently discovered.

Penalties

The FBAR is far from new. From the author's memory, it has been around since at least the 1980s.

Eons ago, there was no penalty for failing to file this report. Thus, it is quite likely that few were filed.

At some point from the author's memory, the penalty was elevated to US$5,000 annually for failure to file. While considerable for many of us, this was still not an overwhelming sum.

Commencing with violations occurring after 22 October 2004, the "…civil penalty for **willful** violation of…reporting and recordkeeping requirements…[became] the greater of $100,000.00 or 50% of the balance in the account at the time of the violation."[32] [Emphasis added.] Non-willful violations could result in a penalty as high as US$10,000 for each violation. There were also criminal penalties consisting of further fines and up to five years in prison.

On 17 June 2008, the IRS noted an approximate 85% increase in the receipt of these FBARs. The penalty language remained essentially the same with an added notation of a possible US$500,000.00 criminal fine with the potential prison term increased to ten years.[33]

On 30 March 2010, the IRS published the "Workbook on the Report of Foreign Bank and Financial Accounts". In this document, the IRS includes the following

[32] FS-2007-15 (February 27, 2007) and, *also*, http://www.irs.gov/newsroom/article/0,,id=168194,00.html..

[33] IR-2008-79 (June 17, 2008) and, *also*, http://www.irs.gov/irs/article/0,,id=184037,00.html .

chart outlining the penalties:[34]

The following chart highlights the civil and criminal penalties that may be asserted for not complying with the FBAR reporting and recordkeeping requirements.

Violation	Civil Penalties	Criminal Penalties	Comments
Negligent Violation	Up to $500	N/A	31 U.S.C. § 5321(a)(6)(A) 31 C.F.R. 103.57(h)
Non-Willful Violation	Up to $10,000 for each negligent violation	N/A	31 U.S.C. § 5321(a)(5)(B)
Pattern of Negligent Activity	In addition to penalty under § 5321(a)(6)(A) with respect to any such violation, not more than $50,000	N/A	31 U.S.C. 5321(a)(6)(B)
Willful - Failure to File FBAR or retain records of account	Up to the greater of $100,000, or 50 percent of the amount in the account at the time of the violation.	Up to $250,000 or 5 years or both	31 U.S.C. § 5321(a)(5)(C) 31 U.S.C. § 5322(a) and 31 C.F.R. § 103.59(b) for criminal. The penalty applies to all U.S. persons.
Willful - Failure to File FBAR or retain records of account while violating certain other laws	Up to the greater of $100,000, or 50 percent of the amount in the account at the time of the violation.	Up to $500,000 or 10 years or both	31 U.S.C. § 5322(b) and 31 C.F.R. § 103.59(c) for criminal The penalty applies to all U.S. persons.
Knowingly and Willfully Filing False FBAR	Up to the greater of $100,000, or 50 percent of the amount in the account at the time of the violation.	$10,000 or 5 years or both	18 U.S.C. § 1001, 31 C.F.R. § 103.59(d) for criminal. The penalty applies to all U.S. persons.
Civil and Criminal Penalties may be imposed together. 31 U.S.C. § 5321(d).			

The IRS also references provisions in the US Patriot Act. We did not pursue those issues for purposes of this memo. On the other hand, we know with certainty that we do not want to end up entwined in that morass.

We note with some experienced professional curiosity that the actual Instructions to the FBAR omit so much as a reference to the possibility of a penalty.

Many of our American clients and a few others are of the misimpression that this is somehow unique to the USA. This particular form and reporting requirements are unique to the USA regulatory regime. However, the overall principles and concepts are explicitly not unique to the USA. For example, not so very long ago the now former chairman of DHL (a German company with a global presence) was very publicly arrested in Germany by the German taxing authorities for violating the German equivalent of this USA regulatory regime. Thus, Americans are in no way uniquely singled out.

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[34] Workbook on the Report of Foreign Bank and Financial Accounts (FBAR) (March 30, 2010) and, *also*, http://www.irs.gov/businesses/small/article/0,,id=159757,00.html .

Further, anyone who thinks they can be cagy by failing to file this report or selectively and intentionally omitting selected accounts is kidding themselves. This form is not the sole source of this data available to the world's regulatory authorities. For example, all international wire transfers flow through the Bank of International Settlements ("BIS") centered in Brussels. For the most part, that information is fairly easy to obtain by the world's regulatory authorities should they have reason to question our individual integrity.

The intent of this regulatory regime is obvious. Among other things, it is intended to ferret out those who would nefariously attempt to avoid their global income tax obligations.

We would like to return to the example of Maria above. She is not a person of wealth. Yet should she fail to file the FBAR including therein Sigma's Costa Rican payroll checking account, the monetary penalty could easily exceed her entire but modest wealth. The true source of such an extraordinary monetary penalty would be the account in Sigma. If you recall, we chose Sigma as the employer in our hypothetical example for the very reason that it is not a USA based company including at the holding company level. Thus, it likely has no responsibility to file an FBAR. That legal responsibility rests solely on the shoulders of Maria. The fine or penalty in this example legally belongs to Maria and Maria alone. We do have sympathy for Maria and those similarly situated. One would hope that the regulatory authorities would "take a pass" on enforcing the law with respect to Maria but there is no guarantee.

Further, as a side note, Maria and those similarly situated do have an obligation to file a USA income tax return merely because of what is often a very old green card. While those otherwise required USA income tax returns often generate zero USA income tax, failing to file is a crime and also carries civil penalties. Again, one would hope the regulatory authorities would "take a pass" with respect to someone like Maria… .

Most importantly with respect to Maria and those similarly situated is why would she ever think to even ask if she had such a responsibility? From Maria's point of view, this whole circumstance rightfully defies common sense.

Further, if our assumption concerning Sigma's operational scope is correct (no USA touching), why would management or Sigma's tax and legal advisors in Mexico think to query whether Sigma's or one or more of its most trusted employees in Costa Rica (or elsewhere) would have a filing obligation with respect to the USA?

Generally, the burden of compliance with respect to the FBAR is not that great. Please do not misread. I have to file one annually and curse the process every year. But in reality, ours really is not that bad.

We do, however, represent United States persons who are officers and employees of foreign financial institutions. We can think of a couple where there are more than 350 foreign financial accounts over which the officer has signature authority. The burden of compiling the data on the part of the institution is huge. Further, the time for us to actually prepare the form is meaningful. These clients are certainly better situated financially than most. On the other hand, like Maria, if one adds up the account balances and multiplies by the 50% penalty rate, the result far exceeds our clients' considerable global net worth. Remember, the penalty attaches to the United States person; not the foreign institution.

We hear much ranting and raving about privacy rights and how intrusive this is. With respect to our fellow USA citizens, there is a value to our USA passport and a cost. Hear is one of the costs. Other than the bear minimum time necessary to prepare this form, your (our client's) fee dollar is far better invested elsewhere. We can also assure you that you do not want to incur the cost to defend a material failure with respect to this issue. With respect to privacy and other civil rights issues in the USA, there are far more serious, substantive and legitimate matters.

I am sympathetic with our foreign employer and family clients who get swept into this issue. I am also embarrassed as a citizen of the USA. There is not much more I can say. The risk to the United States persons in your lives is really too great to fully avoid this issue of jurisdictional over reach on the part of the USA.

A Note to Our Financial Auditor and Corporate Attorney Colleagues

As you have seen above, the cost of failing to comply with this filing requirement can be extraordinary. It can and does attach to business enterprises organized both in the USA and under the laws of other countries. The fines for a single year's failure to file could easily be viewed as material from a financial reporting point of view. Further, the liability will escalate as the size and scope of the business escalates.

Thus, there is an issue of a potential unstated liability which, in our view, needs to be a part of the audit for financial reporting purposes.

This is one of those issues which ends up in the pull and tug between the "audit department" and the "tax department". Technically, the risk is that of a fine or penalty; not a tax. Thus, while it has been a few years, we suspect this issue may not be in either the auditors' balance sheet work programs or the tax accrual work programs.

We would encourage its inclusion. We believe it should be in the tax accrual work programs. However, we would also encourage the highlighting of this issue in the audit programs concerning "cash" and "securities". From our practical experience, especially with respect to large private and publicly traded companies, the audit workpapers presented to us as a tax specialist often would not contain sufficient detail for us to see or detect this issue. Thus, you, our audit colleagues, are our first line of defense.

During the course of an audit for financial reporting purposes, counsel to the business being audited provides what auditors call a “comfort letter”. That letter, typically crafted “in the negative” due to privilege issues, addresses issues or concerns of potential liabilities which might not be detected through a review of the business’ accounting records. We would encourage our attorney colleagues to consider this issue and advise our mutual clients as well.

This issue touches on “foreign activities”, including fines and penalties, which, if we recall correctly, can trip some unpleasantness in a financial reporting audit. We highlight this issue but will leave this to our audit specialists for more thoughtful consideration.

I am a unusual “tax person”. Yet today, I am the last “sign off” on the Securities and Exchange filings of a large public company. I assure you, when I have those multiple hats on, I am very aware of these kinds of issues. On the other hand, I am a very old school “auditor”. Yes, I must be independent with respect to the client. But independence in no way prevents me from advising and alerting my client to these or similar issues.

So, could we please first, last and always, alert our collective clients to help them avoid having this problem? If we do, there is no liability to find.

Planning Opportunities

I have a personal rule with these memos or analyses to always end them with some positive or, at least, mitigating and proper planning opportunities.

The clear and obvious as well as only one available is to minimize the number of foreign financial accounts especially with respect to employer accounts over which United States persons have signature or other authority. That is fairly difficult if one is an officer in a foreign financial institution or if the United States person has a greater than 50% equity interest whether the business enterprise is USA based or foreign.

But, it is not nearly as difficult to minimize or eliminate the issue in other businesses. Thus, unless it is absolutely necessary as a business matter, do not give United States persons signature or other authority over bank or other financial accounts. Vest that authority locally. If necessary, give the United States person authority over a single bank account.

A word of caution is in order. By example, the United States person senior partner of a foreign accounting firm declines signature authority over the firm’s checking account vesting that authority in her secretary. We would suggest, due to the relationship, the United States person senior partner needs to include the firm's checking account in her FBAR. The point is, when we shift the authority within a business, it needs to be shifted to a non-United States person who is **not** subordinate to the United States person.

For United States persons, limit the number of foreign bank and other financial accounts. While one should generally diversify one's holdings including among more than one institution, such diversification should not be excessive.

Some of the other legitimate planning opportunities involve those Americans with foreign spouses. We are not going to go into detail here as it would also necessitate a discussion of the USA estate and gift tax regime. Please be aware that the USA estate and gift tax regime applicable where one spouse is foreign differs materially from that which applies where both spouses are United States persons.

Ending Thoughts

I apologize for the tone of this memo. In thirty-three years of practice, I have represented a government on only one occasion. I am not a cop. My true personal and professional sympathies lie with my private clients, their families and their businesses. This issue, however, has little room for legitimate interpretation or planning but it has grossly disproportionate consequences for failure to comply especially as that relates to the vast majority who are good people.

I wrote this over a two day period ended 27 May 2010. The law in this area appears to be changing rapidly. *See*, for example, the evolution of the penalties. Thus, one cannot rely for long that the foregoing accurately and completely reflects the state of the law. The changes, however, are generally of an ever increasing level of coverage and severity.