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special NEWSLETTER

US entities and US Foreign Bank and Financial Account Reporting (FBAR) Requirements



On February 23, 2011, the Financial Crimes Enforcement Network of the Department of the Treasury ("FinCEN") released final regulations (the "Final Regulations") under the US Bank Secrecy Act of 1970 (the "BSA") relating to annual information reporting requirements for certain foreign bank and financial accounts in which United States persons have a financial interest or over which they have signature or other authority (such report referred to as an "FBAR").

The act requires that "US persons" file an annual FBAR report disclosing details where they have "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 a calendar year".

The Final Regulations apply to FBARs required to be filed by the 30th of June 2011 with respect to calendar year 2010 and FBARs for all subsequent calendar years.

DEFINITION OF "US PERSON"

Often in international structures for commercial reasons and/or to avoid the application of potential fiscal 'blacklists' clients would utilise US LLCs. In these cases there would be no US beneficial owners, no US assets and no US business activity.

In these circumstances it was historically believed that such a US LLC would not fall within the definition of "US person" and accordingly it was thought that FBAR filing regulations were not applicable.

Over the last year as part of the ongoing IRS crackdown on US taxpayers the need to submit current and outstanding FBAR forms has been widely published by the IRS and this has been accompanied by further clarification of who falls within the definition of a US person and extension of the persons covered by the FBAR requirements was made.

A "United States person" is:

- A citizen or resident of the United States.
- A **domestic entity** (including a **corporation, partnership, or limited liability company**, regardless of whether the entity has made an election to be disregarded for federal income tax purposes). A domestic entity for this purpose is an entity created, organized or formed in, or under the laws of, the United States.
- A domestic trust or estate.

The IRS have confirmed that in their view a US LLC is a US person for the purposes of the FBAR reporting regime and the fact that for US federal income tax purposes such a US LLC would be treated as a 'disregarded' entity is not relevant.

The above extension of the definition of US person means that LLC-s created, organised or formed in, or under the laws of, the United States:

- **will be subject to FBAR reporting requirements, but**
- **will not be subject to federal income taxation in the US, as the law currently stands.**

The FBAR reporting requirement will not currently result in federal income tax liability, though there is no guarantee that this will not change in the future.

TYPES OF REPORTABLE ACCOUNTS (FOREIGN FINANCIAL ACCOUNTS)

Foreign financial accounts include the following accounts:

- Bank accounts such as savings, demand, checking, deposit and any other accounts maintained with a financial institution or other person engaged in the business of a financial institution;
- Securities accounts such as mutual funds, brokerage accounts, securities derivatives or other financial instruments accounts. A reportable securities account is an account maintained with a person in the business of buying, selling, holding or trading stock or other securities;
- Accounts where the assets are held in a commingled fund that is a mutual fund;
- Any other account(s) maintained in a foreign financial institution or with a person engaged in the business of a financial institution;

that are located outside the following:

- United States
- Northern Mariana Islands
- District of Columbia
- American Samoa
- Guam
- Puerto Rico
- U.S. Virgin Islands
- Trust Territories of the Pacific Islands

DEFINITION OF "FINANCIAL INTEREST"

Under the Final Regulations, a U.S. person is treated as having a financial interest in a foreign financial account when that **person is the owner of record or the holder of legal title to the account**, regardless of whether the account is maintained for the U.S. person's own benefit or for the benefit of others. When an account is maintained in the name of more than one person, each U.S. person in whose name the account is maintained has a financial interest in the account and is therefore subject to the FBAR reporting requirement.

In addition, a U.S. person is treated as having a financial interest in a foreign financial account when the owner of record or holder of legal title is:

1. A person acting on behalf of the U.S. person, such as an attorney, agent, or nominee;
2. A corporation in which the U.S. person owns directly or indirectly more than 50 percent of the voting power or total value of the shares; a partnership in which the U.S. person owns directly or indirectly more than 50 percent of the profits interest or capital; or any other entity (other than a trust) in which the U.S. person owns directly or indirectly more than 50 percent of voting power, total value of the equity interest or assets, or interest in profits;
3. A trust, if the U.S. person is the trust grantor and has an ownership interest in the trust under the grantor trust rules (sections 671-679); or
4. A trust in which the U.S. person either has a present beneficial interest in more than 50 percent of the assets or from which the U.S. person receives more than 50 percent of the current income.

DEFINITION OF "SIGNATURE OR OTHER AUTHORITY"

Signature or other authority means the authority of an individual (alone or in conjunction with another) to control the disposition of money, funds or other assets held in a financial account by direct communication (whether in writing or otherwise) to the person with whom the financial account is maintained.

The filing requirement is therefore placed on the person who has the authority to directly deliver instructions to the foreign financial institution(account signatory).

REPORTING FOR JOINT ACCOUNTS

If two persons jointly maintain an account, or if several persons each own a partial interest in an account, then each U.S. person has a financial interest in that account and each person must file an FBAR.

REPORTING DEADLINE

The FBAR is due by the **30th of June** of the year following the year that the account holder meets the \$10,000 threshold.

REPORTING PROCEDURE

FBAR reports for calendar year 2010 must currently be filed **on paper** by 30th of June 2011.

FBAR forms are available:

- Online via www.irs.gov;
- Online via Department of the Treasury's Financial Crimes Enforcement Network website, www.fincen.gov;

Completed forms must be sent by mail to the following addresses:

By post:

U.S. Department of the Treasury
P.O. Box 32621
Detroit, MI 48232-0621

By express delivery:

IRS Enterprise Computing Center
ATTN: CTR Operations Mailroom, 4th Floor
985 Michigan Avenue
Detroit, MI 48226

Failure to file an FBAR when required to do so may potentially result in civil penalties, criminal penalties or both.

RECORDKEEPING

FBAR records should be kept for **five years** from the due date of the report which is June 30 every calendar year.

The records should contain the following:

- Name maintained on each account.
- Number or other designation of the account.
- Name and address of the foreign bank or other person with whom the account is maintained.
- Type of account.
- Maximum value of each account during the reporting period.

Failure to maintain required records may potentially result in civil penalties, criminal penalties or both.

Penalties

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).			

CONCLUSION

The primary intent of the widened FBAR reporting requirements is to capture data that will assist US authorities in determining whether US Residents and Citizens have additional incomes that should be subject to US taxes.

Unfortunately LLCs created, organized or formed in, or under the laws of, the United States will face additional administrative duties and increased costs of annual filing even if they have no US beneficial owners, no US assets and no US business activity.

The following options are available to such LLCs:

1. Striking off of the US LLC and registration of a new company in a different jurisdiction

Although as the law currently stands the LLCs registered through LAVECO Ltd. would not be subject to federal tax in the USA, we believe that this situation could change in the near future. In our opinion, it would be better for clients to distance themselves now from all such US entities, and to establish companies in different jurisdictions. For "holding" purposes, for example, companies registered in the Seychelles, Belize or Anguilla etc. may be just as suitable, while more prestigious solutions may be offered by Hong Kong or LLPs registered in the UK.

2. Continuation, re-registration of the US LLC in another jurisdiction

To avoid the filing requirement, LLCs may be re-domiciled to other jurisdictions. Re-domiciliation would mean that the existing LLC ceases to exist in the USA, and is "continued" in a jurisdiction with less stringent filing requirements, such as the Seychelles, Belize, BVI etc. This will involve a certain amount of administrative work and a not insignificant fee.

3. Compliance with FBAR reporting requirements

As the current law will not make LLCs registered through LAVECO Ltd. subject to federal tax, complying with the FBAR requirements will not lead to a substantial tax burden for such companies. However, compliance will involve additional administrative work and costs for the annual filing, as well as exposure to the IRS.

4. Non-compliance with FBAR reporting requirements

Failure to comply and maintain the necessary records may result in civil penalties, criminal penalties or both.



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