

June 16, 2009

U.S. Investors in Offshore Hedge Funds Should File the Report of Foreign Bank and Financial Accounts (FBAR)

On June 12, three IRS personnel participated in a teleconference designed to address open questions regarding the FBARs for calendar year 2008 that must be filed by June 30.¹ It was their position that an offshore hedge fund is a “foreign financial account” for FBAR purposes and that, therefore, every U.S. investor in an offshore hedge fund should file an FBAR, whether or not the fund has any offshore bank or securities accounts.

The FBAR needs to be filed by U.S. persons that have a financial interest in, or signature or other authority over, a foreign financial account or accounts if the aggregate value of the account(s) exceeds \$10,000 at any time during the year. The instructions to the FBAR 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 FBAR purposes.

Based on the instructions to the FBAR and this insight from IRS personnel, until further guidance is issued by the IRS, we recommend that an FBAR 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)

This requirement is in addition to FBAR requirements applicable to U.S. persons or entities that have a direct or indirect interest in an offshore bank, securities or securities derivatives account. Therefore, any U.S. person or entity (for example, a U.S. hedge fund) that has a financial interest in such foreign financial account or owns more than 50% of the equity of an entity that has a foreign financial account needs to file the FBAR. Similarly, anyone with signature or other similar authority over such foreign financial accounts needs to file the FBAR.

¹ Present on the panel were: Samuel Berman, Special Counsel, IRS SB/SE Division Counsel; Rod Lundquist, IRS SBSE BSA Policy Liaison to FinCen; and John C. McDougal, IRS Counsel (SBSE).

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The FBAR relating to foreign financial accounts of a calendar year is due June 30 of the following year, e.g., June 30, 2009, is the deadline for an FBAR filing for calendar year 2008. The IRS has advised that taxpayers who failed to file the FBAR for prior years but reported and paid tax on all taxable income should file FBARs for the prior six years by September 23, 2009, with an attachment providing the reason why the FBARs were not timely filed and copies of their tax returns. In this situation, the IRS has advised that no penalties will be imposed for the late filing of FBARs.

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