

# FBAR Principles For A Fund Principal – Follow Up To FBAR Controversies

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Foreign Bank and Financial Account (“FBAR”) reporting, historically and currently driven by the Bank Secretary Act (“BSA”), as of late captured the interest of the IRS, which now administers FBAR compliance. This teaming up has created a number of definitional and interpretational questions with respect to the FBAR reporting requirements, which have yet to be clarified. Many clients and practitioners find themselves in a difficult position due to the recent, unofficial yet very definite statements from the IRS that appear to have greatly expanded the types of financial accounts that may require FBAR reports. The IRS released on May 6, 2009 details on Frequently Asked Questions (“FAQs”) regarding FBAR compliance, with FAQ describing the relief available for FBARs filed by September 23, 2009 if the taxpayer recently learned of the filing requirement and 2008 tax has been paid. While the IRS has granted taxpayers an extension of time to file 2008 FBAR forms (and in some cases where taxpayers were unaware of a filing requirement for prior periods), there is still much uncertainty in the rules themselves.

The Treasury Form TD F 90-22.1

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(Report of Foreign Bank and Financial Accounts) was extensively revised and greatly lengthened in October 2008. Though the October expansion of the rules captured a broad audience, the space that it most significantly affected was the Alternative Investment Fund (“AIF”) space, particularly hedge funds, including entities, principals and investors. Much confusion resulted from what those structures and their operations implied in the context of applying the detailed and often confusing FBAR reporting requirements to specific situations and fact patterns.

The statutory provision authorizing the FBAR requirement is very general, and the Treasury Department regulations governing the definitions, such as what is a “financial account,” are not detailed. Interpretation of the FBAR requirements is left to the instructions to the form, and to informal guidance by IRS personnel. The instructions state that a “financial account” includes “any bank, securities, securities derivatives or other financial instruments accounts.” The instructions go on to state that a financial account includes “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).”

Thus, the instructions include in the definition of “account” a mutual fund, but provide no further definitional language and do not address whether a private investment company organized

under the laws of a foreign jurisdiction (that is, an “offshore hedge fund”) is a “foreign account.” Several IRS personnel have recently been reported to have stated that a foreign fund is treated as a “foreign account” for FBAR reporting purposes. Therefore, in the view of these IRS employees, every U.S. person that is an investor in a foreign fund has an obligation to file an FBAR report. For protective purposes, many large banks that administer hedge funds internally issued a deluge of letters to investors in late June, and these holdings are now being reviewed on an individual basis for potential reporting requirements for the new September deadline.

Explained elsewhere in the definitional provisions of the Instructions, a “Financial Interest” in a “Financial Account” can also include a U.S. person where the account is maintained on their behalf by another person and a U.S. person who owns more than a 50 percent profits or capital interest in a partnership (or more than a 50 percent of value or voting power in interest in the case of a corporation). Though not specifically stated, it can be interpolated that any instance where 50 percent or more of the “control” of an entity can be attributed to any U.S. person, that person would have a filing requirement. For example, in a typical hedge fund context, if a domestic LLC “controls” the master offshore fund, that domestic LLC must file an FBAR for the underlying offshore master fund, as “financial interest” is

now defined to represent “ownership” of 50 percent or more of the value or 50 percent or more of the voting power (in this case interchangeable with “control”) of an underlying entity otherwise holding a financial account, if that underlying entity is organized as a corporation. Similar principles would apply if the underlying entity is organized as a partnership.

In the most common hedge fund structures, including the basic Master-Feeder structure, the Side-by-Side structure, and the Mini-Master-Feeder model, the principal generally has several channels of exposure, including signature authority over the GP and Management Company entities, but unlikely through the Onshore Feeder Fund, which in most cases is only fractionally owned by the principal and hence any foreign holdings of the Onshore Fund are diluted to the individual investors in that entity.

While the correct reporting is still a matter of speculation, in light of the potential for penalties for failure to report an account, preparing FBAR reports to include all accounts and/or situations discussed above has been most practitioners’ response to the last-minute hiatus over the FBAR filing requirements. Further guidance is awaited from the IRS, which may require amended or late filings for years prior to and including 2008. In the meantime, taxpayers should use this time to review their holdings and identify any potential filing requirements.

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## Tests For Statutory Residency Versus Domicile In New York State And City

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One of the most contested areas of state and local tax law are the concepts of statutory residency and domicile. In the metropolitan area, the issue arises in particular when a taxpayer may live in New Jersey but also maintain a residence in New York City. This is a particularly sensitive area if the taxpayer has earned income derived from New York sources. While the statutory residency rules are generally more black-and-white, domicile is somewhat more subjective in determining a taxpayer's obligations to the State of New York, as well as, New York City.

Under the Statutory Residency Test, an individual will be considered a resident of New York State if a permanent place of abode is maintained in New York that is “suitable for living year-round.” A home may be considered “maintained” if the individual has exclusive use of a residence even if someone other than the occupant is paying the expenses. Additionally, an individual is considered a Statutory Resident of New

York if he or she also spends more than 183 days of the taxable year in New York. A “day” is defined as “any part of a calendar day.” The counting of a day in New York is disregarded if it is solely for boarding a plane, train, ship or bus for a location outside New York, or continuing travel which originated outside the state by automobile, plane, or train to a destination outside the state. Additionally, treatment at a hospital, other than outpatient treatment, may also be disregarded. Overall, a taxpayer who maintains a permanent place of abode and is not considered a domiciliary of New York becomes a statutory resident after the 183rd day that he or she spends in New York. At this point, the taxpayer is required to file a resident tax return and pay tax on worldwide income.

By definition, domicile in any U.S. state is the place that an individual considers his or her permanent “place of abode.” With the objective of establishing a pattern, the following information is analyzed in determining the domicile: (i) the use and maintenance of the New York home compared to another home outside New York; (ii) patterns of employment and business activities in New York; (iii) time spent in New York; (iv) location of items with sentimental value including family heirlooms, works of art and other valuable collections. Other sources of information influenc-

ing this determination include the location of close family members (i.e. spouse and children), location of bank accounts, auto registrations, and telephone records. It should be noted that a taxpayer who is domiciled in New York, must file a resident tax return regardless of the number of days he or she is in the state if he or she maintains a permanent place of abode.

Circumstances that involve a taxpayer that files a New York non-resident tax return due to earned income in the state, and where the taxpayer has indicated on the return that he or she possesses a New York residence often result in an audit where residency status is challenged. In these cases, the auditors will likely first look to investigate statutory residence (number of days in New York State / City). If a physical presence test is not met, they can proceed to examine the notion of domicile.

Other than the factors relating to residency and domicile above, in case of a New York audit, the auditor will then look at the following “other” factors:

1. The address at which bank statements, bills, financial data and correspondence concerning other family business is primarily received;
2. The physical location of the safe deposit boxes used for family records and valuables;
3. Location of auto, boat and airplane

registrations as well as personal driver's or operator's license;

4. Indication as to where you are registered to vote and an analysis of the exercise of said privilege; the auditor should not limit the review to the general elections in November, but also question the taxpayer's participation in primary or other off-season elections, including school board and budget elections;

5. Possession of a New York City Parking Tax exemption;

6. An analysis of telephone services at each residence including the nature of the listing, the type of service features, and the activity at the location;

7. The citation in wills, testaments and other legal documents that a particular location is to be considered your place of domicile; and

8. Physical presence by use of credit card or EZ-Pass records.

Overall, maintaining a part-time residence in New York can potentially lead to a question of domicile and raise the potential for a taxpayer to be classified as a New York resident. Earning income alone in New York while domiciled out-of-state will not lead to a question of residency. Combining employment with a part-time residence in New York only further complicates the matter and increases the probability that a taxpayer would be subject to the income tax obligations of a New York resident.

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