



October 5, 2009

**Via Electronic Mail:** [Notice.Comments@irs.counsel.treas.gov](mailto:Notice.Comments@irs.counsel.treas.gov)

Internal Revenue Service  
Attn: CC:PA:LPD:PR (Notice 2009-62)  
Room 5203  
P.O. Box 7604  
Ben Franklin Station  
Washington, D.C. 20044

**Re: Application of FBAR to Private Investment Funds and Related Issues**

Dear Sir or Madam:

Managed Funds Association (“MFA”)<sup>1</sup> appreciates the opportunity to provide comments in accordance with the requests set forth in Notice 2009-62 (the “Notice”) and Announcement 2009-51 (the “Announcement”).<sup>2</sup> MFA respectfully submits its comments and recommendations concerning the compliance requirements for Reports of Foreign Bank and Financial Accounts (TD F 90-22.1 or commonly referred to as “FBAR”) as they apply to investments in hedge funds, private equity funds and similar private investment funds, and certain related issues. MFA and its members are committed to working with the Department of the Treasury (“Treasury”), Internal Revenue Service (“IRS”) and the Financial Crimes Enforcement Network (“FinCEN”) within Treasury to promote full and timely compliance with the requirements of FBAR. We commend the IRS on the initiative that it has taken by deferring certain of the filing dates for FBARs so that the industry can provide comments on the FBAR filing obligations and the IRS can issue comprehensive guidance to enable those U.S. persons that are subject to the FBAR rules to fulfill their filing obligation properly.

**I. Summary of MFA’s Position**

In Notice 2009-62, comments were requested on a broad range of issues under FBAR, several of which involve questions that have a direct effect on MFA’s membership, which consists primarily of U.S. based hedge fund managers and the funds they advise, both domestic and those organized outside of the United States. MFA has limited its comments to those questions and its principal recommendations are as follows:

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<sup>1</sup> MFA is the voice of the global alternative investment industry. Our members include professionals in hedge funds, fund of funds and managed futures funds. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members represent the vast majority of the largest hedge fund groups in the world that manage a substantial portion of the approximately \$1.5 trillion invested in absolute return strategies. MFA is headquartered in Washington D.C. with an office in New York, NY.

<sup>2</sup> See IRS Notice 2009-62, I.R.B. 2009-35 (August 7, 2009); see also Announcement 2009-51, 2009-25 I.R.B. 1105 (June 5, 2009).

(i) An investment in a hedge fund, private equity fund or other similar private investment fund organized outside the United States should not be treated as an investment in a foreign financial account.

(ii) The existing exemption for officers and employees of banks and certain publicly-held companies with respect to foreign financial accounts of their employer should be extended to officers and employees of non-public companies (including partners in the case of an employer that is a partnership) where the officer, partner or employee has no financial interest in the account and has been advised in writing by the chief financial officer or similar responsible officer of the employer that the employer has filed a current FBAR that includes the account. As discussed below, MFA also requests that consideration be given to elimination of CFO certification requirements from the current and proposed exemption.

(iii) A non-U.S. hedge, private equity or similar private investment fund should not be treated as “in” the United States under FBAR solely by reason of the fact that the fund has a U.S.-based manager.

(iv) The criteria to determine whether a non-U.S. hedge, private equity or similar private investment fund is “doing business in the United States” should be the same as the criteria applicable to determine whether such a fund is engaged in the conduct of a “trade or business within the United States” under section 864(b) of the Internal Revenue Code of 1986, as amended (the “Code”), and investments that generate “effectively connected income” solely by reason of the application of the FIRPTA provisions of the Code should not be treated as “doing business in the United States” under FBAR.

We provide more detailed discussion regarding these and certain additional recommendations in Sections III and IV below.

## **II. Background**

In 1970, Congress enacted the Currency and Foreign Transactions Reporting Act (commonly known as the “Bank Secrecy Act” or “BSA”).<sup>3</sup> A principal purpose of the BSA was respond to use by U.S. persons of financial institutions in certain bank secrecy jurisdictions to avoid U.S. tax and regulatory requirements. Under the BSA, U.S. persons are required to keep records and file reports with respect to transactions with foreign financial agencies.<sup>4</sup> To implement this requirement, regulations were promulgated that generally require U.S. persons that have a financial interest in, or signature or other authority over, a foreign financial account to file reports with the IRS.<sup>5</sup> FBAR is used for this purpose. Filings are required for each calendar year and, with respect to any calendar year, must be filed by June 30 of the immediately

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<sup>3</sup> See 31 USC 5311 *et. seq.*

<sup>4</sup> 31 U.S.C. 5314.

<sup>5</sup> 31 C.F.R. 103.24.

succeeding calendar year (*e.g.*, FBAR filings for calendar year 2008 were generally due by June 30, 2009).<sup>6</sup> There are substantial penalties for failure to file a timely FBAR.

The principal guidance issued by the IRS with respect to the application of the FBAR requirements consists of the instructions to the FBAR form itself. The IRS most recently updated these instructions in October 2008 for use in making filings in 2009. In part as the result of changes made in those instructions, and as has been widely described by MFA and others in prior submissions to the IRS, there was widespread confusion in the private sector with respect to many aspects of the application of the FBAR requirements, including the questions whether investments in hedge funds and other similar private investment funds organized outside the United States were to be considered as an investment in a “foreign financial account”, and how the IRS would interpret the addition to the definition of U.S. Person of “persons in and doing business in the United States.”

As a result, the IRS has commendably taken a series of steps to defer certain of the filing dates so that comprehensive guidance can be issued to enable those U.S. persons that are subject to FBAR to fulfill their filing obligations properly. Specifically, in Notice 2009-62, the IRS announced that it would extend the filing dates for 2008 and earlier years to June 30, 2010 for those persons that either (i) have signatory or other authority over, but no financial interest in, any covered foreign financial account, or (ii) have a financial interest in and/or signatory authority over, a commingled fund that is treated as a covered foreign financial account. In addition, in Announcement 2009-51, the IRS suspended the application of the expanded definition of U.S. person for filings due June 30, 2009 and stated that additional guidance would be issued with respect to FBARs due in subsequent years.

### **III. Classification of Non-U.S. Hedge Funds as “Financial Accounts”**

Notice 2009-62 requests comments concerning when an interest in a foreign entity such as a corporation or partnership should be subject to FBAR reporting and also whether a U.S. person should be relieved from an FBAR filing requirement with respect to a foreign commingled fund when such a filing would be duplicative of other reporting.

In its Prior Submissions,<sup>7</sup> MFA has taken the position that an investment in a hedge or other private investment fund organized outside the United States should not be treated as an investment in a foreign financial account. MFA continues to believe that this is the correct result notwithstanding the fact that, in the confusing environment immediately preceding the June 30, 2009 filing date, some filings were made with respect to these funds. Many private investment funds and other persons filed FBARs on the advice of many professionals that did not think such funds should be treated as “foreign financial accounts”. Nevertheless, these professionals suggested that funds and certain persons file FBARs if possible given the severe penalties for failure to file lack of guidance on this issue from the IRS, the mixed messages to the industry

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<sup>6</sup> As discussed below, this date was extended by the IRS.

<sup>7</sup> MFA made the following submissions to the IRS relating to FBAR concerns: MFA letter dated August 3, 2009 to Treasury, the IRS and FinCEN; MFA letter dated June 19, 2009; MFA letter dated May 13, 2009; MFA letter dated April 9, 2008; MFA letter dated May 7, 2007; and a letter dated June 19, 2006 by the law firm of Schulte, Roth & Zabel LLP (collectively, the “Prior Submissions”). Copies of the Prior Submissions are available on MFA’s Web site at: [www.managedfunds.org](http://www.managedfunds.org).

from different personnel at the IRS and the absence at that time of a comprehensive extension, which the IRS subsequently provided in Notice 2009-62.<sup>8</sup>

Prior to the issuance of the new FBAR instructions in October 2008, MFA and others generally believed that a non-U.S. private investment fund was not covered by the definition of “foreign financial account”, which since 2000 had included a reference to “commingled funds”. In 2008, the IRS amended the instructions to add “(including mutual funds)” to the reference to commingled funds and this specific reference led to speculation about the status of non-U.S. hedge and private equity funds. Thereafter, although the IRS declined to issue a response to MFA’s request for guidance, certain IRS personnel made oral statements that, in light of the revised instructions, hedge funds should likewise be treated as commingled funds. Two of the questions set forth in Notice 2009-62, as set forth above, suggest that the IRS will now give formal consideration to the question.

While there are a number of significant differences between open-ended mutual funds on the one hand and hedge funds and private equity funds on the other, the most significant consideration for this purpose is that open-ended mutual funds provide an opportunity for investors to have their interests in the fund redeemed on a daily basis. Daily or immediate liquidity is an essential feature of financial accounts. In contrast, investors in hedge funds and private equity funds do not have any opportunity to retrieve or redeem funds that even remotely resembles the opportunities available to investors in open-ended mutual funds. As the New York State Bar Association correctly observed with respect to hedge funds:

*Hedge funds often hold investments for much shorter periods [than private equity funds], and generally provide for limited investor liquidity rights, but these liquidity rights [in hedge funds] are light years away from a traditional bank account, securities account, or open-ended mutual fund. Investors in hedge funds are frequently subject to lock-up periods on entry, typically of one to two years, and following this initial period have the right to withdraw from the fund only at designated intervals (e.g., at quarterly periods, or sometimes longer intervals, and often with other limitations) and typically only upon significant advance notice.<sup>9</sup>*

In MFA’s view, this lack of liquidity, which of course also exists in the case of private equity funds, renders these types of funds as sufficiently non-susceptible to abuses of the type possible with open-ended mutual funds that its absence, together with the substantial restrictions on third

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<sup>8</sup> As of June 30, 2009, the only extension provided by the IRS was available for persons who only recently learned of their obligations to file an FBAR and who could meet certain other conditions. The terms of this extension, which now expires on October 15, 2009, were sufficiently ambiguous that many professionals were unable to advise reliance on it.

<sup>9</sup> See a Letter dated July 17, 2009 from the Tax Section of the New York State Bar Association to: the Honorable Neal S. Wolin, Deputy Secretary, Department of the Treasury; Michael Mundaca, Deputy Assistant Secretary - International Tax Affairs, Department of the Treasury; the Honorable Douglas H. Shulman, Commissioner, Internal Revenue Service; and James H. Freis, Director, Financial Crimes Enforcement Network, Department of the Treasury (the “NYSBA Letter”). Please note that the NYSBA Letter makes several other recommendations, comments and points on which MFA does not take an official position.

party transfers, should serve as the basis for excluding hedge funds and private equity funds organized outside the United States from the definition a foreign financial account. Accordingly, MFA recommends that the IRS modify the definitions of “foreign financial account” and “commingled fund” to limit their application to those funds that provide redemption rights that are similar to those provided by banks, broker-dealers and open-ended mutual funds.

As noted above, Notice 2009-62 also requested comments concerning whether U.S. persons should be relieved from an FBAR filing requirement with respect to a foreign commingled fund when filing would be duplicative of other reporting. MFA believes that if the IRS were to adopt MFA’s proposed definition of “commingled fund”, it would avoid the duplicate filing requirements that would be created if the FBAR requirements are applied to non-U.S. hedge and private equity funds. In this connection, MFA notes that many, if not most, non-U.S. hedge funds are organized as corporations or as entities that will be treated as corporations for U.S. tax purposes. As a result, these funds generally will be classified as passive foreign investment companies (“PFICs”) and the provisions of the Internal Revenue Code of 1986, as amended (the “Code”) applicable to PFICs generally would make investments in them unattractive for most U.S. investors other than tax-exempt entities, although, as noted in MFA’s prior submissions, some U.S. taxable investors may invest in these funds.

In response to the question in Notice 2009-62 regarding duplicative reporting, MFA notes that U.S. persons who hold equity interests in non-U.S. hedge funds that are treated as corporations would typically be subject to the PFIC shareholder filing requirements (Form 8621) and potentially to the requirement to file Form 926, relating to transfers of property to foreign corporations, and Form 5471, the return of U.S. persons with respect to certain foreign corporations. In those cases where the non-U.S. fund is treated as a partnership for U.S. tax purposes, U.S. persons that invest in the fund are required to file Form 8865 if, for example, they transfer more than \$100,000 to the fund or if they own at least a 10 percent interest in partnership and make transfers to the fund. Moreover, in certain cases, the fund itself may be required to file a U.S. tax return (Form 1065).

To summarize, MFA believes that non-U.S. hedge funds and private equity funds simply do not present the potential for non-tax abuses such as money laundering that are available through bank accounts and open-ended mutual funds and therefore interests or investments in such funds should be excluded from the definitions of “foreign financial account” and “commingled fund” for FBAR reporting purposes. Moreover, to the extent there are potential tax issues arising in such cases, there are already extensive filing requirements in place and, as to these tax issues, the application of FBAR would be duplicative and thus superfluous.

#### **IV. Other Issues Requiring Guidance.**

There are a number of other issues for which the IRS has solicited comments. In addition, there are issues for which the MFA seeks guidance from the IRS in complying with FBAR requirements. We discuss the most important of these issues immediately below.

##### **A. Signature or Other Authority.**

The 2008 FBAR instructions provide that, with certain exceptions, a person who has “signatory authority” over an account must file an FBAR with respect to that account, if: “[S]uch person can control the disposition of money or other property in it by delivery of a document

containing his or her signature (or his or her signature and that of one or more other persons) to the bank or other person with whom the account is maintained.” The instructions also provide that a person has “other authority” if he or she: “[C]an exercise comparable power over an account by communication with the bank or other person with whom the account is maintained, either directly or through an agent, nominee, attorney, or in some other capacity on behalf of the U.S. person, either orally or by some other means.”

Notice 2009-62 requests comments regarding when a person with signature authority over, but no financial interest in, a foreign financial account should be relieved of filing an FBAR for the account (*e.g.*, whether relief from filing would be appropriate if a person with a financial interest in the account has filed an FBAR). The Notice also seeks comments on whether the current exceptions from FBAR filing available for officers and employees of banks and certain publicly-traded domestic companies might be expanded to officers and employees with only signatory authority over an employer’s accounts and/or accounts owned by clients of their employer.

MFA believes that the IRS should substantially narrow the class of U.S. persons who must make FBAR filings where they have no “financial interest” in the account, but only “signatory or other authority” over the account. The manner in which hedge funds of the type MFA represents are organized illustrates the need for such a targeted approach. A “hedge fund” typically consists of both a domestic fund and a non-U.S. fund. These two either invest on a parallel basis or they invest in a master fund which in turn makes the investments. The funds are managed by a U.S.-based manager that is typically organized as a partnership or an entity that is treated as a partnership for U.S. tax purposes. The manager has numerous partners and employees who determine what investments will be made, execute those decisions by opening and closing positions, making deposits and withdrawals and otherwise administering the funds provided by investors in accordance with the governing documents of the fund. One or more of the accounts in which the investor-owned funds are deposited may be located outside the United States and one or more partners or employees of the manager will have authority to transfer funds from one account to another, but they generally do not have a “financial interest” in the account.<sup>10</sup> Indeed, many partners and employees may have such authority, but only so long as they are partners in or employees of the manager. As such, they resemble “back office” employees of a bank or other financial institution and MFA believes there is no discernable policy reason why each such partner and employee should be required to make a separate filing.

MFA recommends that the IRS issue guidance that would provide relief from FBAR filing now available under the existing exemption for banks and certain publicly-held companies available to U.S. persons with respect to foreign financial accounts of their employer (including partners in the case of an employer that is a partnership) where the officer, partner or current or former employee<sup>11</sup> has no financial interest in the account and has been advised in writing by the chief financial officer or similar responsible officer of the employer that the employer has filed a

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<sup>10</sup> In this connection, MFA believes that the IRS should clarify that deferred fees payable by a non-U.S. fund to its U.S. manager should not be treated as a “financial interest” in the fund since the U.S. manager is merely an unsecured creditor of the fund.

<sup>11</sup> Because of the difficulty of FBAR filings by employers on behalf of former employees, particularly with respect to filings of delinquent FBARs for prior years, employers should be exempted from filing FBARs with respect to persons who are no longer employed by the employer.

current FBAR that includes the account. Our recommendation here would cover partners in, and employees of, hedge fund management companies that, for example, are named as authorized signatories to move monies to and from foreign prime brokerage or other foreign accounts owned by the management entity or related trading entity. (In this connection, MFA believes that the IRS should consider eliminating the chief financial officer certification requirement in all cases.)

MFA also recommends that similar relief be provided with respect to U.S. persons who have no financial interest in an account of a *client* of their employer (including partners in the case of an employer that is a partnership). In the private investment fund context, this recommendation would apply to employees or partners who make decisions with respect to client managed accounts.

MFA further recommends that a U.S. person who, as an officer, partner or employee of a hedge or other investment fund manager, determines what investments will be made or terminated and when such actions will be taken should not be treated as a person who has “signature or other authority” over a foreign financial account where others implement his or her investment decisions by authorizing the transfer of funds from one account to another to implement those decisions. This recommendation would cover portfolio managers or other investment officers of an investment fund management company who does not have explicit authority to dispose of money in an account. MFA’s position on this issue is supported by the example of “Other Account Authority” provided by the IRS in its Workbook on the Report of Foreign Bank and Financial Accounts (February 19, 2009), which states that “a person who has the power to direct how an account is invested but cannot make disbursements or deposits to the account does not have to file an FBAR because the person has no power of disposition” of money or other property in the account.<sup>12</sup>

If the IRS determines that, contrary to MFA’s recommendations in the preceding section of this letter, an investment in a non-U.S. hedge fund is itself a foreign financial account, there are several important collateral issues that should be addressed, including, without limitation:

- Who will be treated as having “signatory or other authority” over the investment in the foreign account? MFA recommends that neither the U.S. manager nor its partners, officers or employees be treated as having such authority.
- Do the directors of the fund (in the case of a fund organized as a corporation) have signatory authority if they have the right, in coordination with the other directors, to, among other things, declare dividends or effect withdrawals and distributions to shareholders (*i.e.*, investors)? MFA recommends that such directors be treated as having such authority.
- Similarly, do holders of those interests (and their officers and employees with signatory authority) have signatory authority by reason of their ability to initiate redemption requests? MFA assumes that Treasury and IRS will conclude that such holders do have signature authority.

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<sup>12</sup> IRS, FAQs regarding Report of Foreign Bank and Financial Accounts (FBAR), #20, available at <http://www.irs.gov/businesses/small/article/0,,id=148845,00.html>

Finally, MFA notes that, under the current instructions to FBAR, where a U.S. person has signatory authority over a foreign financial account, he or she is required to identify any primary owner with a financial interest in that account. MFA recommends that, if an investment in a non-U.S. fund is treated as an account, those with signatory authority over that account should be required to identify only those U.S. persons who have a financial interest in the account. A requirement that the filer also identify those non-U.S. persons who have an interest in the account (*i.e.*, non-U.S. investors in the fund) would not advance any of the purposes of the BSA and could deter non-U.S. investors from investing with U.S.-based fund managers. In this connection, MFA believes that the IRS should specify the criteria to be used in determining who is (and is not) a “primary owner” of a covered financial account.

#### B. Definition of U.S. Person.

Prior to the issuance of the FBAR instructions in October 2008 (the “2008 FBAR Instructions”), the term “United States Person” was defined to include only: (i) a citizen or resident of the United States; (ii) a domestic partnership; (iii) a domestic corporation; or (iv) a domestic estate or trust. The 2008 FBAR Instructions included an amendment to this definition, which added “persons in and doing business in the United States”. Many professionals were uncertain as to the intended scope of this new component of the definition of U.S. person. For example, some questioned whether such a person would have to be physically present in the United States as well as doing business in the United States, or whether it was sufficient merely to be doing business in the United States. Given these and other questions, the IRS issued Announcement 2009-51 on June 5, 2009, suspending the application of the new component of the definition of U.S. person and requesting comments on the issues involved.

These issues have significance for non-U.S. hedge funds. For example, if a non-U.S. hedge fund has a U.S. manager, questions exist as to whether the U.S.-based manager creates a sufficient presence for the non-U.S. fund (or any other non-U.S. investor) to be treated as “in” the United States. This question exists whether or not the fund also makes investments within the United States. There is also the question at what point would investing be considered to be the conduct of a trade or business within the United States and taking into account the fact that, in the case of domestic taxpayers “investing” generally is not treated as a trade or business while “trading” is so treated. It is noteworthy that foreign investors may rely on the safe harbors in section 864(b) of the Code for both trading and investing activities. It is not clear whether the section 864(b) safe harbors are applicable for FBAR purposes. Finally, there is the question whether, if such a fund makes real estate related investments that are subject to tax under Foreign Investment Real Property Tax Act (or “FIRPTA”), the resulting “effectively connected income” will be treated as sufficient to constitute “doing business within the United States.”

MFA believes that the manner in which these questions are resolved could have a potentially significant effect on the continued willingness of many passive foreign investors to invest in the United States and may deter those who continue to invest from doing so through funds with U.S.-based managers. Particularly in the current economic environment, such results should be avoided where possible, as is the case here, since extension of the FBAR requirement

to those who are essentially passive investors in the United States would not materially advance any purposes for which the BSA was enacted.<sup>13</sup>

For these reasons, MFA recommends that the IRS issue guidance that: (i) a non-U.S. hedge fund, private equity fund, or other similar non-U.S. fund will not be treated as “in” the United States under FBAR solely by reason of the fact that the fund has a U.S.-based manager; (ii) the criteria to determine whether such a fund is “doing business in the United States” for FBAR purposes is the same as the criteria applicable to determine whether the fund is engaged in the conduct of a “trade or business within the United States” under section 864(b) of the Code; (iii) the section 864(b) safe harbors for stock, securities, and commodities trading will apply for FBAR purposes; and (iv) income earned by a foreign investor that is treated as “effectively connected with the conduct of a trade or business within the United States” solely by reason of the application of FIRPTA will not result in the treatment of the foreign investor as “doing business in the United States” under FBAR.

## **V. Conclusion**

MFA appreciates the opportunity to provide these comments and stands ready to respond to any questions you may have concerning this letter or other FBAR issues. We would be pleased to meet with IRS staff to further discuss our comments in greater detail. If the staff has comments or questions, please do not hesitate to contact Carl Kennedy or me at (202) 367-1140.

Respectfully submitted,

/s/ Stuart J. Kaswell

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<sup>13</sup> In this connection, as the New York State Bar Association has noted in its letter, non-U.S. funds like all persons are subject to anti-terrorist financing rules of the “Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001” (the “U.S.A. PATRIOT ACT”).