FROM LEIMBERG:

EXECUTIVE SUMMARY:

In a recently issued Reference Guide for FBAR reporting, the IRS includes an example imposing FBAR filing liability on power of attorney holders if they are granted signatory authority over foreign accounts of their principal. This can have substantial ramifications and liability exposure for agents under durable powers of attorney.

FACTS:

U.S. persons with an interest in a non-U.S. account must annually file a FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR) if the aggregate maximum values of the foreign financial accounts exceed $10,000 at any time during the calendar year. FinCEN Form 114 superseded Treasury Form TD F 90-22.1 and must be filed electronically through the BSA E-Filing System. Having 'signature authority' over a foreign account is enough of an interest in the account to be required to report it on an FBAR. Penalties for nonfiling can be quite substantial, including 50% of the value of the account for willful violations (repeated for each year of violation). Criminal penalties can also apply.

The IRS recently issued a "Reference Guide on the Report of Foreign Bank and Financial Accounts (FBAR)," which summarizes and augments previously published information on the FBAR filing requirements. The Guide defines 'signature authority' as "the authority of an individual (alone or in conjunction with another individual) to control the disposition of assets held in a foreign financial account by direct communication (whether in writing or otherwise) to the bank or other financial institution that maintains the financial account." It then goes on to provide this example of signature authority:

Example: Megan, a United States resident, has a power of attorney on her elderly parents' accounts in Canada, but she has never exercised the power of attorney. Megan is required to file an FBAR if the power of attorney gives her signature authority over the financial accounts. Whether or not the authority is ever exercised is irrelevant to the FBAR filing requirement.

Powers of attorney, especially durable powers of attorney, are a staple of estate planning. Planners will suggest them at the time estate planning documents are done so as to allow a trusted family member or friend to handle financial and legal affairs in the event of incapacity. Many, if not most, of durable powers of attorney, include authority to sign on behalf the principal for bank accounts of the principal. Per the above Example and the Guide's definition of signature authority, persons named in such powers of attorney appear to be at risk for FBAR filing obligations and penalties in regard to foreign accounts of the person issuing the power.

COMMENT:

The application of the FBAR reporting rules, or at least the possible application under the current Guide and rules, raises a number of concerns and issues:

· One can legitimately question how many of such power holders (or their tax preparers or other tax professionals) are aware of this responsibility. One can also question the appropriateness of this responsibility and liability.

· Durable powers are set up before there is incapacity, and thus there may be a long period of dormancy where the powers are not exercised because the principal is well and capable of managing his or her own financial affairs. In most such situations, the power holder is not doing anything and often has no knowledge of the assets or accounts of the principal. It is clearly not the norm for such power holders to ask, inquire, or gather information regarding the accounts of the principal. So how is the power holder to know about the accounts? Is the IRS now requiring that the entire dynamic of the durable power of attorney relationship be modified, such that the power holder must inquire and obtain details of the principal's accounts?

· Often, the power holder does not even know they are appointed. The durable power is signed, but then may be kept with the testator's estate planning documents and not delivered to the power holder until it is needed. Alternatively, the powers are often left in escrow or custody with the estate planning attorney, to be released only if the attorney learns of a need for their use. How will the IRS address this situation? See the discussion below regarding lack of knowledge.

· Some states allow for "springing" powers – powers that are not effective until the principal is incapacitated or has some other mental or physical condition. Thus, even if the power holder knows of its existence, he or she may not be advised once it becomes effective. One can also foresee disputes with the IRS over when or if such springing power took effect.

· How effective will a “lack of knowledge” defense be to penalties? Even if effective for removing the most egregious penalties that rely on willfulness, it may not remove all penalties, such as a non-willful violation (up to $10,000 per violation) and negligent violations (up to $500). Further, no one wants to rely on proving lack of knowledge – it is unknown how many levels of IRS audit, review and litigation may be needed to prevail on such a claim, if one is successful at all. It is not an easy thing to prove a negative. At a minimum, the IRS should make the concession and clarify that lack of knowledge voids the penalty.
· What happens if the principal reports the account, but the account holder does not, or vice-versa? The Guide, in discussing agents in general, indicates that both of them must file (if both are U.S. persons).
· If a power of attorney is signed in the U.S., there is always the question of its enforceability in foreign jurisdictions. This might be another area of dispute with the IRS. As to filers, it would not be a good idea to rely on this – as in most foreign filings where there is a question, the better advice is usually to file notwithstanding any uncertainty.
· Most durable powers of attorney do not specifically describe each account to which it applies with specificity, but instead have a general description by type – e.g., “bank accounts” and “brokerage accounts.” The general definition of ‘signature authority’ coupled with the Example lead to the conclusion that the IRS intends to apply this rule to such generally described accounts. The Example describes a power of attorney over an account. Perhaps the example can be read narrowly to apply only to a specifically named account in the power of attorney instrument. If so, that would remove most of the above concerns, and if that is intended the IRS should so clarify the example. It would be a logical and fair limitation on such liability.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

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