KIRKLAND & ELLIS LLP

KIRKLANDPEN
Private Equity Newsletter

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Filing Deadline for Holders of Foreign Bank and Financial Accounts Looms

PENpoints

U.S. persons who have a financial interest in, or signature or other authority over, foreign bank or financial accounts exceeding $10,000 in the aggregate at any time during a calendar year must file a form with the Department of the Treasury by June 30, 2009.

Each U.S. person who has a financial interest in, or signature or other authority over, foreign bank or financial accounts exceeding $10,000 in the aggregate at any time during a calendar year must file a form (an "FBAR") with the Department of the Treasury by June 30 of the following year; thus, the deadline for the 2008 calendar year is June 30, 2009. The Treasury must receive the FBAR on or before June 30, and there are no extensions. However, the IRS has indicated that it will not assert penalties under certain circumstances if taxpayers file FBARs by September 23, 2009, along with copies of income tax returns for the relevant prior years and a statement explaining why the FBARs were not timely filed.

Generally, private equity funds, their principals or their investors may be required to file an FBAR in three situations:

- a U.S. fund owns an indirect interest in foreign accounts through a controlled portfolio company or its subsidiaries;
- a general partner principal has signature or other authority over foreign financial accounts at the fund or GP level, in an AIV or in a portfolio company or subsidiary; or
- a U.S. person has an interest in a non-U.S. fund or GP entity—a situation where we believe no filing should be required, but recent IRS statements have created uncertainty.

The application of the rules to these situations is fairly technical; we have included as an appendix to this article a memo that discusses the FBAR requirements in more detail.

If you have any questions about the matters addressed in this *KirklandPEN* article, please contact the following Kirkland authors or your regular Kirkland contact.

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Appendix: Foreign Financial Account Reporting with Respect to Interests in Private Equity Funds

Each U.S. person who has a financial interest in, or signature or other authority over, foreign "financial accounts" exceeding $10,000 in the aggregate at any time during a calendar year must report such accounts by filing Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (the "FBAR") with the Department of the Treasury. The form must be received by (not merely be in the mail to) the Treasury on or before June 30 of the succeeding year. There is no extension for filing the FBAR. However, the Internal Revenue Service (the "IRS") has announced that it will not assert penalties (described below) for failure to file FBARs for previous years (which was updated in an IRS FAQ dated June 24, 2009, to include FBARs with respect to the 2008 calendar year due June 30, 2009) so long as the taxpayer (i) only recently learned of its FBAR filing obligation, (ii) in the case of filings for the 2008 calendar year, had insufficient time to gather the necessary information to complete the FBAR, and (iii) correctly reported and paid tax on all its taxable income for the delinquent years. To avoid penalties pursuant to this announcement, taxpayers must file delinquent FBARs by September 23, 2009, along with copies of income tax returns for the relevant prior years and a statement explaining why the FBARs were not timely filed.

A civil penalty of up to $10,000 can be assessed for each failure to file an FBAR (which can be waived for reasonable cause provided the balance in the accounts was "properly reported").[1] In addition, willful violations can result in civil penalties of up to the greater of $100,000 and 50% of the value of the account and possible criminal penalties.

The instructions to Form TD F 90-22.1 define a "financial account" as follows:

"This term includes any bank, securities, securities derivatives or other financial instruments accounts. Such accounts generally also encompass 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). The term also means any savings, demand checking, deposit, time deposit, or any other account (including debit card and prepaid credit card accounts) maintained with a financial institution or other person engaged in the business of a financial institution. Individual bonds, notes or stock certificates held by the filer are not a financial account nor is an unsecured loan to a foreign trade or business that is not a financial institution."

Generally, private equity funds, their principals or their investors may be required to file an FBAR in the three situations described below.

1. U.S. Fund Owns Indirect Interest in Foreign Accounts Through Controlled Portfolio Companies

For purposes of the FBAR, a U.S. person is treated as having a financial interest in a foreign financial account if such U.S. person owns, directly or indirectly, 50% or more of the vote or value of a corporation or 50% or more of the capital or profits interests in a partnership and the controlled entity holds a foreign financial account.

Therefore, if a U.S. fund owns directly more than 50% of the stock of a portfolio company, or owns indirectly more than 50% of the stock of a subsidiary of a portfolio company, the U.S. fund will be required to file an FBAR with respect to each foreign financial account owned by such controlled portfolio company or controlled portfolio company subsidiary.

- For example, assume a U.S. fund owns 100% of the equity interests in a Luxembourg SARL, which

1 Although not clear in this context, "properly reported" apparently requires that the asset was reported on the U.S. person's financial statements, if any, and any taxable income from the asset was reported on the U.S. person's tax return.

in turn owns 80% of the stock of a German portfolio company, which in turn owns 100% of the stock of a Hong Kong subsidiary. The U.S. fund must file an FBAR with respect to all foreign financial accounts owned by the Luxembourg SARL, the German portfolio company and the Hong Kong subsidiary.

- Alternatively, assume a U.S. fund owns 80% of the stock of a U.S. corporate portfolio company, which owns 100% of the stock of a Hong Kong subsidiary. The U.S. fund must file an FBAR with respect to all foreign financial accounts owned by the U.S. portfolio company and the Hong Kong subsidiary. (This filing obligation by the U.S. fund exists notwithstanding that the U.S. portfolio company is also obligated to make a filing with respect to any foreign financial accounts of it and its Hong Kong subsidiary.)[2]

2. General Partner Principal has Signature or Other Authority over Foreign Financial Accounts

A U.S. person who has signature or other authority over a foreign financial account must make an FBAR filing with respect to the account even if such person has little or no financial interest in the account. For this purpose, a person has signature or other authority over a foreign financial account if such person can control the disposition of money or other property of the account either by delivering a signature or by other direction.

- For example, assume a U.S. or non-U.S. fund owns equity interests in a Luxembourg SARL, which maintains a Luxembourg bank account. A U.S. principal of the fund general partner has signature authority over the account. The U.S. principal must make an FBAR filing with respect to the Luxembourg account. (This filing obligation by the principal exists notwithstanding that the fund (if organized in the U.S.) is also obligated to make a filing with respect to the account.)

3. Interests in Non-U.S. Fund May Be Treated as a "Financial Account"

An IRS representative recently stated that the term "financial account" includes interests in a foreign hedge fund that is serving a function similar to a mutual fund.[3] This has raised concerns that the references to "commingled fund" and "mutual funds" under the current FBAR instructions could be read broadly enough to include interests in non-U.S. private equity funds, which previously was never thought to be the case.

Based on the current FBAR instructions and other published guidance, we believe that interests in a typical non-U.S. private equity fund should not be viewed as constituting "financial accounts," and therefore that U.S. persons should not be required to make an FBAR filing with respect to interests in a non-U.S. private equity fund. The types of accounts identified as "financial accounts" bear little resemblance to interests in a typical private equity fund. In particular, the listed accounts (including the reference to "mutual funds," which was added in October 2008) seem to share the characteristic of accommodating discretionary deposits to and withdrawals from the account. This liquidity feature is completely lacking in a typical "closed-end" private equity fund that does not provide for periodic redemption of investor interests.

Two additional points buttress the no-filing position for most U.S.-sponsored, but offshore-organized, private equity funds.

First, the purpose of the FBAR, which for many years has been a reporting requirement under the Bank Secrecy Act, is to ferret out hidden offshore accounts and prevent money laundering. In the case of an offshore private equity fund that (a) is taxed as a partnership for U.S. income tax purposes, (b) has U.S.-source income and (c) has U.S. partners, the offshore fund is required to file a U.S. tax return, including Schedule K-1s, with the IRS, which include essentially the same

2 If a non-U.S. fund owned by U.S. and non-U.S. investors (such as a fund organized as a Cayman Islands limited partnership with a Cayman Islands general partner) owns foreign financial accounts directly, or indirectly through its ownership of other entities, pursuant to an IRS annoucement issued June 5, 2009, the non-U.S. fund is not required to make an FBAR filing for the 2008 calendar year with respect to its direct or indirect ownership of the foreign financial accounts, although pending further guidance from the IRS, such non-U.S. fund may be required to file FBARs in future years. See, however, Section 2 in the text for discussion of filing requirements by a U.S. person if that U.S. person has signature or other authority over a foreign financial account.

3 This statement was made during a panel discussion at an American Bar Association-sponsored teleconference that took place on June 12, 2009.

information that would be provided on an FBAR. Therefore, a U.S. partner's interest in such a non-U.S. private equity fund should not be viewed as a potentially hidden asset. Moreover, as noted above, a typical private equity fund provides no liquidity to investors and therefore is not attractive as a money laundering vehicle. As a result, no FBAR filing should be required as a policy matter.

Second, a fund organized offshore, but managed and administered in the U.S., may not be "foreign" even if it is viewed as a "financial account." In this regard, for purposes of determining whether an account is "in a foreign country," the FBAR instructions state that "the geographical location of the account, not the nationality of the financial entity institution in which the account is found, determines whether it is an account in a foreign country." For example, it is clear that a bank account at a foreign bank's New York branch is not a "foreign" account for this purpose. Accordingly, where the assets of an offshore fund are maintained in the U.S. there would appear to be a reasonable position that an offshore fund is not a "foreign" account.

For the above reasons, we believe that U.S. persons should not be required to make FBAR filings with respect to their interests in offshore private equity funds.[4] However, because the cost of making an FBAR filing is low in relation to the potential penalties that may be imposed for a failure to file (if it is ultimately determined that a filing is required), a U.S. person may want to consider making FBAR filings with respect to interests in offshore private equity funds.

4 Similarly, for the reasons discussed above, we believe that interests in a non-U.S. general partner of a typical private equity fund should not be viewed as constituting "financial accounts" for purposes of FBAR reporting, and therefore that U.S. principals should not be required to make an FBAR filing with respect to such interests.

PENnotes

The Practising Law Institute's Private Equity Forum 2009
New York, New York
July 13-14, 2009

This forum, hosted by the Practising Law Institute, will cover topics such as structuring private equity investments and private equity funds, dealing with fund sponsor issues, current regulatory, legislative and tax issues and how private equity funds are addressing issues raised by the current environment, including fund and investor liquidity issues. Kirkland partner Mark Mifsud will speak on EU regulatory developments in a panel titled "Implications of the New Regulatory Environment."

American Bar Association's Section of Business Law Annual Meeting
Chicago, Illinois
July 31-August 3, 2009

Kirkland partner Bruce Ettelson will speak on "Private Equity Fund Issues in the Current Market: Defaulting LPs, Carried Interest Renegotiation and Taxation of Carried Interest" on Sunday, August 2, 2009, at the annual meeting of the American Bar Association.

The Fourth Annual Kirkland & Ellis LLP Real Estate Private Equity Forum
New York, New York
September 24, 2009

This Kirkland seminar, titled "Real Estate Private Equity: Through the Looking Glass," will explore creative responses to the current market and its likely effects on the real estate private equity business. Kirkland real estate partners, including Stephen G. Tomlinson, P.C., and special guest panelists representing both the GP and LP communities, will look at issues and opportunities for real estate funds in the current market, focusing on the current real estate private equity model, whether it needs fixing and what those fixes might be, as well as opportunities for real estate funds for the remainder of 2009 into 2010.

The Practising Law Institute's Mergers and Acquisitions 2009: What You Need to Know Now
Chicago, Illinois
September 24-25, 2009

This seminar, hosted by the Practising Law Institute, will focus on the continuing effects of uncertainty in the credit and equity markets, the impact of government intervention in financial markets, how contract terms are changing in light of current risks and uncertainties and trends and tactics in hostile bids and takeover battles. Kirkland partner R. Scott Falk, P.C., is a co-chair of this event and will participate in a panel discussion on "The Current M&A Landscape" and partner Marc Kieselstein, P.C., will participate in a panel discussion on "Acquisitions of Distressed Businesses."

***Private Equity International*'s Infrastructure Investor Seminar**
New York, New York
September 29-30, 2009

This seminar, hosted by *Private Equity International*, is targeted to infrastructure investors, fund managers, government officials and other stakeholders, and will focus on the proliferating opportunities in infrastructure, developing viable fund structures and securing capital amidst current financial conditions. Kirkland partner Sean Patrick Maloney, former First Deputy Secretary to the Governor of New York and architect of the Governor's multi-billion dollar proposal to monetize the New York State Lottery and the New York State Commission on State Asset Maximization, will discuss "The Future of PPPs in the U.S." Partner Bruce Gelman will lead a "Fund Terms & Conditions" workshop.

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