

PERSPECTIVE



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FBARS: A FORCE TO RECKON WITH

By Nina Worthington, CFP, AEP
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Is there an FBAR in your future? Listen to the words of IRS Commissioner Douglas Shulman at an AICPA conference on October 26, 2009: "If you are a US individual holding overseas assets, you must report and pay your taxes or we [the IRS] will be increasingly focused on finding you." Complying with FBAR reporting can be challenging, given the peculiarities of the revised legislation and the many unresolved issues that it raises.

In the IRS tradition of catchy acronyms, an "FBAR" is actually Treasury Department Form 90-22.1 or a "Report of Foreign Bank and Financial Accounts" that was revised in 2008. On this form US persons must report the existence of a "financial interest in or signature or other authority over any foreign financial accounts, in a foreign country, if the aggregate value of these financial accounts exceeds \$10,000 at any time during the calendar year." FBAR reporting is not based on year-end values; instead, balances for the entire year must be scrutinized to determine reporting responsibilities.

"US persons" include individuals, corporations, partnerships, trusts, and tax-exempt entities like pensions, 401(k) plans and individual retirement accounts (IRAs). Beginning with the 2008 tax year, foreign corporations and persons in and doing business in the US must file FBARs, regardless of residence, although enforcement has been suspended for 2009.

The United States is one of a handful of countries that requires their citizens to report and pay taxes on their world-wide income. Other countries tax only the income generated within their borders. Not only are FBARs required for personal income tax returns; they are also required for fiduciary income tax returns; partnership returns, and corporate income tax returns.

Failure to report income from foreign sources, as well as failure to file an FBAR, may result in substantial penalties, both civil and criminal. Civil fines for "willful" violations range from \$10,000 to \$100,000. Civil penalties may be assessed within six years of the violation, but it is unclear whether the failure to file extends the period in which the IRS can act.

If the failure to file is determined to be a criminal violation, the maximum fine increases to \$250,000, five years in jail, or both. If the failure to file is deemed part of an illegal or criminal activity, the fine increases to \$500,000, ten years in jail, or both. Taxpayers received an amnesty from civil and criminal penalties if they disclosed offshore accounts by October 15, 2009, the final deadline given taxpayers by the IRS for voluntary disclosure. To encourage voluntary compliance, the IRS lowered the maximum penalty of 50% to 20%.

Voluntary disclosure to avoid civil and criminal penalties involves having the taxpayer go back six years (but no earlier than 2003) and reconstruct their foreign accounts. This remedy is available only to those who have never reported foreign accounts, nor paid their income tax.

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Those who had reported and paid income taxes on their foreign accounts but failed to file an FBAR must file “delinquent” FBAR reports. The voluntary disclosure initiative was a success. At least 14,700 taxpayers applied for amnesty; by contrast, only 1,300 taxpayers responded to a 2003 initiative regarding foreign credit cards.

Since these accounts are with foreign financial institutions, reconstruction may be difficult. Currency exchange is an obvious complication. The exchange rate at the end of each year, as well as at the time of withdrawals, must be used to determine value. Language, bureaucracy, distance and other factors hinder reconstruction. However, the IRS is not very sympathetic to this argument, stating that “taxpayers are successful” ... “when they genuinely attempt to do so [obtain information from foreign institutions]”.

Interestingly, an FBAR is a report, not a tax return. You would expect that US taxpayers who did not report and pay taxes on income derived from foreign accounts would be in trouble, and you would be right. However, even a US person who discloses and pays US income tax on a foreign account may still be in trouble if the US person did not also file an FBAR! And FBAR reporting focuses on the value of a foreign asset as a whole, not just on the income derived from it. If a US taxpayer received no income from a foreign investment, he or she still must report the investment on an FBAR.

FBARs are filed separately from a tax return and sent to an IRS center in Detroit, Michigan, by June 30th of the year following the year when the account was established. FBARs must be received, not just postmarked, by June 30th. And there are no extensions for filing an FBAR, as there are for filing income tax returns.

FBAR reporting casts a wide web. You may be subject to FBAR reporting if you studied abroad and forgot to close a foreign bank account. Perhaps you bought retirement real estate in Mexico. You must file an additional form (Form 3520) if you receive an inheritance or gift in excess of \$100,000 from foreign persons during the tax year, establish a foreign trust such as an offshore asset protection trust, contribute property to or receive distributions from a foreign trust.

Not all FBAR definitions are clear. What constitutes a “financial account” and the relationship between “authority” and reporting responsibilities come first to mind.

The definition of a “financial account” is decidedly broad. Not limited to bank accounts, the term encompasses securities, securities derivatives and any other financial instrument held by a foreign institution, including debit and prepaid credit cards issued by a foreign financial institution. Specifically, an IRS spokesperson told the AICPA and the ABA on June 12, 2009, that FBARs were required for US persons investing in foreign hedge funds, foreign private equity funds, and foreign partnerships, regardless of the US person’s ownership percentage. Prior FBAR regulations did not apply to these investments.

Then there’s the issue of what constitutes “authority.” The term includes trustees and persons having “signature or other authority” over an account. Signature authority involves the ability to “control the disposition of money or other property ... by delivery of a document to a bank or other person.” The definition of authority also includes a person “who can exercise comparable power ... either directly or through an agent, nominee, attorney or in some other capacity on behalf of a US person.”

The FBAR definition of “signature authority” and the lack of distinction between “discretionary” and “directed” authority runs counter to the common law premise that an agent is responsible only for doing what the principal directs but is not responsible for a principal’s action. Fiduciary law states that trustees hold legal title to a trust’s assets solely for management purposes. Equitable title always belongs to the creator of the trust and his or her beneficiaries. FBAR reporting and fiduciary practice collide in the following situations.

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What if a trustee holds an interest in a foreign asset that was purchased for the trust by a third-party investment advisor? Or if a German investment manager of an international mutual fund establishes an account with Deutsche Bank in Hamburg to facilitate trading? What about custodial accounts? Fiduciary practice has never equated mere custody of an asset with full ownership, control or signature authority.

Who is actually responsible for filing the FBAR – the taxpayer, the taxpayer’s agent, the trustee or beneficiaries, in the case of a trust? To be safe, it appears that everyone should file. In response to an earlier question concerning the filing responsibilities for a US person and his attorney-in-fact, the IRS stated that both must file because “the power of attorney has signature or other authority over the accounts and because he is a US person.”

Multiple filers for a foreign account give rise to the question of who pays the penalties. Only one 20% offshore penalty will be applied to voluntary disclosures pertaining to the same account, according to the IRS, and the penalty may be allocated among the filers. The IRS further states that “the reporting requirements for filing an FBAR, however, do not change. Therefore, every individual who is required to file an FBAR must file one.”

Clarifying reporting requirements for foreign commingled funds has caused the IRS to postpone FBAR reporting for these assets until June 30, 2010. The Service must decide, for example, if the manager of the foreign commingled fund, hedge fund, and the like, files an FBAR for the entity, do the holders of the fund have a reporting responsibility as well?

If you believe that there is the slightest possibility that you have an FBAR reporting requirement, consult with your legal or tax advisor immediately to resolve the complex issues surrounding foreign accounts.

CB & T VIEWPOINT



November 2, 2009

Manufacturing, pending home sales fuel recovery hopes

By Lucia Mutikani

U.S. stock indexes surged on the data, which calmed fears that the economic recovery that started in the third quarter might falter as unemployment mounts. U.S. Treasury debt prices added to losses.

“All the numbers show stabilization and the start of some expansion. That’s a continuation of what we’ve been seeing for the past couple of months,” said **Thomas Nyheim**, vice president and portfolio manager at **Christiana Bank & Trust Co.** in Greenville, Delaware.

THE WALL STREET JOURNAL

November 5, 2009

Today’s Markets

Insurer Selloff Curbs Stocks

By Peter A. McKay and Geoffrey Rogow

The Fed kept its key rate target near zero, as expected, and its policy statement contained no major changes in language from the one issued in late September, though the central bank cut the amount of agency debt that it plans to purchase to \$175 billion from \$200 billion.

For the longer haul, most traders and analysts think low rates are what’s in order for the U.S. economy, which remains beset with a weak employment picture. But some dissenters worried about the downside of low rates following the Fed’s statement Wednesday.

“I am a little disappointed,” said **Scott Armiger**, portfolio manager with **Christiana Bank & Trust Co.** “While there’s plenty of slack in the economy and no reason to think we need to start hiking rates a lot real quickly, the Fed has a history of being slow to react to inflation and it would send a great signal to say ‘we’re on it.’”

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By clicking on “Individual and Family Trusts,” you will find a list of services designed to meet the needs of families everywhere. The “Corporate and Institutional Trusts” section details the variety of services offered by Christiana Bank & Trust Company that take advantage of Delaware’s highly favorable business legislation.

2009 REVISIONS TO DELAWARE'S TRUST LEGISLATION

By Amy S. Brown, Vice President, Christiana Bank & Trust Company and Doris J. Krick, Vice President, Christiana Trust Company, LLC

The Delaware legislature is constantly looking for ways to fine-tune its trust legislation, and 2009 was no exception. Although many of these changes are technical in nature, some are of interest to a general audience.

Trustee's Power to Divide Trusts

Some background: A popular estate-planning technique is to create a "sprinkle" or "pot" trust for groups of descendants until the youngest of the class reaches a specified age. At that point the trustee divides the sprinkle trust into equal shares for each beneficiary alive at the time. Typically, trustees are directed to use the trust's income or principal according to each beneficiary's needs but not necessarily equally, based on the premise that older beneficiaries have frequently received greater funds from their parents, while younger beneficiaries require funds in excess of what the older children have received for college or similar expenses. The sprinkle trust allows beneficiaries from the oldest to the youngest to start life with the same advantages.

When a trust comes into existence, the trustee may find holding the assets as one trust for multiple beneficiaries may not be in the family's best interest. Prior Delaware law permitted trustees to divide or sever trusts, provided the separate trusts were administered according to the identical terms of the original agreement; The 2009 Trust Act now permits trustees to administer separate trusts on terms that are "substantially equivalent" to the original document, a more flexible approach.

Representation of Unborn or Unknown Beneficiaries

Administering trusts involves balancing the interest of the income beneficiary with those of the remaindermen, the trust's ultimate recipients. Each interest must be represented separately to ensure proper protection. Unborn or incompetent beneficiaries are protected by those with "substantially identical interests" in a process known as virtual representation. Under the new act, a "presumptive remainder beneficiary" may represent and bind contingent successor remainder beneficiaries in the same manner as an "ascertainable competent beneficiary" may "represent and bind a minor, incapacitated, unborn or unascertainable person," an expansion of his or her powers.

Delegation of Fiduciary Responsibilities

Delaware law permits creators of trusts to use advisors to direct the trustee in its administrative duties, and protects them, as well as the trustee, when they work together. Advisors are considered to be fiduciaries and subject to the same legal and ethical standards as a trustee. The 2009 Act expanded the protective provisions of fiduciaries to include "agents to the extent delegated duties by another," whether or not such agents are co-fiduciaries.

These changes, combined with the existing body of fiduciary law, keep Delaware in the forefront of states in which to establish trusts. If you or your clients are interested in learning how a Delaware trust might be beneficial, please call Amy Brown at 302.888.7740 in Delaware, or in Nevada, Doris Krick at 702.732.9734. We at Christiana Bank & Trust Company look forward to your call.



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