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**Foreign Income**

In the third article of a series on U.S. persons' foreign accounts, Stephen J. Dunn of Dunn Counsel considers the pivotal yet elusive concept of beneficial ownership of foreign accounts. "The beneficial owner of an account is its real, true owner, the person entitled to control the account, and to realize the benefit of it," he writes.

## **Beneficial Ownership of a Foreign Financial Account**

BY STEPHEN J. DUNN

The first article in this series examined the status of intergovernmental exchange agreements in identifying U.S. persons' foreign accounts<sup>1</sup> and the second article addressed another, more expeditious weapon available to the Internal Revenue Service in identifying U.S. persons' noncompliant foreign accounts—"John Doe" summonses.<sup>2</sup>

Beneficial ownership is a pivotal concept. A person can have nominal legal title to property, but only the beneficial owner of a foreign financial account:

■ is subject to income tax on income produced by the account<sup>3</sup>;

■ is required to file Form 8938, Statement of Specified Foreign Financial Assets, reporting the account, if the taxpayer meets the Form 8938 filing threshold<sup>4</sup>; or

■ is required to include the foreign financial account in the beneficial owner's miscellaneous U.S. Code Title 26 offshore penalty base.<sup>5</sup>

<sup>3</sup> Joint Committee on Taxation Report on Pub. L. No. 111-147, at n. 129 (March 18, 2010) (beneficial ownership of capital stock).

<sup>4</sup> Treas. Reg. Section 1.6038D-2(b)(1); Instructions to Form 8938, Statement of Specified Foreign Financial Assets, at p. 5 (2015).

<sup>5</sup> "Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers" (effective for OVDP submissions made on or after July 1, 2014), <http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers-2012-Revised>, FAQ 38. "The answer might be different if: (1) the account over which the taxpayer has signature authority is held in the name of a related person, such as a family member or an entity controlled by the taxpayer; (2) the account is held in the name of a foreign entity for which the taxpayer had a Title 26 reporting obligation; or (3) the account was related in some other way to the taxpayer's tax non-compliance (e.g., was used by the taxpayer as a conduit). In these cases, the taxpayer may have an OVDP asset to which the offshore penalty applies. See FAQ 35." In an OVDP case, the taxpayer's miscellaneous Title 26 penalty base also includes the rental real property income the taxpayer has omitted from the taxpayer's U.S. income tax return. "Offshore Voluntary Disclosure Program Frequently Asked Questions and

<sup>1</sup> Dunn, "Status of Intergovernmental Information Sharing Concerning U.S. Persons' Foreign Financial Accounts," 211 DTR J-1, 11/2/15.

<sup>2</sup> Dunn, "The Use of John Doe Summons in Identifying U.S. Persons' Accounts," 220 DTR J-1, 11/16/15.

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What is beneficial ownership of an account? The beneficial owner of an account is its real, true owner, the person entitled to control the account, and to realize the benefit of it.<sup>6</sup> The beneficial owner of an account is the person to whom, in equity, the account belongs.<sup>7</sup>

In the Michigan Supreme Court's *Nurrie v. Fitzgerald*,<sup>8</sup> Charles Nurrie subcontracted with the Marble-Palmer Co. to lay track for the Michigan Central Railway. As Nurrie was away from home during banking hours, his wife Mary Ann received his checks from the Marble-Palmer Co. and deposited them into an account titled solely in her name at the First National Bank of Kalamazoo. She withdrew from the account sums needed to pay wages to her husband's workers and other business expenses, and for household expenses.

Shortly before Mary Ann Nurrie's death, she executed a will bequeathing \$2,000 to her mother, \$500 to her sister, and the balance of her estate to her husband. Her executor claimed the \$5,655 balance in the First National Bank of Kalamazoo account at her death as an asset of her estate.

This would have left Charles Nurrie without working capital needed to operate his business. So he sued the executor in the Kalamazoo County Circuit Court, arguing that although the account was titled solely in his wife's name, the account was beneficially owned by him.

## **Legal and beneficial ownership are distinguished from signature authority.**

The circuit court agreed with Nurrie, and the Michigan Supreme Court affirmed.

The legal owner of a financial account is the person whose name appears as the owner of the account on the financial institution documents creating the account. For banks in the U.S., such documents were traditionally called "signature cards," although they are now more likely to be business-sized sheets of paper.

Legal and beneficial ownership are distinguished from signature authority, which is the authority of an individual (alone or in conjunction with another) to control the disposition of money, funds or other assets held in a financial account by direct communication

Answers" (effective for OVDP Submissions made on or after July 1, 2014), FAQ 35.

<sup>6</sup> *Cent. Bank and Tr. Co. v. Shipman*, 127 So.2d 706, 707 (Fla. Dist. Ct. App. 1961); *Hale v. Windsor Sav. Bank*, 90 Vt. 487, 98 A. 993, 996 (1916); *Union Stock-Yards Nat'l Bank v. Gillespie*, 137 U.S. 411, 422, 11 S.Ct. 118, 122 (1890). Cf. *Dove v. White*, 211 Md. 228, 126 A.2d 835, 846 (1956) (beneficial ownership of a house).

<sup>7</sup> *Farrakhan v. First Pac. Bank of Chicago*, 123 Ill.App.3d 756, 758-59, 463 N.E.2d 732, 734-35 (1984), *after remand*, *Muhammad v. First Pac. Bank of Chicago*, 165 Ill.App. 3d 890, 893, 520 N.E.2d 795, 797 (1987), *leave to appeal denied*, *In re Estate of Muhammad*, 119 Ill.2d 557, 522 N.E.2d 1247 (1988), and cases there cited. See also *Barber v. Unionbank (In re Johnson)*, 232 B.R. 735, 739 (Bankr., C.D. Ill. 1999); 5 Michie, Banks and Banking Section 79, at 217 (1950).

<sup>8</sup> 222 Mich. 327, 331, 192 N.W. 573, 575 (1923).

(whether in writing or otherwise) to the person with whom the financial account is maintained.<sup>9</sup>

A person with a financial interest in an account, or signature authority over it, must disclose the account in Schedule B, Line 7a of Form 1040, U.S. Individual Income Tax Return, and, if the total balance or value of such accounts exceeds \$10,000 at any time during the year, file Financial Crimes Enforcement Network (FinCEN) Form 114, Report of Foreign Bank and Financial Accounts ("FBAR"), reporting the account.

A U.S. person also has a financial interest in each bank, securities or other financial account in a foreign country for which the owner of record or holder of legal title is:

- a person acting as an agent, nominee, attorney or in some other capacity on behalf of the U.S. person with respect to the account;

- a corporation in which the U.S. person owns directly or indirectly more than 50 percent of the voting power or the total value of the shares, a partnership in which the U.S. person owns directly or indirectly more than 50 percent of the interest in profits or capital, or any other entity (other than an entity described in 31 Code of Federal Regulations Sections 1010.350(e)(2)(iii) through (iv)) in which the U.S. person owns directly or indirectly more than 50 percent of the voting power, total value of the equity interest or assets, or interest in profits;

- a trust, if the U.S. person is deemed the owner of the trust under the grantor trust rules of Internal Revenue Code Sections 671-679 and the regulations thereunder;

- a trust in which the U.S. person either has a present beneficial interest in more than 50 percent of the assets or from which such person receives more than 50 percent of the current income; or

- any other entity in which the U.S. person owns directly or indirectly more than 50 percent of the voting power, total value of equity or assets, or interest in profits.<sup>10</sup>

## **Example**

Gustav, a native of Sweden, has resided in the U.S. since 2007. In 2011 he became a naturalized citizen of the U.S. In 2010, Gustav's mother transferred title to an account holding 1 million kronor (\$117,500) at a Swedish bank to Gustav's name. Gustav's mother remained a signatory on the account, and from time to time she made withdrawals from the account.

Gustav made no transactions in the account, and acknowledged the account as his mother's. Gustav hasn't reported income from the account on his U.S. income tax return, or reported the account on Form 8938, Statement of Specified Foreign Financial Assets, or an FBAR.

In 2015, on the advice of Gustav's U.S. counsel, title to the account was transferred back to Gustav's mother. Gustav isn't under criminal investigation or civil examination by the Internal Revenue Service. His U.S. coun-

<sup>9</sup> 31 C.F.R. Section 1010.350(f)(1).

<sup>10</sup> 31 C.F.R. Section 1010.350(e)(2); FBAR Instructions, at p. 5.

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sel opines that Gustav never had beneficial ownership of the Swedish bank account.

Therefore, Gustav need not amend his U.S. income tax returns to report income from the account or file Form 8938 reporting the account. Gustav need not enter the IRS's Offshore Voluntary Disclosure Program or its Streamlined Filing Compliance Procedures. All Gustav needs do to comply with U.S. law concerning

the account is file FBARs for the years 2009-2015 reporting the account.<sup>11</sup>

Next up—personal foreign investment companies.

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<sup>11</sup> See <https://www.irs.gov/Individuals/International-Tax-payers/Delinquent-FBAR-Submission-Procedures>.