



## Just in Time for the 2012 Tax Filing Season – Internal Revenue Service Releases Form 8938, Statement of Specified Foreign Financial Assets

Starting with the 2011 tax year, certain individuals holding interests in “specified foreign financial assets” with an aggregate value generally exceeding \$50,000 in a tax year must report those assets to the Internal Revenue Service (IRS) on new Form 8938, *Statement of Specified Foreign Financial Assets*, which must be attached to their individual federal income tax returns. An individual also may be required to file Form TD F 90-22.1, *Report of Foreign Bank and Financial Accounts (FBAR)*. Rather than being filed with the individual’s 2011 federal income tax return, the FBAR must be filed with the Treasury Department on or before June 30, 2012. An individual may be required to file both Form 8938 and the FBAR, and there may be duplicative reporting on the two forms.

The Foreign Account Tax Compliance Act (FATCA) enacted Internal Revenue Code Section 6038D as part of the HIRE Act of 2010. Section 6038D is effective for tax years beginning after March 18, 2010, which, for most taxpayers, means the form is required to be filed with their 2011 federal income tax returns. The IRS recently issued Temporary Regulations, proposed to be effective December 19, 2011, that are intended to provide guidance to those individuals required to comply with this new reporting obligation. The Temporary Regulations require “specified individuals” (U.S. citizens, residents and certain non-resident aliens) to complete and attach Form 8938 to their individual income tax returns. The IRS released the final version of Form 8938 and its instructions on December 21, 2011.

**Individuals Required to File Form 8938.** Under the Temporary Regulations, the “specified individuals” required to file Form 8938 include U.S. citizens, resident aliens of the United States for any part of the tax year, and nonresident aliens who have elected to be treated as resident aliens or who are residents of American Samoa or Puerto Rico. A resident alien who elects to be taxed as a resident of a foreign country under the provisions of a U.S. income tax treaty also is required to file Form 8938. A specified person who is not otherwise required to file a federal income tax return for a tax year does not have to file a Form 8938 for that tax year

**Reporting Thresholds.** A specified individual must file Form 8938 only if the value of the individual’s specified foreign financial assets exceed certain thresholds. The reporting thresholds vary based on whether the specified person files a joint tax return or lives abroad (as defined in the regulations) and are higher for married couples and taxpayers who live abroad.

STATUS	VALUE THRESHOLDS
Unmarried taxpayers living in the U.S.	>\$50,000 on last day or >\$75,000 on any day
Married taxpayers filing jointly, living in the U.S.	>\$100,000 on last day or >\$150,000 on any day
Married taxpayers filing separately, living in the U.S.	>\$50,000 on last day or >\$75,000 on any day
Taxpayers living abroad, other than filing jointly	>\$200,000 on last day or >\$300,000 on any day
Taxpayers living abroad, married filing jointly	>\$400,000 on last day or >\$600,000 on any day

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**Specified Foreign Financial Assets.** Specified foreign financial assets required to be reported include:

- (1) a financial account maintained by a foreign financial institution and
- (2) the following assets, if they are held for investment and not held in an account maintained by a financial institution (“other specified foreign financial assets”):
  - (a) stock or securities issued by a non-U.S. person,
  - (b) a financial instrument or contract that has an issuer or counterparty that is not U.S. person, and
  - (c) an interest in a foreign entity.

An asset is “held for investment” if it is not used in, or held for use in, the conduct of a trade or business.

A “financial account” is any depository or custodial account maintained by, as well any equity or debt interest (other than interests that are regularly traded on an established securities market) in, a financial institution.

A “foreign financial institution” is any entity that is not a U.S. person that (a) accepts deposits in the ordinary course of a banking or similar business, (b) as a substantial portion of its business, holds financial assets for the account of others, or (c) is engaged (or holds itself out as being engaged) primarily in the business of investing, reinvesting or trading in securities, partnership interests, commodities, or any interest in such securities, partnership interests or commodities. A foreign financial institution includes investment vehicles such as foreign mutual funds, foreign hedge funds and foreign private equity funds.

The Temporary Regulations provide examples of assets that may be considered “other specified foreign financial assets” (and will need to be reported if held for investment and not in a financial account), including a note, bond or other form of indebtedness issued by a foreign person, a swap agreement with a foreign counterparty, an option or other derivative instrument entered into with a foreign counterparty or issuer, a capital or profits interest in a foreign partnership, and an interest in a foreign estate or trust. An interest in a foreign estate or trust is not a specified foreign financial asset unless the specified individual knows or has reason to know of the interest

based on readily accessible information of the interest. If an individual receives a distribution from the foreign trust or foreign estate, he or she will be considered to have actual knowledge of the interest.

Limited information is required to be included on Form 8938 for assets reported on a timely filed Form 3520, Form 3520-A, Form 5471, Form 8621, Form 8865, or Form 8891. The value of specified foreign financial assets reported on these other forms are included in determining the total value of assets for the reporting threshold, but the assets do not need to be reported on Form 8938. In this situation, the taxpayer identifies on Form 8938 which and how many of these form(s) report the specified foreign financial assets.

**Interest in a Specified Foreign Financial Asset.**

A specified individual has an interest in a specified foreign financial asset if any income, gains, losses, deductions, credits, gross proceeds, or distributions attributable to holding or disposing of the asset are or would be required to be reported, included or otherwise reflected on such individual’s tax return. The owner of a disregarded entity or a grantor trust generally is treated as having an interest in any specified foreign financial assets held by the disregarded entity or grantor trust. A specified individual generally is not treated as having an interest in any specified foreign financial assets held by a corporation, partnership, trust (other than a grantor trust) or estate solely as a result of the individual’s status as a shareholder, partner, or beneficiary of such entity.

**Asset Valuation.** Taxpayers will need to determine the fair market values of their specified foreign financial assets in order to determine if the aggregate value exceeds the applicable threshold. Generally, the taxpayer reports a reasonable estimate of the highest fair market value of the asset during the tax year, but special rules apply that may ease valuation burdens.

**Non-compliance with Form 8938 Reporting**

**Requirements.** Taxpayers required to file Form 8938 who do not do so may be subject to the following penalties: (1) a \$10,000 failure to file penalty, (2) an additional penalty of up to \$50,000 for continued failure to file after IRS notification, and (3) a 40 percent penalty on an understatement of tax attributable to non-disclosed assets.

Generally, the IRS has three years from the date an income tax return is filed to assess tax for that tax year. If the taxpayer omits \$5,000 from gross income attributable to a specified foreign financial asset, without regard to the reporting threshold or any reporting exceptions, the statute of limitations for assessing tax is six years after a taxpayer's return is filed.

If the taxpayer fails to file, or properly report an asset on, Form 8938 for a particular tax year, the statute of limitations for that tax year covering any item required to be reported on the tax return remains open for three years after the taxpayer provides the required Form 8938 information. If the failure is due to reasonable cause, the statute of limitations is extended only with regard to the item or items related to such Form 8938 failure and not the entire tax return.

**Proposed Extension to U.S. Entities.** The IRS also issued Proposed Regulations in December 2011 that would extend the Form 8938 reporting obligation to certain U.S. entities. The Proposed Regulations will be effective for tax years beginning after December 31, 2011. Therefore, U.S. entities do not have a Form 8938 filing obligation for the 2011 tax year.

If you are a U.S. citizen or resident alien in 2011, you should inform your U.S. tax return preparer of all of your non-U.S. assets and financial accounts.

Please contact us if you have any questions related to this new reporting requirement

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