

Tax Bulletin

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FORM 8938 – Expansion of International Tax Reporting Requirements

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The HIRE Act of 2010 enacted Section 6038D as part of the Foreign Account Tax Compliance Act. Drafts of the Form 8938 were issued by the IRS last year, and temporary and proposed regulations were issued late in the year. This Tax Bulletin summarizes the requirements of Section 6038D and the recent regulations as well as the Form. The Form is applicable for tax years beginning after March 18, 2010, which for most individuals will be the 2011 tax year.

Note that Form 8938 is a tax form to be filed with an individual's U.S. income tax return; there are overlaps between the information to be reported on Form 8938 and Form 90-22.1, which is a Treasury Department form. Form 8938 does not replace or supplant Form 90-22.1, and individuals may now be required to file both forms. Recall that the Form 90-22.1 is filed with the Treasury Department on or before June 30 with respect to the preceding taxable year, while Form 8938 is filed with the IRS along with the individual's income tax return.

Specified Foreign Financial Assets: Section 6038D requires an individual who holds any interest in a specified foreign financial asset during the taxable year to report certain information to the IRS if the aggregate interests exceed \$50,000. For these purposes, a specified foreign financial asset includes a finance account maintained by a foreign financial institution, or, if not held at a financial institution, any stock or security issued by a foreign person, a financial instrument or contract that has a foreign issuer or counterpart, or an interest in any foreign entity where such instrument is held for investment. A financial instrument or contract includes interest and currency swaps, other swap contracts, options and other derivative contracts. Gold held in a safety deposit box, artworks, interests in a social security, social insurance or other similar program, and real estate do not constitute specified foreign financial assets. However, gold held by a custodian, interests in foreign trusts, foreign estates, foreign pension plans and foreign deferred compensation plans do constitute a specified foreign financial asset.

Note that for purposes of Section 6038D and reporting on Form 8938, a U.S. branch of a foreign financial institution is not considered to be a foreign financial institution and thus assets held at the US branch need not be reported on Form 8938.

Who Must File: Section 6038D applies to U.S. citizens, a person who is a resident alien at any time during the taxable year, and a person who is a resident alien but elects to be taxed as a resident of a foreign country under the relevant income tax treaty residency tie-breaker tests. This leads to a requirement that a person who might not otherwise be required to file a U.S. tax return, now has to file the U.S. tax return in order to report their interests in specified foreign financial assets.

At present, only individuals must file Form 8938; domestic entities are not required to file Form 8938, although they remain subject to the other numerous international information reporting forms. Once the proposed regulations are finalized, certain domestic entities will be required to file Form 8938. A U.S. individual who is otherwise treated as the owner of a foreign trust is not required to report any specified assets held by the foreign trust provided the individual timely files Form 3520, the trust timely files Form 3520-A, and the filing of those returns is reported on the individual's Form 8938.

What Constitutes an "Interest": An individual is considered to have an interest in a specified foreign financial asset if any income, gains, losses, deductions, credits, gross proceeds or distributions attributable to the holding or disposition of such asset is or would be required to be reported by the individual on a U.S. income tax return.

Reporting Thresholds; Valuation of Assets: The temporary regulations increase the statutory reporting threshold of \$50,000 to \$50,000 on the last day of the taxable year, or \$75,000 at any time during the taxable year for most individuals. The threshold is further increased to \$100,000 or \$150,000 in the case of married individuals filing joint returns, \$200,000 or \$300,000 for individuals who live abroad

and qualify under Section 911(d)(1), and \$400,000 or \$600,000 for married individuals who live abroad, qualify under Section 911(d)(1) and file a joint return.

The reporting threshold is tested by valuing the specified foreign financial assets at the end of the taxable year, and converting foreign currency denominated assets into U.S. Dollars using the U.S. Treasury Department's Financial Management Service exchange rates. If the \$50,000 threshold is met, then the amount reported on Form 8938 is the maximum fair market value of the asset at any time during the taxable year. Accordingly, there are two separate valuation dates for each specified foreign financial asset. If an asset is owned jointly with a person other than that person's spouse, then the full value of that asset is taken into account in determining whether the reporting thresholds are met.

Duplicative Reporting: In order to avoid duplicative reporting on other information returns, assets reported on Form 3520, 5471, 8621, 8865 or 8891 need not be reported on Form 8938, although the individual must report on Form 8938 the number of such other form filed by the individual.

Information to be Reported: Form 8938 requires that the name, address and account number, type of account, and maximum value be reported for each interest in a specified foreign financial asset. With respect to assets other than foreign deposit or custodial accounts, the date the asset was acquired or disposed of must also be reported as well. Lastly, the income, deductions and credits resulting from each asset must be separately reported on Form 8938 including a listing of where those amounts were reported on the income tax return filed by the individual.

Foreign Trusts and Estates: A beneficial interest in a foreign trust or estate is not a specified foreign financial asset unless the individual knows or has reason to know of the interest. If a person receives a distribution from the foreign trust or estate, they are considered to have actual knowledge of the interest. The maximum value of an interest in a foreign trust is equal to the amounts actually received by the individual during the taxable year plus the value on the last day of the taxable year of any mandatory distributions. In the case of foreign estates, pension plans and deferred compensation plans, the maximum value is either the fair market value of the individual's beneficial interest in such plan, or if the individual does not know such information, then the value of the amounts received from such plan during the taxable year.

Penalties; Statute of Limitations: A \$10,000 penalty applies for failure to file a Form 8938; the penalty is increased by an additional \$10,000 (up to a maximum of \$50,000) for each 30 day period the failure continues for more than 90 days after the IRS mails a notice of failure to file the Form. The penalty will not be imposed if the failure to file was due to reasonable cause and not willful neglect.

A separate accuracy related penalty applies if a person underpays his or her U.S. tax liability as a result of a transaction which is not disclosed on Form 8938. The amount of the penalty is 40% of the underpayment.

If Form 8938 is not filed with the required U.S. income tax return, or a specified foreign financial asset is not reported on a filed Form 8938, then the statute of limitations remains open with respect to the unreported assets until 3 years after the date a Form 8938 reporting that asset is filed. In addition, if amounts relating to one or more specified foreign financial assets are not included in gross income, then the tax on that unreported income can be assessed at any time with 6 years from the date the income tax return was filed. This extends the normal 3 year statute by an additional 3 years.