

Your Assets Exposed! What The United States Is Doing To Make You Completely Bare

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On December 14, 2011, the Internal Revenue Service ("IRS") issued temporary and proposed regulations in a Notice of Proposed Rulemaking relating to provisions that require foreign financial assets to be reported to the IRS for tax years beginning after March 18, 2010.

The Foreign Account Tax Compliance Act ("FATCA"), enacted in 2010 as part of the Hiring Incentives to Restore Employment (HIRE) Act, requires certain U.S. taxpayers holding foreign financial assets with an aggregate value exceeding either \$50,000 on the last day of the taxable year or \$75,000 at any time during the taxable year to report certain information about those assets on a new form -- Form 8938 - Statement of Foreign Financial Assets.

Married individuals filing a joint annual return are not required to file Form 8938 unless the aggregate value of all of the specified foreign financial assets in which either spouse has an interest exceeds \$100,000 on the last day of the taxable year or \$150,000 at any time during the taxable year.

An individual residing outside the U.S. will generally have a greater amount of specified foreign financial assets. Accordingly, the temporary and proposed regulations increase the reporting threshold and provide that such an individual is not required to file Form 8938 unless the aggregate value of the foreign financial assets in which the individual has an interest exceeds \$200,000 on the last day of the taxable year or \$300,000 at any time during the taxable year. If married individuals residing outside the U.S. file a joint return, and either spouse is a qualified individual under Section 911(d)(1) of the Internal Revenue Code, they are not required to file Form 8938 unless the aggregate value of all of the specified foreign financial assets in which either spouse has an interest exceeds \$400,000 on the last day of the taxable year or \$600,000 at any time during the taxable year.

The temporary and proposed regulations provide guidance regarding the requirement in section 6038D of the Internal Revenue Service that individuals attach a statement (Form 8938) to their income tax return to report required information on certain foreign financial assets in which they have an interest.

A foreign financial asset is defined as any financial account maintained by a foreign financial institution; and, to the extent not held in an account at a financial institution: (i) any stock or security issued by any

person other than a United States person; (ii) any financial instrument or contract held for investment that has an issuer or counterparty that is not a United States person; and (iii) any interest in a foreign entity.

The value of a specified foreign financial asset must be determined both for purposes of determining if the aggregate value of the specified foreign financial assets in which a specified person holds an interest exceeds the reporting thresholds set forth in the temporary and proposed regulations and for purposes of reporting the maximum value of a specified foreign financial asset on Form 8938. Generally, the value of a specified foreign financial asset is the asset's fair market value and for reporting the maximum value of a specified foreign financial asset it is the asset's highest fair market value during the taxable year.

In order to determine the maximum value of a specified foreign financial asset other than a financial account maintained with a foreign financial institution, the asset's fair market value on the last day during the taxable year is the maximum value of the asset.

Form 8938 must be attached to the taxpayer's annual tax return. Failure to report foreign financial assets on Form 8938 will result in a penalty of \$10,000 (and a penalty up to \$50,000 for continued failure after IRS notification). Further, underpayments of tax attributable to non-disclosed foreign financial assets will be subject to an additional substantial understatement penalty of 40 percent.

A draft Form 8938 and Instructions have been published by the IRS, but not yet finalized. Simultaneously with the temporary and proposed regulations, the IRS published Announcement IR-2011-117 and stated that it will soon release the Form 8938 that taxpayers will use this coming tax filing season to report specified foreign financial assets for the 2011 tax year. Notice 2011-55 provides guidance for affected taxpayers required to file prior to the availability of Form 8938.

The majority of the temporary regulations are effective December 19, 2011, and affect individuals who must file Form 1040, "U.S. Individual Income Tax Return," and some individuals required to file Form 1040-NR, "Nonresident Alien Income Tax Return."

In addition to filing a Form 8938, taxpayers will still be required to file a TD F 90-22.1 Report of Foreign Bank Accounts ("FBAR") if necessary. Although certain information may be reported on both Form 8938 and the FBAR, the information required by the forms is not identical in all cases, and reflects the different rules, key definitions (for example, "financial account"), and reporting requirements applicable to Form 8938 and FBAR reporting.

The temporary and proposed regulations also includes a proposed regulation which applies to certain domestic entities that are formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets. The Department of the Treasury and the Internal Revenue Service anticipate that

this proposed regulation in particular will be issued as a final regulation during 2012 and will apply to taxable years beginning after December 31, 2011. Until this proposed regulation is issued as a final regulation, no domestic entity is required to file Form 8938 to report specified foreign financial assets with its annual return.

If you have foreign financial assets it is our recommendation that you contact us immediately so we may review your particular facts and circumstances and assist in the preparation of your income tax returns and other informational forms.

For related information, please see our Practice Update published July 15, 2011, "Guidance Outlining Phased Implementation of FATCA Beginning in 2013."

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