

To: Our Clients and Friends

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Treasury Issues Draft Instructions for Reporting Interests in Specified Foreign Financial Assets

The FATCA provisions of the HIRE Act included a new annual information reporting requirement applicable beginning 1st January 2011 (for calendar year taxpayers). A draft of the Form 8938 to be used by taxpayers to meet these requirements which was issued in late June made it clear that an interest in a foreign entity such as a foreign trust or a foreign estate is included within the reporting requirements.

Draft instructions to Form 8938 were recently posted on the Internal Revenue Service website. Based on these instructions:

- An individual who is not required to file a US Federal income tax return for a calendar year is exempt from filing Form 8938 for that year. This should eliminate annual Form 8938 filing requirements for many minor US taxpayer beneficiaries of foreign trusts because often such minors do not have sufficient gross income to require the minor to file a US Federal income tax return.
- A beneficiary does not have a reportable interest in a foreign trust or estate "unless you know or should have known of the interest".
- "In most cases" a beneficiary who has a reportable interest in a foreign trust or estate is not in addition treated as having a reportable interest in the specified foreign financial assets owned by that trust or estate. So although an individual entitled to all income of a foreign trust must include on his or her annual "Report of Foreign Bank and Financial Accounts" all of the foreign financial accounts held directly or indirectly by the trust, the draft instructions for Form 8938 indicate that such a beneficiary would not be required to report the specified foreign financial assets of the trust on Form 8938.
- An individual who files a Form 3520 for a calendar year is not required to complete Form 8938 fully to report his interest in the foreign trust or estate reported on Form 3520, however, he does have to complete a portion of Form 8938 to identify the number of Forms 3520 filed by the taxpayer for that calendar year.

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- The instructions if literally interpreted would not treat a specified person who is a beneficiary of a foreign grantor trust but who is not the grantor of the trust as having a reportable interest because "an interest" is defined with reference to whether certain items related to the asset or entity "are or would be required to be reported, included, or otherwise reflected" on an income tax return. Technically an "income tax return" refers to Form 1040 and its schedules, and does not include a Form 3520 which is the only form on which a US taxpayer beneficiary of a foreign grantor trust who is not the grantor of the trust must report any interaction with the trust arising during the calendar year. However there is no specific reference in the instructions to that fact pattern so it is not yet clear whether that strict interpretation of an "income tax return" is intended.
- The definition of "an interest in a specified foreign financial asset" just described leaves unresolved the question of whether a US taxpayer who could benefit from a foreign trust in future but is not an object of trustee discretion during the calendar year of reporting is considered to have a reportable interest.
- A number of detailed rules are provided for valuing and reporting directly held interests in foreign financial accounts, foreign issued stock, securities and financial interests not held in a foreign financial account and interests in foreign partnerships or other entities including rules applicable to joint accounts and differing value reporting thresholds depending on whether the individual reporting lives in the United States or outside the United States.
- Only individuals are required to comply with Form 8938 filing requirements for calendar year 2011; US "domestic entities" are exempted from the reporting requirement until future regulations or other guidance impose such a reporting requirements on domestic entities.

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