

Reporting Of Specified Foreign Financial Assets – Trusts & Estates

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EXECUTIVE SUMMARY. Taxpayers with non-U.S. financial assets are subject to new and extensive reporting, commencing with the 2011 tax year filings. The IRS has recently issued guidance, which includes specific rules relating to grantor trusts and interests in foreign trusts and estates. All return preparers should have some familiarity with these new rules.

FACTS. Code §6038D, enacted as part of the Hiring Incentives to Restore Employment (HIRE) Act, will result in the first foreign asset disclosure filings in 2012. Form 8938 will be used to report. In recent weeks, Treasury has released a final version of the Form 8938, Instructions under the form, and temporary and proposed regulations relating to this reporting. Before addressing the specific provisions relating to estates and trusts, a short overview of the filing requirements is helpful.

WHO MUST FILE? (a) A “specified person,” (b) with an “interest,” (c) in “specified foreign financial assets (SFFAs),” (d) that meet stated filing thresholds, and (e) that otherwise has to file an income tax return, is required to prepare the Form 8938. Generally, a “specified person” at this time is an individual that is a U.S. citizen or resident alien. An “interest” means ownership of a subject asset in such a manner that income, gain, loss, expense from that item would be reported on an annual return of the taxpayer (regardless of whether there is income, gain, loss or expense for the current year). The filing threshold for a U.S. resident is SFFAs in excess of \$50,000 on the last day of the tax year or \$75,000 at any time during the year. Higher thresholds exist for married persons, and persons residing abroad.

WHAT IS AN SFFA? There are two types of assets that are a “specified foreign financial asset.” The first is a financial account of the taxpayer maintained by a foreign financial institution. The second is an asset not held in such an account, if held for investment, and that is: (a) stock or securities issued by a non-U.S. person, (b) a financial instrument or contract with a non-U.S. issuer or counterparty, or (c) an interest in a non-U.S. entity.

VALUATION. Values of SFFAs must be determined, both to determine if the filing threshold has been met, and to report the value on the Form 8938. Reasonable estimates of value are (thankfully) allowed.

PENALTIES. Failure to fully disclose will result in monetary penalties of \$10,000 (up to a maximum of \$50,000), absent reasonable cause. Failure to report will also result in statute of limitations extensions on income, both relating to the unreported SFFAs and potentially to all income of the taxpayer.

DUPLICATIVE REPORTING. For FSSAs reported on other tax forms, reporting may not be necessary under the Form 8938. However, those filings must be referenced on the Form 8938.

TRUST AND ESTATE ISSUES. There are some specific rules and aspects that relate to trusts and estates.

1. At this point in time, domestic trusts are not reporting taxpayers – only individuals need to report. At some point in the future, domestic entities that are availed of to avoid reporting will also need to report.

2. In counting SFFAs to see if the filing threshold is exceeded, or in actually reporting SFFAs, a beneficiary is not treated as owning the assets of a trust or estate. However, owners of an interest in a grantor trust will report the SFFAs of the trust attributed to them, subject to some exceptions.

3. An interest of a beneficiary in a foreign trust or a foreign estate is itself an SFFA. However, the beneficiary needs to know or have reason to know about the foreign trust or estate based on readily accessible information before it will be considered an SFFA. A receipt of a distribution from the estate or trust constitutes knowledge for this purpose.

4. In determining the “maximum value” of a beneficial interest in a foreign trust, the maximum value is the sum of (a) the fair market value on the last day of the year of all cash and property distributed to the beneficiary, and (b) the actuarial value on the last day of the year of the beneficiary’s rights to receive mandatory distributions. If the beneficiary cannot obtain information to calculate (b), they can use only the value under (a).

5. In determining the value of a beneficial interest in an estate, the taxpayer can limit the computation to that described in 4.(a) above, if it cannot obtain the information needed to value the beneficial interest.

COMMENT. Tax preparers are now obligated to inquire about the foreign assets of their clients so that proper reporting can be made. This will require preparers to be familiar with the foregoing rules, including what constitutes an SFFA and the application of the rules to interests in trusts and estates. Note that the Form 8938 instructions and accompanying regulations provide additional detail and exceptions beyond the general overview provided above.

Importantly, reporting of foreign accounts on an FBAR does NOT relieve taxpayers of reporting SFFAs on the Form 8938.

As noted above, a mere beneficial interest in a foreign trust or a foreign estate is an SFFA that is subject to reporting if the filing thresholds are met. There is no guidance that limits this to current beneficiaries or vested remainder beneficiaries. Thus, contingent beneficiaries at this point should report to avoid a risk of penalty, although an argument can be made that such persons do not have the requisite “interest.”

The valuation aspects are interesting. As to interests in a foreign trust, a beneficiary is not generally required to obtain valuation of the trust assets, since he or she needs only to report the value of distributed property. However, if the beneficiary has a mandatory distribution right, an actuarial computation is required. To compute this, the value of the underlying trust assets in that situation will be needed. For foreign estates, some effort will need to be undertaken to obtain the value of the beneficiary's interest. Helpfully for beneficiaries of foreign trusts and foreign estates, if readily accessible value information is not available, valuation can be limited to the value of distributed property that is received.

The question arises whether values reported on the Form 8938 can be used by the IRS to challenge asset values for other purposes, such as estate or gift tax transfer values for transfers occurring in the tax year or in the future. There is nothing that prohibits the IRS from using the reported values, although the probative value of such reporting is arguably limited since the form only requires "reasonable estimates" of value.

Nonetheless, to avoid issues if there are somewhat contemporaneous transfers subject to estate or transfer taxes, some coordination of reporting is advisable to avoid creating inconsistent reporting problems to the extent workable within the confines of the Form 8938 reporting rules.

CITES: Code §6038D; Form 8938 and Instructions; TD 9567, Reporting of Specified Foreign Financial Assets (12/14/11); Treas.Reg. §1.6038D-1T, -2T, -3T, -4T, -5T, -7T, & -8T.

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