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More IRS Offshore Penalties May be Coming!

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Taxpayers with certain foreign held assets will be required to describe those assets on a new form which must be attached to their 2011 Form 1040 individual income tax returns. The new form, still in draft format is Form 8938. The use of the new form is mandated under section 6038D of the HIRE Act, which is a 2010 amendment to the Internal Revenue Code.

If an individual taxpayer held \$100,000 in specified foreign financial assets at anytime during 2011 or had held \$50,000 in such assets at the end of the year reporting is required. Specified Foreign Financial assets include investments that produce interest or dividends and include listed and non-listed funds. Failure to report specified foreign financial assets through the use of Form 8938 subject the taxpayer to penalties up to \$50,000. But that is not the end of the range of penalties.

U.S. taxpayers are required to report gifts or bequests from foreign sources, if those gifts or bequests exceed \$100,000 per year. Failure to report the gifts or bequests can result in penalties from 25% – 35% of the gross amount of the gift or bequest. Form 8938 asks specifically if reports of foreign Gifts or Bequests, were made (using Form 3520, and 3520A). Taxpayers are required to check a box on the Form 8938 to indicate if they filed the required forms to report the foreign source gifts or bequests. Form 8938 will most likely be an essential tool in auditing by the IRS. Dual citizens and other U.S. taxpayers may find themselves confronting very substantial penalties if on audit the revenue agent determines that report of foreign gift or bequest should have been filed and was not.

The question that taxpayers must now confront is how to come into compliance with the reporting foreign gift and bequest reporting rules. Under the 2009 and 2011 Offshore Voluntary Disclosure programs the penalties for not filing a Report of Foreign Bank Account (FBAR), Report of Foreign Gift or Bequest, (Form 3520) and other information returns was integrated into a single miscellaneous civil penalty. But is no longer possible to enter those programs and taxpayer now face major penalties if discovered. Compliance options range from running the “audit lottery” (waiting to be caught) to filing now and asking for a penalty waiver based upon reasonable cause. Some taxpayers may even consider expatriation, an extreme response no doubt. Whichever approach a taxpayer chooses, the one approach that is unwise is non-disclosure.

Law Offices of Sanford I. Millar

Office: 310-556-3007

Fax: 310-556-3094

Address: 1801 Avenue of the Stars, Suite 600
Los Angeles, CA. 90067

Email: smillar@millarlaw.net

www.millarlawoffices.com