

MARCH 2012

NEW IRS FOREIGN FINANCIAL ASSET REPORTING RULE REQUIRES CERTAIN U.S. EMPLOYEES TO FILE ADDITIONAL INFORMATION WITH THEIR 2011 U.S. INCOME TAX RETURNS

Certain U.S. taxpayers who hold certain foreign equity awards or have deferred compensation plans issued by foreign entities now are required to file Form 8938, "Statement of Specified Foreign Financial Assets," with their federal income tax returns, beginning with their 2011 Form 1040. Absent an extension, Form 1040 is due on or before April 17, 2012. **There are potentially significant penalties for failure to comply.**

The filing covers interests in specified foreign financial assets. These include all financial accounts maintained by a foreign financial institution and any of the following assets held for investment: (i) stock or securities issued by non-U.S. persons, (ii) financial instruments or contracts issued by non-U.S. persons, including foreign pensions and deferred compensation plans, and (iii) any interest in a foreign entity. The specified foreign financial assets also include most foreign stock options, restricted stock units, and similar equity awards.

The filing applies only if the aggregate value of non-U.S. assets exceeds certain thresholds. For single U.S. taxpayers residing in the U.S., the threshold value is at least \$50,000 at year-end or \$75,000 at any time during the year (for married individuals filing jointly, the corresponding thresholds are \$100,000 and \$150,000). For U.S. taxpayers residing outside of the U.S., the threshold value is at least \$200,000 at year-end or \$300,000 at any time during the year (for married individuals filing jointly, the corresponding thresholds are \$400,000 and \$600,000). No filing is required if the

aggregate value of non-U.S. assets is below these thresholds.

It is likely that some taxpayers will not be aware of their filing obligations. For example, suppose a single U.S. taxpayer employee owns \$40,000 worth (at 2011 year-end) of foreign company stock from a former employer, and has an interest in a foreign private equity fund that was worth \$15,000 at 2011 year-end. That taxpayer may well neglect to aggregate his or her private equity holdings with the foreign company stock, and thus not realize that a filing is required. This oversight could subject the taxpayer to a tax penalty of up to \$50,000.

A reasonable estimate of fair market value is required for the filing. For financial accounts maintained by a foreign financial institution, individuals may rely on periodic account statements for the tax year to report a financial account's maximum value, unless they have information that this amount does not reflect a reasonable value. For assets other than a financial account maintained by a foreign financial institution, the individual may treat the fair market value on the last day of the taxable year on which they had an interest in the asset as the maximum value, unless they have information indicating that this amount does not reflect a reasonable value. It may be reasonable to take the view that only vested equity compensation awards count in performing the valuation. It is unclear how to value stock options, as the IRS guidance does not address this.

An individual who is required to file Form 8938 but fails to do so is subject to a \$10,000

penalty. If the failure continues for 90 days after the IRS mails a notice of failure to the individual, the IRS may impose an additional \$10,000 penalty for each 30-day period during which the failure is uncorrected, up to a maximum of \$50,000.

Even though the Form 8938 is an individual requirement, employers may wish to notify potentially affected employees. Many employees are undoubtedly unaware of the new rules and the substantial penalties for noncompliance.

This WSGR Alert is intended only as a general summary. If you have any questions regarding this alert, please contact any member of the employee benefits and compensation practice of Wilson Sonsini Goodrich & Rosati.

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