

IRS Releases Additional Guidance for Reporting Foreign Financial Assets on Form 8938

Legal Alert
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The Internal Revenue Service recently published additional guidance regarding Form 8938, Statement of Specified Foreign Financial Assets, which will be of interest to taxpayers filing 2011 tax returns. The additional guidance issued on June 7, 2012 addresses areas that either were not clearly stated in prior IRS announcements, the Instructions to Form 8938, or which had not been directly addressed.

Form 8938 was authorized by the Foreign Account Tax Compliance Act (FATCA), enacted as part of the Hiring Incentives to Restore Employment Act (HIRE Act). Temporary and Proposed Regulations under Internal Revenue Code Section 6038D were issued on December 14, 2011 and set forth the basic requirements for filing Form 8938.

Who must file Form 8938?

A "specified individual" must file Form 8938 if the applicable threshold value for foreign financial assets is met. A "specified individual" includes a U.S. citizen, a resident alien of the United States, a nonresident alien who makes an election to be treated as a resident alien for purposes of filing a joint income tax return, and a nonresident alien who is bona fide resident of American Samoa or Puerto Rico.

The applicable threshold for filing depends upon the filing status of the "specified individual" and where the "specified individual" lives.

Specified individual living in the United States must file Form 8938 as follows:

Unmarried taxpayers: The total value of specified foreign financial assets is more than \$50,000 on the last day of the tax year or more than \$75,000 at any time during the tax year.

Married taxpayers filing a joint income tax return: The total value of specified foreign financial assets is more than \$100,000 on the last day of the tax year or more than \$150,000 at any time during the tax year.

Married taxpayers filing separate income tax returns: The total value of specified foreign financial assets is more than \$50,000 on the last day of the tax year or more than \$75,000 at any time during the tax year.

Specified individuals living outside the United States must file Form 8938 as follows:

A return other than a joint return is filed and the total value of specified foreign assets is more than \$200,000 on the last day of the tax year or more than \$300,000 at any time during the year; or

A joint return is filed and the value of specified foreign assets is more than \$400,000 on the last day of the tax year or more than \$600,000 at any time during the year.

Form 8938, and the applicable regulations have special rules for determining the value of "specified foreign assets." In determining whether to file Form 8938, all reportable foreign financial assets must be aggregated. The following foreign assets if maintained by a foreign financial institution are reportable and count towards the reporting threshold:

Savings, deposit, checking and other brokerage accounts held with a bank or broker-dealer.

An interest in a foreign entity, any financial instrument or contract held for investment must be reported if issued by someone who is not a U.S. Person.

Examples of reportable investment assets include the following:

- Stock or securities issued by a foreign corporation;
- Notes, bonds or debentures issued by a foreign person;
- Interest rate swap, currency swap, basis swap, interest rate cap, interest rate floor, commodity swap, equity swap, equity index swap, credit default swap or similar agreement with a foreign counterparty;
- An option or other derivative instrument with respect to any of these examples or with respect to any currency or commodity that is entered into with a foreign counterparty, or issuer;
- A partnership interest in a foreign partnership;
- An interest in a foreign retirement plan or a deferred compensation plan;
- An interest in a foreign estate; or
- An interest in a foreign-issued insurance contract or annuity with a cash-surrender value.

The IRS has indicated that the above list of examples is not an exclusive list.

Reporting Requirements for Tangible Assets

Foreign owned real estate is not a specified asset required to be reported unless it is held through an entity. Therefore, unless a U.S. person holds a foreign personal residence and/or foreign rental property through a foreign entity, the value is not reportable.

The IRS has provided guidance regarding the items which do NOT have to be reported on Form 8938. Excluded assets include:

- Foreign currency not held in a financial account;
- Shares of a U.S. mutual fund that owns foreign stocks or securities;
- Financial accounts with a U.S. financial institution that holds foreign stocks and securities;
- Financial accounts with a U.S. branch or U.S. affiliate of a foreign financial institution;
- Right to receive payment from the foreign equivalent of social security or social security benefits or similar programs of a foreign government;
- Art, antiques, jewelry, cars and other collectibles located outside the United States;
- Precious metals held for investment purposes and located outside the United States; and
- Safety deposit box at a foreign financial institution.

If Form 8938 is required, all specified foreign financial assets, regardless of value, must be reported. What this means is that even if the special valuation rules assign a value of "zero" to an asset (as could be the case, for example, with an interest a "specified individual" has in a discretionary foreign non-grantor trust), that asset must be reported once the applicable threshold is met, although it would be reported with a "zero" value. Furthermore, even though ownership of precious metals does not have to be reported, the contract to sell precious metals to a foreign person has to be reported.

A U.S. taxpayer who is not required to file a U.S. tax return is exempt from filing Form 8938.

If a taxpayer has failed to file Form 8938 with their U.S. tax return for 2011, file Form 1040X (amended return), with Form 8938 attached.

Form 8938 and Form TD F 90-22.1

For advisors and U.S. Persons who have become familiar with Form TD F 90-22.1 or "FBAR," they will find a new group of definitions that apply to Form 8938, and, generally a broader range of assets that must be reported. A "specified individual" meeting certain thresholds must file a Form 8938, while a "U.S. Person," meeting certain thresholds must file an FBAR. They will also find different and higher dollar-value thresholds for reporting on Form 8938 than on the FBAR.

Finally, filing Form TD F 90-22.1 and Form 8938, is not mutually exclusive. Often a taxpayer is obligated to file both forms, and frequently the same information has to be reported on both forms. There is some relief for taxpayers who file Forms 3520, 3520-A, 5471, 8621, 8865 or 8891. These taxpayers do not need to duplicate the information provided on these forms, but Part IV of Form 8938 must indicate that these forms have been filed.