

Form 8938

On March 18, 2010, the Foreign Account Tax Compliance Act (“FATCA”) was enacted as part of the Hiring Incentives to Restore Employment (“HIRE”) Act. Section 511 of FATCA creates new Internal Revenue Code Section 6038D. Internal Revenue Code Section 6038D requires specified individuals who own interests in specified foreign financial assets with an aggregate value of more than \$ 50,000 (or such higher value as Internal Revenue Service (“IRS”) prescribes) to report certain information relating to those assets to the IRS by attaching the requested information to their Federal Form 1040, for tax years beginning after March 18, 2010. Internal Revenue Code Section 6038D(h) directs the IRS to issue regulations or other guidance to implement Internal Revenue Code Section 6038D. On December 15, 2011, the IRS issued Draft Form 8938 and Draft Instructions to Form 8938. The Form became final later in the same month and is in accordance with the regulations. This article examines the reporting requirements of Form 8938 <http://www.irs.gov/formspubs/article/0,,id=248113,00.html>.

Specified Individual

The Instructions to Form 8938 define a Specified Individual as:

- A U.S. Citizen.
- An individual who is a **resident alien for any part of the tax year**. However, an individual who becomes or ceases to be a U.S. tax resident during a tax year only must report assets that he or she held during the period that he or she was a U.S. tax resident.
- A nonresident alien who makes an election to be treated as a resident alien for purposes of filing a joint income tax return.
- A nonresident alien who is a bona fide resident of American Samoa or Puerto Rico.

Internal Revenue Code Section 6038D(f) also gives the IRS the power to promulgate regulations requiring domestic entities with interests in specified foreign financial assets to file Form 8938 or an equivalent form. The Instructions to Form 8938 indicate that the IRS intends to issue such regulations; however, at the time of the issuance of Form 8938, only individuals are required file Form 8938.

Specified Foreign Financial Assets Defined

Specified foreign financial assets include the following assets:

1. Any financial account maintained by a foreign financial institution.
2. Other foreign financial assets, which include any of the following assets that are held for investment **and are not held in an account** maintained by a financial institution:

- a. Stocks or securities issued by someone other than a U.S. Person.
- b. Any interest in a foreign entity.
- c. Any financial instrument or contract that has an issuer or counterparty that is other than a U.S. person.

The Reporting Threshold

A taxpayer who is a specified individual is required to file a Form 8938 if the value of the taxpayer's specified foreign financial assets meets the reporting threshold. The reporting threshold for a particular taxpayer **depends on whether the taxpayer files a joint tax return with his or her spouse and whether the taxpayer resides in the U.S. or abroad.**

The Reporting Threshold for Taxpayers Living in the United States

Unmarried taxpayers and married taxpayers filing separate returns who live in the United States are required to file Form 8938 if:

- the **aggregate value** of all of their specified foreign financial assets **exceed \$ 50,000 on the last day of the calendar year**; or
- the **aggregate value** of their specified foreign financial assets **exceed \$ 75,000 on any day during the calendar year.**

Married taxpayers living in the United States and filing a joint return are required to file Form 8938 if:

- the aggregate value of all of their specified foreign financial assets **exceed \$ 100,000 on the last day of the calendar year**; or
- the aggregate value of their specified foreign financial assets **exceed \$ 150,000 on any day during the calendar year.**

The Reporting Threshold for Taxpayers Living Abroad

Unmarried taxpayers and married taxpayers filing separate returns who live **abroad** are required to file Form 8938 if:

- the **aggregate value** of all of their specified foreign financial assets **exceed \$ 200,000 on the last day of the calendar year**; or

- the aggregate value of their specified foreign financial assets **exceed \$ 300,000 on any day during the calendar year.**

Married taxpayers living **abroad** and filing a joint return are required to file Form 8938 if:

- the aggregate value of all of their specified foreign financial assets **exceed \$ 400,000 on the last day of the calendar year;** or
- the aggregate value of their specified foreign financial assets **exceed \$ 600,000 on any day during the calendar year.**

For Form 8938 reporting purposes, taxpayers are considered to be living abroad if they meet the bona fide resident test or the physical presence test of Internal Revenue Code Section 911.

A taxpayer meets the bona fide residence test if the taxpayer can establish that he or she has established a tax home in a foreign country or countries.

A taxpayer meets the physical presence test if the taxpayer can establish that he or she was physically present in a foreign country or countries for at least 330 full days during a 12-month period ending in the tax year for which the Form 8938 is filed.

It is not clear from the Instructions to Form 8938 what reporting threshold a taxpayer must apply if the taxpayer meets the physical presence test for only part of a calendar year.

Specified Foreign Financial Assets Owned Jointly by Spouses

If married taxpayers file a joint return and jointly own specified foreign assets with each other, the taxpayers should include the entire value of the asset on their jointly filed Form 8938 and for purposes of determining whether they meet the filing threshold.

If married taxpayers who file separate tax returns jointly own specified foreign financial assets and both spouses are specified individuals, taxpayers must include one-half of the value of the value of the jointly owned specified foreign financial asset on their separately filed Forms 8938 and for purposes of determining whether each spouse meets the filing threshold.

If married taxpayers jointly own a specified foreign financial asset and one spouse is not a specified individual, the spouse who is a specified individual is required to include the entire value of the jointly owned specified foreign financial asset on his or her Form 8938 and for purposes of determining whether he or she meets the filing threshold.

Specified Foreign Financial Assets Owned Jointly by Unmarried Individuals

If a taxpayer jointly owns specified foreign financial assets with a party or parties who is not his or her spouse or if one of the joint owning spouses is not a specified individual, the taxpayer must include the entire value of the jointly owned specified foreign financial asset on their Form 8938 and for purposes of determining whether he or she meets the filing threshold.

Specified Foreign Financial Assets Owned through Entities

A taxpayer who owns a disregarded entity or a grantor trust (treated as owned by the taxpayer), must include the underlying value of specified foreign financial assets owned by the disregarded entity or grantor trust on Form 8938 and for purposes of determining whether they meet the Form 8938 filing threshold.

Generally, if a taxpayer owns an interest in a partnership, corporation, non-grantor trust (separate entity from the taxpayer) or an estate, which in turn owns an interest in specified foreign financial assets, **such taxpayer is not considered to own an interest in the entity's specified foreign financial assets and is not required to include the value of the entity's assets on his/her Form 8938 and for purposes of determining whether they meet the Form 8938 filing threshold.**

However, taxpayers with interests in foreign partnerships, corporations, non-grantor trusts or foreign estates may be required to include the value of their interest in the entity itself on Form 8938 and for the purposes of determining whether they meet the Form 8938 filing threshold.

Specified Foreign Financial Assets Owned by Minor Children

If a taxpayer files Form 8814 (making a kiddie tax election), and the child for whom the election was made owns an interest in a specified foreign financial asset, the taxpayer must include the value of the child's specified foreign financial asset on their Forms 8938 and for purposes of determining whether they meet the Form 8938 filing threshold.

Valuing Specified Foreign Financial Assets

Taxpayers are permitted to rely on periodic statements to determine a specified foreign financial asset's value unless they have reason to know the statements do not represent a reasonable estimate of the asset's value.

If a taxpayer has an interest in an estate, pension plan or deferred compensation plan and the taxpayer does not know or have reason to know the fair market value of the asset, the taxpayer must report the value of all distributions of cash and property received from the asset during the tax year.

Currency Exchange Rates

If a specified foreign financial asset is denominated in a foreign currency, the value of the asset **must be determined in the foreign currency and then converted to U.S. Dollars using the currency exchange rate on the last day of the tax year.**

Specified Foreign Financial Assets with no Fair Market Value

If the fair market value of a specified foreign financial asset is less than zero, taxpayers must use a value of zero for the asset for purposes of determining whether they meet the reporting threshold and report the value of the asset as \$ 0 on the filed Form 8938.

Duplicative Reporting

Taxpayers are not required to include an asset on their Form 8938, if the taxpayer files one of the following forms with the IRS with respect to the asset:

- **Form 3520 Annual Return to Report Transactions with Foreign Trusts and with Respect to Certain Foreign Gifts**
- **Form 5471 Information Report with Respect to Certain Foreign Corporations**
- **Form 8621 Return by a Shareholder of a Passive Foreign Investment Company or a Qualified Electing Fund**
- **Form 8865 Return of U.S. Person with Respect to Certain Foreign Partnerships**
- **Form 8891 Beneficiaries of Canadian Registered Retirement Plans**

A taxpayer who files the above forms must specify on a Form 8938 the forms on which the asset was reported and the number of each form filed by the taxpayer. The taxpayer must include the value of the specified foreign financial asset reported on the above referenced forms when determining whether the taxpayer meets the Form 8938 filing threshold.

Penalties for Failing to File Form 8938

The IRS can impose a \$ 10,000 civil penalty for failing to file a Form 8938 by the due date.

If the IRS notifies a taxpayer that he or she is required to file a Form 8938 or correct a Form 8938 that the taxpayer previously filed and the taxpayer fails to do so within 90 days, after the 90 days expires there is an additional \$ 10,000 penalty for every 30 day period (or partial period) that the taxpayer fails to file or correct the Form 8938, up to \$ 50,000.

If a taxpayer understates his or her tax liability as a result of a transaction involving an undisclosed specified foreign financial asset, the IRS can impose an **accuracy related penalty of 40% of the underpayment**. If the underpayment is due to fraud, the penalty is increased to 75% of the underpayment.

A taxpayer who fails to file a Form 8938 may also be subject to criminal penalties.

Statute of Limitations

If a taxpayer fails to file a Form 8938 or to include a specified foreign financial asset on a Form 8938, all or a portion of the taxpayer's return will remain open for assessment until three years after the date the taxpayer files the Form 8938.

If a taxpayer fails to include more than \$ 5,000 of income from a specified foreign financial asset on their tax return, tax can be assessed for six years after the tax return is filed. Normally, absent fraud or substantial understatement of income, tax can be assessed for three years following the filing of a tax return.

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