

SMITH CARMICHAEL ASSOCIÉS

NEW FORM FOR 2011!!!

Specified Foreign Financial Assets – Form 8938

The IRS recently released temporary and proposed regulations implementing code § 6038D which requires reporting of a specified foreign financial asset (“SFFA”). This provision was enacted as part of the FATCA provisions of the 2010 Hiring Incentives to Restore Employment Act. It is effective for tax years beginning after March 18, 2010 and therefore individuals should report for 2011 calendar tax years if they meet certain requirements and their interests in SFFAs exceed certain thresholds.

If reporting is required, the taxpayer must disclose its SFFA holdings on **Form 8938 (Statement of Specified Foreign Financial Assets)**, with their U.S. federal income tax return, In addition to the newly issued regulations, the final Form 8938 and Instructions were also recently released.

Who should report? *Specified individuals*

Specified individuals are subject to reporting requirements if they meet certain reporting thresholds described below. The term “specified individual” includes:

- U.S. citizens
- U.S. resident aliens for any part of the tax year. This includes green card holders.

A specified individual is not required to file Form 8938 if he or she is not required to file an annual return with the IRS.

Reporting thresholds

Specified individuals who exceed certain thresholds must report any interest in a SFFA. The regulations provide the following threshold amounts, which generally depend on the filing status (single, Married Filing Joint, and Married Filing Separate) **and where the person is living:**

File Form 8938 if...	Individual lives in the U.S.	
	Total Value of SFFAS during tax year at any time exceeds:	OR, total value of SFFAS on last day of tax year exceeds:
Single	\$75,000	\$50,000
MFJ	\$150,000	\$100,000
MFS	\$75,000	\$50,000

File Form 8938 if...	Individual lives outside the U.S.	
	Total Value of SFFAS during tax year at any time exceeds:	OR, total value of SFFAS on last day of tax year exceeds:
Single	\$300,000	\$200,000
MFJ	\$600,000	\$400,000
MFS	\$300,000	\$200,000

What is a SFFA?

Financial accounts

The temporary regulations define a SFFA as including any financial account maintained by a foreign financial institution. The financial account – not the underlying account assets – should be reported in this case. This category includes any depository or custodial account as well as any equity or debt interest in a foreign financial institution (other than interests that are regularly traded on an established securities market.) Examples may include foreign mutual funds, foreign hedge funds, foreign private equity funds and certain foreign insurance products.

“Other” SFFAs

The temporary regulations provide that certain other assets held for investment –but *not* held in a financial account maintained by a foreign financial institution – are SFFAs for Form 8938 reporting purpose. Such foreign financial assets generally include (i) stock or securities issued by a person other than a U.S. person, (ii) a financial instrument or contract issued by a person other than a U.S. person (e.g., certain options, swaps, or derivatives), and (iii) any interest in a foreign entity (e.g., a capital or profits interest in a foreign partnership.)

--Foreign pensions and deferred compensation plans

One of the most significant clarifications in the temporary regulations is that interests in foreign pension plans and foreign deferred compensation plans typically constitute SFFAs. The temporary regulations provide some guidance but certain questions remain such as whether unvested stock-based compensation awards must be reported. The instructions make clear that these SFFA interests should be reported as “other” SFFAs on Part II of Form 8938 and the underlying assets held by such plans are not reportable.

--Foreign trusts and estates

A SFFA generally includes an interest in a foreign trust or estate. The temporary regulations clarify a favorable exception: An interest in such a trust or estate is not an SFFA unless the person know or has reason to know about the interest based upon information that is readily accessible. The receipt of distributions constitutes actual knowledge for this purpose.

--Foreign social security

The temporary regulations also provide the favorable clarification that an interest in a social security, social insurance, or other similar program of a foreign government does *not* constitute a SFFA;

Who has an “interest”?

The temporary regulations retain the core concept that a specified individual is generally considered to have an interest in a SFFA if any income, gains, losses, deductions, credits, gross proceeds, or distributions attributable to the holding or disposition of the SFFA are or would be required to be reported, included, or otherwise reflected on the individual’s annual return filed with the IRS. This rule remains true even if no income, gains, losses, deductions, credits, gross proceeds, or distributions are actually attributable to the asset for a particular tax year.

An owner of an entity that is disregarded as separate from its owner for U.S. federal tax purposes (so-called “disregarded entities”) is treated as having an interest in any SFFA owned by that entity. In addition, a specified individual who is treated as the owner of a trust or any portion of certain trusts (generally relating to grantor trusts), is treated as having an interest in any SFFA held by the trust (or portion thereof), with certain exceptions for bankruptcy trusts. The temporary regulations expressly provide that a specified individual is not treated as having an interest in any SFFA held by a partnership, corporation, trust, or estate *solely* as a result of the individual’s status as a partner, shareholder, or beneficiary.

Valuation of SFFAs

The values of a SFFA is generally the fair market value, although special rules apply for valuing interests in foreign trusts, estates, pension funds, and deferred compensation plans. For instance, in the case of foreign estates, pension plans, and deferred compensation plans, if the owner does not know or have reason to know the fair market value of the interest during the year based on readily accessible information, the owner is required to treat the value as either the fair market value of all distributions received as a beneficiary or participant (including cash) as of the last day of the year, or if there were no distributions during the year, zero.

Taxpayers should take special notice of Final Form 8938 Part II, which is the section of the form where taxpayers disclose the value of their “other” SFFAs. To help ease administrative burden, this section includes the ability to disclose the value of these assets in ranges of \$50,000 increments where such assets are valued at less than \$200,000.

Periodic account statements

The maximum value of a financial account means a reasonable estimate of the maximum value of the holdings of the financial account at any time during the taxable year.

Joint ownership

Generally, the joint owners of a SFFA each include the full value of such asset in determining whether the reporting threshold is satisfied. Each joint owner generally reports the entire value of the asset when they must report maximum value. Special rules apply for married individuals, e.g., if they are filing a joint return, they must take into account the value of a jointly owned asset only once.

Conversion to U.S. dollars

Assets denominated in foreign currency must be converted to U.S. dollars according to guidance in the instructions, generally using the U.S. treasury Department’s Financial Management Service foreign currency exchange rates (www.fms.treas.gov/intn.html.) When calculating the maximum value of a SFFA, the currency determination date is generally the exchange rate on the last day of the tax year, even in the event a SFFA is disposed of prior to the end of the tax year.

Tracing requirements

In addition to reporting the SFFAs and their values, the final Form 8938 also requires taxpayers to summarize the tax items attributable to SFFAs. Individuals must trace and report the tax items such as interest, dividends, gains, credits, or deductions (if any) that correspond to the specific financial account or other SFFA that is being disclosed. In addition, the individual must list which form, schedule, and line these tax items are otherwise reported.

The temporary regulations provide that a taxpayer meeting the filing threshold need not report a SFFA on Form 8938 in the event that such taxpayer has reported it on other forms for the same tax year. The following forms would qualify for this “duplicative reporting” exception:

Duplicative reporting___Reporting on other IRS forms

- Form 3520: *Annual Return to Report Transactions with Foreign Trusts and Receipt of Foreign Gifts*
- Form 3520-A: *Annual Information Return of Foreign Trust with a U.S. Owner*
- Form 5471: *Information Return of U.S. Persons 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. Persons with respect to Certain Foreign Partnerships*

If a specified individual meets the thresholds described above, he or she is still required to file Form 8938 and must disclose what other report was filed.

FBAR: MORE DUPLICATE REPORTING !

The temporary regulations anticipate situations where SFFAs may have to be reported both on Form 8938 and Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (so-called “FBAR” form.)

Penalty and statute of limitation consideration

FAILURE TO FILE PENALTY

Failure to file the Form may result in a penalty of up to **\$60,000!**

PENALTY ON UNDERPAID TAX

If an underpayment of income tax is attributable to an undisclosed SFFA, the accuracy related penalty may be assessed up to 40% of the underpaid tax.

LONGER STATUTE OF LIMITATIONS

The normal statute of limitations on an income tax return is 3 years (generally speaking). However, if a taxpayer has failed to file the Form 8938, the statute of limitations will remain open indefinitely with respect to the entire tax return. In the case that failure is due to reasonable cause and not willful neglect, the statute of limitations on assessment will remain open only with respect to the item that is not properly reported.

The Bottom Line

Compliance with these new reporting requirements will likely require a much greater administrative burden than anticipated for taxpayers and their advisors. A significant amount of time and effort may need to be incurred in order to perform due diligence and gather data from third parties regarding the identification of SFFAs, determining the value of any SFFA, and analyzing whether the individual surpasses the thresholds to file and disclose. The reporting on Form 8938 itself will demand additional time and effort not only to simply disclose the details of the SFFAs but also to comply with the other requirements of the forms. The tracing section under Part III may be particularly time consuming.

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