

FOREIGN FINANCIAL ASSET REPORTING EXPANDED FOR 2011 FILINGS

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Taxpayers with foreign financial assets should be aware that tax reporting in 2011 doesn't end with FBAR (U.S. Treasury Form 90-22.1, Report of Foreign Bank Accounts). Instead, certain individuals will need to attach the new Form 8938, Statement of Specified Foreign Financial Assets, to Form 1040 this tax season, in addition to filing the FBAR.

The HIRE Act, enacted March 18, 2010, requires expanded reporting for citizens, resident aliens and certain residents of U.S. territories having ownership in specified foreign assets exceeding an aggregate value threshold. Form 8938 is required for affected individual filers beginning with their 2011 returns and will be required in later years for affected domestic entities.

FBAR and Form 8938 differ with respect to categories of required filers, filing thresholds, types of foreign financial assets reported, and rules for valuation and currency conversion. An exception from filing Form 8938 exists for individuals who are not otherwise required to file an income tax return even if their ownership exceeds the applicable reporting threshold.

Filing thresholds vary, with the lowest threshold being \$50,000. Filing is required where an affected individual has an interest in one or more specified foreign assets having an aggregate fair market value exceeding either \$50,000 on the last day of the year or \$75,000 at any time during the year. In the case of married individuals filing a joint return, the aggregate values are applied to all specified assets in which either spouse has an interest and are doubled to \$100,000 and \$150,000, respectively. For qualified individuals residing outside of the U.S., the threshold is \$200,000 on the last day of the year or \$300,000 at any time during the year. For married individuals filing a joint return and residing outside of the U.S., the thresholds are \$400,000 and \$600,000, respectively.

The definition of an interest in a foreign financial asset is paired to the associated income subject to U.S. tax. Under this circular definition, a financial interest is deemed to exist if there is a tax item attributable to that ownership interest. A tax item includes any income, gain, loss, deduction, credit, gross proceeds, or distribution attributable to the holding or disposition of the asset that is required to be reported or included on the individual's U.S. income tax return (or would be reported except for the fact that there was no income, deduction, etc. attributable to the asset for a particular year). Form 8938 even requires a mapping of the reported foreign asset to the location of the associated tax item on the individual's 1040.

Similar to FBAR, reportable assets include any financial or custodial account maintained by a foreign financial institution. Unlike FBAR, reportable assets include any stock or security issued by a non-U.S. person, any financial instrument or contract held for investment having a non-U.S. issuer or counterparty, and any interest in a foreign entity. This expanded reporting captures foreign investment regardless of percentage of ownership, any debt issued by a foreign person, "known" interests in foreign trusts and estates (to the extent distributions are received or the taxpayer knows or has reason to know of its existence), currency and interest swaps involving foreign persons, and interests in foreign pension or deferred compensation plans.

Reporting includes ranges of maximum values using somewhat lenient valuation rules. Independent appraisals are not required. For foreign-denominated currencies, the maximum value is to be determined in foreign currency and then converted to U.S. dollars using last day of the year U.S. Treasury-published rates (www.fms.treas.gov/intn.html). In determining maximum values for financial accounts, reliance may be given to values indicated on periodic or annual statements unless there is reason to believe more reliable, accessible information is available (such as for publically traded stocks). Year-end values may also be used in the case of other financial assets where more reliable, accessible information is not known. Accounts with no positive value are to be reported at zero.

Name, address, and account information for reportable financial assets is required along with other information not currently on FBAR. Additional disclosures include whether the account was opened or closed during the year and whether an asset was acquired or disposed of. Some good news -- individual asset reporting may be waived where there is duplicative reporting on other international forms, such as Forms 3520, 5471, 8621, 8865, or 8891.

Failure to file a complete Form 8938 when required to do so subjects the individual to a \$10,000 penalty. A continuing \$10,000 failure-to-file penalty may be assessed for each 30 day period an affected individual fails to file or correct a filing after being notified by the IRS. The maximum penalty is \$50,000. For purposes of penalty assessment, the Commissioner may presume that the aggregate threshold is exceeded if insufficient information is provided.

Failure to file a complete Form 8938 may also extend the statute of limitations for income tax. The statute of limitations is extended to three years after the date of filing of Form 8938 or an amendment. In addition, the statute of limitations is extended to six years after filing Form 1040 if there is an omission of more than \$5,000 in gross income from a specified foreign financial asset (even if the asset is reported on Form 8938). A reasonable cause exception allows for waiver of penalties absent willful neglect.

Reporting for affected domestic entities will be effective upon issuance of temporary regulations under §1.6038D-6T.

December 20, 2011