

## **Form 8938, Statement of Specified Foreign Financial Assets (November 2011)**

It is a new reporting requirement for tax year 2011. Part of the Foreign Account Tax Compliance Act ("FATCA") of 2010

### General Test for filing Form 8938

In order for the requirement to file Form 8938 to arise, a three- prong test must be satisfied:

- (1) The taxpayer must be a "specified individual",
- (2) The specified individual must own (or hold an interest in) "specified foreign financial assets";  
and
- (3) The value of those assets must exceed the applicable reporting threshold

If the taxpayer meets all three prongs of the test, then he must file Form 8938 together with his annual income tax return

A taxpayer is considered a "specified Individual" if he is a:

- (1) U.S Citizen
- (2) Resident alien of the United States for any part of the tax year
- (3) Nonresident alien who makes an election to be treated as a resident alien for purposes of filing a joint income tax return
- (4) Nonresident alien who is a bona fide resident of America Samoa or Puerto Rico.

A taxpayer is a resident alien for US tax purposes under the green card test or the substantial presence test. If you qualify as a resident alien under either rule, you are a "specified individual" even if you elect to be taxed as a resident of a foreign country under the provisions of a U.S. income tax treaty. If you have to file Form 8938, attach it to Form 1040NR

The IRS anticipates issuing further guidance that will include a specified domestic entity in the definition of a specified person, requiring certain U.S. entities to file.

### Specified Foreign Financial Asset

A specified foreign financial asset is defined as any: (1) financial account maintained by a foreign financial institution and, (2) to the extent not held in an account at a financial institution:

- any stock or security issued by person other than a United States person (non U.S. Persons)
- an interest in a foreign entity,
- any financial instrument or contract held for investment that has an issuer or counterparty that is not a United States Person

The IRS instructions specifically list the following investment vehicles as "foreign financial institutions": foreign mutual funds, foreign hedge funds and foreign private equity funds.

Foreign social security – an interest in a social security, social insurance or other similar program of a foreign government is not a specified foreign financial asset

#### Other Specified Foreign Financial Assets

Examples of other specified foreign financial assets include the following, if they are held for investment and not held in a financial account

- Stock issued by a foreign corporation
- A capital or profits interest in a foreign partnership
- A note, bond, debenture, or other form of indebtedness issued by a foreign person
- An interest in a foreign trust or foreign estate
- An 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 of these examples or with respect to any currency or commodity that is entered into with a foreign counterparty or issuer
- Foreign pension plan or foreign deferred compensation plan

#### Mapping of Foreign Assets

- The definition of an interest in a foreign financial asset is paired to the associated income subject to U.S. tax. A financial interest is deemed to exist if there is a tax item attributable to that ownership interest. A tax item includes any income, gains, losses, deductions, credits, gross proceeds or distributions attributable to the holding or disposing of the asset are that is required to be reported or included on the individual's US. Income tax return (or would be reported be reported except for the fact that 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 individuals' 1040. See Part III, Summary of Tax Items Attributable to Specified Foreign Assets.

- Disregarded entities – If you are the owner of a disregarded entity, you have an interest in any specified foreign financial asset owned by the disregarded entity.
- A specified person is not generally treated as having an interest in any specified foreign financial assets held by a partnership, corporation, trust (with some exceptions), or estate solely as a result of the specified person's status as a partner, shareholder, or beneficiary.
- A parent that makes an election to include certain unearned income of a child (kiddie tax) in the parent's gross income required to be reported for taxable income has an interest in any specified foreign financial asset held by the child.
- Jointly owned assets – a joint owner of an asset has an interest in the entire asset. In general, each joint owner includes the full value of the jointly owned asset for purposes of determining

whether the aggregate value of all specified foreign financial assets in which the joint owner has an interest exceeds the reporting thresholds

The reporting thresholds are dependent on the taxpayers' filing status as outlined below:

Filing Status	Value on the Last day of the year is at least:	Or, at any time during the tax year, the value is greater than
Unmarried taxpayers living in the U.S.	\$50,000	\$100,000
Married taxpayers filing jointly living in the U.S.	\$100,000	\$200,000
Married taxpayers filing separately living in the U.S. \$100,000	\$50,000	\$100,000
Taxpayers not filing a joint return living abroad that are bona fide residents of a foreign country or that are present in foreign countries for 330 full days during a 12-month period	\$200,000	\$ 400,000
Married taxpayers filing jointly who live abroad and are bona fide residents of a foreign country or that are present in foreign countries for 330 full days during a 12-month period	\$400,000	\$600,000

Valuation

- Use the currency exchange rate on the last day of the year to figure the maximum value of a specified foreign financial asset for purposes of determining the maximum value for the reporting threshold. Use this rate even if you sold or otherwise disposed of the specified foreign financial asset before the last day of the year.
- Valuing financial accounts - You may rely on periodic account statements for the tax year to report a financial account's maximum value unless you know or have reason to know based on readily accessible information that the statements do not reflect a reasonable estimate of the maximum account value during the tax year.
- Valuing other specified foreign financial assets- value as of the last day of the year. A reasonable estimate is all that is required. An appraisal is not required.
- Valuing interests in foreign trusts – beneficiary of a foreign trust, (if you do not know or have reason to know based on readily accessible information), the fair market value is the maximum value of your interest in the trust determined as the sum of the following amounts.
  - (1) The value of all of the cash or other property distributed during the tax year from the trust to you as a beneficiary, and
  - (2) The value using the valuation tables under Section 7520 of your right as a beneficiary to receive mandatory distributions as of the last day of the year

- Valuing of an interest in a foreign estate, foreign pension plan, and foreign deferred compensation - if you do not know or have reason to know based on readily accessible information the fair market value during the year, the value to be included is the fair market value, determined as of the last day of the year, of the currency and any other property distributed during the tax year to the specified person as a beneficiary or participant. If you received no distributions during the tax year and do not know or have reason to know based on readily accessible information the fair market value of your interest, use a value of zero for the interest

Excepted Specified Foreign Financial Assets – Not reported on Form 8938, but still subject to reporting threshold test

- Certain specified foreign financial assets are excepted from reporting obligations imposed under Section 6038D. Assets reported by an individual on forms:
  - 5471 & 8621 - ownership of a foreign corporation
  - 3520 & 3520-A - interest in a foreign trust or estate (Foreign Grantor Trust below), and
  - 8865 (interest in a foreign partnership)
  - 8891 – Canadian retirement plan, check the box for Form 3520 and enter how many Forms you filed

that are timely filed with the IRS are not required to file Form 8938, but if a specified person is required to file Form 8938, the number of such other forms filed with the IRS must be reported on Form 8938.

- In addition, the value of specified foreign financial assets that qualify for this exception is included for purposes of determining whether the aggregate value of specified foreign financial assets in which a specified individual has an interest exceeds the applicable reporting threshold.
- Foreign grantor trusts - if you are considered the owner under the grantor trust rules of any part of a foreign trust, YOU DO NOT HAVE to report any of the specified foreign financial assets held by the part of the trust you are considered to own if you satisfy the following conditions.
  - You report the trust of a Form 3520 that you timely file with the IRS for the same tax year
  - The trust timely files Form 3520-A. with the IRS for the same tax year
  - Instead you must identify on Form 8938 how many of these forms you filed in Part IV.

Excepted Specified Foreign Financial Assets – Not reported on Form 8938 and not subject to the reporting threshold test

- The owner or grantor of a domestic investment trust or bankruptcy trust. (if the trust owns/holds specified foreign financial assets).
- Additionally, certain assets (organized or held in an account in a US possession) by a specified individual who is a bona fide resident of a U.S possession.

A beneficial interest in a foreign trust or foreign estate is not a specified foreign financial asset of a specified person unless the specified person knows or has reason to know based on readily accessible information of the interest. Receipt of a distribution from the foreign trust or foreign estates is deemed for this purpose to be actual knowledge

Penalties-

- Form 8938 must be attached to the taxpayer's annual tax return. As with the Foreign Bank Account Report ("FBAR"), the civil penalties for not filing Form 8938 are severe, including a penalty of \$10,000 (and a penalty up to \$50,000 for continued failure after IRS notification). Also, criminal penalties may apply.
- Further, underpayment of tax attributable to non-disclosed foreign financial assets will be subject to an additional substantial understatement penalty of 40 percent.
- In addition to the penalties, the statute of limitations for assessing tax will not begin until Form 8938 is filed and the statute increases from three to six years if gross income is understated by \$5,000 or more.
- A taxpayer is not required to file Form 8938 for any taxable year for which such person is not required to file an annual income tax return with the IRS.

Legal and professional concerns –

- Return preparers may have to refer clients to tax counsel once the return preparer discovers the existence of unreported foreign holdings, in order to preserve attorney client privileges. The absence of a specific voluntary disclosure program, like the 2009 OVDP and 2011 OVDI means that taxpayers may now have to apply to enter the general voluntary disclosure program or make a decision to file returns and make a reasonable cause argument for penalty abatement
- Form 8938 may have income tax and estate and gift tax consequences.
- By implementing Form 8938, the IRS has tremendously expanded its reach not only with respect to the types of foreign financial assets that need to be reported, but also who must report them.

**Form 8938 vs. FBAR – Foreign Bank Account Reporting**

- The filing requirement of Form 8938 does not alleviate the need for a taxpayer to file an FBAR (Form TD F 90-22.1). The foreign financial accounts that are required to be reported on Form 8938 parallel the financial accounts reported on the FBAR. The thresholds for the Form 8938 are higher than those for the FBAR, but the financial asset rules apply to more persons and to

more types (foreign stock and securities and interests in foreign entities). Form 8938 also looks only at direct ownership of foreign financial accounts and does not require disclosure of signature or other authority.

- *Foreign real estate* – if you hold foreign real estate directly, there is no reporting requirement. However, certain countries like Mexico require that foreign citizens cannot hold property directly and must hold real estate through trusts (a fideicomiso in Mexico) or a local entity. If held through such an entity it would appear that a filing requirement would exist. Foreign real estate held through a foreign trust or entity would not be reportable on the FBAR.
- *Foreign life insurance or annuity policies* – would appear to require reporting as they would be considered a financial contract issued by someone other than a U.S. person.
- Precious metal investments held through a foreign financial account also would require reporting. However, precious metals held in a foreign safe deposit box, private vault, or buried abroad would not be reportable.

For Additional Information Contact:

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# Statement of Specified Foreign Financial Assets

OMB No. 1545-2195

▶ See separate instructions    ▶ Attach to your tax return

Attachment  
Sequence No. 175

If you have attached additional sheets, check here

Name(s) shown on return	Identifying number
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Number, street, and room or suite no. (if a P.O. box, see instructions)

City or town, province or state, and country (including postal code)

For tax year beginning \_\_\_\_\_, 20\_\_\_\_, and ending \_\_\_\_\_, 20\_\_\_\_

**Note.** All information must be in English. Show all amounts in U.S. dollars. Show currency conversion rates in Part I, line 6(2), or Part II, line 6(2).

**Type of filer**

- a Specified individual    (1)  Married filing a joint return    (2)  Other individual  
b Specified domestic entity    (1)  Partnership    (2)  Corporation    (3)  Trust    (4)  Estate

Check this box if this is an original, amended, or supplemental Form 8938 for attachment to a previously filed return . . . . .

**Part I Foreign Deposit and Custodial Accounts** (see instructions)

If you have more than one account to report, attach a continuation sheet with the same information for each additional account (see instructions).

1 Type of account <input type="checkbox"/> Deposit <input type="checkbox"/> Custodial	2 Account number or other designation
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3 Check all that apply    a  Account opened during tax year    b  Account closed during tax year  
c  Account jointly owned with spouse    d  No tax item reported in Part III with respect to this asset

4 Maximum value of account during tax year . . . . . \$

5 Did you use a foreign currency exchange rate to convert the value of the account into U.S. dollars? . . .  Yes     No

6 If you answered "Yes" to line 5, complete all that apply.

(1) Foreign currency in which account is maintained	(2) Foreign currency exchange rate used to convert to U.S. dollars	(3) Source of exchange rate used if not from U.S. Treasury Financial Management Service
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7 Name of financial institution in which account is maintained

8 Mailing address of financial institution in which account is maintained. Number, street, and room or suite no.

9 City or town, province or state, and country (including postal code)

**Part II Other Foreign Assets** (see instructions)

**Note.** If you reported specified foreign financial assets on Forms 3520, 3520-A, 5471, 8621, or 8865, you do not have to include the assets on Form 8938. You must complete Part IV. See instructions.

If you have more than one asset to report, attach a continuation sheet with the same information for each additional asset (see instructions).

1 Description of asset	2 Identifying number or other designation
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3 Complete all that apply  
a Date asset acquired during tax year, if applicable . . . . .  
b Date asset disposed of during tax year, if applicable . . . . .  
c  Check if asset jointly owned with spouse    d  Check if no tax item reported in Part III with respect to this asset

4 Maximum value of asset during tax year (check box that applies)  
a  \$0 - \$50,000    b  \$50,001 - \$100,000    c  \$100,001 - \$150,000    d  \$150,001 - \$200,000  
e If more than \$200,000, list value . . . . . \$

5 Did you use a foreign currency exchange rate to convert the value of the asset into U.S. dollars? . . .  Yes     No

**Part II Other Foreign Assets (continued)**

**6** If you answered "Yes" to line 5, complete all that apply.

(1) Foreign currency in which asset is denominated	(2) Foreign currency exchange rate used to convert to U.S. dollars	(3) Source of exchange rate used if not from U.S. Treasury Financial Management Service
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**7** If asset reported in Part II, line 1, is stock of a foreign entity or an interest in a foreign entity, report the following information.

- a Name of foreign entity \_\_\_\_\_
- b Type of foreign entity (1)  Partnership (2)  Corporation (3)  Trust (4)  Estate
- c  Check if foreign entity is a PFIC
- d Mailing address of foreign entity. Number, street, and room or suite no. \_\_\_\_\_
- e City or town, province or state, and country (including postal code) \_\_\_\_\_

**8** If asset reported in Part II, line 1, is not stock of a foreign entity or an interest in a foreign entity, enter the following information for the asset.

**Note.** If this asset has more than one issuer or counterparty, attach a continuation sheet with the same information for each additional issuer or counterparty (see instructions).

- a Name of issuer or counterparty \_\_\_\_\_  
Check if information is for  Issuer  Counterparty
- b Type of issuer or counterparty (1)  Individual (2)  Partnership (3)  Corporation (4)  Trust (5)  Estate
- c Check if issuer or counterparty is a  U.S. person  Foreign person
- d Mailing address of issuer or counterparty. Number, street, and room or suite no. \_\_\_\_\_
- e City or town, province or state, and country (including postal code) \_\_\_\_\_

**Part III Summary of Tax Items Attributable to Specified Foreign Financial Assets (see instructions)**

Asset Category	Tax Item	Amount reported on form or schedule	Where reported	
			Form and line	Schedule and line
I. Foreign Deposit and Custodial Accounts	a Interest	\$		
	b Dividends	\$		
	c Royalties	\$		
	d Other Income	\$		
	e Gains (losses)	\$		
	f Deductions	\$		
	g Credits	\$		
II. Other Foreign Assets	a Interest	\$		
	b Dividends	\$		
	c Royalties	\$		
	d Other Income	\$		
	e Gains (losses)	\$		
	f Deductions	\$		
	g Credits	\$		

**Part IV Excepted Specified Foreign Financial Assets (see instructions)**

If you reported specified foreign financial assets on the following forms, check the appropriate box(es). Indicate number of forms filed. You do not need to include these assets on Form 8938 for the tax year.

- 3520 Number of forms \_\_\_\_\_
- 3520-A Number of forms \_\_\_\_\_
- 5471 Number of forms \_\_\_\_\_
- 8621 Number of forms \_\_\_\_\_
- 8865 Number of forms \_\_\_\_\_