

# “What keeps you up at night?”

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## IRS issues instructions and form for reporting foreign financial assets

By Harry D. Shapiro and Elizabeth A. Mullen

### SUMMARY

**Under new IRS reporting requirements, U.S. taxpayers with specified foreign financial assets that exceed certain thresholds must report those assets using a complex new form, Form 8938. Those who have this filing obligation and fail to file Form 8938 with their Form 1040 may face substantial penalties.**

In March 2010, Congress enacted the Foreign Account Tax Compliance Act (“FATCA”) and added its provisions to the Internal Revenue Code (the “Code”) as new Section 6038D. FATCA is an important reporting and withholding regime designed to improve tax compliance involving foreign financial assets and offshore accounts. Under FATCA, certain U.S. taxpayers with specified foreign financial assets that exceed certain thresholds must report those assets to the IRS. This reporting will be made on Form 8938, *Statement of Specified Foreign Financial Assets*, which taxpayers must attach to their federal income tax returns starting this tax filing season.

Following Treasury’s proposed regulations under Code Section 6038D, the IRS has recently posted Form 8938 with instructions on its website. This alert explains some of the key provisions and filing requirements.

### WHO IS REQUIRED TO FILE?

As explained in more detail below, a U.S. taxpayer must file Form 8938 if:

- 1) The taxpayer is “specified individual,”
- 2) The taxpayer has an interest in a “specified foreign financial asset,” and
- 3) The aggregate value of the taxpayer’s specified foreign financial assets exceeds the applicable reporting threshold.

**Specified Individuals**

For purposes of FATCA, a “specified individual” includes:

- a) A U.S. citizen,
- b) A resident alien of the U.S. for any part of the tax year,
- c) A nonresident alien who makes an election to be treated as resident alien for purposes of filing a joint income tax return, or
- d) A nonresident alien who is a bona fide resident of American Samoa or Puerto Rico.

Upon issuance of final regulations, FATCA may require reporting by specified domestic entities. However, for the moment, only specified individuals are required to file Form 8938.

**Specified Foreign Financial Asset**

For purposes of FATCA, a “specified foreign financial asset” includes:

- a) Any financial account maintained by a foreign financial institution (with a few exceptions explained below)
- b) Other foreign financial assets held for investment that are not in an account maintained by a financial institution, namely:
  - i. stock or securities issued by a non-U.S. person,
  - ii. any interest in a foreign entity, and
  - iii. any financial instrument or contract that has as an issuer or counterparty a non-U.S. person.

A specified foreign financial asset does not include:

- a) a financial account maintained by a U.S. payee (including a domestic branch of a foreign bank or foreign insurance company),
- b) a foreign branch or a foreign subsidiary of a U.S. financial institution.

Duplicative reporting relief is provided for those filing Forms 3520, 5471, 8621, 8865 and 8891. Taxpayers who file one of these other forms are only required to provide the identifying information requested on Form 8938 (at the top of the form, above Part I) and disclose the number of such other forms that have been filed.

**Aggregate Value Threshold**

Finally, Form 8938 reporting is required if the taxpayer’s foreign financial assets meet the following thresholds:

- a) Unmarried taxpayers (and married taxpayers filing separate income tax returns) living in the U.S. If the total value of the taxpayer’s 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.
- b) Married taxpayers filing a joint income tax return and living in the U.S. If the total value of the taxpayers’ 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.
- c) Certain taxpayers living abroad:
  - i. If the taxpayer files a return other than a joint return and the total value of the taxpayer’s 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
  - ii. If the taxpayer files a joint return and the value of the taxpayer’s specified foreign asset is more than \$400,000 on the last day of the tax year or more than \$600,000 at any time during the year.

The Instructions to Form 8938 and the proposed Treasury Regulations under Code Section 6038D each provide a detailed explanation of the valuation methods to be employed for different types of foreign financial assets.

## WHEN TO FILE FORM 8938

Form 8938 reporting applies for specified foreign financial assets in which the taxpayer has an interest in taxable years starting after March 18, 2010. For most individual taxpayers, this means they will start filing Form 8938 with their 2011 income tax return to be filed this coming tax filing season.

## FAILURE TO FILE

Taxpayers may be subject to a \$10,000 penalty if they fail to file a correct Form 8938 by the time they file their Form 1040, including extensions. If a correct and complete Form 8938 is not filed within 90 days after the IRS mails a notice of the failure to file, the taxpayer may be subject to an additional \$10,000 penalty for each 30-day period (or portion thereof) up to a maximum of \$50,000, during which the failure continues. It is worth noting that liability for penalties is joint and several for married taxpayers who file a joint return; but, there is a reasonable cause exception. If the taxpayers underpay their tax as a result of a transaction involving an undisclosed specified foreign asset on the Form 8938, the persons may be subject to a 40 percent accuracy related penalty. There are increased penalties for fraud and criminal penalties for egregious circumstances.

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Once taxpayers conclude that they have a Form 8938 filing obligation, they will likely be overwhelmed by the quantity of information required by the Form. We are in a position to advise clients regarding compliance with this reporting aspect of FATCA and welcome your inquiries regarding the reporting thresholds and preparation of the form itself. We urge your clients to address these issues now in order to complete reporting during this tax filing season.

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