

## New IRS Foreign Asset Disclosure Requirements

The Internal Revenue Service (IRS) recently issued guidance relating to the new requirement for individuals to report ownership of "specified foreign financial assets." This reporting requirement is part of the Hiring Incentives to Restore Employment (HIRE) Act, which became law on March 18, 2010. 2011 will mark the first year for which reporting is required. Those required to make the disclosures must file a new IRS form, Form 8938, with their 2011 Form 1040. In short, foreign investment-type assets must be disclosed if the value of such assets owned by the taxpayer exceeds certain thresholds, which vary depending upon whether the taxpayer files a joint return and whether the taxpayer lives in the United States or abroad.

### To Whom do the New Reporting Requirements Apply?

Individuals who are required to report ("specified persons") include U.S. citizens, resident aliens, and certain foreign individuals. When final treasury regulations are issued, reporting also will be required by certain closely held domestic corporations, partnerships and trusts.

### What Types of Assets Must be Disclosed?

The scope of assets required to be reported, called "specified foreign financial assets," is extremely broad. These assets include, but are not limited to, foreign bank and brokerage accounts, interests in offshore hedge funds, mutual funds and private equity funds, and, to the extent held for investment and not held in an account maintained by a financial institution, foreign stocks and securities, financial instruments issued by a non-U.S. person, and any other interest in a foreign entity. There are a few exceptions to these far-reaching disclosure requirements for assets used in a specified person's trade or business and assets subject to mark-to-market accounting.

In general, for 2011, specified foreign financial assets held by a domestic corporation, partnership, trust or estate do not need to be reported by the specified persons who own interests in those entities. However, once regulations are finalized, those domestic entities may have to report such assets under certain circumstances.

Disclosure of specified foreign financial assets is required regardless of the specified person's ownership percentage of such assets, in contrast to reporting requirements already in effect that, for example, might only apply if a taxpayer owned 10% of the foreign entity.

The Form 8938 filing requirement does not take the place of a specified person's obligation to file an FBAR (Foreign Bank Account Report, Treasury Form TD F 90-22.1) to report a financial interest in or signature authority over a foreign financial account. There will be duplicate reporting for the same foreign bank account or brokerage account, for example, or for the same foreign entity if certain ownership requirements (for purposes of the FBAR) are met. There are special rules in place to deal with duplicative IRS reporting, such as reporting on Forms 8865, 5471, 8621 and 3520.

## Reporting Thresholds

The reporting requirements apply to individuals who hold, in the aggregate, specified foreign financial assets whose value exceeds \$50,000 on the last day of the taxable year, or \$75,000 at any time during the taxable year. These thresholds are doubled for married taxpayers filing jointly.

For individuals living abroad who meet certain requirements, the threshold is increased to \$200,000 on the last day of the taxable year, or \$300,000 at any time during the taxable year. Those increased thresholds are, in turn, doubled in the case of joint filers who live abroad.

If a specified person is a joint owner of a specified foreign financial asset, then the entire value of the asset – not 50% – is included in the determination of whether the filing thresholds are met. This rule does not apply to a married couple that jointly files Form 8938; in that case, the jointly held asset in that case is counted only once. Special valuation rules apply to interests in foreign trusts, estates, pension plans and deferred compensation plans.

## Penalties for Failure to Report

A \$10,000 penalty applies for failure to report specified foreign financial assets on Form 8938. Increased penalties apply if the IRS notifies the taxpayer of the failure and the taxpayer does not respond. The penalty does not apply in the case where the taxpayer can show the failure to file was due to reasonable cause. Accuracy-related penalties of up to 40% may also apply if a specified person underpays his or her tax as a result of a transaction involving a specified foreign financial asset not reported on Form 8938. In addition, failure to report on Form 8938 may extend the statute of limitations for the relevant tax year. These penalties are in addition to any penalties that might apply for failure to report on an FBAR. ♦

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**If you would like more information about this alert, please contact one of the following attorneys or call your regular Patterson contact.**

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