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IRS Chart Clarifies Separate Form 8938 and FBAR Reporting Requirements

As part of the Hiring Incentives to Restore Employment (HIRE) Act, the Foreign Account Tax Compliance Act established a new and distinct foreign asset disclosure regime under Section 6038D requiring specified persons that hold interests in “specified foreign financial assets” to attach Form 8938, the “Statement of Specified Foreign Financial Assets,” to the person’s annual federal tax or information return reporting certain information if the aggregate value of those assets exceeds certain threshold amounts. The new form is required to be filed in 2012 with respect to the 2011 year. Taxpayers will be required to file Form 8938 in addition to Form TD 90-22.1, the “Report of Foreign Bank and Financial Accounts” (FBAR), if required. The FBAR is used by U.S. persons to report certain financial interests in or signature or other authority over a foreign financial account maintained with a financial institution.

The new filing requirement and the new Form 8938 have been criticized as creating confusion with the FBAR form in terms of required disclosures and in creating unnecessary duplication. According to the IRS, different policy considerations apply to Form 8938 and FBAR reporting, which are reflected in the different categories of persons required to file Form 8938 and the FBAR, the different filing thresholds for Form 8938 and FBAR reporting, and the different assets (and accompanying information) required to be reported on each form. Although certain information must be reported on both Form 8938 and the FBAR, the information required by the forms is not identical in all cases, and reflects the different rules, key definitions and reporting requirements applicable to Form 8938 and FBAR reporting. Therefore, in an effort to clarify the ever more complicated reporting requirements for reporting foreign assets, the IRS recently published a chart to help taxpayers understand the key differences in filing Form 8938 and the FBAR.

Points of Comparison between the FBAR and Form 8938.

Persons required to file Form 8938 include U.S. citizens, U.S. resident aliens, certain nonresident aliens and certain domestic entities that are formed or availed of for purposes of holding specified foreign financial assets (reporting by specified domestic entities is not required until Prop. Reg. §1.6038D-6 is issued as a final regulation, which is expected later this year). Persons that are required to file the FBAR include U.S. citizens, U.S. resident aliens and U.S. entities including corporations, partnerships, limited liability companies, trusts and estates. In some cases, bona fide residents of a U.S. territory, Puerto Rico or a Section 931 possession may not be required to file Form 8938. However, bona fide residents of a U.S. territory, Puerto Rico or a Section 931 possession are not granted any exception from filing an FBAR.

If a taxpayer is subject to Section 6038D, the taxpayer must attach Form 8938 to his or her annual federal tax return. This is unlike the FBAR, which is filed directly with the Treasury office in Detroit and not attached to the filer’s return (although a holder of a foreign bank account must report the account on his or her U.S. income tax return). Reporting on the new Form 8938 is effective for tax years beginning after March 18, 2010. Therefore, most individual taxpayers are subject to the rules beginning with their 2011 tax year for the first time. Form 8938 is due by the due date for the individual’s income tax return, including any extensions. The FBAR, on the other hand, must be received by June 30 and no extensions of time to file the FBAR are allowed.

Section 6038D requires that a specified individual holding an interest in a “specified foreign financial asset” during the tax year must attach to his or her tax return certain information for each such asset if the fair market value of all such assets exceeds \$50,000 *on the last day* of the tax year or \$75,000 *at any time during the tax year* and higher thresholds for the following categories of persons:

- married specified individuals filing a joint annual return—\$100,000 on the last day or \$150,000 at any time,
- specified individuals who qualify as living abroad under Section 911(d)(1)—\$200,000 on the last day or \$300,000 at any time, and
- specified married individuals who file a joint annual return and either spouse qualifies as living abroad under Section 911(d)(1)—\$400,000 on the last day or \$600,000 at any time.

The Form 8938 filing thresholds are evaluated on the last day of the tax year *and* at any time during the year. On the other hand, the FBAR filing threshold is met if the aggregate value of the foreign financial accounts exceeds \$10,000 at any time during the tax year.

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All of the following are considered "specified foreign financial assets" for purposes of filing Form 8938:

- a depository, custodial or other financial account maintained by a foreign financial institution;
- a stock or security held for investment and issued by a person other than a U.S. person;
- a financial instrument or contract held for investment that has an issuer or counterparty other than a U.S. person; and
- an interest in an entity that is not a U.S. person that is held for investment.

The scope of assets to be reported on Form 8938 is significantly broader than those that must be reported on the FBAR. Interests held in offshore hedge funds, for example, are specified foreign financial assets, but are not reportable accounts for FBAR purposes unless the shares in the fund are available to the general public. Also, bonds, notes and stocks of foreign issuers held directly by a reporting person are not financial accounts for purposes of FBAR reporting, but may be specified foreign financial assets.

Reportable interests for purposes of Form 8938 and the FBAR are also determined differently. An interest in a specified foreign financial asset is reportable if any income, gain, loss, deduction, credit, gross proceed or distribution attributable to the holding or disposing of a specified foreign financial asset is required to be reported, included or reflected on the person's annual return. A financial interest is reportable on the FBAR if the taxpayer is the owner of record or holder of legal title of a foreign financial account or if the taxpayer owns a significant interest in another entity that owns the foreign financial account. Signature authority is reported on the FBAR if the taxpayer has the authority to control the disposition of assets held in a foreign financial account by direct communication to the financial institution that maintains the financial account. There is no signature authority reporting requirement for Form 8938, as there is for the FBAR.

Finally, the baseline penalty for failing to disclose assets on Form 8938 and the FBAR is \$10,000. However, if the IRS mails a notice of failure to file Form 8938, and such failure continues for 90 days thereafter, the taxpayer is subject to additional penalties of \$10,000 for each 30-day period of noncompliance after the 90-day period, up to \$50,000. The maximum penalty for willfully failing to file an FBAR is the greater of \$100,000 or 50 percent of the account balances. In both cases, willful failure to file can result in criminal penalties. The one possible form of relief in filing either form is that penalties will not be imposed if the failure to disclose is due to "reasonable cause" and not due to willful neglect.

The chart published by the IRS also compares whether specific types of foreign assets are reportable on Form 8938 and the FBAR. For example, the following assets must be reported on both forms (although each form requires the reporting of different specific information):

- financial deposit and custodial accounts held at a foreign financial institution,
- financial account held at a foreign financial institution holds foreign stock or securities,
- foreign mutual funds and
- foreign-issued life insurance or annuity contracts with a cash value.

The following assets are not required to be reported on either form:

- financial account held at a U.S. branch of foreign financial institution;
- domestic mutual fund investing in foreign stocks and securities;
- foreign real estate directly or held through a foreign entity;
- foreign currency held directly;
- precious metals held directly;
- personal property, held directly, such as art, antiques, jewelry, cars and other collectibles; and
- Social Security-type program benefits provided by a foreign government.

The following assets must be reported on Form 8938 and not the FBAR:

- foreign stock or securities not held in a financial account,
- foreign partnership interests and
- foreign hedge funds and foreign private equity funds.

The following assets must be reported on the FBAR and not the Form 8938:

- financial accounts held at a foreign branch of a U.S. financial institution,
- foreign financial accounts for which the taxpayer has signature authority and
- indirect interests in foreign financial assets through an entity.

There will undoubtedly be much confusion over the information required to be filed on these two forms and individuals should pay close attention to the requirements of each and seek professional assistance where appropriate.

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