

February 2012 | Form 8938: Statement of Specified Reporting of Financial Assets

Danger in Nuisance Reporting

Background

Sometimes when the IRS rolls a hand grenade at you, the implications are not immediately clear. This is the case with a new Form 8938 where ownership of foreign financial assets is disclosed.

This filing requirement is directly related to the scandal at UBS where the bank was forced to turn over information on 4,700 U.S. citizens with accounts. From 2009 through 2011 the IRS had an amnesty program where individuals could voluntarily declare unreported foreign income and avoid criminal prosecution. About 20,000 individuals elected to participate in the program.

The amnesty program amounted to shaking the tree. The real enforcement now starts with expanded reporting of foreign assets.

Form 8938

Form 8938 is required to be filed with your individual income tax return if the value of foreign financial assets exceeds \$100,000 at year-end and exceeds \$150,000 at any time during the year. The filing thresholds are \$50,000 and \$75,000 for unmarried taxpayers and married individuals filing separate returns. Assets are disclosed at fair market value.

Specified Foreign Assets include the following:

- **Financial accounts maintained at a foreign institution**
This does not include U.S. branches of foreign banks or foreign branch or subsidiary of a U.S. financial institution. It does include foreign mutual funds, foreign hedge funds, and foreign private equity funds.
- **Stock or securities issued by a non-U.S. person or an interest in a foreign entity NOT HELD IN AN ACCOUNT AT A FINANCIAL INSTITUTION.**
This would be holding stock in foreign corporations in certificate form.
- **Any financial instrument or contract that has an issuer or a counterparty that is not a U.S. person.**
The most common example would be a life insurance policy with foreign company.

Action:

- If you have any of these assets, notify your tax preparer when submitting tax documents.

The downside to not filing

The instructions to Form 8938 are quite explicit.

“Statute of limitation. If you fail to file Form 8938 or fail to report a specified foreign financial asset that you are required to report, the statute of limitation for the tax year may remain open for all or part of your income tax return until 3 years after the date on which you file Form 8938.”

So if you choose to park financial assets overseas and not report them to the IRS, there is no statute of limitations on that year's income tax return. In the future if the IRS is able to establish a filing requirement, they will be able to make adjustments to your income tax returns.

(Note: The normal statute of limitations is three years from the extended filing deadline of the return. This is extended to six years if there is more than a 25% understatement of gross income on a return. There is no statute of limitation on fraudulently filed returns.)

The last thing any taxpayer needs is no statute of limitations.

Other reporting of foreign assets

Taxpayers already have a filing requirement for other foreign assets.

- If foreign real estate is owned by a trust, it must be reported on Forms 3520 or 3520A.
- If foreign real estate is held in a foreign corporation, it must be reported on Form 5471.
- Interests in and signature authority over foreign bank accounts must be reported on TDF 90-22.1.

Reporting of assets on the 3520 or 5471 does not have to be duplicated on form 8938.

Investment in passthrough entities

You may have a reporting requirement through ownership of a partnership that has investments in foreign entities. The only way you will be aware of a foreign reporting requirement is through disclosures in the K-1.

Action:

- Pay attention to all communications from partnerships regarding reporting of foreign assets. These may in be the K-1s or may be in separate correspondence.

Planning to minimize reporting of foreign investments

Investments in foreign financial assets can be made through U.S. entities (such as U.S. investment partnerships), or can be held in an account at U.S financial institution, or at a U.S. branch of a foreign financial institution. None would require reporting on Form 8938.

Action:

- Consider moving direct foreign investments into accounts maintained at a U.S. financial institution.