INTERNATIONAL

Foreign Account Reporting Using Form 8938—Has the Service Created Compliance Traps?

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A new reporting obligation for taxpayers with foreign accounts, in addition to the now relatively well-known FBAR, may be ignored or dismissed by taxpayers unfamiliar with the new requirements and the accompanying penalty provisions. The government is quite serious, however, and taxpayers will run considerable risks if they fail to comply.

U.S. law requires taxpayers who own foreign assets, have a connection to foreign entities, or who engage in foreign activities to report such assets, entities, and activities to the IRS. Taxpayers who fail to file the appropriate information forms risk being subjected to significant monetary penalties. The Foreign Account Tax Compliance Act (FATCA) [1] increases the number of required information forms by two. FATCA section 521 amended the Code to require shareholders in a passive foreign investment company (PFIC) to file an annual information return disclosing their ownership of the PFIC. [2] FATCA section 511 added new **Section 6038D** , creating a new annual filing for U.S. taxpayers with specified foreign financial assets (SFFAs).

Form 8938, which taxpayers will use to meet the **Section 6038D** requirement, is only the newest—and by no means the only or last—information return that applies to individuals with foreign assets. Statistically speaking, it is likely that more than a few taxpayers, and probably those who are new to the U.S. or live abroad, will run afoul of the U.S. tax rules—and perhaps Form 8938.

BACKGROUND

Section 6038D reads pretty clearly. It requires *individuals* who hold an *interest* in a *specified foreign financial asset* during the tax year to attach to their tax returns the required information if the aggregate value of the SFFAs *exceeds $50,000* or such higher threshold as IRS may determine.

The reporting obligation applies to assets held during tax years beginning after FATCA's 3/18/10 effective date. For calendar-year taxpayers, this requires Form 8938 to be attached to their 2011 income tax returns filed during 2012.

In an effort to assist taxpayers with preparing this form, Treasury released Temporary Regulations (**TD 9567**, 12/14/11) approximately 19 months after the legislation was enacted, which are effective for tax years beginning after 12/19/11. Then on 2/29/12, IRS posted guidance in the form of 14 FAQs discussing the breadth of the filing obligation. [3]

Form 8938 history. The IRS initially released a draft version of Form 8938 in July 2010, but there were no accompanying instructions. A revised draft Form 8938 was released in June 2011, again without instructions.

About the same time that the revised June 2011 draft Form 8938 came out, the Service issued **Notice 2011-55, 2011-29 IRB 53** , relieving taxpayers of the filing requirement until such time as Form 8938 was officially released. The Notice also indicated that the

IRS intended to issue Regulations for **Section 6038D**. On 10/3/11, the IRS finally posted draft instructions. These instructions provided transitional rules that essentially relieved taxpayers of the requirement to file Forms 8938 until 2012. (If a taxpayer had a 2011 filing obligation, the form for such year would be filed in 2012, along with any required 2012 form.)

SPECIFIED INDIVIDUALS

The Form 8938 obligation applies only to specified individuals with ownership in an SFFA. Not all persons with such ownership have a filing obligation, however. **Temp. Reg. 1.6038D-1T(a)(2)** makes clear that the following individuals are specified individuals for **Section 6038D** purposes:

(1) U.S. citizens.

(2) Permanent residents (i.e., green card holders).

(3) Individuals satisfying the "substantial presence" test. [4]

(4) A nonresident alien making an election to file a joint income tax return with a U.S. spouse.

(5) A nonresident alien who is a bona fide resident of a U.S. possession. [5]

Even if a permanent resident or substantially present resident elects to be treated as a foreign resident under an income tax treaty, that person continues to be a specified individual, and Form 8938 must be filed. It would appear that the permanent resident always will be required to file, but it remains unresolved as to whether Form 8938 must be filed by a substantially present taxpayer who is able to qualify as a nonresident alien under the "closer connection" test. [6]

Nevertheless, despite a specified individual's having ownership in an SFFA in excess of the filing threshold, the Form 8938 obligation does not exist unless the specified individual is required to file either Form 1040 or Form 1040-NR. As a result, not all bona fide residents of a U.S. possession who own the requisite SFFA will have a Form 8938 filing obligation. [7]

Domestic entities. **Section 6038D(f)** states that the IRS may apply the reporting requirement to domestic entities formed or availed of for purposes of holding, directly or indirectly, SFFAs. This filing season, however, there is no requirement for a domestic entity to file a Form 8938. Nevertheless, **Prop. Reg. 1.6038D-6(a)** (REG-130302-10, 12/14/11) would bring certain domestic entities—corporations, partnerships, and trusts—within the purview of **Section 6038D** , and thus require the filing of a Form 8938. If finalized, the Proposed Regulations will apply for tax years beginning after 2011. The determination as to whether such a domestic entity is availed for the stated purpose of holding an SFFA would be made annually.

INTEREST IN AN SFFA

Under **Temp. Reg. 1.6038D-2T(b)(1)**, a specified individual is defined to have an interest in an SFFA if that person reports on her tax return any income, gain, loss, deduction, credit, gross proceeds, or distribution attributable to the holding or disposition of the asset. Specified individuals still can have an interest in an SFFA, however, even if no income, gain, loss, deduction, credit, gross proceeds, or distribution is attributable to the holding or disposition of the asset during the tax year.

If a parent makes an election under **Section 1(g)(7)** to include her child's unearned income on the parent's tax return, the parent is deemed to have an interest in any SFFA held by the child. [8]

Because the Proposed Regulations are not yet effective, a specified individual is not deemed to have an interest in an SFFA held by a partnership, corporation, trust or estate, solely as a result of the taxpayer's being a partner, shareholder, or beneficiary. [9] A specified individual who owns a disregarded entity, however, must file Form 8938 if the entity owns an SFFA. Similarly, if the specified individual owns any part of a grantor trust (other than a bankruptcy liquidating trust or a domestic widely held fixed investment trust), the taxpayer is deemed to own any SFFA held by the trust. [10]

FILING THRESHOLD

Specified individuals who own SFFAs are obligated to file a Form 8938 if the total value of those assets exceeds a threshold. The amount of the threshold varies depending on the filing status of the taxpayer. Additionally, the filing status is premised on the high value or year-end value exceeding certain thresholds. For single taxpayers living in the U.S., the high value threshold is $75,000, and

the year-end value threshold is $50,000. [11] The thresholds are the same for married taxpayers living in the U.S. who file separate returns. For married taxpayers living in the U.S. and who file a joint return, however, the high-value threshold is doubled to $150,000 and the year-end value threshold is doubled to $100,000. [12]

The filing thresholds are more generous for taxpayers living abroad. If the taxpayer is a bona fide resident of a foreign country, which is defined as living uninterrupted in the foreign jurisdiction for an entire tax year or for at least 330 full days during a tax year, the high-value threshold is $300,000 and the year-end value threshold is $200,000 so long as the taxpayer does not file a joint income tax return. [13] This level applies to both single taxpayers and those who are married but file separate returns. The high-value threshold is $600,000 and the year-end value threshold is $400,000 for married taxpayers who live abroad, file a joint return, and satisfy the foreign residency requirements described above. [14] These filing thresholds are summarized in Exhibit 1.

Exhibit 1. Summary of Form 8938 Filing Thresholds

Taxpayers have a Form 8938 filing obligation if they meet the thresholds in either the year-end or high-value column.

	12/31 aggregate value of all SFFAs exceeds	High annual balance exceeds
Single living in U.S.	$ 50,000	$ 75,000
Single living outside U.S.	200,000	300,000
Married filing joint returns, living in U.S.	100,000	150,000
Married filing separate returns, living in U.S.	50,000	75,000
Married filing separate returns, living outside U.S.	200,000	300,000
Married filing joint return, living outside U.S.	400,000	600,000

When an SFFA is jointly owned, the rules for determining if a taxpayer has exceeded the thresholds depend on the identity and filing status of the joint owners. For example, if the joint owners are married, are specified individuals, and file separate returns, each owner includes 50% of the asset's value when computing the total value of their SFFAs. [15] When it comes to filing Form 8938, however, each spouse has a separate Form 8938 filing obligation and is required to report 100% of the jointly held asset, not the 50% value used when computing the threshold. [16] If the joint owners are both specified individuals who file a joint income tax return, they must file one Form 8938 reporting each SFFA owned by either of them. [17] If the joint owner is a spouse who is not a specified individual, then the specified individual includes 100% of the asset's value when computing the threshold and reports 100% of the value on Form 8938. [18] Similarly, if the joint owner is not a spouse and both owners are specified individuals, each includes 100% of the asset's value when computing the threshold and reporting the asset. [19]

WHICH FOREIGN ASSETS ARE SFFAs?

SFFAs include both foreign financial accounts and other foreign assets.

Foreign Accounts

The most notable SFFA is a foreign financial account. For purposes of **Section 6038D** , the account must be "maintained" (a term not defined in the statute or Regulations) by the foreign financial institution. "Financial account" and "foreign financial institution," however, are defined by reference to the withholding provisions in **Section 1471** .

Under **Section 1471(d)(2)**, a financial account includes any depository or custodial account maintained by a financial institution. It also includes any equity or debt interest in a financial institution (other than interests which are regularly traded on an established securities market).

Section 1471(d)(5) provides that a financial institution is an entity which:

(1) Accepts deposits in the ordinary course of a banking or similar business;

(2) Holds financial assets for the account of others as a substantial portion of its business; or

(3) Is engaged or holds itself out as being engaged primarily in the business of investing, reinvesting, or trading in securities (as defined in **Section 475(c)(2)** without regard to the last sentence thereof), partnership interests, commodities (as defined in **Section 475(e)(2)**), or any interest (including a futures or forward contract or option) in such securities, partnership interest, or commodities.

Even though **Section 1471(d)(4)** specifically excludes a foreign financial institution organized under the laws of a U.S. possession from the withholding regime, an account located within a U.S. possession is included within the definition of an SFFA. [20] As such, a specified individual with an account located in a U.S. possession has an SFFA. Notwithstanding that characterization, a specified individual who is a bona fide resident of a U.S. possession is exempt from reporting such account. [21]

Clearly an account held with either a financial institution located in the U.S. or a domestic branch of a foreign financial institution is not an SFFA, as the account is not foreign. An account held with the foreign branch or foreign subsidiary of a U.S. financial institution also is exempt from the filing requirement. [22]

Foreign Assets

Foreign assets held outside of a financial institution also can be classified as an SFFA. Almost any kind of foreign asset may qualify as an SFFA, such as:

- Life insurance or annuities with a cash surrender value.
- An interest in an estate.
- An interest in a retirement plan.
- An account held with a trust company.
- Shares in a mutual fund.
- An interest in a hedge fund or private equity fund.
- Deferred compensation and pension plans held by U.S. expatriates working abroad.

The key is the asset must be held for investment to be reportable. The Regulations note that the categories are broad, and as a result an SFFA may qualify under multiple categories.

Section 6038D(b)(2) includes the following assets held for investment:

(1) Stock or securities issued by a non-U.S. person. [23]

(2) Any financial interest or contract held for investment that has a non-U.S. issuer or counterparty. U.S. taxpayers with foreign family members should be alert that a loan from or to a foreign family member can qualify as an SFFA under this provision.

(3) Any interest in a foreign entity (as defined in **Section 1473(5)** as an entity that is not a U.S. person).

The Form 8938 instructions and **Temp. Reg. 1.6038D-3T(d)** provide the following examples of other assets that qualify as SFFAs:

- 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 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 currency or commodity that is entered into with a foreign counterparty or issuer.

As noted above, a foreign asset is reportable if it is held for investment. **Temp. Reg. 1.6038D-3T(b)(3)** instructs that an asset is held for investment and therefore reportable unless the taxpayer uses it or holds it for use in the conduct of a trade or business. To

determine how the asset is used, **Temp. Reg. 1.6038D-3T(d)(4)** applies, with certain modifications, the asset-use test of **Reg. 1.864-4(c)(2)** (under the rules for determining whether income is effectively connected (ECI) with a U.S. business). Consequently, an asset will qualify for the exception if it is:

(1) *Held for the principal purpose of promoting the present conduct of a trade or business.* Confusion may exist with whether compensatory stock options are truly held for investment or whether they satisfy this prong of being held for the principal purpose of promoting the business. The Temporary Regulations do not provide clarity since they simply track the ECI rules in determining whether there is a trade or business. Nevertheless, the business is conducted whether the employee receives the stock option or not, which would appear to work against satisfying the principal purpose standard.

(2) *Acquired and held in the ordinary course of a trade or business.* For example, when the business accrues an account receivable.

(3) *Otherwise held in a direct relationship to the trade or business.* An asset is presumed to have a direct relationship if it was purchased with assets generated by the trade or business, the income from the asset is reinvested in the business, and employees from the trade or business operate significant management and control over the asset.[24] Stock will never qualify for the trade or business exception, nor will an asset acquired to help with future diversification or future business contingencies.[25]

Rules for Foreign Estates and Trusts

A specified individual does not have to report a beneficial interest in a foreign estate or foreign trust unless that taxpayer has reason to know of the interest. If the taxpayer receives a distribution from the trust or estate, however, knowledge is attributable to her.[26]

FOREIGN ASSETS EXCLUDED FROM FORM 8938

While it would be impossible to provide an exhaustive list of foreign assets that are excluded from the Form 8938 filing obligation, the following general rules apply.

- Real estate, whether developed or rented, is not a reportable asset.
- Personal property, such as art work, jewelry, and automobiles, is not reportable.
- Foreign currency and payments received by a specified individual in the form of social security, social insurance, or other comparable programs administered by a foreign government do not qualify as an SFFA unless the payments are deposited into a foreign account.

It appears, however, that an unreported asset, such as real estate, may become reportable if the specified individual holds title to the asset through a foreign entity. In addition, if the real estate is leased, while the real estate is not reportable, the lease is likely deemed a contract held for investment, and reportable. If the entity is a disregarded entity or grantor trust, however, the otherwise unreported asset will continue to be exempt from reporting.

The Form 8938 instructions and the Temporary Regulations provide an exemption for SFFAs that otherwise would be reported on more than one information return. In an effort to eliminate duplicative filings, if a taxpayer reports the existence of an SFFA on a Form 3520, Form 3520A, Form 5471, Form 8621, Form 8865, or Form 8891, the asset does not need to be reported on Form 8938.[27] Nevertheless, the taxpayer still must complete Part IV of Form 8938 and provide the identifying information requested at the top of the form. The duplicative filing exception does *not* apply to the FBAR.

U.S. possessions. If the specified individual is a bona fide resident of a U.S. possession, and such person has to file a Form 8938, **Temp. Reg. 1.6038D-7T(c)** excludes the following SFFAs:

(1) A financial account maintained by a financial institution organized under the laws of the U.S. possession where the taxpayer is a resident.

(2) A financial account maintained by a branch of an institution not organized under the laws of the U.S. possession where the taxpayer is a resident, if the branch is subject to the same tax and information reporting requirements that apply to financial institutions in the U.S. possession.

(3) Stock or securities issued by an entity organized in the U.S. possession where the taxpayer is a resident.

(4) An interest in an entity organized under the laws of the U.S. possession where the taxpayer is a resident.

(5) A financial instrument or contract held for investment, if each issuer or counterparty that is not a U.S. person is either an entity organized under the laws of the U.S. possession where the taxpayer is a resident or is a bona fide resident of such U.S. possession.

Consequently, if the specified individual's only SFFAs are those located within the U.S. possession where that taxpayer is a bona fide resident, there is no requirement to file Form 8938. Similarly, recall that if the specified individual does not otherwise have to file a U.S. income tax return, there also is no requirement to file Form 8938.

Dealers. Accounts maintained by dealers or traders in securities or commodities are exempt if all of the holdings are subject to the mark-to-market accounting rules for dealers in securities or an election under **Section 475(e)** or **(f)** is made. [28]

DETERMINING VALUE

The value of an SFFA must be computed for two purposes, i.e., (1) determining if the aggregate value of the SFFAs in which the specified individual holds an interest exceeds the threshold, and (2) reporting the maximum value on Form 8938. For both purposes, the asset's maximum value generally is its highest FMV during the tax year. Four general rules apply when determining an asset's value:

(1) All foreign currencies must be converted to U.S. dollars,

(2) FMV is the default valuation,

(3) A value is never less than zero, and

(4) Appraisals are not required.

If the SFFA is a financial account, the specified individual may rely on statements provided by the financial institution (if issued at least annually) unless the taxpayer has reason to know that the statements do not provide a reasonable estimate of the account's maximum value. [29] Similarly, taxpayers may use the year-end value for an asset that is not a financial account unless they have reason to know that the year-end value does not reflect a reasonable estimate of the asset's maximum value. [30]

If the taxpayer is a beneficiary of a foreign trust, the maximum value is the sum of (1) the total of all distributions received during the tax year from the trust, whether money or property, and (2) the value as of the last day of the taxpayer's right to mandatory distributions, with such distributions valued in accordance with the rules in **Section 7520** . [31]

If the taxpayer is a beneficiary of a foreign estate, foreign pension plan, or foreign deferred compensation plan, the maximum value is the FMV of the taxpayer's interest as of year-end. If the taxpayer does not know the value or cannot determine the value, the value to be used is equal to the cash and other property distributed to the taxpayer during the year. [32] If the taxpayer did not receive any distributions during the year, however, the value of the interest is zero.

Foreign currency conversion. **Temp. Reg. 1.6038D-5T(c)** provides rules for determining value in U.S. dollars. Treasury's Financial Management Service foreign currency exchange rate is used to convert the foreign value of an SFFA into U.S. currency for purposes of both computing the aggregate value of such assets and the maximum value of an SFFA. If there is no Financial Management Service foreign currency exchange rate available for the foreign currency, any other publicly available exchange rate may be used, but the source must be disclosed on Form 8938.

The value of an SFFA for purposes of both computing its aggregate and maximum value is first determined in the local foreign currency. The foreign currency value is then converted into U.S. dollars using the foreign currency exchange rate applicable for purchasing U.S. dollars. The applicable foreign currency exchange rate used is that for the last day of the tax year, regardless as to whether the SFFA was sold during the year.

INFORMATION REPORTED ON FORM 8938

Under **Temp. Reg. 1.6038D-4T(a)**, a specified individual with a Form 8938 filing obligation is required to disclose the following information for each SFFA:

- If the SFFA is a foreign financial account, the name and address of the financial institution, the account number, and the date on which the account was opened or closed.
- If the SFFA is a stock or security, the name and address of the issuer, other information necessary to determine the class or issue of the stock or security, and the date on which the SFFA was acquired or sold.
- If the SFFA is a financial instrument or contract held for investment, the names and addresses of all issuers and counterparties, including information that identifies the financial instrument or contract.
- If the SFFA is an interest in a foreign entity, information that identifies the interest, including the name and address of the entity.
- The maximum value of the SFFA during the portion of the year in which the specified individual held an interest.

Form 8938 also requests information regarding the taxable income associated with the SFFA, where on an income tax or informational return the information is provided, as well as information on the foreign currency exchange rate used for conversion purposes.

PENALTIES

Taxpayers who have a Form 8938 disclosure requirement will likely also have an FBAR filing requirement. While the penalty for failure to file the FBAR is much harsher than the penalty under **Section 6038D** for failure to file Form 8938, both of these penalties may be assessed.

Under **Section 6038D(d)**, the minimum penalty for failing to submit the required disclosure is $10,000, and it increases by $10,000 for each 30-day period following notification from Treasury, with the maximum penalty being $50,000. There is, however, a 90-day grace period following notification from Treasury before the additional $10,000 penalties accrue.

This is similar to the penalties that apply to a failure to file Form 5471 or Form 3520. As with those forms, the penalty may be waived if the taxpayer is able to demonstrate the failure to file was due to reasonable cause. The burden will be on the taxpayer to establish reasonable cause exists. [33]

While the determination will be based on the facts and circumstances of the specific case, it will be difficult to ascertain what standards the revenue agent will use in order for the taxpayer to demonstrate reasonable cause. The fact that a foreign jurisdiction would impose a civil or criminal penalty for disclosing the information will not satisfy reasonable cause. [34]

Married taxpayers filing a joint return who fail to file a Form 8938 are treated as one specified person for penalty purposes, although the liability for the penalty will be joint and several. [35]

For penalty purposes, **Temp. Reg. 1.6038D-8T(d)** contains a presumption that a specified individual's SFFAs have a value in excess of the filing threshold in the event the taxpayer cannot substantiate the value when requested by the Service.

If the taxpayer underpays tax as a result of an undisclosed SFFA, the deficiency will be subjected to a 40% penalty. [36] If the taxpayer underpays tax as a result of fraud, the deficiency will be subject to a 75% penalty. [37] In addition to the failure-to-file penalty, accuracy-related penalty, and fraud penalty, criminal penalties also may apply for failure to file Form 8938, failure to report an asset, or underpayment of tax. [38]

Statute of limitations. If a taxpayer omits more than $5,000 of income attributable to one or more assets required to be reported under **Section 6038D** , the IRS will have six years from the date Form 8938 is filed to audit the taxpayer. [39] Even if there is no omission of income attributable to an SFFA, the three-year statute of limitations is tolled until the form is filed. [40]

FBAR

Taxpayers and practitioners alike should note that the FATCA reporting requirement set forth in **Section 6038D** is much broader than the FBAR, so it is possible that individuals who do not have an FBAR filing obligation may be subject to the FATCA reporting requirement. For example, the FATCA reporting requires taxpayers with investments in foreign entities, such as foreign hedge funds and private equity funds, to report the existence of these investments. The FBAR regulations issued by FinCEN on 2/26/10 exempt these assets from FBAR reporting. [41] Nevertheless, many taxpayers may find that they must file both an FBAR and Form 8938; see Exhibit 2.

Exhibit 2a.

Exhibit 2b.

The FBAR generally is required to be filed by a U.S. person with a financial interest, signature authority, or other authority over foreign financial accounts if at any point during the calendar year the aggregate value of all such foreign accounts exceeded $10,000, even if for one day. By contrast, **Section 6038D** disclosure is required to report SFFAs when the aggregate value exceeds $50,000 "(or such higher dollar amount as the Secretary may prescribe)."

For practitioners who question why there are duplicative filings, the answer lies in the source of the filing obligation. The FBAR is mandated by Title 31, whereas the FATCA filing is mandated by Title 26. Title 31 is titled "Money and Finance," and the purpose of the FBAR as stated in section 5311 is "to require certain reports or records where they have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism." As such, the information contained in FBARs is not confidential, and federal officials are able to access the computer database in which FBAR information is entered. The information on Form 8938, however, will be subject to the same confidentiality rules in **Section 6103** governing tax returns.

CONCLUSION

In an effort to help spur the economy, President Obama has initiated several efforts to generate jobs. One such effort, the "We Can't Wait" campaign, brought the President to Disney World on 1/19/12 where he proclaimed "America is open for business." [42] He went on to announce that his Administration was launching a national initiative to attract more foreign travelers to boost tourism and, in turn, jobs.

This was not the Administration's only attempt to attract foreign dollars. For example, on 8/2/11, Alejandro Mayorkas, chief of U.S. Citizenship and Immigration Services, a unit of the Department of Homeland Security, announced initiatives designed to attract and retain foreign entrepreneurs. [43] In an effort to attract and retain such entrepreneurs, the plan is to make it easier for these desired foreigners to obtain work visas and qualify for permanent residence.

One might wonder if the Administration will provide the foreigners it's recruiting with a summary of the U.S. tax rules and the ever-expanding number of information returns that must be filed. After all, domestic tax preparers and taxpayers have enough trouble staying abreast of the latest tax developments. Since permanent residents can be deported for tax violations, [44] and taxpayers failing to file informational forms are subject to strict liability penalties, it would be kind of the government to provide these highly sought after foreign recruits with a blueprint of common traps.

Because this is the first year that Form 8938 is required to be filed by taxpayers, one would hope that the IRS will abate any penalties for mistakes associated with filing the form. While there is nothing illegal or improper about holding foreign accounts and assets, the government continues to increase the level of transparency and compliance required by those holding such assets. The penalties for failing to comply are costly. Even though the monetary cost of not complying with the Form 8938 requirements is far less severe than the FBAR requirement, the ancillary penalties are no mere slap on the wrist. The statute of limitations will not begin to run until the form is filed, there is a six-year statute of limitations if $5,000 of income associated with an SFFA is omitted, and a 40% deficiency penalty associated with unreported income from an SFFA.

Practice Notes

Because the penalties can be severe and the reporting obligation is new with this filing season, practitioners must be careful to ensure that taxpayers owning specified foreign financial assets comply with **Section 6038D** . There has been no indication from the Service that it might abate penalties for the first year that Form 8938 is due.

[1] Section 511 of the Hiring Incentives to Restore Employment (HIRE) Act, P.L. 111-147, 3/18/10.

[2] **Section 1298(f)**. Practitioners should be on the lookout for a revised Form 8621. Under previous law, PFICs needed to be disclosed only when taxpayers made a qualifying elective fund election, received certain distributions from the PFIC, or disposed of their interest

in the PFIC.

[3] Available at www.irs.gov/businesses/corporations/article/0,,id=255061,00.html.

[4] See **Reg. 301.7701(b)-1(c)** : "An individual satisfies this test if he or she has been present in the United States on at least 183 days during a three year period that includes the current year."

[5] **Temp. Reg. 1.6038D-1T(a)(5)** defines "U.S. possession" to include American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, and the U.S. Virgin Islands. See Packman and Weinstein, "Establishing Residency in the U.S. Virgin Islands—A Look at Section 937's Reach," **105 JTAX 33 (July 2006)** , for rules explaining bona fide residency in the U.S. Virgin Islands.

[6] **Reg. 301.7701(b)-2** (among other requirements, "the individual has a closer connection during the current year to a single foreign country in which he or she maintains a tax home than to the United States").

[7] **Temp. Reg. 1.6038D-2T(a)(7)(i)**.

[8] **Temp. Reg. 1.6038D-2T(b)(2)**.

[9] **Temp. Reg. 1.6038D-2T(b)(3)**.

[10] *Id.*

[11] **Temp. Reg. 1.6038D-2T(a)(1)**.

[12] **Temp. Reg. 1.6038D-2T(a)(2)**.

[13] **Temp. Reg. 1.6038D-2T(a)(3)**.

[14] **Temp. Reg. 1.6038D-2T(a)(4)**.

[15] **Temp. Reg. 1.6038D-2T(c)(1)(ii)**.

[16] **Temp. Reg. 1.6038D-2T(c)(2)(ii)**.

[17] **Temp. Reg. 1.6038D-2T(c)(2)(i)**.

[18] *Id.*

[19] **Temp. Reg. 1.6038D-2T(c)(1)(i)**.

[20] **Temp. Reg. 1.6038D-3T(a)(2)**.

[21] **Temp. Reg. 1.6038D-7T(c)**.

[22] **Temp. Reg. 1.6038D-3T(a)(3)(i)**.

[23] A U.S. person is defined in **Section 7701(a)(30)** .

[24] **Temp. Reg. 1.6038D-3T(b)(5)(ii)**.

[25]

Temp. Reg. 1.6038D-3T(b)(5)(i).

[26]

Temp. Reg. 1.6038D-3T(c).

[27]

Temp. Reg. 1.6038D-7T(a)(1) (Form 3520, "Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts"; Form 3520A, "Annual Information Return of Foreign Trust With a U.S. Owner"; Form 5471, "Information Return of U.S. Persons With Respect to Certain Foreign Corporations"; Form 8621, "Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund"; Form 8865, "Return of U.S. Persons With Respect to Certain Foreign Partnerships"; and Form 8891, "U.S. Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans").

[28]

Temp. Reg. 1.6038D-3T(a)(3)(ii).

[29]

Temp. Reg. 1.6038D-5T(d).

[30]

Temp. Reg. 1.6038D-5T(f)(1).

[31]

Temp. Reg. 1.6038D-5T(f)(2)(i).

[32]

Temp. Reg. 1.6038D-5T(f)(3)(i).

[33]

Temp. Reg. 1.6038D-8T(e)(2).

[34]

Temp. Reg. 1.6038D-8T(e)(3).

[35]

Temp. Reg. 1.6038D-8T(b).

[36]

Temp. Reg. 1.6038D-8T(f) and **Section 6662(j)** .

[37]

See the Form 8938 instructions.

[38]

Temp. Reg. 1.6038D-8T(f)(2).

[39]

Section 6501(e)(1)(A)(ii).

[40]

Section 6501(c)(8)(A).

[41]

See Packman, "Reporting Foreign Accounts: Treasury Applies the Carrot and the Stick," **112 JTAX 334 (June 2010)** .

[42]

See www.nationaljournal.com/whitehouse/quick-take-in-disney-world-obama-looks-to-boost-tourism-create-jobs-20120119.

[43]

See online.wsj.com/article/SB10001424053111904292504576482573203358158.html.

[44]

See Kawashima v. Holder, 132 S.Ct. 1166 (3/21/12).