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Foreign Asset Reporting Under Code Section 6038D

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Background

For decades, every U.S. person with a financial interest in, or signature or other authority over, one or more foreign financial accounts has been required to report such accounts to the Treasury Department if the aggregate value of such accounts exceeded \$10,000 at any time during the calendar year. The report is made on TD F 90-22.1 (Report of Foreign Bank and Financial Accounts), commonly referred to as the “FBAR,” and must be *received* by Treasury on or before June 30 of the following year.¹

The FBAR is not a tax return. The obligation to file an FBAR arises under Title 31, the Bank Secrecy Act (BSA), rather than under Title 26, the Internal Revenue Code. Thus, the enforcement and information collection procedures generally available under the Code are unavailable for enforcement of the FBAR and for collection of the FBAR penalties.²

While the Code also requires a variety of filings with respect to certain interests in foreign entities and other offshore relationships,³ Congress felt these rules were inadequate to uncover all of the hidden foreign assets of U.S. taxpayers. Also, the fact that FBARs are filed with the Treasury Department, rather than with the IRS, is a bit inconvenient for the IRS.

HIRE Act Enactment of Section 6038D

In 2010, Congress enacted the Hiring Incentives to Restore Employment (“HIRE”) Act, which added Section 6038D to the Code. Code Sec. 6038D is effective for tax years beginning after March 18, 2010, *i.e.*, starting in 2011 for taxpayers whose tax year is a calendar year.

New Code Sec. 6038D greatly expands the categories of information that must be reported with respect to offshore assets. Under this provision, any individual who, during the tax year, holds any interest in a “specified foreign financial asset” (“SFFA”) must attach to his or her income tax return for that tax year certain information (the “Required Information”) if the aggregate value of all such assets exceeds \$50,000 or such higher threshold as Treasury may prescribe.⁴ For this purpose, an SFFA generally includes the following:

- Any financial account maintained by a foreign financial institution.⁵
- Any stock or security issued by a person other than a U.S. person.⁶

- Any financial instrument or contract held for investment that has an issuer or counterparty that is other than a U.S. person.⁷
- Any interest in a foreign entity.⁸

The Required Information generally includes the following:

- In the case of an account, the name and address of the financial institution at which an account is maintained and the number of the account.
- In the case of any stock or security, the name and address of the issuer, and such information as is necessary to identify the class or issue of which the stock or security is a part.
- In the case of any other instrument, contract, or interest, (i) such information as is necessary to identify the foreign instrument, contract or interest, and (ii) the names and addresses of all issuers and counterparties with respect to such instrument, contract, or interest.
- The maximum value of the asset during the tax year.⁹

Although section 6038D is directed primarily at individuals, the statute authorizes the Treasury Department to extend such reporting obligations to “any domestic entity which is formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets, in the same manner as if such entity were an individual.”¹⁰

The statute also provides Treasury with a broad grant of authority to prescribe such regulations or other guidance as may be necessary or appropriate to carry out the purposes of Code Sec. 6038D, including rules providing appropriate exceptions from reporting in the case of (1) classes of assets, including any assets with respect to which Code Sec. 6038D reporting would be duplicative of other required disclosures; (2) nonresident aliens; and (3) *bona fide* residents of any possession of the United States.¹¹

Treasury Regulations and Form 8938

Detailed guidance regarding the Code Sec. 6038D reporting requirement is set forth in Treasury Regulations that were issued on December 19, 2011,¹² and IRS Form 8938, with instructions. The Treasury Regulations issued on December 19, 2011, include temporary regulations that are currently in effect (the “Temporary Regulations”) and proposed regulations that, if finalized, will take effect for tax years beginning after December 31, 2011 (the “Proposed Regulations”).¹³ The key elements of such guidance are described below.

Limitation of Filing Obligation to Certain “Specified Persons”

Reporting under section 6038D is made on Form 8938, *Statement of Specified Foreign Financial Assets*, but this filing obligation only applies to a “specified person,” and only if the aggregate value of the SFFAs in which such specified person has an interest exceeds a specified reporting threshold, described below.¹⁴ A specified person is defined as either (1) a specified individual, or (2) a specified domestic entity (“SDE”).¹⁵

Specified Individual A specified individual means an individual who is any of the following:

- A U.S. citizen.
- A resident alien for any portion of the tax year.
- A nonresident alien for whom an election under Code Sec. 6013(g) or (h) is in effect.¹⁶
- A nonresident alien who is a bona fide resident of Puerto Rico or a Code Sec. 931 possession, as defined in Reg. § .931-1(c)(1).¹⁷

Specified Domestic Entity. The Temporary Regulations reserve on the definition of SDE. The Proposed Regulations provide a definition, but only for tax years beginning *after* December 31, 2011. Therefore, for tax years beginning on or before December 31, 2011, the obligation to file Form 8938 only applies to individuals. This is confirmed by the instructions to Form 8938 (the “Instructions”).

Under the Proposed Regulations, a domestic corporation, partnership or trust will be an SDE if, and only if, it is considered to have been “formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets” (the “formed or availed of test”).¹⁸

Domestic corporations and partnerships. With limited exceptions, a domestic corporation or partnership will satisfy the formed or availed of test (and will thus be an SDE) if and only if:

- after applying certain “aggregation rules” described below, such corporation or partnership has an interest in SFFAs with an aggregate value exceeding the applicable threshold;¹⁹
- the corporation or partnership is “closely held” by a specified individual (the “closely held test”); and
- after applying certain aggregation rules described below, either:
 - at least 50 percent of the corporation’s or partnership’s gross income for the tax year is passive income,²⁰ or at least 50 percent of the assets held by the corporation or partnership at any time during the tax year are assets that produce (or are held for the production of) passive income, or
 - at least 10 percent of the corporation’s or partnership’s gross income for the tax year is passive income, or at least 10 percent of the assets held by the corporation or partnership at any time during the tax year are assets that produce (or are held for the production of) passive income, *and* (ii) the corporation or partnership is “formed or availed of” with “a principal purpose” of avoiding reporting under Code Sec. 6038D.²¹

In the case of a domestic corporation, the closely held test is satisfied if a specified individual owns (directly, indirectly, or through application of certain constructive ownership rules) stock possessing at least 80 percent of the total voting power or total value of the corporation’s outstanding stock on the last day of the corporation’s tax year.²²

In the case of a domestic partnership, the closely held test is satisfied if a specified individual owns (directly, indirectly, or through application of certain constructive ownership rules) an interest in the partnership possessing at least 80 percent of the capital or profits interests on the last day of the partnership’s tax year.²³

The following “aggregation rules” must be taken into account in applying the tests above. For purposes of determining if a domestic corporation or partnership has interests in SFFAs in excess of the applicable reporting threshold, all domestic corporations and partnerships that have any interests in SFFAs and are closely held by the same specified individual are treated as a single entity. Thus, each is considered to own the SFFAs owned by all such other related entities.²⁴

A somewhat different aggregation rule applies for purposes of applying the passive income and passive asset tests described above. For such purposes, all domestic corporations and partnerships that are closely held by the same specified individual, and that are connected through “stock or partnership interest ownership with a common parent corporation or partnership,” are treated as a single entity.²⁵ Thus, each member of the “group” is considered to own the combined assets, and to earn the combined income, of the entire group, and various “intercompany items” are disregarded.²⁶

The aggregation rules may best be illustrated by an example:²⁷

Facts: A specified individual wholly owns DC1, a domestic corporation, and also owns a 90 percent capital interest in DP, a domestic partnership. DC1 owns 80 percent of the sole class of stock of DC2, another domestic corporation. DC1 has no interest in any SFFAs and no interest in any entity other than DC2. DC2 and DP own SFFAs.

Analysis: For purposes of determining whether DC2 and DP have SFFAs in excess of the applicable reporting threshold, they are treated as a single entity (and, thus, each is considered to have an interest in the SFFAs owned by the other), because they are closely held by the same specified individual.²⁸ For purposes of applying the passive income and passive asset tests, DC1 and DC2 are treated as a single entity,²⁹ because (i) they are closely held by the same specified individual, and (ii) they are connected through DC1’s ownership of 80 percent of stock of DC2. DP is not treated as a member of the DC1/DC2 group for this purpose, because it is not connected to either corporation through stock or partnership interest ownership through a common parent entity. Thus, for purposes of applying the passive income and passive asset tests to DP, its income and assets are measured on a standalone basis.

Notwithstanding the general rules set forth above, certain corporations and partnerships that are viewed as unlikely to hide assets offshore are automatically exempt from SDE status. Such exempt entities include: (1) publicly traded corporations and their affiliates, (2) regulated investment companies, and (3) real estate investment trusts.³⁰

Domestic trusts. With limited exceptions, a domestic trust will satisfy the formed or availed of test if (and will thus be an SDE), and only if the trust:

- has an interest in SFFAs with an aggregate value exceeding the applicable threshold;³¹ and
- has one or more specified persons as a current beneficiary.³²

Notwithstanding the general rules set forth above, certain trusts that are viewed as unlikely to hide assets offshore are automatically exempt from SDE status. Such exempt trusts include: (1) certain trusts with a trustee that (i) has supervisory authority over (or fiduciary obligations with regard to) the trust’s SFFAs, (ii) timely files annual returns and information returns on behalf of the trust, and (iii) is a bank, financial

institutions registered with the SEC, or domestic corporation that is publicly traded (or an affiliate of a publicly traded corporation); and (2) grantor trusts to the extent owned by one or more specified persons.³³

Reporting Thresholds

As indicated above, section 6038D requires reporting only if the aggregate value of all SFFAs in which a specified person has an interest exceeds \$50,000 or such higher threshold as Treasury may prescribe.³⁴ The Temporary Regulations (and Instructions) prescribe a higher threshold in many, but not all, instances.

General Rule. Subject to the exceptions described below, a specified person generally must file Form 8938 only if the aggregate value of the SFFAs in which such person has an interest exceeds (1) \$50,000 as of the last day of the tax year, or (2) \$75,000 at any time during the tax year.³⁵ This general rule is applicable to individuals living in the United States who are unmarried or filing separate returns, and to SDEs for tax years beginning after December 31, 2011.

Persons Eligible for Higher Thresholds. If two specified individuals are married and file a joint return, then they generally must file Form 8938 (jointly) only if the aggregate value of the SFFAs in which either spouse has an interest exceeds (1) \$100,000 as of the last day of the tax year, or (2) \$150,000 at any time during the tax year.³⁶ If at least one of them is a “qualified individual” under Code Sec. 911(d)(1), however, then they must file Form 8938 (jointly) only if the aggregate value of the SFFAs in which either spouse has an interest exceeds (1) \$400,000 as of the last day of the tax year, or (2) \$600,000 at any time during the tax year.³⁷

If a specified individual is a qualified individual under Code Sec. 911(d)(1), but does not file jointly with another specified individual, he or she must file Form 8938 only if the aggregate value of the SFFAs in which he or she has an interest exceeds (1) \$200,000 as of the last day of the tax year, or (2) \$300,000 at any time during the tax year.³⁸

Code Sec. 911(d)(1) defines a “qualified individual” as an individual (1) whose tax home is in a foreign country, and (2) who is (a) a U.S. citizen who has been a *bona fide* resident of a foreign country or countries for an uninterrupted period that includes the entire tax year, or (b) a U.S. citizen or resident who is present in a foreign country or countries at least 330 full days during any period of 12 consecutive months that ends in the tax year being reported.³⁹

Treatment of Joint Interests. Each specified person that is a joint owner of an SFFA generally must include the full value of such SFFA for purposes of determining if the aggregate value of SFFAs in which such person has an interest exceeds the applicable threshold.⁴⁰ This general rule is subject to exceptions for SFFAs that are jointly owned by married specified individuals.

If specified individuals are married and file a joint return, then they include the value of their jointly owned SFFA only once in determining whether the aggregate value of SFFAs in which either spouse has an interest exceeds the applicable threshold.⁴¹ If two specified individuals are married and file separate returns, each takes into account only 50 percent of the value of their jointly owned SFFAs.⁴² Notably, neither exception applies if a specified individual is married to a person who is not a specified indi-

vidual. In that event, the specified individual must take into account the full value of any SFFA that is jointly owned with his or her spouse.

SFFAs to Which Certain Reporting Exceptions Apply. As discussed below, certain SFFAs are exempt from reporting (or eligible for less detailed reporting) on Form 8938. In some (but not all) instances, such SFFAs may be disregarded in determining whether a specified person has interests in SFFAs with an aggregate value in excess of the applicable reporting threshold. See below under the caption *Reporting Exceptions*.

Manner of Filing

Any specified person that is required to file Form 8938 with respect to a tax year must attach such form to such person's annual return for such tax year.⁴³ If a person is not required to file an annual return for the year, there is no obligation to file Form 8938 (even if the SFFAs in which such person has an interest exceed the applicable reporting threshold).⁴⁴

Definition of SFFA and Interest in SFFA

Under the guidance set forth in the Regulations (and Instructions), an SFFA generally is defined to include all of the following:

- Any financial account maintained by (i) a foreign financial institution, or (ii) a financial institution that is organized under the laws of a U.S. possession.⁴⁵ An exception applies if the account is maintained by a "U.S. payor" as defined in Reg. §1.6049-5(c)(5)(i), or if all of the holdings are marked to market under the rules of Code Sec. 475(a) or an election under Code Sec. 475(e) or (f).⁴⁶ There also *appears* to be an exception for any interest in a social security, social insurance, or other similar program of a foreign government.⁴⁷
- Any financial account maintained by a financial institution that is organized under the laws of a U.S. possession.⁴⁸
- Any of the following, if held for "investment" (as defined below) and not in an account maintained by a financial institution:
 - Any stock or security issued by a person other than a U.S. person.⁴⁹
 - Any financial instrument or contract that has an issuer or counterparty that is other than a U.S. person.⁵⁰
 - Any interest in a foreign entity.⁵¹

An asset is held for investment if it is not used in, or held for use in, a trade or business of a specified person.⁵² An asset is considered to be used in, or held for use in, the conduct of a trade or business (and not held for investment) if the asset is: (1) held for the principal purpose of promoting the present conduct of a trade or business, (2) acquired and held in the ordinary course of the trade or business as, for example, in the case of an account or note receivable arising from that trade or business, or (3) otherwise held in a "direct relationship" to the trade or business.⁵³

In some cases, there may be considerable uncertainty as to whether a given asset constitutes an SFFA. For example, it is clear that real estate directly owned by a specified person is not an SFFA,⁵⁴ but what if there is a contract with a foreign person to sell (or buy) real estate that is not in any way associated with a trade or business, *e.g.*, a vacation home? As indicated above, an SFFA includes any “financial instrument or contract” with a foreign person that is not used, or held for use, in the conduct of a trade or business. Unless a contract to buy or sell real estate is not a “financial instrument or contract,” SFFA status seems unavoidable (through perhaps unintended).

As a general rule, a specified person is considered to have an interest in an SFFA if any income, gains, losses, credits, gross proceeds, or distributions attributable to the holding or disposition of the SFFA are or would be required to be reported, included, or otherwise reflected by such person on an annual return.⁵⁵ Thus for example, a specified person will have an interest in assets held through a disregarded entity. Notwithstanding this general rule, however, a specified person generally is *not* considered to have an interest in an SFFA held by a corporation, partnership, trust, or estate solely as a result of such person’s status as a shareholder, partner, or beneficiary of such entity.⁵⁶ However, a specified person that is the owner or all or a portion of a grantor trust is generally considered to have an interest in any SFFAs owned by the grantor trust or such portion thereof.⁵⁷ This “attribution” rule does not apply in the case of a domestic widely held fixed investment trust under Reg. §1.671-5, and a domestic liquidating trust created under certain provisions of the Bankruptcy Code. Thus, a specified person owning an interest in any such domestic trust should not be considered to have an interest in any of the SFFAs owned by the trust.

An interest in a foreign trust or estate is not a specified foreign financial asset unless the specified person knows or has reason to know of the interest, based on readily accessible information.⁵⁸ For this purpose, receipt of a distribution from the foreign trust or estate is deemed to constitute actual knowledge.⁵⁹

Required Information

The Required Information to be reported on Form 8938 includes the following:

- In the case of an account maintained by a foreign financial institution, the name and address of the financial institution and the account number.
- In the case of any stock or security, the name and address of the issuer, and such information that identifies the class or issue of which the stock or security is a part.
- In the case of a financial instrument or contract, information that identifies the financial instrument or contract, including the names and addresses of all issuers and counterparties.
- In the case of 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 tax year in which the specified individual had an interest in such SFFA.
- In the case of a financial account that is a depository or custodial account, whether the account was opened or closed during the tax year.⁶⁰

- The date, if any, on which the SFFA (other than a depository or custodial account) was either acquired or disposed of during the taxable year.
- The amount of any income, gain, loss, deduction, or credit recognized during the tax year with respect to the SFFA, and the schedule, form, or return filed with the IRS on which such items, if any, were reported or included by the specified person.
- The foreign currency exchange rate.
- For any SFFAs to which the so-called exception for duplicative reporting (described below) applies, the number of Forms 3520, 3520-A, 5471, 8621, 8865, 8891, or other applicable forms, timely filed with respect to such SFFAs.⁶¹

Reporting Exceptions

“Exceptions” for Duplicative Reporting. The Temporary Regulations provide that a specified person is “not required to report a specified foreign financial asset on Form 8938” if such specified person: (1) reports the asset on any of certain specified forms,⁶² and (2) reports the filing of such specified form on Form 8938.⁶³ Similarly, a specified person that is considered the owner of all or a portion of a foreign grantor trust is not required to report any of the trust’s SFFAs on Form 8938 if: (1) such specified person timely files Form 3520; (ii) the trust timely files Form 3520-A, Annual Information Return of Foreign Trust With a U.S. Owner; and (iii) the Form 8938 filed by the specified person reports the filing of Forms 3520 and 3520-A.⁶⁴

Strangely, a prerequisite to the application of these “duplicative reporting exceptions” is that the specified person who seeks to enjoy such exception must file Form 8938. Moreover, the Temporary Regulations expressly provide that all of the SFFAs to which such duplicative reporting exceptions apply are still taken into account in determining the aggregate value of the SFFAs in which such specified individual has an interest.⁶⁵ Thus, there is literally no scenario in which the duplicative reporting exceptions will actually relieve a specified individual of the obligation to file Form 8938.⁶⁶

Suppose, for example, that a specified individual (who is unmarried and resides in the United States) owns a controlled foreign corporation with a maximum value during the year of \$200,000, that is properly disclosed on a timely Form 5471, and has foreign financial accounts with a maximum value during the year of \$5,000. Notwithstanding the so-called reporting exception, such specified individual must still file Form 8938 both to disclose that he filed Form 5471, and to report financial information with respect to the \$5,000 account. This may prove a significant trap for the unwary.

In the case of a domestic entity, the analysis is significantly different. The Proposed Regulations provide that, for purposes of determining whether a domestic entity has interests in SFFAs with an aggregate value in excess of the applicable threshold, the SFFAs taken into account are “other than assets excepted from reporting as provided in §1.6038D-7T.”⁶⁷ The duplicative reporting exceptions are set forth in Proposed Reg. §1.6038/-7T(a), and thus part of Proposed Reg. §1.6038D-7T. Moreover, as indicated above, these exceptions apply, by their terms, to any specified person. Accordingly, any SFFAs that are timely reported by a domestic entity on the enumerated forms set forth in the Temporary Regulations should be disregarded in determining whether such domestic entity has interests in SFFAs that exceed

the applicable threshold, with the result that the duplicative reporting exceptions may actually permit a domestic entity to avoid SDE status and thereby avoid the obligation to file Form 8938.⁶⁸

Exception for Owners of Certain Domestic Grantor Trusts. A specified person that is treated as the owner of all or a portion of a domestic trust is not required to file Form 8938 to report any SFFAs owned by the trust, if the trust is: (1) a widely held fixed investment trust under Reg. §1.671-5, or (2) a liquidating trust under certain provisions of the Bankruptcy Code.⁶⁹ In this case the exception seems more meaningful to specified individuals.

First, the exception does not by its terms require a specified person to file Form 8938. Second, the Temporary Regulations provide that the value of any SFFA in which a specified individual has an interest and that is excluded from reporting under this exception “is excluded for purposes of determining the aggregate value of specified foreign financial assets.”⁷⁰ Thus, a specified individual to whom this exception applies is not required to file Form 8938 unless he or she has interests in other SFFAs that, by themselves, have a value in excess of the applicable threshold.

The application of the exception to domestic entities should be comparable. The SFFAs taken into account for purposes of determining if a domestic entity exceeds the applicable reporting threshold are “other than assets excepted from reporting as provided in §1.6038D-7T,”⁷¹ and the above reporting exception for certain domestic grantor trusts is set forth in Proposed Reg. §1.6038D-7T(b), which by its terms applies to all specified persons. Thus, any SFFAs owned by a domestic grantor trust to which the above reporting exception applies should be disregarded in determining whether a domestic entity that owns all or a portion of the trust has SFFAs in excess of the applicable threshold.⁷²

Exception for Bona Fide Resident of a U.S. Possession. As indicated above, a resident of a U.S. possession is a specified individual who (if the applicable reporting threshold is satisfied) must file Form 8938. However, a “specified individual who is a bona fide resident of a U.S. possession” is not required to report the following SFFAs:

- A financial account maintained by a financial institution organized under the laws of the U.S. possession of which he or she is a bona fide resident (the “U.S. possession of residence”)
- A financial account maintained by a branch of a financial institution not organized under the laws of the U.S. possession of residence, if the branch is subject to the same tax and information reporting requirements that apply to a financial institution organized under the laws of the such U.S. possession
- Stock or securities issued by an entity organized under the laws of the U.S. possession of residence
- An interest in an entity organized under the laws of the U.S. possession of residence
- A financial instrument or contract held for investment, provided each issuer or counterparty that is not a U.S. person is either an entity organized under the laws of the U.S. possession of residence or a bona fide resident of such U.S. possession

In the case of a specified individual, any SFFAs qualifying for such “possessions exception” are excluded for purposes of determining whether the aggregate value of SFFAs in which such specified individual has an interest exceed the applicable reporting threshold.⁷³ Thus, a specified individual to whom

this exception applies is not required to file Form 8938 unless he or she has interests in other SFFAs that, by themselves, have a value in excess of the applicable reporting threshold.

Notably, the “possessions exception” is, by its terms, only available to a specified individual (and, moreover, one that is a *bona fide* resident of a U.S. possession). Thus, such exception should not be relevant for purposes of determining whether a domestic entity has interests in SFFAs that exceed the applicable reporting threshold.⁷⁴

Valuation Rules

Preliminarily, it should be observed that the value of an SFFA is relevant for two separate purposes. First, value is important for purposes of determining whether the aggregate value of SFFAs in which a specified person has an interest during the year exceeds the applicable reporting threshold (“reporting threshold purposes”). Second, if a specified person is required to file Form 8938, such form generally must disclose the maximum value of such SFFAs during the year (“maximum value purposes”).

Value generally means “fair market value,”⁷⁵ but the applicable valuation rules will, in many cases, simplify the valuation process. With limited exceptions, these rules apply for both reporting threshold purposes and maximum value purposes. The applicable rules include the following:

- A “reasonable estimate” of maximum fair market value during the tax year generally may be used, so appraisals are not required.⁷⁶
- An SFFA that is denominated in foreign currency, must first be valued in foreign currency and then converted into U.S. Dollars, based on the exchange rate in effect on the last day of the specified person’s tax year (even if the SFFA was disposed of prior to such date).⁷⁷
- In the case of a financial account, periodic account statements may be relied upon to determine maximum value, in the absence of actual knowledge, or reason to know based on readily accessible information (hereinafter, “actual or constructive knowledge”) that such statements do not reflect a reasonable estimate of the maximum account value during the tax year.⁷⁸
- In the case of SFFAs not held in a financial account, year-end value generally may be relied upon to determine maximum value, in the absence of actual or constructive knowledge that such value does not reflect a reasonable estimate of maximum value.⁷⁹
- For maximum value purposes, an interest in a foreign trust has a maximum value equal to the sum of (1) all trust distributions to the specified person during the year, and (2) the value of any right to mandatory distributions, as determined under Code Sec. 7520.⁸⁰ This rule also applies for reporting threshold purposes, unless the specified person has actual or constructive knowledge of the fair market value of such trust interest during the tax year.⁸¹
- For maximum value purposes, the maximum value of an interest in a foreign estate, pension plan, or deferred compensation plan is the year-end fair market value of such interest.⁸² In the absence of actual or constructive knowledge, such year-end fair market value is deemed to be the fair market value, determined as of the last day of the taxable year, of the currency or other property distributed during the tax year to such specified person (as a beneficiary or participant).⁸³ In that event, such amount may also be relied upon for reporting threshold purposes.⁸⁴

Coordination with FBAR Filing Requirement

Taxpayers, and their return preparers, should keep in mind that the filing of Form 8938 does not obviate the need to file an FBAR (if otherwise required).⁸⁵ Furthermore, depending upon an individual's particular circumstances, it is possible that either form may be required, but not the other. For example, notwithstanding that Form 8938 reaches a far broader class of financial assets than the FBAR, an individual may be required to file an FBAR, but not Form 8938, if he or she has (1) signatory authority over (but no financial interest in) a foreign financial account, or (2) a financial interest in a foreign financial account with a maximum value during the year that exceeds \$10,000 but is not more than \$50,000. And, of course, a U.S. entity may be required to file the FBAR but is not required to file Form 8938 for 2011.

Consequences of Noncompliance

Penalties. The penalty for failure to timely file Form 8938 is \$10,000.⁸⁶ If the failure continues for more than 90 days after the day on which the IRS mails a notice of the failure to the specified person, the penalty will be increased by \$10,000 for each 30-day period (or fraction thereof) during which the failure continues after the expiration of the 90-day period, provided that the total additional penalty cannot exceed \$50,000.⁸⁷ There is a reasonable cause exception,⁸⁸ but the fact that a foreign jurisdiction would impose a civil or criminal penalty on the specified individual (or any other person) for disclosing the required information is deemed not to constitute reasonable cause.⁸⁹

If the IRS determines that a specified person has an interest in one or more SFFAs and such person does not provide sufficient information to demonstrate the aggregate value of such SFFAs, then the aggregate value of such SFFAs is presumed to exceed the applicable reporting threshold, with the result that the specified person is presumed to have been required to file Form 8938.⁹⁰

In addition, an accuracy penalty applies to an underpayment of tax attributable to any transaction involving an undisclosed SFFA. The penalty for such failure is 40 percent of the underpayment.⁹¹ Finally, a failure to fully comply with the reporting requirements of Code Sec. 6038D and the regulations thereunder may result in criminal penalties.

Statute of Limitation. If a specified person fails to timely file Form 8938 (or certain other specified forms) for a tax year, the statute of limitations period with respect to such year generally will remain open, as to *all* items (whether or not related to unreported SFFAs), until three years after the date on which Form 8938 is filed.⁹² If the specified person can show such failure was due to reasonable cause and not willful neglect, then such extended statute of limitations period only applies only to the items related to such failure.⁹³

Furthermore, if a specified person fails to include in gross income an amount in excess of \$5,000 that relates to one or more SFFAs, the statute of limitations period for assessing the tax related to such item is extended to six years from the date of filing of such specified person's federal income tax return.⁹⁴ Notably, this rule applies even if the specified person was not required to file Form 8938.

¹ Notably the "mailbox rule," which generally deems a tax filing to have been made on the date of mailing, does not apply for FBAR purposes. As noted below, the FBAR is not a tax return.

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- ² All “Code” references herein are to the Internal Revenue Code of 1986, as amended. All “Code Sec.” references herein are to sections of the Code.
- ³ For example, Code Sec. 6038 requires U.S. shareholders of a controlled foreign corporation to file Form 5471.
- ⁴ Code Sec. 6038D(a). The Required Information, a term that does not exist in the statute and is used herein solely for convenience, is set forth in Code Sec. 6038D(c). If adequate information is not available, the aggregate value of SFFAs is deemed to exceed the applicable threshold. Code Sec. 6038D(e).
- ⁵ Code Sec. 6038D(b)(1). The terms “financial account” and “foreign financial institution” are defined in Code Secs. 1471(d)(2) & 1471(d)(4), respectively.
- ⁶ Code Sec. 6038D(b)(2)(A).
- ⁷ Code Sec. 6038D(b)(2)(B).
- ⁸ Code Sec. 6038D(b)(2)(C). The term “foreign entity” is defined in Code Sec. 1473.
- ⁹ Code Sec. 6038D(c).
- ¹⁰ Code Sec. 6038D(f).
- ¹¹ Code Sec. 6038D(h). With respect to the potential exception for nonresident aliens, it should be emphasized that the general rule, set forth in Code Sec. 6038D(a), is not limited to U.S. citizens or residents.
- ¹² TD 9567; REG-130302-10.
- ¹³ Except for the special rules pertaining to “specified domestic entities” (described below) the Proposed Regulations generally do nothing more than incorporate by reference the provisions of the Temporary Regulations.
- ¹⁴ See Temporary Reg. §1.6038D-2T(a)(1).
- ¹⁵ Temporary Reg. §1.6038D-1T(a)(1).
- ¹⁶ A nonresident alien with respect to whom either election is in effect is treated as a resident alien for certain income tax purposes and thus permitted to file a joint return with a U.S. citizen or resident spouse.
- ¹⁷ Temporary Reg. §1.6038D-1T(a)(2).
- ¹⁸ Proposed Reg. §1.6038D-6(a).
- ¹⁹ Certain SFFAs, however, are excluded purposes of this determination. *See* below under the caption *Reporting Exceptions*.
- ²⁰ The definition of passive income is set forth in Proposed Reg. §1.6038D-6(b)(2).
- ²¹ Proposed Reg. §1.6038D-6(b)(1). The Proposed Regulations provide, in the Treasury Department’s typically unhelpful manner, that for purposes of determining whether such principal purpose is present, “all facts and circumstances are taken into account.” Proposed Reg. §1.6038D-6(b)(1)(iii)(B)(2).
- ²² Proposed Reg. §1.6038D-6(b)(3)(i). For this purpose, the constructive ownership rules of Code Sec. 267(c) and (e)(3) apply, except that Code Sec. 267(c)(4) is applied as if the family of an individual included the spouses of other family members. Proposed Reg. §1.6038D-6(b)(3)(iii).
- ²³ Proposed Reg. §1.6038D-6(b)(3)(ii). For this purpose, the constructive ownership rules of Code Sec. 267(c) and (e)(3) apply, except that Code Sec. 267(c)(4) is applied as if the family of an individual included the spouses of other family members. Proposed Reg. §1.6038D-6(b)(3)(iii).
- ²⁴ Proposed Reg. §1.6038D-6(b)(4)(i).
- ²⁵ Proposed Reg. §1.6038D-6(b)(4)(ii). A domestic corporation or partnership is considered to be connected through stock or partnership interest ownership with a common parent corporation or partnership if an 80 percent interest in the entity (specifically, 80 percent of the voting power or value of the stock, in the case of a corporation, or 80 percent of the profits or capital interests, in the case of a partnership) is owned by the parent entity, or other members of the “group.”
- ²⁶ *Id.*
- ²⁷ For more detailed examples, *see* Proposed Reg. §1.6038D-6(b)(5), Examples 1 & 2.
- ²⁸ DC1 is not considered to have any interest in the SFFAs owned by DC2 or DP, for this purpose, because DC1 does not itself own any SFFAs.

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- ²⁹ The application of such test is, of course, not relevant to DC1. It cannot in any event be an SDE, because it has no interest in any SFFAs and thus cannot exceed the applicable reporting threshold.
- ³⁰ See Proposed Reg. §1.6038D-6(d)(1), exempting any entity described in Code Sec. 1473(3), other than a charitable remainder trust .
- ³¹ Certain SFFAs, however, are excluded for purposes of this determination. See below under “*Reporting Exceptions.*”
- ³² Proposed Reg. §1.6038D-6(c). For this purpose, a current beneficiary means, with respect to any tax year, any person who at any time during such year is entitled to, or at the discretion of any person, may receive, a distribution from the principal or income of the trust (determined without regard to any power of appointment that has not been exercised as of the end of the taxable year).
- ³³ See Proposed Reg. §1.6038D-6(d)(1) - (3).
- ³⁴ Code Sec. §6038D(a).
- ³⁵ Temporary Reg. §1.6038D-2T(a)(1).
- ³⁶ Temporary Reg. §1.6038D-2T(a)(2).
- ³⁷ Temporary Reg. §1.6038D-2T(a)(4).
- ³⁸ Temporary Reg. §1.6038D-2T(a)(3).
- ³⁹ The Instructions set forth the same requirements, but do not refer to Code Sec. 911(d)(1) or use the term “qualified individual.”
- ⁴⁰ Temporary Reg. §1.6038D-2T(c)(1)(i).
- ⁴¹ Temporary Reg. §1.6038D-2T(c)(1)(ii).
- ⁴² *Id.*
- ⁴³ Temporary Reg. §1.6038D-2T(a)(1)-(4). Since the reporting obligation with respect to 2011 applies only to individuals, the only relevant annual returns for 2011 are Forms 1040 and 1040-NR. A special rule applies in the case of an SDE that is a member of an affiliated group filing consolidated returns.
- ⁴⁴ Temporary Reg. §1.6038D-2T(a)(7)(i).
- ⁴⁵ Temporary Reg. §1.6038D-3T(a)(1) & (2). Any asset held in such account is not required to be separately reported on Form 8938.
- ⁴⁶ Temporary Reg. §1.6038D-3T(a)(3)(i) and (ii).
- ⁴⁷ Both the preamble to the Temporary Regulations and the Instructions provide for this exception, but, curiously, it is nowhere to be found in the Temporary Regulations themselves.
- ⁴⁸ Temporary Reg. §1.6038D-3T(a)(2).
- ⁴⁹ Temporary Reg. §1.6038D-3T(b)(1)(i).
- ⁵⁰ Temporary Reg. §1.6038D-3T(b)(1)(ii).
- ⁵¹ Temporary Reg. §1.6038D-3T(b)(1)(iii). The term “foreign entity” is given the same meaning as in Code Sec. 1473(5) and the regulations thereunder. Temporary Reg. §1.6038D-1T(a)(10).
- ⁵² Temporary Reg. §1.6038D-3T(b)(3).
- ⁵³ Temporary Reg. §1.6038D-3T(b)(4). For rules as to when an asset is considered to be held in a direct relationship with a trade or business, see Temporary Reg. §1.6038D-3T(b)(5).
- ⁵⁴ It is not unusual for real estate to be held through a foreign entity, in which case the interest in the foreign entity would itself typically constitute an SFFA.
- ⁵⁵ Temporary Reg. §1.6038D-2T(b)(1). This rule applies even if no such items are attributable to the holding or disposition of the asset for the taxable year at issue.
- ⁵⁶ Temporary Reg. §1.6038D-2T(b)(3).
- ⁵⁷ *Id.*
- ⁵⁸ Temporary Reg. §1.6038D-3T(c).

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- ⁵⁹ Temporary Reg. §1.6038D-3T(c).
- ⁶⁰ Query whether a principal purpose of this information item is to help the IRS determine when a specified person has failed to properly report a foreign account for the year in which it was opened.
- ⁶¹ Temporary Reg. §1.6038D-4T(a). Form 8938 does not, however, include a place to indicate the number of Forms 8891 filed by the specified person. Apparently, Form 8938 was finalized before this oversight was detected. The Instructions (which clearly were finalized at a later time) essentially provide that Forms 8891 should be treated as if they were Forms 3520. Thus, for example, a specified individual who filed three Forms 3520 and two Forms 8891 for 2011 must report that he or she filed five Forms 3520.
- ⁶² Such specified forms are: Form 3520, *Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*, Form 5471, *Information Return of U.S. Persons With Respect To Certain Foreign Corporations*, Form 8621, *Information 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*. The IRS may specify additional forms in the future as well. Temporary Reg. §1.6038D-7T(a)(1)(i).
- ⁶³ Temporary Reg. §1.6038D-7T(a)(1).
- ⁶⁴ Temporary Reg. §1.6038D-7T(a)(2).
- ⁶⁵ Temporary Reg. §1.6038D-1(b)(6).
- ⁶⁶ Of course, the “exception” still has some utility in that detailed financial information will not need to be provided.
- ⁶⁷ Proposed Reg. §1.6038D-6(b)(1)(i) & (c)(1).
- ⁶⁸ The IRS could potentially take the position that the exceptions by their terms apply only if the domestic entity actually files Form 8938 to indicate the filing of such enumerated forms, as per Temporary Reg. §1.6038D-7T(a)(1)(ii), but this does not appear to be intended.
- ⁶⁹ Temporary Reg. §1.6038D-7T(b). The Temporary Regulations confirm that any SFFAs to which this reporting exception applies and in which a specified individual has an interest are not taken into account in determining the aggregate value of the SFFAs in which such specified individual has an interest. Temporary Reg. §1.6038D-1(b)(6).
- ⁷⁰ Temporary Reg. §1.6038D-1(b)(6).
- ⁷¹ Proposed Reg. §1.6038D-6(b)(1)(i) & (c)(1).
- ⁷² Moreover, it appears that the domestic entity should not even be considered to have an interest in the trust’s SFFAs. *See* Temporary Reg. §1.6038D-2T(b)(3).
- ⁷³ Temporary Reg. §1.6038D-1(b)(6).
- ⁷⁴ Some ambiguity arguably arises by reason of the fact that Proposed Reg. §1.6038D-6(b)(1)(i) refers to “assets excepted from reporting as provided in §1.6038D-7T,” and the possessions exception is set forth in Temporary Reg. §1.6038D-7T(c), but this does not seem to be enough to overcome the fact that such exception clearly seems intended to apply solely to specified individuals.
- ⁷⁵ Temporary Reg. §1.6038D-5T(a).
- ⁷⁶ Temporary Reg. §1.6038D-5T(b).
- ⁷⁷ Temporary Reg. §1.6038D-5T(c)(2) & (4).
- ⁷⁸ Temporary Reg. §1.6038D-5T(d).
- ⁷⁹ Temporary Reg. §1.6038D-5T(f)(1).
- ⁸⁰ Temporary Reg. §1.6038D-5T(f)(2)(i).
- ⁸¹ Temporary Reg. §1.6038D-5T(f)(2)(ii).
- ⁸² Temporary Reg. §1.6038D-5T(f)(3)(i).
- ⁸³ *Id.*
- ⁸⁴ Temporary Reg. §1.6038D-5T(f)(2)(ii).

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- ⁸⁵ As previously explained, the FBAR form is required under the BSA, not the Code, and thus the IRS does not have the authority to substitute its form for the FBAR.
- ⁸⁶ Code Sec. 6038D(d)(1); Temporary Reg. §1.6038D-8T(a). Married specified individuals are subject to penalties as if they were a single specified individual. Temporary Reg. §1.6038D-8T(b). They are jointly and severally liable for such penalties.
- ⁸⁷ Code Sec. 6038D(d)(2); Temporary Reg. §1.6038D-8T(c).
- ⁸⁸ These penalties will not be imposed with respect to any failure that is shown to be due to reasonable cause and not due to willful neglect. Temporary Reg. §1.6038D-8T(e)(1). In order to do so, the specified individual must “make an affirmative showing of all of the facts alleged as reasonable cause for the failure to disclose.” Temporary Reg. §1.6038D-8T(e)(2).
- ⁸⁹ Code Sec. 6038D(g); Temporary Reg. §1.6038D-8T(e)(3).
- ⁹⁰ *See* Code Sec. 6038D(e); Temporary Reg. §1.6038D-8T(d).
- ⁹¹ *See* Code Sec. 6662(a), (b)(7) & (j); *see also* Temporary Reg. §1.6038D-8T(f)(1).
- ⁹² *See* Code Sec. 6501(c)(8)(A).
- ⁹³ *See* Code Sec. 6501(c)(8)(B).
- ⁹⁴ *See* Code Sec. 6501(e)(1)(A)(ii).