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Tax Enlightenment

New Reporting Requirements for Foreign Financial Assets

By: Christopher Rossi, *MST Student*

What is the best method to keep kids honest with regard to the cookie jar that sits in the middle of the kitchen filled with fresh baked cookies? Count the cookies! Of course, most parents do not go to these extremes over something as small as a cookie, but leave it to the federal government and you can be positive they would be counting the cookies and even the crumbs leftover if certain foreign assets of U.S. taxpayers are involved.

For many years now, the federal government has sought to obtain information with regard to the taxpayer's financial transactions with foreign financial institutions in order to ensure that U.S. taxpayers are properly reporting income that the foreign financial institutions might not be reporting to the Internal Revenue Service. One such information return is the Treasury Department Form TD F 90-22.1, "Report of Foreign Bank and Financial Accounts", ("FBAR"), which requires certain taxpayers to report their interest and/or authority over foreign bank and financial accounts if certain thresholds are met. The penalties, including criminal penalties, are quite steep for failure to file the information report and have been enforced more strictly in recent years.



The "Hiring Incentives to Restore Employment (HIRE) Act" enacted in March 2010 created new reporting requirements primarily for individuals with foreign financial assets. These new reporting requirements apply to more than just foreign bank and financial accounts. These rules are part of the "Foreign Account Tax Compliance Act" ("FATCA") provisions of the HIRE Act.

The new reporting requirements are effective for tax years beginning March 18, 2010, which for calendar year taxpayers would be their 2011 tax year. The new legislation requires that any individual taxpayer who holds an aggregate of \$50,000 or greater in "specified foreign financial assets" must disclose each asset on an individual's income tax return. The IRS has issued federal Form 8938, "Statement of Foreign Financial Assets," to be filed with an individual's income tax return to disclose the required information with regard to the taxpayer's "specified foreign financial assets."

At this point you may be asking yourself, "What is a 'specified foreign financial asset'?" A "specified foreign financial asset" is:

- Any financial account with a foreign financial institution; and
- Any of the following assets not held with a financial institution:
 - Stock or security of non-U.S. person; or
 - Financial instrument or contract whose issuer is a non-U.S. person; or
 - Any interest in a foreign entity.

With that clarified, it is clear that the ten Euros that you brought home with you from your last family vacation is not going to cause you any heartburn with regard to the new reporting requirements.

It is very important that you take time to inventory your personal financial assets to determine whether any of your investments could possibly be considered a “specified foreign financial asset” as there are substantial penalties for failing to disclose under the new rules. If a taxpayer fails to comply with the new information reporting requirements he could face an initial penalty of \$10,000 plus an additional \$10,000 each month after 90 days of receiving a notice from the IRS, not to exceed a maximum of \$50,000.

If you determine that you meet the requirements for the new disclosure, the information to be disclosed is not extensive, such as the name and address of the foreign financial institutions and/or the foreign financial securities. Perhaps the most difficult information to obtain will be the maximum value of the “specified foreign financial asset” during the tax year, which is required to be disclosed. For example, an interest held in a foreign limited partnership may not have an easily ascertainable fair market value unless a valuation report is obtained. With this said, the IRS has recently issued regulations that clarified that the maximum value to be reported only needs to be a reasonable estimate. Additional information can be found in the Form 8938 instructions. It will be interesting to see the extent to which the IRS scrutinizes the value of the assets that are based on estimates.

As always, due to the complexity of the tax law it is highly recommended that you consult your tax advisor if you have any questions or concerns with regard to the new reporting requirements and whether or not they may apply to you. The IRS also maintains a FATCA website at

<http://www.irs.gov/businesses/corporations/article/0,,id=236667,00.html>.

