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## New Reporting Requirements for Foreign Financial Assets

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Prior to this year, persons with foreign financial assets were primarily concerned with meeting one set of reporting requirements. Generally, this reporting requirement mandates that you disclose any account in which you have a financial interest or as to which you have signatory or other authority on Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (the “FBAR”), if the aggregate of such accounts total at least \$10,000. The FBAR is not part of the income tax return, however, and taxpayers are not required to disclose information reported on the FBAR on their tax returns. This much has not changed.

On March 18, 2010, the Hiring Incentives to Restore Employment Act (the “HIRE Act”) was signed into law. The Hire Act imposes a new reporting requirement for foreign financial assets **in addition to** the FBAR reporting requirements.

### New Reporting Requirement

Section 6038D of the Internal Revenue Code of 1986 (the “Code”) applies to tax years beginning after March 18, 2010. If the aggregate value of an individual taxpayer’s interests in “specified foreign financial assets” exceeds \$50,000 during the tax year, then the taxpayer must report the following on their income tax return.

1. The maximum value of such assets during the tax year;
2. The name and address of the financial institution and the account number for any financial accounts;
3. The name and address of the issuer of stocks and securities and such other information necessary to identify the class or issue of which the stock or security is a part; and

4. The information necessary to identify all instruments, contracts or interests along with the names and addresses of all issuers and counterparties with respect to the instrument, contract or interest.

A “specified foreign financial asset” includes any depository, custodial, or other financial account maintained by a foreign financial institution and any stock or security issued by a person other than a U.S. person, any financial instrument or contract held for investment that has an issuer or counterparty other than a U.S. person, or any interest in a foreign entity that are not held in an account maintained by a financial institution. Beneficiaries of trusts holding specified foreign financial assets may be required to disclose their interest in such trust with their tax return if the value of their interest in the trust, together with the value of their other specified foreign financial assets, exceeds the \$50,000 aggregate value threshold.

### Direct Penalty

The penalties for failing to comply with the new requirement are significant. The initial penalty is \$10,000. If the failure to disclose the required information continues for more than 90 days after notification from the IRS, an additional penalty of \$10,000 is assessed for each additional 30-day period during which the failure continues. The maximum penalty may not exceed \$50,000. A taxpayer may avoid the penalty only if they can show that the failure is due to reasonable cause, not including civil or criminal penalty imposed by a foreign jurisdiction for disclosing the required information, and not due to willful neglect.

### Other Penalties

In addition to the penalties described above, Code §6662 now lists “undisclosed foreign financial asset understatement” as an activity subjecting a taxpayer to the accuracy-related penalty on underpayments. This penalty is 40% of the portion of the understatement for the year that is attributable to any transaction involving an undisclosed foreign financial asset. An undisclosed foreign financial asset includes, but is not limited to, any asset that is subject to the information reporting requirements of Code §6038D for which the required information was not provided by the taxpayer in the manner required. As with Code §6038D, the only way a taxpayer can avoid this penalty is by a showing of reasonable cause for underpayment and good faith.

### Statute of Limitations

Generally, there is a three (3) year limitation period on assessment of taxes that commences when a timely and complete return is filed. There is now a new exception to the three (3) year statute of limitations period for assessment of tax in the case of certain omissions of income attributable to foreign financial assets. If a taxpayer omits more than \$5,000 from gross income and such amount is attributable to a foreign financial asset with respect to which (i) information reporting is required under Code §6038D or (ii) information reporting would be required if Code §6038D were applied without regard to the \$50,000 aggregate value threshold, then the limitations period is extended to six (6) years.

Accordingly, the extended statute of limitations applies not only in cases where the omitted income is attributable to foreign financial assets subject to the reporting requirements of

Code §6038D, but also applies in cases where the omitted income is attributable to foreign financial assets that the taxpayer **does not** have to report under Code §6038D because the value of the assets are less than \$50,000. Thus, taxpayers with more than \$5,000 in income from foreign financial assets have an incentive to report such amounts in gross income, even if the aggregate value of all of their foreign financial assets is less than \$50,000.

The new limitations exception applies to returns filed after March 18, 2010 **and** applies to returns filed on or before such date if the three (3) year limitation period has not expired as of such date. Consider the individual taxpayer who filed an income tax return on April 15, 2008. Such a taxpayer would be two (2) years into the limitations period for the 2008 return, which would ordinarily expire on April 15, 2011. Since the limitation period has not expired, the new limitations exception extends the limitation period to April 15, 2014.

### Conclusion

These provisions represent some very significant changes for those who have an interest in foreign financial assets. If you have, or believe you might have, specified foreign financial assets, now is a good time to review them to determine if you meet the new filing rules. You should consult with your legal and tax advisors to determine if you should report your specified foreign financial assets next year.

Attorneys in the Dean Mead Tax Department are familiar with all aspects of the new provisions and are able to discuss its application with you.

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