

Asset Management Alert



Form 8938 and Specified Foreign Financial Asset Reporting for Alternative Funds under §6038D

Section 6038D was enacted and added to the Internal Revenue Code by the Hiring Incentives to Restore Employment Act (the “HIRE Act”) passed in March 2010. This legislation requires any individual holding specified foreign financial assets (“SFFAs”) to report with their income tax return information about each such asset. To have a filing obligation, the taxpayer’s SFFAs must have an aggregate value for the year exceeding the applicable threshold, which currently varies based on an individual’s filing status and residency. Reporting is required for assets held in taxable years beginning after March 18, 2010 and generally comes into effect with the 2011 income tax filings for calendar year taxpayers. The Department of Treasury and the IRS also have regulatory discretion to require certain US entities that pose a significant risk of tax evasion to also report, and have issued proposed regulations that will require certain closely held domestic entities to report their SFFAs for tax years beginning after December 31, 2011.

In December 2011, the IRS issued a final version of Form 8938, Statement of Specified Foreign Financial Assets, along with instructions. Form 8938 is devised to facilitate the SFFA reporting requirements of §6038D, and requests information on account owner, type and value, among other items. The reporting is similar, but more detailed, than that currently done on Form TD F 90-22.1, *Report of Foreign Bank and Financial Accounts* (also known as FBAR).

While the impact of SFFA reporting on funds themselves is currently minimal, investors may be asking funds for additional information to complete their required filings. Below is a short overview of the current filing requirements and the type of assets that are required to be reported.

Note: This Alert is not intended to be a full summary of the reporting requirements under §6038D and of Form 8938. Please refer to the PwC Global Information Reporting Newsbrief on §6038D reporting and form instructions for further guidance, including details on filing thresholds, asset valuation and exceptions to filing for specified individuals. Links provided below.

Frequently asked questions

FAQ 1 – When is the filing due?

Form 8938 is required to be attached to the taxpayer’s annual income tax return and filed by the due date (including extensions) of that return.

FAQ 2 – Who currently needs to file?

Currently only “specified individuals” are required to file Form 8938. Specified individuals include US citizens, resident aliens in the US under IRC §7701(b) for any part of the year, statutory residents who elect non resident status under a tax treaty, non-resident aliens that make an election to file a joint resident return, bona fide residents of America Samoa or Puerto Rico, and bona fide residents of US territories if required to file an income tax return with the IRS.

FAQ 3 – Do entities need to file?

The proposed regulations relating to specified domestic entities only apply to taxable years beginning after December 31, 2011. Thus, there are no Form 8938 filing requirements for domestic entities, including alternative funds, at this time. The proposed regulations would apply to domestic entities formed or availed of for the purposes of holding, directly or indirectly, specified foreign financial assets. Such entities are referred to as “specified domestic entities” and include certain closely held corporations and partnerships that meet certain passive income/asset tests.

FAQ 4 – What assets need to be reported?

§6038D requires SFFAs to be reported once certain reporting thresholds have been met. SFFAs are defined under 2 broad categories:

- 1) Any **financial account** maintained by a foreign financial institution:
 - a) A financial account is any depository or custodial account maintained by a foreign financial institution
 - b) Any debt or equity interest in a foreign financial institution (other than interests regularly traded on an established securities market).

Generally, a **foreign financial institution** (FFI) is any financial institution that is not a US entity and satisfies one or more of the following: (1) accepts deposits in the ordinary course of business, (2) holds financial assets for the account of others as a substantial part of its business or, (3) is engaged (or holds itself out as being engaged) in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interest (including a futures or forward contract or option) in such securities, partnership interests, or commodities. Note the definition of “engaged in a trade or business” differs under §6038D from its definition under other code sections. Regardless of a fund’s status as trader or investor, Treasury has specifically stated that an FFI includes investment vehicles such as foreign mutual funds, foreign hedge funds and foreign private equity funds.

- 2) **Other foreign financial** assets held for investment that are **not** in an account maintained by a US or foreign financial institution, including:
 - a) Stock or securities issued by someone other than a US person
 - b) Any interest in a foreign entity
 - c) Any financial contract that has an issuer or counterparty that is other than a US person.

Specified individuals that have an investment in excess of the applicable threshold in a non-US fund would be required to file Form 8938 and report the value of the fund.

FAQ 5 – What type of information will investors in non-US funds require?

Filers will need to report a description of the asset, identifying number or other designation, the date the fund interest was acquired or disposed, maximum value during the year, exchange rate used to convert the value to USD if the fund does not use USD as its functional currency, name of fund, address, entity type and entity’s PFIC status. Investors will also need to report the amount and character of taxable income attributable to the fund in Part III of the form.

Generally, investors in hedge and private equity funds will need to report their interest in the fund itself, but not the assets of the funds. There is no “look-through” required for investors.

FAQ 6 – How should the reporting requirement and necessary information be communicated to investors?

While it is not the fund’s responsibility to determine an investor’s tax filing obligations, from an investor relations standpoint funds may choose to notify investors of the potential new reporting requirement. As such, and given much of the information may already be provided to investors through existing investor communications and documents (i.e., Schedule K-1, PFIC statements, NAV reports, subscription documents, etc.), funds will vary in their approach to providing any additional information required by investors or in summarizing information their investors may already have.

Where the reporting obligation lies with investors in a foreign partnership that files a US tax return, funds may notify investors of the filing obligation and provide information to complete the filing by adding an additional footnote to the K-1. Where the reporting obligation lies with investors in a foreign corporation, funds may provide the information through a letter/statement to investors. Footnotes and statements can be simple notifications of a potential filing obligation, or more detailed summaries with the information needed to complete the form. Alternatively, funds may choose to wait for investors to request additional information and respond on an as needed basis. Where funds choose a simple notification or choose to deal with requests on an as needed basis, they should consider gathering and reviewing the necessary reporting information as part of the overall tax reporting process, facilitating the response to any subsequent investor request.

FAQ 7 – In which section of the Form 8938 are funds reported?

Funds would be reported in Part II, Other Foreign Assets.

FAQ 8 – What if the investor already files Form 8621, 8865 or 5471 with respect to the fund?

To avoid duplicative reporting, if the investor already files an informational form with respect to an asset, the asset does not need to be reported in detail on Form 8938. Instead, Part IV of Form 8938 should be completed on which the taxpayer should indicate what other informational form was filed. See Part IV of Form 8938 for a full listing of qualifying forms.

FAQ 9 – Does an interest in a §475(f) fund need to be reported on Form 8938?

If a fund has a §475(f) election in place for all of its holdings, the fund is not considered a SFFA and the interest is not required to be reported.

FAQ 10 – There is a lot of overlap between Form 8938 and Form TD F 90-22.1 – do investors still need to file the FBAR?

Yes, filing Form 8938 does not relieve you of the requirement to file the FBAR or vice-versa.

FAQ 11 – What are the penalties?

Failure to report foreign financial assets will result in a penalty of \$10,000, rising to \$50,000 for continued failure after 90 days from IRS notification. Furthermore, underpayments of tax attributable to non-disclosed foreign financial assets will be subject to the additional substantial understatement penalty of 40 percent. If the taxpayer fails to file or properly report an asset on Form 8938, the statute of limitations for the taxable year may be extended until 3 years after the taxpayer provides the required information.

If you have additional questions on the above, please contact James Cameron at 646 471 8234, Puneet Arora at 646 471 1691, Kevin Ciavarra at 646 471 8203 or Candace Ewell at 202 312 7694.

For more information:

Please click here to download Form 8938: <http://www.irs.gov/pub/irs-pdf/f8938.pdf>

Please click here to download the instructions to Form 8938: <http://www.irs.gov/pub/irs-pdf/i8938.pdf>

Please click here to download a related PwC Global IRW Newsbrief:

<http://www.publications.pwc.com/DisplayFile.aspx?Attachmentid=5251&Mailinstanceid=22952>

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