

HRS Insight

Human Resource Services

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Although the IRS is still in the process of interpreting the reporting requirements, it has released temporary regulations that may impose significant burdens on foreign employers and parent companies and their employees here in the U.S. and abroad.

IRS Issues Temporary Regulations on Reporting of Foreign Financial Assets Held by Individuals

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Potential Impact on Compensation Plans

Under the Hiring Incentives to Restore Employment Act, an individual who holds specified foreign financial assets during the taxable year is required to report information on those assets on the individual's federal income tax return if the total value of those assets for that year exceeds a certain dollar threshold. The IRS has issued temporary regulations on these reporting requirements for individuals. Reporting must begin for the individual's 2011 tax year. Reporting under the Treasury Department Report of Foreign Bank and Financial Accounts (FBAR, TD F90-22.1) rules is not

sufficient; taxpayers subject to both reporting regimes must provide separate reporting. Penalties of up to \$50,000 per year may be assessed on the individual for a missing or incomplete filing.

Although the IRS is still in the process of interpreting the statute, it has released temporary regulations that may impose significant burdens on foreign employers and parent companies and their employees in the U.S. and abroad. **It is possible that compensation plans such as deferred compensation, stock options and RSUs offered by foreign companies to U.S. taxpayers will be covered by these rules.**



Comments on the temporary regulations and requests for a public hearing are due by February 18, 2012. Employers should take this opportunity to review the new rules, consider how these compensation programs sponsored by non-U.S. entities may be impacted, and determine how to assist employees in accumulating the required information. Employers may wish to submit comments or testimony to the IRS on potential burdens and possible exclusions under these rules.

Background

The new law requires an individual who holds any interest in a specified foreign financial asset during the tax year to report the foreign financial asset and its value as part of the individual's tax return for the year if the aggregate value of all such foreign assets exceeds a dollar threshold. This information must be reported on Form 8938, Statement of Specified Foreign Financial Assets. The IRS has issued temporary regulations providing guidance on this reporting requirement. The regulations apply to tax years ending after December 19, 2011; thus, individuals must provide this information on their 2011 Form 1040.

Individuals Subject to Reporting

This reporting requirement applies to U.S. citizens, resident aliens of the U.S., and non-resident aliens who have made an election to be taxed as a U.S. resident. The dollar threshold for

married individuals filing a joint return is \$100,000 on the last day of the taxable year or \$150,000 at any time during the taxable year, and for all other taxpayers it is \$50,000 at the end of the year or \$75,000 at any time during the taxable year. In addition, an individual residing outside of the U.S. who is a qualified individual under Section 911(d)(1) is subject to the reporting requirements only if the value of all specified foreign financial assets exceed \$200,000 on the last day of the tax year or \$300,000 at any time during the year (or for married individuals filing a joint return specified foreign assets exceeding \$400,000 at the end of the year or \$600,000 at any time during the taxable year). Taxpayers who are not required to file Form 1040 or Form 1040-NR for a tax year are not required to file Form 8938.

Interest in a specified Foreign Financial Asset

For these purposes, a specified person is generally considered to have an interest in a specified foreign financial asset if any income, gains, losses, or distributions attributable to the holding or disposition of the asset are or would be required to be reported, included, or otherwise reflected on the specified individual's tax return, even if no income, gains, etc. are attributable to the asset for a particular year.

The temporary regulations provide that specified foreign financial assets include financial accounts maintained by foreign financial institutions, as well

as certain other foreign financial assets or instruments, even if these assets or instruments do not have a positive value. Specified foreign financial assets also include (i) stock issued by a foreign corporation, (ii) a capital or profits interest in a foreign partnership, (iii) an interest in a foreign trust, (iv) a note, bond or other form of indebtedness issued by a foreign person, and (v) an option or other derivative instrument issued with respect to stock, a capital or profits interest, or a note, bond or other indebtedness.

Observation: If a U.S. citizen working in the U.S. receives a restricted stock unit in a foreign parent company's stock and the award provides for the current payment of dividend equivalent amounts, it is possible that the U.S. citizen would be subject to these reporting requirements (if the dollar limits are met). The temporary regulations do not limit reporting on options to publicly traded options; thus, it appears that a U.S. citizen would have to include compensatory options granted on foreign parent stock. Further, there is no discussion in the regulations on the impact of a vesting schedule. It is possible that an option or restricted stock grant will have to be reported even if the employee's rights are subject to a substantial risk of forfeiture.

Information that Must Be Reported

The information that must be disclosed for each foreign financial asset includes:

- (i) The name and address of the foreign financial institution, the foreign entity, or the issuer of the foreign financial asset;
- (ii) All applicable account numbers;
- (iii) The date, if any, on which the foreign financial asset was acquired or disposed of (or both) during the taxable year;
- (iv) The maximum value of the foreign financial asset during the portion of the taxable year in which the individual has an interest in the asset; and
- (v) The amount of any income, gain, loss, deduction, or credit recognized for the taxable year with respect to the foreign financial asset, and the schedule, form or return filed with IRS reporting such income, loss, etc.

Valuation

The fair market value of the foreign asset on the last day of the individual's

tax year generally may be used as the maximum value of the asset for the full year. The fair market value may be determined using publicly available information or from other verifiable sources. An individual is not required to get a third party valuation to estimate the asset's value.

The temporary regulations establish special rules for valuing interests in foreign pension plans and deferred compensation plans. For these purposes, the maximum value of an individual's interest in a foreign pension plan or foreign deferred compensation plan is the fair market value on the last day of the tax year of the individual's beneficial interest in the pension or deferred compensation plan. If that value is not known or cannot be determined from readily accessible information, the maximum value to be reported is the fair market value at year-end of any currency and other property distributed during the taxable year to the individual as a beneficiary or participant.

Observation: *The regulations do not distinguish between vested and unvested rights under a plan. It is possible that the IRS will require reporting for unvested rights in a pension or deferred compensation arrangement.*

Penalties for Noncompliance

If a specified person fails to file

Form 8938 with the required information with respect to any taxable year, a penalty of \$10,000 may apply to that person. If the failure continues for more than 90 days after the date the IRS mails a notice of the reporting failure, the specified person is subject to an additional \$10,000 for each 30-day period (or fraction thereof) after the end of the 90-day period with a maximum penalty of \$50,000 for each failure. No penalty will be imposed if the specified person shows that the reporting failure is due to reasonable cause and not due to wilful neglect. However, the temporary regulations provide that the fact that a foreign jurisdiction would impose a civil or criminal penalty on the individual or any other person for disclosing the required information is not reasonable cause, therefore it appears that the IRS may set a high bar to overcome.

Next Steps

Both foreign employers and U.S. subsidiaries of a foreign parent company should review compensation programs in light of the temporary regulations. If U.S. participants in these arrangements are subject to this new reporting, the participants may need assistance in assembling the necessary information, including the valuation of foreign assets.

For more information, please do not hesitate to contact your local PwC professional:

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