

Expert Analysis

# Countdown To Tax Compliance For Global Individuals

By **Lucy Lee and James Maynor** September 18, 2018, 3:25 PM EDT

The due date for filing 2017 U.S. federal income tax returns for individuals who have requested an extension is Oct. 15, 2018. With only one month left until the deadline, we have prepared a list of 10 common tax reporting obligations that may be relevant to global individuals with cross-border assets or activities.



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## Information Returns Relating to Offshore Entities

### 1. Form 5471

Form 5471 is used by U.S. persons who are officers, directors or shareholders in certain foreign corporations, including controlled foreign corporations, or CFCs, to satisfy the reporting requirements of Sections 6038, reporting with respect to certain foreign corporations, and 6046, returns relating to organizations and reorganizations of foreign corporations.[1]



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Recent legislation known as the Tax Cuts and Jobs Act expanded the definition of a “United States shareholder” to include U.S. persons who own stock representing 10 percent or more of the total value or total voting power of a foreign corporation.[2] Previously, the definition considered only voting power and not value. In addition, the TCJA expanded the scope of the “downward” attribution rules to allow stock owned by a foreign person to be treated as owned by a U.S. person.[3]

As a result of these rules, foreign corporations with U.S. ownership are more likely to be classified as CFCs and U.S. persons owning stock in such corporations are more likely to be classified as United States shareholders — likely causing a substantial increase in Form 5471 reporting obligations and deemed dividend inclusions under the Subpart F rules.[4]

Therefore, U.S. persons should comprehensively analyze the application of the new rules to their existing ownership structures to determine if they have Form 5471 reporting obligations that did not exist prior to the TCJA.

Failure to file can result in an initial penalty of \$10,000 for each form and suspension of the statute of limitations with respect to the individual's entire tax return.

## **2. Form 926**

U.S. persons generally file Form 926 to report certain transfers and deemed transfers of property to a foreign corporation.[5] The potential scope of this reporting requirement is broad and even insubstantial transfers may be subject to reporting. For example, a U.S. person that transfers cash to a foreign corporation is required to report the transfer on Form 926 if: immediately after the transfer, the U.S. person holds (directly, indirectly or by attribution) at least 10 percent of the total voting power or total value of the foreign corporation (regardless of the amount of cash transferred); or the amount of cash transferred by the U.S. person or any related person to the foreign corporation during the 12-month period ending on the date of the transfer exceeds \$100,000.[6]

Failure to file can result in a penalty equal to 10 percent of the fair market value of the property transferred.

## **3. Form 8621**

In general, a U.S. person is required to file Form 8621 for a passive foreign investment company, or PFIC, for any tax year in which the U.S. person directly owns stock of the PFIC or is the "lowest-tier" U.S. person that is an indirect shareholder of the PFIC.[7] Additionally, a U.S. person who owns an interest in a PFIC through another U.S. person is required to file Form 8621 in various circumstances, including when the first-mentioned U.S. person is treated as receiving an excess distribution with respect to the PFIC or is required to include an amount in income with respect to the PFIC.[8]

Form 8621 is also used to make "purging" elections to avoid the onerous tax consequences of PFIC ownership under the excess distribution regime.

The Department of the Treasury regulations governing Form 8621 filing, which were

finalized in December 2016,[9] contain a variety of complex special rules and exceptions beyond the general summary provided above. U.S. taxpayers should carefully analyze the application of this recent guidance to their existing PFIC interests to determine how their Form 8621 reporting obligations may be affected.

Failure to file can result in an initial penalty of \$10,000 for each form and suspension of the statute of limitations with respect to the individual's entire tax return.

#### ***4. Forms 8865 and 8858***

For U.S. persons owning interests in foreign pass-through entities, Form 8865, for foreign partnerships, or Form 8858, for foreign disregarded entities, filing obligations may be applicable.[10] At a very high level, these filing requirements can be described as analogous to Form 5471 and Form 926 reporting with respect to foreign corporations. However, the Treasury regulations implementing these rules are complex and have been subject to recent amendments, so U.S. taxpayers would be well-advised to review how the current rules apply to their existing ownership structures.

### **Information Returns Relating to Offshore Trusts**

#### ***5. Forms 3520 and 3520-A***

U.S. persons who maintain or engage in certain transactions with an offshore trust during the year are generally required to report such transactions on Form 3520. Such reportable transactions include: the creation of an offshore trust; gratuitous transfers to an offshore trust; the receipt of property or distributions (actual or deemed) from an offshore trust;[11] and the receipt, in the aggregate, of gifts or bequests in excess of \$100,000 from a nonresident alien or a non-U.S. estate during the year.[12] In addition, a U.S. person who is treated as the owner of any part of an offshore grantor trust is required to cause the trust to file Form 3520-A to report information about the trust's activities, income and assets.[13]

Failure to file Form 3520 can result in a penalty of 35 percent of the gross value of the property transferred to or received from the trust or 25 percent of the value of gift or bequest. Failure to file Form 3520-A can result in a penalty imposed on the grantor equal to 5 percent of the gross value of the portion of the trust's assets treated as owned by the individual.

## **Information Returns Relating to Offshore Financial Assets**

### ***6. Report of Foreign Bank and Financial Accounts***

In general, each U.S. person having a financial interest in, or signature or other authority over, a bank, securities or other financial account in a foreign country exceeding \$10,000 is required to report such relationship by filing a report of foreign bank and financial accounts, or FBAR.[14] The FBAR filing is made electronically on FinCEN Form 114.

FBAR filings for a calendar year used to be due on June 30 of the following year. However, 2015 legislation changed the FBAR filing deadline to April 15 to coincide with the due date for U.S. individual federal income tax returns. In addition, FinCEN has granted all filers failing to meet the April 15 due date an automatic extension to Oct. 15 of each year.[15] FBAR filers for the 2017 calendar year therefore have an extension to Oct. 15, 2018, even if they did not request an extension.

A nonwillful failure to file can result in a penalty of \$10,000 for each account, while a willful failure to file can result in a penalty of the greater of \$100,000 or 50 percent of the value of foreign accounts. There can also be criminal penalties.

### ***7. Form 8938***

U.S. persons who own interests in specified foreign financial assets are required to file Form 8938 if the value of such assets exceeds certain thresholds.[16] For this purpose, “specified foreign financial assets” include:

- Financial accounts maintained by a foreign financial institution;
- Other foreign financial assets held for investment if they are not held at a foreign financial institution including:
  - Stock or securities issued by a non-U.S. person,

- Any interest in a foreign entity, and
- Any financial instrument or contract that has a non-U.S. person issuer or counterparty; and
- Certain other foreign financial assets, including interests in foreign pension or deferred compensation plans, foreign trusts or estates and certain foreign life insurance policies.

Although there are some exceptions for duplicative reporting (e.g., for assets reported on Form 5471), there currently is no exception for assets reported on an FBAR. Therefore, both an FBAR and Form 8938 must be filed (if required), even if they report the same assets. Failure to file can result in an initial penalty of \$10,000.

## **Disclosures Relating to Residency Status**

### **8. Form 8833**

An individual who would otherwise be classified as a U.S. resident under U.S. domestic law may be eligible to elect nonresident status under the “tie-breaker rules” of an applicable U.S. income tax treaty. Such individuals are required to file Form 8833 to disclose their position that their residency is determined under a treaty, as well as to disclose other treaty-based reporting positions.[17]

### **9. Form 8840**

An individual who would otherwise be classified as a U.S. resident under the “substantial presence test” must file Form 8840 to claim nonresident status pursuant to the “closer connection exception.”[18] If a foreign person would not otherwise be required to file a U.S. federal income tax return, Form 8840 may be submitted separately to the [IRS Service Center](#) in Austin, Texas. Importantly, the applicable Treasury regulations provide that the IRS may deny an individual’s eligibility to claim the closer connection exception if Form 8840 is not timely filed.[19]

### **10. Form 8843**

Form 8843 is used by a nonresident to claim that she can exclude days of physical

presence in the United States for purposes of the substantial presence test. For example, Form 8843 filing may be required in various circumstances by teachers, trainees, students, athletes or individuals with a medical condition.[20] Failure to file the form by an individual seeking exemption as a professional athlete or because of a medical condition or medical problem can result in the individual's exempt status being denied.

## Conclusion

Due to the complexities of the reporting obligations described above, taxpayers are urged to consult with their tax professionals before filing their returns.

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[1] Unless otherwise noted, all section references herein are to the Internal Revenue Code of 1986, as amended, and the regulations thereunder.

[2] **I.R.C. § 951** (b). The revised definition applies to tax years of foreign corporations beginning after Dec. 31, 2017, and tax years of U.S. shareholders with or within which such tax years of foreign corporations end. See Pub. L. 115-97 § 14214(b).

[3] **I.R.C. § 958** (b). These rules apply to the last tax year of foreign corporations beginning before Jan. 1, 2018, and each subsequent tax year of the foreign corporations, and tax years of U.S. shareholders in which or with which such tax years of foreign corporations end. See Pub. L. 115-97 § 14213(b).

[4] The IRS has issued guidance announcing relief from Form 5471 filing for certain constructive owners of a CFC. See IRS Notice 2018-13, § 5.02. However, the relief is limited to situations in which no United States shareholder owns stock directly or indirectly in the CFC, so it will not be available to all U.S. persons affected by the new downward attribution rules.

[5] I.R.C. § 6038B (b); Treas. Reg. §§ 1.6038B-1 and 1.6038B-1T.

[6] Treas. Reg. § 1.6038B-1(b)(3).

[7] Treas. Reg. § 1.1298-1(b)(1).

[8] Treas. Reg. § 1.1298-1(b)(2).

[9] See 81 Fed. Reg. 95459 (Dec. 28, 2016).

[10] I.R.C. §§ 6038, 6038B, and 6046A.

[11] I.R.C. § 6048 (a).

[12] I.R.C. § 6039 F(a); IRS Notice 97-34, 1997-1 C.B. 422. A lower limitation (\$15,797 for the 2017 tax year) applies for gifts received from foreign partnerships or foreign corporations. See Rev. Proc. 2016-55.

[13] I.R.C. § 6048(b).

[14] 31 C.F.R. §§ 1010.350 (a); 1010.306 (c).

[15] See FinCEN Statement, “FBAR Due Date Clarification” (Feb. 2, 2018).

[16] The thresholds are: (i) for taxpayers living in the United States, \$50,000 (\$100,000 for married taxpayers filing a joint return) on the last day of the tax year or \$75,000 (\$150,000 for married taxpayers filing a joint return) at any time during the tax year; and (ii) for taxpayers living outside of the United States, \$200,000 (\$400,000 for married taxpayers filing a joint return) on the last day of the tax year or \$300,000 (\$600,000 for married taxpayers filing a joint return) at any time during the tax year.

[17] [Treas. Reg. § 301.7701\(b\)-7\(b\)](#) .

[18] [Treas. Reg. § 301.7701\(b\)-8\(a\)\(1\)](#) .

[19] [Treas. Reg. § 301.7701\(b\)-8\(d\), \(e\)](#).

[20] [Treas. Reg. § 301.7701\(b\)-8\(a\)\(2\)](#).