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Comments on
Internal Revenue Bulletin: 2012-8, February 21, 2012, REG-130302-10, Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations Reporting of Specified Foreign Financial Assets (T.D. 9567)

The Estate and Gift Taxation Committee of the New York City Bar Association (the "Committee") respectfully submits its comments with respect to Proposed Regulations §§ 1.6038D-0 through -8, which pertain to the required reporting of foreign financial assets on Form 8938, "Statement of Specified Foreign Financial Assets."

The Exception to the Definition of Specified Domestic Entities for Certain Domestic Trusts under Prop. Reg. § 1.6038D-6(d) Should Be Extended to Trusts Not Required to File U.S. Income Tax or Information Returns

Summary: For the sake of fairness and consistency, a domestic trust for which the bank, financial institution, or corporate trustee is not required to file any annual tax or information returns for a particular tax year on behalf of such domestic trust should be exempt from filing Form 8938 for such tax year.

Background: Under Prop. Reg. § 1.6038D-6(a), "specified domestic entities," which are subject to the reporting requirements of Code section 6038D, include certain domestic trusts within the meaning of Code section 7701(a)(30)(E).

While Prop. Reg. § 1.6038D-2(a)(7)(i) exempts "specified persons" from the Code section 6038D reporting requirements with respect to a tax year if such persons are not required to file a Form 1040 for such year, no such exception exists for certain domestic trusts that may not be required to file Form 1041 for a particular tax year.

Under Prop. Reg. § 1.6038D-6(d)(2), certain domestic trusts do not fall under the "specified domestic entity" rubric if the trustee meets the following requirements: (i) it has supervisory authority over or fiduciary obligations

with regard to the specified foreign financial assets held by the trust; (ii) it timely files (including any applicable extensions) annual returns and information returns on behalf of the trust; and (iii) it is a bank or financial institution examined or regulated by certain federal agencies or is a domestic corporation.

The Committee believes that it would be wholly consistent with the objective of the Proposed Regulations to exclude otherwise compliant trustees from the Code section 6038D reporting requirements in the case of domestic trusts that are not required to (and, consequently, do not) file with the IRS a Form 1041 or information returns for a particular tax year. Such a change would be consistent also with the filing requirements for specified individuals under the Proposed Regulations.

Recommendation: The language of Prop. Reg. § 1.6038D-6(d)(2)(ii) should be broadened to exclude from the "specified domestic entity" rubric for a particular tax year a domestic trust for which the bank, financial institution, or corporate trustee is not required to file any annual tax or information returns for such tax year on behalf of such domestic trust.

The Exception to the Definition of Specified Domestic Entities for Certain Domestic Trusts under Prop. Reg. § 1.6038D-6(d) Should Be Extended to Include Entities Owned by the Specified Domestic Entity

Summary: When a domestic trust (or trusts) having a bank, financial institution, or corporate trustee or trustees is exempt from filing Form 8938 for a certain tax year, any specified domestic entity that is a corporation or partnership that is 100% owned by such specified domestic trust (or trusts) should also be exempt from filing Form 8938 for such tax year.

Background: Under Prop. Reg. § 1.6038D-6(a), "specified domestic entities," which are subject to the reporting requirements of I.R.C. § 6038D, include certain domestic trusts within the meaning of I.R.C. § 7701(a)(30)(E).

As discussed above, under Prop. Reg. § 1.6038D-6(d)(2), certain domestic trusts do not fall under the "specified domestic entity" rubric if the trustee meets certain requirements.

If a domestic trust that otherwise meets the requirements of the exception owns its assets through a corporation or partnership that meets the definition of a specified domestic entity under Prop. Reg. § 1.6038D-6(b), then the corporation or partnership is required to file Form 8938.

The Committee believes that it would be wholly consistent with the objective of the Proposed Regulations to exclude from the I.R.C. § 6038D reporting requirements a domestic corporation or partnership that is 100% held by a domestic trust (or trusts) that is otherwise exempt from the reporting requirements of I.R.C. § 6038D.

Recommendation: The language of Prop. Reg. § 1.6038D-6(b) should be broadened to exclude from the "specified domestic entity" rubric for a particular tax year a domestic corporation or partnership that is wholly owned by a domestic trust (or trusts) for which the bank, financial institution, or corporate trustee is exempt for such tax year from the reporting requirements of I.R.C. § 6038D.

Disregarded Entities

Summary: Prop. Reg. 1.6038D-7(a)(1)(i) provides that a specified person is not required to report a specified foreign financial asset ("SFFA") on Form 8938 if such SFFA is reported on certain other timely filed forms. U.S. owners of foreign disregarded entities already must report SFFAs on Form 8858. The Proposed Regulations should be amended so as not to require the reporting of SFFAs on both Form 8938 and Form 8858.

Background: Section 1.B of the Explanation of Provisions in the preamble to the temporary 6038D regulations provides that "[a] specified person that is the owner of an entity disregarded as an entity separate from its owner . . . is treated as having an interest in any specified foreign financial assets held by the disregarded entity." Owners of foreign disregarded entities must file Form 8858, "Information Return of U.S. Persons With Respect To Foreign Disregarded Entities," and any SFFAs held by the disregarded entity must be reported on said form.
Prop. Reg. 1.6038D-7(a)(1)(i) provides that a specified person is not required to report a SFFA on Form 8938 if such SFFA is reported on certain other timely filed forms. Form 8858 currently is not listed among such forms. The Committee respectfully submits that Prop. Reg. 1.6038D-7(a)(1)(i) should specifically include Form 8858 among such forms, so that a SFFA reported on a timely filed Form 8858 for a particular taxable year will not have to be reported also on Form 8938.

Recommendation: The Committee respectfully submits that Prop. Reg. 1.6038D-7(a)(1)(i) should provide that a specified person is not required to report a SFFA on Form 8938 for a particular tax year if such SFFA is reported on a timely filed Form 8858 for that year.

Reporting of Interests by Trusts with Discretionary Beneficiaries

Summary: Many trusts allow the trustee at his or her discretion to make distributions of income or principal to a beneficiary. Until a discretionary beneficiary receives an actual distribution from a discretionary trust, however, such discretionary beneficiary's interest in such trust generally is unvested and contingent. Prop. Reg. § 1.6038D-6 provides that domestic trusts formed or availed of for the purpose of "holding, directly or indirectly, specified foreign assets" must report under the same rules as an individual if the trust (i) has an interest in a foreign financial asset and (ii) has one or more specified persons as current beneficiaries. A "current beneficiary" is defined in Prop. Reg. § 1.6038D-6(c)(2) as any person who could receive a distribution. The Committee respectfully submits that the definition of "current beneficiary" is too broad in its application to domestic discretionary trusts. Rather, there should be an exception for domestic discretionary trusts that either do not make distributions to U.S. persons or have a minority of domestic beneficiaries.

Background: I.R.C. § 6038D requires that individuals who hold any interest in SFFAs valued in the aggregate at more than $50,000 on the last day of the taxable year or $75,000 at any time during the taxable year must attach to their individual income tax return a statement (Form 8938) reporting information about such SFFAs. I.R.C. § 6038D(f) applies these reporting requirements to certain entities that are "formed or availed of for the purpose of holding, directly or indirectly,

specified foreign financial assets, in the same manner as if such entity were an individual" to the extent provided in regulations or other guidance.

Prop. Reg. § 1.6038D-6(c) provides that a domestic trust is a specified domestic entity if the trust was "formed or availed of for the purpose of holding, directly or indirectly, specified foreign assets if and only if the trust—(1) [h]as an interest in specified foreign financial assets . . . and (2) [h]as one or more specified persons as a current beneficiary."

Prop. Reg. § 1.6038D-6(c)(2) defines the term "current beneficiary" as "any person who at any time during such taxable year is entitled to, or at the discretion of any person may receive, a distribution from the principal or income from the trust . . . ." This language can be read so broadly as to encompass all domestic trusts that have an interest in SFFAs and that have a specified person as a beneficiary, whether or not such beneficiary's interest in the trust ever vests. Accordingly, under the current definition, a trust that never makes a distribution to a specified beneficiary of a domestic discretionary trust could still have an annual reporting requirement.

The definition of "current beneficiary" also would include the situation in which a domestic discretionary trust with (i) an interest in SFFAs whose aggregate value meets the filing threshold and (ii) 100 contingent beneficiaries, only one of whom could be defined as a specified person, would still have an annual reporting requirement under I.R.C. § 6038D, even if that one specified person's interest in the trust never vests, i.e., that specified person never receives a distribution.

Recommendation: The Committee respectfully submits that Prop. Reg. § 1.6038D-6(c) should limit the application of the reporting requirements under I.R.C. § 6038D for a domestic discretionary trust to domestic trusts (i) that make actual distributions to a specified person in a tax year or (ii) 50% or more of whose beneficiaries are specified persons. A domestic trust that merely has a specified person as a contingent beneficiary and that does not make distributions to such person during the taxable year should not rise to the level of having to report its interest in SFFAs for such taxable year under I.R.C. § 6038D.

Reporting of Interests by Discretionary Beneficiaries of Foreign Trusts

Summary: Often trusts are created by non-U.S. persons in foreign jurisdictions for local law purposes. To the extent that a specified person knows or has reason to know of his or her interest in a foreign trust, or receives a distribution from a foreign trust, such person must report the interest on Form 8938. Prop. Reg. § 1.6038D-5 and the Form 8938 Instructions provide for a method of valuing an interest in a foreign trust when actual distributions are made, or when there is a mandatory right to distributions. The Committee reads this to mean that when a specified person is a discretionary beneficiary of a foreign trust, to the extent that the discretionary beneficiary is otherwise required to file Form 8938, his or her interest in a foreign trust must be reported as having a zero value for years in which such person does not receive a distribution. The Committee respectfully submits that a specified person who otherwise meets the reporting threshold of I.R.C. § 6038D should not have to report his or her contingent interest in a foreign trust to the extent that no distributions are made in a particular tax year.

Background: Prop. Reg. § 1.6038D-3(c) provides that "[a]n interest in a foreign trust or a foreign estate is not a specified foreign financial asset of a specified person unless the person knows or has reason to know based on readily accessible information of the interest. Receipt of a distribution from the foreign trust or foreign estate constitutes actual knowledge for this purpose."

The Committee believes that reporting on the part of discretionary trust beneficiaries should be required only for those years in which a discretionary beneficiary actually receives a distribution from a trust. First, it is unclear what constitutes "readily accessible information" under Prop. Reg. § 1.6038D-3(c). For example, a family member may have told a specified person only that the latter is a discretionary beneficiary of a foreign trust, without revealing to the beneficiary the terms of the trust agreement, the identity of the trustee, or the size of the trust corpus. It would be helpful if the Proposed Regulations were amended to include examples to clarify the meaning of "readily accessible information."

The valuation of an interest in a foreign trust is calculated under Prop. Reg. § 1.6038D-5, which provides that the value of the specified person's interest in a foreign trust is calculated by taking the sum of (i) the fair market value of property distributed from the foreign trust to the specified person as beneficiary plus (ii) the present value of the mandatory beneficiary's right to receive income. In other words, the valuation guidelines under Prop. Reg. § 1.6038D-5 provide guidance for mandatory beneficiaries of foreign trusts rather than for discretionary beneficiaries of trusts.

The Committee reads the guidance provided under Prop. Reg. § 1.6038D-5 to mean that discretionary beneficiaries of a foreign trust, to the extent that they otherwise are required to file Form 8938, are obliged to disclose their interest in a foreign trust, even if they did not receive a distribution in that taxable year, or, indeed, even if they never receive a distribution from such foreign trust. Information concerning the zero value of a trust that may never even benefit the specified person does not appear to provide any substantive information to the IRS, nor does it appear to further the intent of the I.R.C. § 6038D reporting requirements.

Further, a discretionary beneficiary in question receiving no distributions from a trust is not required to file Form 3520, "Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts," in connection with his or her interest in such trust. The Committee suggests that if a beneficiary does not have to file Form 3520 for a particular tax year in connection with distributions received from a foreign trust, then such beneficiary should not be required to file Form 8938 with respect to such trust.

Alternatively, if a discretionary beneficiary must file Form 8938 in such a case, the Committee feels that the Form 8938 Instructions should be amended to provide explicitly for a reporting value of $0. Currently, the Regulations do not address the issue. The Form 8938 Instructions provide specifically that, in valuing interests in foreign estates, foreign pension plans, and foreign deferred compensation plans, if the filer received no distributions during the tax year and does not "know or have reason to know based on readily accessible information" the fair market value of his or her interest as of the last day of the tax year, the filer should "use a value of zero as the maximum value of the asset" (p. 2). No similar language is provided in the Instructions

for valuing interests in foreign trusts. Rather, the Form 8938 Instructions state that, in valuing one's interest in a foreign trust, the maximum value is the sum of (i) the value of all cash and other distributions received from the trust during the calendar year and (ii) the value under Code section 7520 of the beneficiary's right to receive mandatory distributions (p. 5, based on the provisions of Prop. Reg. 1.6038D-5(f)(2)(i)). Obviously, if a discretionary beneficiary receives no distributions during a calendar year, the value of (i) would be zero, and the value of (ii) would be zero as well by definition, since a discretionary beneficiary has no right to receive mandatory distributions. It would be much clearer, however, if the Instructions were amended to provide that if the filer received no distributions during the tax year from a foreign trust and does not know or have reason to know based on readily accessible information the fair market value of his or her interest in the trust as of the last day of the tax year, then the filer should use a value of zero as the maximum value of the trust.

Recommendation: The Committee respectfully submits that the discretionary beneficiary of a foreign trust who does not receive a distribution in a tax year should not be required to report a zero value for such trust on Form 8938, even if he or she is filing the form because he or she otherwise meets the filing threshold. Alternatively, the Committee recommends that the Form 8938 Instructions be amended to state explicitly that, in such a situation, the reportable value of such discretionary beneficiary's interest in such trust is, indeed, zero.

Other Foreign Assets Not Reportable Under the Categories

Summary: The definition of "other foreign financial assets" under Prop. Reg. § 1.6038D-3 encompasses unusual assets that are not easily categorized under Part II of Form 8938. In the case in which a SFFA is held for investment but is otherwise not maintained by a financial institution, Form 8938 is too limiting to properly disclose the required information under Prop. Reg. § 1.6038D-4. The Committee respectfully submits that Part II of Form 8938 should provide an "other" option in order to report unusual assets required to be reported under Prop. Reg. § 1.6038D-3.

Background: Prop. Reg. § 1.6038D-2 requires an individual who holds any interest in a SFFA during the taxable year to attach Form 8938 to his or her individual income tax return if the aggregate value of such SFFAs exceeds $50,000 on the last day of the taxable year or $75,000 at any time during the taxable year. Prop. Reg. § 1.6038D-3 defines an SFFA as any financial account maintained by a foreign financial institution and, to the extent not held in an account at a financial institution, (i) any stock or security issued by any person other than a U.S. person; (ii) any financial instrument or contract held for investment that has an issuer or counterparty that is not a U.S. person; and (iii) any interest in a foreign entity.

Part II of Form 8938 is the prescribed method of reporting SFFAs that are not held in foreign deposit or custodial accounts. However, Part II of Form 8938 is too limiting to report the information required under Prop. Reg. § 1.6038D-4.

For example, there are certain assets, such as U.K. premium bonds, that are SFFAs under Prop. Reg. § 1.6038D-3 and that generally are not held in foreign deposit or custodial accounts. A U.K. premium bond, which is similar to a zero-coupon bond in the U.S., is an asset held for investment and issued by the U.K. government. However, Part II, Line 8b of Form 8938 does

not provide the option to select a counterparty other than an individual, partnership, corporation, trust, or estate.

Further, additional guidance is necessary in the Proposed Regulations with regard to an interest in "social security, social insurance, or other similar program of a foreign government." While the preamble to the temporary 6038D regulations provides in Section 2.D(3) of the Explanation of Provisions that such an interest is not considered to be an SFFA, this specific exemption is not found in the Proposed Regulations themselves.

Recommendation: The Committee respectfully submits that Part II of Form 8938, which is the prescribed form to report a specified person's interest in SFFAs that are not otherwise held in a foreign deposit or custodial account, should provide for options to allow for the reporting of unusual assets held for investment. The Committee respectfully recommends that Part II, Line 8b should provide an option for "other." Furthermore, the Committee respectfully suggests that further examples of what does and does not constitute a SFFA be placed in the Proposed Regulations, especially with regard to bullion, coins, and interests in social security, social insurance, or other similar programs of a foreign government.

Sincerely,

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