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REMINDER: Final Regulations on Requirements for Certain Domestic Entities to Report Specified Foreign Financial Assets – APPLICABLE TO 2016 TAX RETURNS

On Feb. 23, 2016, the IRS released final regulations under Treas. Reg. Section 1.6038D-6 providing guidance to certain domestic entities on the reporting of specified foreign financial assets on Form 8938. The regulations affect certain domestic corporations, partnerships and trusts. The effective date for the final regulations is for tax years beginning after Dec. 31, 2015.

Since 2011, only individuals were required to report (on Form 8938) certain foreign financial assets under IRC Sec. 6038D(a) until Treasury issued Regulations as permitted under Sec. 6038D(f) to extend the filing requirement to entities. Starting with the 2016 tax year, certain domestic entities will also be required to file Form 8938 with their U.S. income tax returns.

The original proposed regulations were simplified so that an objective test could be applied to determine whether or not a domestic entity is subject to the filing requirement. Form 8938 will be required if at least 50 percent of the entity's gross income or at least 50 percent of the entity's assets are passive (the assets produce passive income) and the entity is at least 80 percent owned by a specified individual. Passive assets are measured using a weighted average measured quarterly, and corporations and partnerships are permitted to use either fair market value or book value (measured under U.S. or international accounting standards). Specified individuals are U.S. citizens, resident aliens, and certain nonresident aliens electing to file a U.S. joint income tax return with a qualifying spouse, and nonresident aliens resident in Puerto Rico or certain possessions. Attribution rules under IRC Sec. 267 apply for the purpose of the ownership test.

In addition, assets and income owned by related entities of the same specified individual will be combined to determine whether the reporting threshold is met. The filing requirement is determined on an annual basis. The specified foreign financial asset reporting threshold for domestic entities is an aggregate value of assets exceeding \$50,000 on the last day of the taxable year, or \$75,000 at any time during the taxable year.

Additional changes in the final regulations consisted of:

- Modifying the definition of “passive income” to better resemble the definition under sections 1471-1472 (FATCA)
- Certain rents and royalties derived in the conduct of an active trade or business conducted “at least in part” by employees of the entity will not be considered passive income
- Adding an exception for certain active business gains or losses from the sale of commodities
- Defining notional principal contracts by adding a reference to the section 446 regulations
- Adding an exception for dealers, similar to what was added to the section 1472 regulations
- Expanding the definition of “current beneficiary” of domestic trusts to include any holder of a general power of appointment, whether or not exercised, that was exercisable at any time during the taxable year

If you have any questions, please contact your tax advisor or:

Kellie Becker

877.622.2257, Ext. 64904

kellie.becker@plantemoran.com

Carla Smaston

877.622.2257, Ext. 33446

carla.smaston@plantemoran.com

Andy Barnes

877.622.2257, Ext.44767

andy.barnes@plantemoran.com

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