



American Institute of CPAs
1455 Pennsylvania Avenue, NW
Washington, DC 20004-1081

October 25, 2012

The Honorable Douglas H. Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Mr. Steven Musher
Associate Chief Counsel (International)
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

RE: Comments on Form 8938, Statement of Specified Foreign Financial Assets, and
Instructions to Form 8938 regarding valuation of certain assets

Dear Messrs. Shulman, Wilkins, and Musher:

The American Institute of Certified Public Accountants (AICPA) offers the following comments as the government continues to develop Form 8938, Statement of Specified Foreign Financial Assets,¹ instructions to Form 8938,² and other guidance regarding section 6038D³ for use by taxpayers. These comments were developed by the Foreign Asset and Account Disclosures Task Force of the AICPA's International Taxation Technical Resource Panel, and approved by the Tax Executive Committee.

The AICPA is the world's largest member association representing the accounting profession, with nearly 386,000 members in 128 countries and a 125-year heritage of servicing the public interest. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

¹ All references to Form 8938 in this letter refer to the form issued in December 2011.

² All references to instructions to Form 8938 in this letter refer to the instructions issued in December 2011.

³ All section references in this letter are to the Internal Revenue Code of 1986, as amended, or the Treasury regulations promulgated thereunder.

There are many concerns among taxpayers and tax practitioners as it relates to the new section 6038D information reporting of specified foreign financial assets (SFFA). This letter highlights certain of these concerns for the Department of the Treasury (Treasury) and Internal Revenue Service (IRS) and requests consideration of our recommendations as further guidance is developed in this area. In particular, our comments address the following topics: (1) use of any reasonable method in determining fair market value; (2) valuation of financial instruments and contracts; and (3) consistency with the Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR).

Use of Any Reasonable Method in Determining Fair Market Value

The AICPA believes that Part II of Form 8938 should permit the use of any reasonable method in determining fair market value of an SFFA including, but not limited to, tax basis or book value, where a published or external market value is not readily accessible to the taxpayer.

The AICPA also recommends that Treasury and IRS consider adding a safe harbor valuation methodology in future guidance.

Treas. Reg. § 1.6038D-5T(a) states that the “value” of an asset (1) for purposes of determining whether the aggregate value threshold for reporting is exceeded and (2) for determining the maximum value of an SFFA to be disclosed on Form 8938 is generally the fair market value. Part II of Form 8938 requires the disclosure of the “maximum value of the asset during the year.” Treas. Reg. § 1.6038D-5T(b)(1) generally defines “maximum value” as a reasonable estimate of the asset’s maximum fair market value during the taxable year. For SFFAs other than accounts, Treas. Reg. § 1.6038D-5T(f)(1) generally provides that the maximum value of the asset is the fair market value of the asset as of the last day of the tax year unless the taxpayer knows or has reason to know based on readily accessible information that the value does not reflect a reasonable estimate of the maximum value during the tax year.⁴ The instructions provide an example in which publicly traded foreign stock has a year-end value of \$100,000 and a 52-week high value of \$150,000. Under the facts of the example, the 52-week high value of \$150,000 is readily available. Pursuant to this example, the maximum value of the SFFA reported in Part II of Form 8938 with respect to the foreign stock is \$150,000.

We appreciate that the instructions and temporary regulations clearly provide that a third party valuation of an SFFA is not required. However, we are concerned that, unlike the example above, there are many situations where a specified person may have absolutely no ability to obtain the fair market value of an SFFA. Under these circumstances, we do

⁴ Note that this section does not apply to valuation of interests in trusts, estates, pension plans, or deferred compensation plans. Valuation rules for those interests are found in Treas. Reg. § 1.6038D-5T(f)(2) and (3).

not believe that a specified person should be subject to either civil or criminal penalties. The National Taxpayer Advocate has expressed similar concerns, particularly for the average investor who is trying to comply in an increasingly complex reporting environment.⁵

The Form 8938 instructions list several different “other foreign financial assets” that are required to be disclosed on Form 8938. In many, if not most of these cases, the SFFA will not be a publicly-traded instrument. As such, the specified individual must rely upon information provided by the entity with which the SFFA is held. Whether an investment vehicle provides this information to investors, and when it is provided, is often outside the control of the specified individual. Further, non-United States (non-U.S.) legal entities normally have no legal requirement to provide fair market value to any shareholders, unit holders or investors.

A specified person who owns shares in a foreign investment vehicle is dependent upon the entity with respect to fair market value information. If, for instance, the specified person happens to be one of only a few U.S. investors in a foreign partnership that is otherwise controlled by foreign partners, the foreign partnership may view the cost of providing fair market value information to its specified persons as prohibitively expensive and may decline to provide the information. Under these circumstances, the specified person may only have information regarding the tax basis of the partnership investment. In this example, tax basis may be the only information that is readily accessible by the specified person. We therefore recommend that under these circumstances a specified person should be permitted to use his or her tax basis as an estimate of value for purposes of determining the reporting threshold as well as the maximum value under section 6038D.⁶

Similarly, a U.S. minority shareholder in a privately held foreign corporation may not have the information available as to the fair market value of the shares of stock unless the foreign corporation provides this information to the specified person. The only information a specified person may have is the book value of the shares (provided the foreign corporation is willing to provide a capitalization table). In this example, the specified person should be able to use either the book value or the tax basis of the shares

⁵ National Taxpayer Advocate’s 2011 Annual Report To Congress, Volume One, MSP #11, particularly the section entitled “Benign Actors Need Clear Guidance on How to Avoid FBAR, FATCA and Other Penalties if They Are Reasonably Trying to Comply or Return Into Compliance.”

⁶ The use of tax basis could be considered a rule of convenience similar to the rule provided in the instructions to Form 8938 on page 6, first column, under the caption “Valuing interests in foreign estates, foreign pension plans and foreign deferred compensation plans” which provide “[i]f you received no distributions during the tax year and do not have reason to know based on readily accessible information the fair market value of your interest as of the last day of the tax year, use a value of zero as the maximum value of the asset.”

to compute value for purposes of determining the reporting threshold as well as the maximum value under section 6038D.

Permitting taxpayers to determine value based on the best available information if fair market value information is not available may result in values disclosed on Form 8938 that could be significantly different than if a third party appraisal of fair market value were to be obtained. Given the difficulty with complying with the fair market value requirement, we believe that guidance should be issued such that a specified person is able to disclose the value of the SFFA using any reasonable method including, but not limited to, tax basis or book value if fair market value information is not available. However, we are not suggesting that if the specified person has reason to know that an SFFA has materially appreciated or depreciated in value from its tax basis or book value, that it is appropriate for the specified person to report a value other than fair market value.

We have provided the example above based on actual experience with Form 8938 and the temporary regulations over the past filing season. As we note in other parts of this letter, taxpayers are often unsophisticated investors dealing with unsympathetic foreign entities and it would greatly ease their burden if bright line guidance was available. For these reasons, we urge Treasury and the IRS to consider adding a safe harbor valuation methodology in future guidance.

Furthermore, a taxpayer should not be subject to penalties if an SFFA has been reported on Form 8938 (or other form identified in Part IV of Form 8938) and the taxpayer in good faith provides a reasonable estimate of maximum value, but later it is determined that the value disclosed on Form 8938 is incorrect or the IRS disagrees with the taxpayer's methodology for determining value. As with any disclosure regime, the critical part of compliance is reporting the asset. Differences in how the asset is valued may impact the tax liability, but if value is determined in good faith the differences in valuation should not result in penalties.

Valuation of Financial Instruments and Contracts

The AICPA recommends that IRS provide guidance regarding how to value financial instruments or contracts that have a non-U.S. issuer or counterparty. Clarification is needed because neither the temporary regulations nor the instructions for Form 8938 currently provide such guidance. Because it is not always clear how to value financial instruments and contracts, we recommend that the IRS provide specific guidance for how taxpayers should determine value with respect to these SFFAs.

1. Nonpublic, Nontransferable Stock Options

We suggest that IRS issue guidance allowing taxpayers to report the value of unexercised stock options as zero when such options are nontransferable and not publicly traded. Under these circumstances, there is a reasonable view that the value of these types of options is zero due to the restrictions placed on them.

While stock options may be viewed as sophisticated financial instruments, many rank and file employees of U.S. subsidiaries of non-U.S. companies receive stock options of the non-U.S. companies as part of their compensation package. These employees generally do not have accounts or investments outside the United States and are surprised to learn that they may have a Form 8938 reporting obligation. Specific guidance in the regulations and instructions to the Form 8938 providing that the value of unexercised non-transferable stock options is zero would significantly ease the burden of the Form 8938 for many individuals whose only SFFAs are stock options issued by their employers. This approach will reduce the burden with respect to Form 8938 that the U.S. Government Accountability Office (GAO) identified in its report issued February 2012.⁷

2. Rental Contracts

The AICPA recommends that clear guidance be published stating that certain rental or lease contracts not held in a trade or business are SFFAs, if it is the intent of IRS and Treasury to include those types of assets in the definition of SFFAs.

On March 20, 2012, during a joint IRS/AICPA webinar, IRS personnel indicated that certain contracts (e.g., a triple net lease) in which a specified person rents or leases foreign real estate to a foreign person could be an SFFA since it is a contract with a foreign counterparty. While we agree that this view is consistent with the purpose of section 6038D, we are concerned that the regulations and the instructions to the Form 8938 are unclear with respect to rental and lease contracts for foreign real estate and therefore taxpayers may not be aware that they could be subject to section 6038D reporting. This uncertainty is heightened by the published guidance of the Foreign Account Tax Compliance Act (FATCA) frequently asked question (FAQ) #3,⁸ which provides that real estate held directly by a specified person is not reportable on Form 8938.

In addition to clear and unambiguous guidance stating that rental and lease contracts on a foreign rental property are SFFAs, we recommend that the regulations and the instructions to Form 8938 provide specific guidance regarding how to value these types

⁷ GAO-12-403 Reporting Foreign Accounts to IRS: Extent of Duplication Not Currently Known but Requirements Can Be Clarified, February 28, 2012.

⁸ <http://www.irs.gov/businesses/corporations/article/0,,id=255061,00.html>.

of contracts. We further recommend that Treasury and the IRS consider a safe harbor valuation methodology, as it has in other portions of the regulations under section 6038D, with regard to rental and lease contracts for foreign real estate. A safe harbor valuation methodology will increase return accuracy, decrease taxpayer burden and reduce the number of exam-related adjustments.

We further recommend Treasury and IRS include contracts with a foreign counterparty that give rise to non-trade or business rent or royalty income in the definition of excepted SFFAs for purposes of Form 8938 reporting (i.e., the contract is an SFFA, but because it is reported elsewhere in detail in the return, the contract does not need to be separately itemized on Form 8938 Part II). Form 1040, U.S. Individual Income Tax Return, Schedule E, Supplemental Income and Loss, Part I, Income or Loss From Rental Real Estate and Royalties, provides a great deal of information about the type of activity, the physical location, gross income earned or received, expenses incurred, and taxable income derived from rent and royalty contracts with foreign counterparties. The data disclosed on Schedule E is comparable to data provided on information returns (e.g., Form 5471, Information Return of U.S. Persons with Respect to Certain Foreign Corporations) completed for other excepted SFFAs. This recommendation includes modifying Form 8938, Part IV, Excepted Specified Foreign Financial Assets, to include non-trade or business rent or royalty contracts that have a foreign counterparty, the income of which is reported on Form 1040, Schedule E, Part I.

Our members and their clients represent thousands of taxpayers with foreign rental properties. It is important to note that many of these taxpayers are immigrants or U.S. persons on student, teacher or work visas, who rent out their residences in their home countries before returning to their home country at the end of their U.S. assignment. These are not sophisticated taxpayers as it relates to U.S. income tax compliance matters.

Consistency in Valuation Methods of SFFAs for Form 8938 and Form TD F 90-22.1.

The AICPA recommends, based on the findings of the GAO, that taxpayer burden would be reduced if the method for determining maximum value of SFFAs for purposes of Form 8938 was made consistent, in all instances where there is duplicative reporting between the forms, with the method for determining maximum value for purposes of Form TD F 90-22.1.

As discussed above, the GAO issued its report on February 28, 2012 recommending that Treasury seek ways to reduce burden on filers of Form 8938 and Form TD F 90-22.1. Similar to the filers of Form 8938, filers of the FBAR are required to report the maximum value of foreign financial accounts on the form. One way to reduce burden for filers of both forms is to make the definition of maximum value for Form 8938 simpler and consistent with the definition of maximum value for FBAR purposes.

The FBAR has a single standard for determining maximum value. The FBAR rules define maximum value as "a reasonable approximation of the greatest value of currency or nonmonetary assets in the account during the calendar year. Periodic account statements may be relied on to determine the maximum value of the account, provided that the statements fairly reflect the maximum account value during the calendar year." While this standard for maximum value is not perfect, it is simple and provides the flexibility to allow filers to apply it to their particular facts and circumstances without having to worry about penalties, provided there is a reasonable reflection of value. Neither the statute nor the legislative history of section 6038D provides any requirement that maximum value with respect to an SFFA be determined in a manner that is inconsistent with the current FBAR rules. If taxpayers are reasonable in their determination of value reported on Form 8938, reliance on periodic statements should be treated as per se reasonable. In this case, penalties should not be imposed because the purpose of Form 8938, disclosure of SFFAs, has been satisfied.

We recognize that Treasury and IRS have an interest in taxpayers accurately determining maximum value for purposes of determining if the aggregate reporting threshold is satisfied. If the taxpayer uses a maximum value for all SFFAs for the tax year that results in an aggregate SFFA value that is below the filing threshold, the taxpayer bears the risk of making an incorrect determination regarding value. The statute even provides the IRS with a favorable presumption in section 6038D(e) to protect the government against taxpayers who might try to manipulate valuation to avoid filing a Form 8938. In light of this risk, Treasury and the IRS should modify the section 6038D regulations and Form 8938 instructions to allow taxpayers to make a determination of maximum value for both the Form 8938 filing threshold and reporting the asset on Form 8938 which is consistent with the standard for determining maximum value for purposes of the FBAR.

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We appreciate your consideration of our recommendation, and we welcome further discussion. If you have any questions, please contact Neil A.J. Sullivan, Chair, AICPA Foreign Asset and Account Disclosures Task Force, at (914) 713-0503 or neilsullivan@att.net; Christine Ballard, Vice-Chair, AICPA Foreign Asset and Account Disclosures Task Force, at (703) 970-0424 or christine.ballard@dhgllp.com; Joseph M. Calianno, Chair, AICPA International Taxation Technical Resource Panel, at (202) 521-1505 or joe.calianno@us.gt.com; or Kristin Esposito, AICPA Technical Manager, at (202) 434-9241 or kesposito@aicpa.org.

Messrs. Shulman, Wilkins, and Musher

October 25, 2012

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Sincerely,

A handwritten signature in black ink, appearing to read "Jeffrey A. Porter". The signature is fluid and cursive, with the first name "Jeffrey" being larger and more prominent than the last name "Porter".

Jeffrey A. Porter, CPA
Chair, Tax Executive Committee

cc: Mr. Ronald Dabrowski, IRS Deputy Associate Chief Counsel (International)
Mr. Joseph Henderson, IRS Office of Associate Chief Counsel (International)
The Honorable Mark Mazur, Treasury Assistant Secretary (Tax Policy)
Ms. Lisa Zarlenga, Treasury Tax Legislative Counsel