

IRS Issues Proposed Regs on Reporting Foreign Financial Assets

Reporting of Specified Foreign Financial Assets

[4830-01-p]

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

[REG-130302-10]

RIN 1545-BJ69

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In the Rules and Regulations section of this issue of the Federal Register, the Internal Revenue Service is issuing temporary regulations relating to the requirement that individuals attach a statement to their income tax return to provide required information regarding foreign financial assets in which they have an interest. The text of the temporary regulations also serves as the text of these proposed regulations. This notice of proposed rulemaking also includes a proposed regulation setting forth requirements for certain domestic entities to report foreign financial assets in the same manner as an individual.

DATES: Written or electronic comments and requests for a public hearing must be received by March 19, 2012. * * * Comments on the collection of * * * information should be received by February 17, 2012.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-130302-10), room 5205, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-13030210), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC., or sent electronically, via the Federal eRulemaking Portal at www.regulations.gov (IRS REG-130302-10).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Joseph S. Henderson, (202) 622-3880 ; concerning submission of comments and/or requests for a hearing, Richard.A. Hurst@irs.counsel.treas.gov, (202) 622-7180 (not a toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by February 17, 2012.

Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance and purchase of service to provide information.

The collection of information in these proposed regulations is in §§ 1.6038D-2 and 1.6038D-4. The collection of information is mandatory with respect to a specified person that has an interest in specified foreign financial assets and the value of those assets is more than the applicable reporting threshold. The respondents are U.S. citizens, U.S. residents, certain nonresidents and, to the extent provided in future regulations, certain domestic entities. The collection of information is satisfied by filing Form 8938, "Statement of Specified Foreign Financial Assets," OMB No. 1545-2195, with the respondent's income tax return.

Estimated total annual reporting burden: 378,000 hours.

Estimated annual burden per respondent: 1 hour and 5 minutes.

Estimated number of respondents: 350,000.

Estimated annual frequency of responses: once.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential as required by 26 U.S.C. 6103.

Background

Section 6038D was enacted by section 511 of the Hiring Incentives to Restore Employment (HIRE) Act, Public Law 111-147 (124 Stat. 71). Section 6038D(a) requires an individual who holds any interest in a specified foreign financial asset during the taxable year to attach a statement to that individual's return of tax imposed by subtitle A of the Internal Revenue Code (Code) to report the information identified in section 6038D(c), if the aggregate value of the specified foreign financial assets in which the individual holds an interest exceeds \$50,000 for the taxable year, or such higher dollar amount as the Secretary may prescribe.

Section 6038D(f) provides that, to the extent provided by the Secretary in regulations or other guidance, section 6038D shall apply to any domestic entity which is formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets, in the same manner as if the entity were an individual.

Temporary regulations in the Rules and Regulations section of this issue of the Federal Register contain amendments to the Income Tax Regulations (26 CFR Part 1) providing guidance to individuals required to report specified foreign financial assets with their annual return pursuant to section 6038D of the Code. The text of those regulations also serves as the text of the regulations contained in this document that are proposed by cross-reference to the temporary regulations, that is §§ 1.6038D-0 through 1.6038D-5, § 1.6038D-7, and § 1.6038D 8. The preamble to the temporary regulations explains the amendments added by the temporary regulations.

This document also contains a proposed amendment to the Income Tax Regulations (26 CFR Part 1) that sets out the conditions under which a domestic entity will be considered a "specified domestic entity." A domestic entity that is a specified domestic entity pursuant to Prop. Reg. § 1.6038D-6 is required to report specified foreign financial assets in which it holds an interest.

Explanation of Provisions

1. Application of Section 6038D to Domestic Entities

Under the proposed regulations, domestic entities that are subject to the reporting requirements of section 6038D are designated as specified domestic entities and

include certain domestic corporations, domestic partnerships, and trusts described in section 7701(a)(30)(E), generally referred to as domestic trusts for purposes of this explanation. Specified domestic entities do not include domestic estates.

A. Domestic corporations and partnerships

For a domestic corporation or partnership to be considered a specified domestic entity, it must satisfy three conditions. First, the domestic corporation or domestic partnership must have an interest in specified foreign financial assets (other than assets excepted from reporting as provided in § 1.6038D-7T) with an aggregate value exceeding the reporting threshold in § 1.6038D-2T(a)(1). Second, it must be closely held by a specified individual (as defined in § 1.6038D1T(a)(2)). A domestic corporation is closely held if a specified individual owns at least 80 percent of the corporation's stock (by vote or value) on the last day of the corporation's taxable year. A domestic partnership is closely held if a specified individual owns at least 80 percent of the capital or profits interest in the partnership on the last day of its taxable year. Direct, indirect, and constructive ownership rules apply in determining whether the corporation or partnership is closely held for this purpose.

Finally, a domestic corporation or partnership must also meet either of the following two conditions:

A) At least 50 percent of the corporation's or partnership's gross income for the taxable year is passive income or at least 50 percent of the assets held by the corporation or partnership at any time during the taxable year are assets that produce or are held for the production of passive income; or

B) At least 10 percent of the corporation's or partnership's gross income for the taxable year is passive income or at least 10 percent of the assets held by the corporation or partnership at any time during the taxable year are assets that produce or are held for the production of passive income, and the corporation or partnership is formed or availed of by a specified individual with a principal purpose of avoiding the reporting obligations under section 6038D. The determination of whether a corporation or partnership is formed or availed of with a principal purpose of avoiding reporting under section 6038D takes into account all facts and circumstances.

Two different aggregation rules apply for purposes of determining whether a domestic corporation or domestic partnership is a specified domestic entity. First, in determining whether a domestic corporation or domestic partnership meets the reporting thresholds in § 1.6038D-2T(a)(1), domestic corporations and domestic partnerships that are closely held by the same specified individual are treated as a single entity. Second, for purposes of determining whether a corporation or partnership meets the passive income or asset test, domestic corporations and domestic partnerships that are closely held by the same individual and that are connected through stock or partnership interest ownership with a common parent corporation or partnership are treated as a single entity.

The determination of whether a corporation or partnership is a specified domestic entity is made annually for each taxable year of such corporation or partnership.

B. Domestic trusts

A domestic trust is considered a specified domestic entity if it has an interest in specified foreign financial assets (other than assets excepted from reporting as provided in § 1.6038D-7T) with an aggregate value exceeding the reporting threshold in § 1.6038D-2T(a)(1) and one or more specified persons as current beneficiaries. For purposes of section 6038D, a current beneficiary is any person who, during the taxable year, is entitled to, or at the discretion of any person may receive, a distribution from the principal or income of the trust (determined without regard to any power of appointment to the extent that such power remains unexercised at the end of the taxable year). As discussed in section 2 of this explanation, certain domestic trusts are not specified domestic entities.

The determination of whether a domestic trust is a specified domestic entity is made annually for each taxable year of such trust.

2. Excepted Specified Domestic Entities

A domestic entity is not considered to be a specified domestic entity if it is described in section 1473(3) and the regulations as excepted from the definition of the term "specified United States person". This exception does not apply to any trust that is exempt from tax under section 664(c).

A domestic trust is not considered a specified domestic entity if the trustee or executor is a bank, financial institution, or domestic corporation that is subject to certain examination, oversight or registration requirements, has supervisory authority over or fiduciary obligations with regard to the trust's specified foreign financial assets, and files income tax returns and information returns on behalf of the trust. In addition, a domestic trust or any portion of the trust that is treated as owned by one or more specified persons under sections 671 through 679 and the regulations issued under those sections is not considered to be a specified domestic entity.

Proposed Effective Date

Section 1.6083D-6 is proposed to apply to taxable years beginning after December 31, 2011.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory

assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations.

It is hereby certified that the collection of information in this notice of proposed rulemaking will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act (5 U.S.C. chapter 6). Small entities generally hold specified foreign financial assets (that is, financial accounts, stocks, securities, financial instruments, contracts, or interests in foreign entities) for use in their trade or business and therefore generally would not have a filing requirement. The burden is further reduced because small entities that do hold specified foreign financial assets generally will be excepted from reporting such assets under these proposed rules if the assets are reported on one or more of the following forms: Form 3520, "Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts"; Form 3520-A, "Annual Information Return of Foreign Trust With a U.S. Owner"; Form 5471, "Information Return of U.S. Persons With Respect To Certain Foreign Corporations"; Form 8621, "Return by a Shareholder of a Passive Foreign Investment Company or a Qualified Electing Fund"; Form 8865, "Return of U.S. Persons With Respect to Certain Foreign Partnerships"; or Form 8891, "U.S. Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans." Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act is not required. Pursuant to section 7805(f) of the Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses. The Internal Revenue Service invites the public to comment on this certification.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The Department of the Treasury and the Internal Revenue Service request comments on all aspects of the proposed regulations. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the Federal Register.

Drafting Information

The principal author of these proposed regulations is Joseph S. Henderson, Office of Associate Chief Counsel (International). However, other personnel from the Internal Revenue Service and the Department of the Treasury participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1 -- INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.6038D-1 also issued under 26 U.S.C. 6038D

Section 1.6038D-2 also issued under 26 U.S.C. 6038D

Section 1.6038D-3 also issued under 26 U.S.C. 6038D

Section 1.6038D-4 also issued under 26 U.S.C. 6038D

Section 1.6038D-5 also issued under 26 U.S.C. 6038D

Section 1.6038D-6 also issued under 26 U.S.C. 6038D

Section 1.6038D-7 also issued under 26 U.S.C. 6038D

Section 1.6038D-8 also issued under 26 U.S.C. 6038D* * *

Par. 2. Section 1.6038D-0 is added to read as follows:

§ 1.6038D-0 Outline of regulation provisions.

The text of proposed § 1.6038D-0 is the same as the text of § 1.6038D-0T published elsewhere in this issue of the Federal Register.

Par. 3. Section 1.6038D-1 is added to read as follows:

§ 1.6038D-1 Reporting with respect to specified foreign financial assets, definition of terms.

The text of proposed § 1.6038D-1 is the same as the text of paragraphs (a) and (b) in § 1.6038D-1T published elsewhere in this issue of the Federal Register.

Par. 4 Section 1.6038D-2 is added to read as follows:

§ 1.6038D-2 Requirement to report specified foreign financial assets.

The text of proposed § 1.6038D-2 is the same as the text of paragraphs (a) through (e) in § 1.6038D-2T published elsewhere in this issue of the Federal Register.

Par. 5 Section 1.6038D-3 is added to read as follows:

§ 1.6038D-3 Specified foreign financial assets.

The text of proposed § 1.6038D-3 is the same as the text of paragraphs (a) through (e) in § 1.6038D-3T published elsewhere in this issue of the Federal Register.

Par. 6. Section 1.6038D-4 is added to read as follows:

§ 1.6038D-4 Information required to be reported.

The text of proposed § 1.6038D-4 is the same as the text of paragraphs (a) and (b) in § 1.6038D-4T published elsewhere in this issue of the Federal Register.

Par. 7. Section 1.6038D-5 is added to read as follows:

§ 1.6038D-5 Valuation guidelines.

The text of proposed § 1.6038D-5 is the same as the text of paragraphs (a) through (g) in § 1.6038D-5T published elsewhere in this issue of the Federal Register.

Par. 8. Section 1.6038D-6 is added to read as follows:

§ 1.6038D-6 Specified domestic entities.

(a) Specified domestic entity. A specified domestic entity is a domestic corporation, a domestic partnership, or a trust described in section 7701(a)(30)(E), if such corporation, partnership, or trust is formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets. Whether a domestic corporation, a domestic partnership, or a trust described in section 7701(a)(30)(E) is a specified domestic entity is determined annually.

(b) Corporations and partnerships -- (1) Formed or availed of. Except as otherwise provided in paragraph (d) of this section, a domestic corporation or a domestic partnership is formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets if and only if --

(i) The corporation or partnership has an interest in specified foreign financial assets (other than assets excepted from reporting as provided in § 1.6038D-7T) with an aggregate value exceeding the reporting threshold in § 1.6038D-2T(a)(1);

(ii) The corporation or partnership is closely held by a specified individual as determined under paragraph (b)(3) of this section; and

(iii) One of the following two conditions is satisfied:

(A) At least 50 percent of the corporation's or partnership's gross income for the taxable year is passive income or at least 50 percent of the assets held by the corporation or partnership at any time during the taxable year are assets that produce or are held for the production of passive income; or

(B)(1) At least 10 percent of the corporation's or partnership's gross income for the taxable year is passive income or at least 10 percent of the assets held by the corporation or partnership at any time during the taxable year are assets that produce or are held for the production of passive income, and

(2) The corporation or partnership is formed or availed of by the specified individual identified in paragraphs (b)(1)(ii) and (b)(3) of this section with a principal purpose of avoiding the reporting obligations under section 6038D. For purposes of determining whether a corporation or partnership is formed or availed of with a principal purpose of avoiding reporting under section 6038D, all facts and circumstances are taken into account.

(2) Passive income. For purposes of paragraph (b) of this section, passive income means the portion of gross income that consists of --

(i) Dividends;

(ii) Interest;

(iii) Rents and royalties, other than rents and royalties derived in the active conduct of a trade or business conducted by employees of the corporation or partnership;

(iv) Annuities;

(v) The excess of gains over losses from the sale or exchange of property that gives rise to passive income described in paragraphs (b)(2)(i) through (iv) of this section;

(vi) The excess of gains over losses from transactions (including futures, forward, and similar transactions) in any commodity, but not including any commodity hedging transaction described in section 954(c)(5)(A) determined by treating the corporation or partnership as a controlled foreign corporation;

(vii) The excess of foreign currency gains over foreign currency losses (as defined in section 988(b)) attributable to any section 988 transaction; and

(viii) Net income from notional principal contracts.

(3) Closely held -- (i) Domestic corporation. A domestic corporation is closely held by a specified individual for purposes of paragraph (b)(1)(ii) of this section if at least 80 percent of the total combined voting power of all classes of stock of the corporation entitled to vote, or at least 80 percent of the total value of the stock of the corporation, is owned, directly, indirectly, or constructively, by one specified individual on the last day of the corporation's taxable year.

(ii) Domestic partnership. A partnership is closely held by a specified individual for purposes of paragraph (b)(1)(ii) of this section if at least 80 percent of the capital or profits interest in the partnership is held, directly, indirectly, or constructively, by one specified individual on the last day of the partnership's taxable year.

(iii) Constructive ownership. For purposes of paragraphs (b)(1)(ii) and (b)(3) of this section, section 267(c) and (e)(3) apply for the purpose of determining the interest of a specified individual in a corporation or partnership, except that section 267(c)(4) is applied as if the family of an individual includes the spouses of the individual's family members.

(iv) Example. The following example illustrates the application of paragraph (b)(3) of this section:

Example. (1) Facts. DC1 is a domestic corporation the total value of the stock of which is owned 60% by A, a specified individual, 30% by B, a member of A's family for purposes of section 267(c)(2) who is not a specified individual, and 10% by FC1, a foreign corporation. DC1 owns 90% of the total value of the stock of DC2, a domestic corporation. FC2, a foreign corporation, owns 10% of DC2. Neither A nor B owns, directly, indirectly, or constructively, any stock in FC1 or FC2.

(2) Ownership determination. DC2 is closely held by A within the meaning of paragraphs (b)(1)(ii) and (b)(3) of this section because A, a specified person, owns more than 80% of its total value. A is considered to own 81% of the total value of DC2 by application of the rules of section 267(c) and this section.

(4) Treatment of related corporations and partnerships -- (i) Determination of reporting threshold. For purposes of applying paragraph (b)(1)(i) of this section and determining whether a domestic corporation or domestic partnership satisfies the reporting threshold in § 1.6038D-2T(a)(1), all domestic corporations and domestic partnerships that have an interest in any specified foreign financial asset and are closely held by the same specified individual as determined under paragraphs (b)(1)(ii) and (b)(3) of this section are treated as a single entity, and each such related corporation or partnership will be treated as owning the specified foreign financial assets held by all such related corporations or partnerships.

(ii) Determination of passive income and asset thresholds. For purposes of applying the passive income and asset thresholds of paragraph (b)(1)(iii) of this section, all domestic

corporations and domestic partnerships that are closely held by the same specified individual as determined under paragraphs (b)(1)(ii) and (b)(3) of this section and that are connected through stock or partnership interest ownership with a common parent corporation or partnership (as determined under this paragraph (b)(4)(ii)) are treated as a single entity. A domestic corporation or a domestic partnership is considered connected through stock or partnership interest ownership with a common parent corporation or partnership if stock representing at least 80 percent of the voting power or value of each such corporation, or partnership interests representing at least 80 percent of the profits interests or capital interests of the partnership, in each case other than stock of or partnership interests in the common parent, is owned by one or more of the other connected corporations, connected partnerships, or the common parent. For purposes of applying paragraph (b)(1)(iii) of this section, each member of a closely held and connected group as determined under this paragraph (b)(4)(ii) is treated as owning the combined assets and receiving the combined income of all members of that group. For purposes of the preceding sentence, any contract, equity, or debt existing between members of such a group, as well as any items arising under or from such contract, equity, or debt relevant to the determination of the passive income percentage under paragraph (b) of this section, are eliminated.

(5) Examples. The following examples illustrate the application of the rules of paragraph (b) of this section:

Example 1. (1) Facts. L is a specified individual. In Year X, L wholly owns DC1, a domestic corporation, and also owns a 90% capital interest in DP, a domestic partnership. DC1 owns 80% of the sole class of stock of DC2, a domestic corporation. DC1 has no assets other than its interest in DC2. DC2's only assets are assets that produce passive income, with a maximum value in Year X of \$40,000 on October 12. DC2's assets are comprised in relevant part on October 12, Year X, of \$15,000 of specified foreign financial assets. DP's only assets are assets that produce passive income and that are specified foreign financial assets with a maximum value of \$90,000 on October 12, Year X and have a value of \$20,000 on December 31, Year X. DC1 and DC2 do not file a consolidated annual return.

(2) Determination of reporting threshold. DC1, DC2, and DP are closely held by L for purposes of applying paragraph (b)(1)(ii) and (b)(3) of this section. Under § 1.6038D-3T, DC2 and DP each has an interest in specified foreign financial assets; DC1 does not have an interest in specified foreign financial assets. For purposes of applying paragraph (b)(1)(i) of this section and § 1.6038D-2T(a)(1) --

(i) DC1. DC1 is not treated as a single entity with DC2 and DP under paragraph (b)(4)(i) of this section. As a result, DC1 does not satisfy the reporting threshold of paragraph (b)(1)(i) of this section; and

(ii) DC2 and DP. DC2 and DP are treated as a single entity under paragraph (b)(4)(i) of this section. Therefore, for purposes of applying the reporting threshold of § 1.6038D-2T(a)(1), DC2 is considered as owning in addition to its own assets the assets of DP,

and DP is considered as owning in addition to its own assets the assets of DC2. As a result, DC2 and DP each satisfies the reporting threshold of § 1.6038D-2T(a)(1), because the value of the specified foreign financial assets each is considered as owning under paragraph (b)(4)(i) of this section exceeds \$100,000 on October 12, Year X.

(3) Determination of passive income or passive asset percentage -- (i) DC1 and DC2. DC1 and DC2 are treated as members of a closely held and connected group of entities under paragraph (b)(4)(ii) of this section, because DC1 and DC2 are closely held by L, and DC2 is connected with DC1 through DC1's ownership of stock of DC2 representing at least 80% of the voting power or value of DC2. As a result, DC1 and DC2 are considered a single entity for purposes of applying paragraph (b)(1)(iii) of this paragraph, and each of DC1 and DC2 is considered as owning the combined assets, and receiving the combined income, of both DC1 and DC2 (under paragraph (b)(4)(ii) of this section). Therefore, DC1 and DC2 each satisfies the passive asset threshold of paragraph (b)(1)(iii)(A) of this section.

(ii) DP. DP is not treated as a member of the DC1 and DC2 closely held and connected group of entities because DC1 and DP are not owned by a common parent corporation or partnership. Therefore, whether the passive income or passive asset threshold of paragraph (b)(1)(iii) of this section is met with respect to DP is determined solely by reference to DP's separately earned passive income and separately held passive assets. DP has only passive assets on October 12, Year X, and, therefore, satisfies paragraph (b)(1)(iii)(A) of this section.

(4) Reporting requirements -- (i) DC1. DC1 is not a specified domestic entity for Year X, and is not required to file Form 8938, because DC1 does not satisfy the reporting threshold of paragraph (b)(1)(i) of this section and § 1.6038D-2T(a)(1).

(ii) DC2 and DP. DC2 and DP are specified domestic entities for Year X, because they each meet the conditions of paragraph (b)(1) of this section: each is closely held by L, a specified individual; each has an interest in specified foreign financial assets with an aggregate value exceeding the reporting threshold of § 1.6038D-2T(a)(1); and each satisfies the passive asset threshold. DC2 and DP must each file Form 8938 for Year X to report their respective specified foreign financial assets and disclose their maximum values as provided in § 1.6038D-4T.

Example 2. (1) Facts. The facts are the same as in Example 1, except that DC2 also has assets and income from a trade or business. The income from such business is not passive income and constitutes 60% of the gross income generated by DC2 in Year X. The assets attributable to such trade or business constitute at least 60% of the value of DC2's assets at all times during Year X. Assume that neither DC1 nor DC2 is formed or availed of by L with a principal purpose of avoiding the reporting obligations under section 6038D.

(2) Determination of reporting threshold. DC1, DC2, and DP are closely held by L for purposes of applying paragraph (b)(1)(ii) and (b)(3) of this section. Under § 1.6038D-3T,

DC2 and DP each has an interest in specified foreign financial assets; DC1 does not have an interest in specified foreign financial assets. For purposes of applying paragraph (b)(1)(i) of this section and § 1.6038D-2T(a)(1) --

(i) DC1. DC1 is not treated as a single entity with DC2 and DP under paragraph (b)(4)(i) of this section. As a result, DC1 does not satisfy the reporting threshold of paragraph (b)(1)(i) of this section; and

(ii) DC2 and DP. DC2 and DP are treated as a single entity under paragraph (b)(4)(i) of this section. Therefore, for purposes of applying the reporting threshold of § 1.6038D-2T(a)(1), DC2 is considered as owning in addition to its own assets the assets of DP, and DP is considered as owning in addition to its own assets the assets of DC2. As a result, DC2 and DP each satisfies the reporting threshold of § 1.6038D-2T(a)(1) because the value of the specified foreign financial assets each is considered as owning under paragraph (b)(4)(i) of this section exceeds \$100,000 on October 12, Year X.

(3) Determination of passive income or passive asset percentage -- (i) DC1 and DC2. DC1 and DC2 are treated as members of a closely held and connected group of entities under paragraph (b)(4)(ii) of this section, because DC1 and DC2 are closely held by L, and DC2 is connected with DC1 through DC1's ownership of stock of DC2 representing at least 80% of the voting power or value of DC2. As a result, DC1 and DC2 are considered a single entity for purposes of applying paragraph (b)(1)(iii) of this section, and each of DC1 and DC2 is considered as owning the combined assets, and receiving the combined income, of both DC1 and DC2 (as determined under paragraph (b)(4)(ii) of this section). DC1 and DC2 do not have sufficient passive income or passive assets to satisfy the thresholds of paragraph (b)(1)(iii)(A) of this section. In addition, because neither DC1 nor DC2 is formed or availed of by L with a principal purpose of avoiding the reporting obligations under section 6038D, neither DC1 nor DC2 meets the conditions described in paragraph (b)(1)(iii)(B) of this section.

(ii) DP. DP is not treated as a member of the DC1 and DC2 closely held and connected group of entities, because DC1 and DP are not owned by a common parent corporation or partnership. Therefore, whether the passive income or asset threshold of paragraph (b)(1)(iii) of this section is met with respect to DP is determined solely by reference to DP's separately earned passive income and separately held passive assets. DP has only passive assets that are specified foreign financial assets on October 12, Year X, and satisfies paragraph (b)(1)(iii)(A) of this section.

(4) Reporting requirements -- (i) DC1. DC1 is not a specified domestic entity for Year X, and is not required to file Form 8938, because DC1 does not satisfy the reporting threshold of paragraph (b)(1)(i) of this section and § 1.6038D-2T(a)(1).

(ii) DC2. DC2 is not a specified domestic entity for Year X, and is not required to file Form 8938, because DC2 does not satisfy the passive income or passive asset threshold of paragraph (b)(1)(iii)(A) of this section and is not formed or availed of with a principal purpose of avoiding the reporting obligations under section 6038D.

(iii) DP. DP is a specified domestic entity for Year X because DP meets the conditions of paragraph (b)(1) of this section: DP is closely held by L, a specified individual; DP has an interest in specified foreign financial assets with an aggregate value exceeding the reporting threshold of § 1.6038D-2T(a)(1); and DP satisfies the passive asset threshold of paragraph (b)(1)(iii)(A) of this section. DP must file Form 8938 for Year X to report its specified foreign financial assets and disclose their maximum value as provided in § 1.6038D-4T.

(c) Domestic trusts. Except as provided in paragraph (d) of this section, a trust described in section 7701(a)(30)(E) is a specified domestic entity that is formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets if and only if the trust --

(1) Has an interest in specified foreign financial assets (other than assets excepted from reporting as provided in § 1.6038D-7T) with an aggregate value exceeding the reporting threshold in § 1.6038D-2T(a)(1), and

(2) Has one or more specified persons as a current beneficiary. For purposes of this paragraph(c)(2), the term current beneficiary means, with respect to the taxable year, 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 of the trust (determined without regard to any power of appointment to the extent that such power remains unexercised at the end of the taxable year).

(d) Excepted domestic entities. An entity is not considered to be a specified domestic entity if the entity is --

(1) Certain persons described in section 1473(3). An entity, except for a trust that is exempt from tax under section 664(c), that is excepted from the definition of the term "specified United States person" under section 1473(3) and the regulations issued under that section;

(2) Certain domestic trusts. A trust described in section 7701(a)(30)(E) provided that the trustee of the trust --

(i) Has supervisory authority over or fiduciary obligations with regard to the specified foreign financial assets held by the trust;

(ii) Timely files (including any applicable extensions) annual returns and information returns on behalf of the trust; and

(iii) Is --

(A) A bank that is examined by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, or the National Credit Union Association;

(B) A financial institution that is registered with and regulated or examined by the Securities and Exchange Commission; or

(C) A domestic corporation described in section 1473(3)(A) or (B), and the regulations issued under that section.

(3) Domestic trusts owned by one or more specified persons. A trust described in section 7701(a)(30)(E) to the extent such trust or any portion thereof is treated as owned by one or more specified persons under sections 671 through 679 and the regulations issued under those sections.

(e) Effective/applicability dates. This section applies to taxable years beginning after December 31, 2011.

Par. 9. Section 1.6038D-7 is added to read as follows:

§ 1.6038D-7 Exceptions from the reporting of certain assets under Section 6038D.

The text of proposed § 1.6038D-7 is the same as the text of paragraphs (a) through (d) in § 1.6038D-7T published elsewhere in this issue of the Federal Register.

Par. 10. Section 1.6038D-8 is added to read as follows:

§ 1.6038D-8 Penalties for failure to disclose.

The text of proposed § 1.6038D-8 is the same as the text of paragraphs (a) through (g) in § 1.6038D-8T published elsewhere in this issue of the Federal Register.

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