

## The Form 8938 Due Date Defect

by Gary W. Carter

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In this article, Carter examines a defect in section 6038D that makes the penalties for failure to file under section 6038D(d) ineffective, and he urges the IRS to pause the penalties until the problem is corrected through legislative action.

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### Introduction

This article exposes a flaw in section 6038D that makes the penalties for failure to file under section 6038D(d) ineffective, and it calls on the commissioner to announce that penalties will not be imposed until the problem is corrected through legislative action.

### The Purpose of Form 8938

Section 6038D was enacted on March 18, 2010, effective for tax years beginning after that date. It was added to the code by the Foreign Account Tax Compliance Act.<sup>1</sup> It requires U.S. citizens, resident aliens, and certain nonresident aliens to file a

statement with their federal income tax returns to report “specified foreign financial assets”<sup>2</sup> exceeding certain thresholds.<sup>3</sup> The form developed for this purpose is Form 8938, “Statement of Specified Foreign Financial Assets.”

Section 6038D is a major component of FATCA, which was passed to improve compliance with tax laws by U.S. taxpayers holding foreign accounts. This was to be achieved by (1) requiring foreign financial institutions to report financial accounts held by U.S. taxpayers or by foreign entities in which U.S. taxpayers hold a substantial ownership interest (see section 1471) and (2) requiring U.S. taxpayers to comply with the new reporting requirements by filing Form 8938 with their tax returns, even though some of the same reporting requirements had existed for many years through the “Report of Foreign Bank and Financial Accounts,” better known as FBAR.<sup>4</sup>

Section 6501(e)(1)(A)(ii), also enacted on March 18, 2010, provides a six-year statute of limitations if taxpayers omit over \$5,000 from gross income of amounts attributable to one or more assets for which information is required to be reported on Form 8938. Also, section 6501(c)(8) was amended to add section 6038D to the list of

<sup>2</sup>“Specified foreign financial assets” are defined in section 6038D(b) and reg. section 1.6038D-4.

<sup>3</sup>Thresholds range from \$50,000 at the end of the year (\$75,000 during the year) for married filing separate and single taxpayers living in the United States, to \$400,000 at the end of the year (\$600,000 during the year) for married taxpayers filing joint returns if the taxpayers live outside the United States and qualify for the foreign earned income exclusion. Reg. section 1.6038D-2(a).

<sup>4</sup>The Bank Secrecy Act of 1970 mandates that U.S. citizens and residents file an FBAR if they have a financial interest in or signature authority over foreign financial accounts with an aggregate value exceeding \$10,000 at any time during the calendar year. For a comparison of FBAR and Form 8938 reporting requirements, see IRS, “Comparison of Form 8938 and FBAR Requirements” (last updated Sept. 18, 2024).

<sup>1</sup>As part of the Hiring Incentives to Restore Employment Act of 2010, Title V, subtitle A, section 511(a) (2010).

code sections for which information must be reported before the three-year statute of limitations begins.<sup>5</sup>

### What Is the Due Date for Form 8938?

Silly question, right? The instructions to Form 8938 clearly require it to be attached to annual returns by the due date (including extensions) of the return. The instructions also say, “If you are required to file Form 8938 but do not file a complete and correct Form 8938 by the due date (including extensions), you may be subject to a penalty of \$10,000.”

But form instructions are not primary tax authority, and courts have not allowed taxpayers to rely on what the IRS publishes in its publications and form instructions. The Tax Court has said that “the authoritative sources of federal tax law are in the statutes, regulations, and judicial decisions and not in . . . informal publications.”<sup>6</sup> The IRS certainly should be held to the same standard as taxpayers. Further, whenever there is a conflict between the statute and the instructions, the courts have held that the statute prevails.<sup>7</sup>

Therefore, rather than relying on the instructions to Form 8938, we must look to the statute or the regulations published under the authority of the statute. Section 6038D(a), which imposes the filing requirements for Form 8938, provides:

In General — Any individual who, during any taxable year, holds any interest in a specified foreign financial asset shall attach to such person’s return of tax imposed by subtitle A for such taxable year the information described in subsection (c) with respect to each such asset if the aggregate value of all such assets exceeds \$50,000 (or such higher dollar amount as the Secretary may prescribe).

Note that section 6038D(a) provides only the manner of filing, saying the information (via Form 8938) must be attached to the taxpayer’s return for the tax year. However, the subsection does not provide a time for filing. It does not say the information must be attached to the taxpayer’s “timely filed” return or to a tax return “filed by the due date (including extensions).” Section 6038D(a) also does not delegate to the secretary<sup>8</sup> the task of providing a time for filing Form 8938 through Treasury regulations or IRS instructions. The only delegation to the secretary in section 6038D(a) is for the express purpose of prescribing filing thresholds.

Nowhere in section 6038D is the time for filing Form 8938 specified. Is there another part of this section that would allow the IRS to dictate a time for filing in the instructions to Form 8938? Note that section 6038D(h) provides a general call for regulations:

Regulations — The Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the purposes of this section, including regulations or other guidance which provide appropriate exceptions from the application of this section in the case of —

- (1) classes of assets identified by the Secretary, including any assets with respect to which the Secretary determines that disclosure under this section would be duplicative of other disclosures,
- (2) nonresident aliens, and
- (3) bona fide residents of any possession of the United States.

<sup>5</sup>Hiring Incentives to Restore Employment Act section 513(a)(1).

<sup>6</sup>*Zimmerman v. Commissioner*, 71 T.C. 367, 371 (1978), also citing *Adler v. Commissioner*, 330 F.2d 91, 93 (9th Cir. 1964); *Green v. Commissioner*, 59 T.C. 456, 458 (1972); and *Aldridge v. Commissioner*, 51 T.C. 475, 482 (1968).

<sup>7</sup>*Zimmerman*, 71 T.C. 367; *Adler*, 330 F.2d 91; *Green*, 59 T.C. 456; and *Aldridge*, 51 T.C. 475.

<sup>8</sup>Meaning secretary of the Treasury, which also includes his delegate, the IRS. See section 7701(a)(11)(B).

The focus of this call for regulations is to identify exceptions from filing and not the due date of Form 8938.<sup>9</sup> Had Congress wanted to call on Treasury to dictate the due date of Form 8938, it would have done so in section 6038D(a) or by specific reference. Moreover, in no regulation published under section 6038D is a due date specified.

Reg. section 1.6038D-8, “Penalties for Failure to Disclose,” does not assume any authority to specify a due date for which Form 1040, with Form 8938 attached, must be filed to avoid the \$10,000 late-filing penalty. The regulation simply repeats “at the time and manner described in section 6038D(a)” rather than stating a particular due date. Treasury determined that the role of this regulation should be merely interpretive rather than legislative since there is no call from the statute to assign a time for filing. An interpretive regulation can only interpret what is already in the code section, as opposed to a legislative regulation that could be tasked with the job of specifying a due date.<sup>10</sup>

### The Operative Language Is Missing

Any code section that imposes a penalty for failure to file a particular form must either tell taxpayers how and when to file or delegate one or both of those tasks to Treasury. When a code section delegates authority to the Treasury secretary to determine how or when taxpayers must complete a filing requirement, the Treasury or IRS has legislative authority to do so, either through legislative regulations or rulemaking. Regulations, rulings, and form instructions lacking the direct authority of the code section are merely interpretive and do not have the force and effect of law.

<sup>9</sup> *National Muffler Dealers Association v. United States*, 440 U.S. 472, 477 (1979) (“In determining whether a particular regulation carries out the congressional mandate in a proper manner, we look to see whether the regulation harmonizes with the plain language of the statute, its origin, and its purpose.”), citing *Commissioner v. South Texas Lumber Co.*, 333 U.S. 496, 501 (1948); *Helvering v. Winmill*, 305 U.S. 79, 83 (1938). *Schuler Industries Inc. v. United States*, 109 F.3d 753, 755 (Fed. Cir. 1997) (“To ascertain the source of authority for a particular regulation, we examine the statutory language and the regulation itself.”).

<sup>10</sup> *Schuler Industries*, 109 F.3d 753 (“While an interpretive regulation is issued under the general authority vested in the Secretary of the Treasury by [section] 7805, a legislative regulation is issued under a specific grant of congressional rulemaking authority and has ‘legislative effect.’”) (citing *Batterton v. Francis*, 432 U.S. 416, 425 (1977)).

### Comparison With Properly Drafted Code Sections

None of the other code sections that impose rules for filing international information returns<sup>11</sup> suffer from the flaw of section 6038D.<sup>12</sup> For example, section 6046 provides the rules for category 2 and category 3 filers of Form 5471, “Information Return of U.S. Persons With Respect to Certain Foreign Corporations.” Section 6046(a) describes who must file and under what circumstances. The manner of filing is addressed in section 6046(b).<sup>13</sup> Section 6046(d) is exclusively dedicated to the time for filing:

**Time For Filing** — Any return required by subsection (a) shall be filed on or before the 90th day after the day on which, under any provision of subsection (a), the United States citizen, resident, or person becomes liable to file such return (or on or before such later day as the Secretary may by forms or regulations prescribe).

This section thus properly calls on the IRS to provide the date for filing.

Similarly, section 6046A, which provides rules for U.S. persons whose interest in a foreign partnership changes, is configured to provide both the manner and time for filing. Section 6046A(a) explains who must file, section 6046A(b) provides the manner, and section 6046A(c) gives us the time for filing:

<sup>11</sup> A term borrowed from the national taxpayer advocate’s “Annual Report to Congress 2023,” at 101 (Dec. 31, 2023). These primarily include 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, Form 8938, and Form 926, “Return by a U.S. Transferor of Property to a Foreign Corporation.”

<sup>12</sup> Note that all assessable penalties in chapter 61 of subtitle F potentially lack enforcement power in light of the Tax Court’s reiteration of its holding in *Farhy v. Commissioner*, 160 T.C. 399 (2023), in *Mukhi v. Commissioner*, 163 T.C. No. 8 (2024), and *Safdieh v. Commissioner*, No. 11680-20L (T.C. 2024).

<sup>13</sup> Section 6046(b) provides that the technical rules and forms are delegated to the IRS to develop:

**Form And Contents Of Returns** — The returns required by subsection (a) shall be in such form and shall set forth, in respect of the foreign corporation, such information as the Secretary prescribes by forms or regulations as necessary for carrying out the provisions of the income tax laws, except that in the case of persons described only in subsection (a)(1)(A) the information required shall be limited to the names and addresses of persons described in subparagraph (B) or (C) of subsection (a)(1).

Time For Filing Return — Any return required by subsection (a) shall be filed on or before the 90th day (or on or before such later day as the Secretary may by regulations prescribe) after the day on which the United States person becomes liable to file such return.

Section 6038 provides operating rules for Form 8858, “Information Return of U.S. Persons With Respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs)”;<sup>14</sup> Form 8865, “Return of U.S. Persons With Respect to Certain Foreign Partnerships”; and Form 5471.<sup>14</sup> Section 6038(a)(1) tells us who must file and provides the general information required, but it also gives broad authority to the secretary to require additional information.<sup>15</sup> Section 6038(a)(2) is dedicated to granting authority to Treasury to provide the rules for the time and manner of filing:

Period for Which Information Is to Be Furnished, Etc. — The information required under paragraph (1) shall be furnished for the annual accounting period of the foreign business entity ending with or within the United States person’s taxable year. The information so required shall be furnished at such time and in such manner as the Secretary shall prescribe.

Likewise, language authorizing legislative regulations to specify the time for filing is in section 6038A(a)<sup>16</sup> for Form 5472, “Information Return of a 25 Percent Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business”;<sup>17</sup> section 6038B(a)<sup>17</sup> for Form 926, “Return by a U.S. Transferor of Property to a Foreign Corporation”; and section

6038C(a)(1)<sup>18</sup> for Form 5472. Each of these examples is representative of the critical language missing from section 6038D(a).

### When Does the Penalty Apply for Failure to File Form 8938?

Section 6038D(d) imposes penalties when taxpayers fail to do what is required under subsection (a). Section 6038D(d)(1) says:

In General — If any individual fails to furnish the information described in subsection (c) with respect to any taxable year at the time and in the manner described in subsection (a), such person shall pay a penalty of \$10,000.

This provision requires individuals to pay a \$10,000 penalty if they fail to furnish the required information “at the time and in the manner described in subsection (a).” However (whoops!), only the manner is specified in section 6038D(a); the time for filing is missing.

Notwithstanding the filing requirement imposed and the manner of filing set by section 6038D(a), at what point is a penalty statutorily authorized for a failure to file? Since there is no time imposed under subsection (a), arguably the filing requirement can be met at any time with either a late-filed original return or an amended return. Thus, whenever the form is filed in the manner detailed in section 6038D(a), the filing requirement is met. This means section 6038D(d)(1) is ineffective.

The penalty supposedly imposed by section 6038D(d)(1) is not the only penalty imposed by section 6038D(d). Section 6038D(d)(2) states:

Increase In Penalty Where Failure Continues After Notification — If any failure described in paragraph (1) continues for more than 90 days after the day on which the Secretary mails notice of such failure to the individual, such individual shall pay a penalty (in addition to the penalties under paragraph (1)) of \$10,000 for each 30-day period (or fraction

<sup>14</sup>For filing categories not controlled by section 6046.

<sup>15</sup>The Secretary may also require the furnishing of any other information which is similar or related in nature to that specified in the preceding sentence or which the Secretary determines to be appropriate to carry out the provisions of this title.”

<sup>16</sup>“Such corporation shall furnish, at such time and in such manner as the Secretary shall by regulations prescribe, the information described in subsection (b).”

<sup>17</sup>“Shall furnish to the Secretary, at such time and in such manner as the Secretary shall by regulations prescribe, such information with respect to such exchange or distribution as the Secretary may require in such regulations.”

<sup>18</sup>“Such corporation shall furnish (at such time and in such manner as the Secretary shall by regulations prescribe) the information described in subsection (b).”

thereof) during which such failure continues after the expiration of such 90-day period. The penalty imposed under this paragraph with respect to any failure shall not exceed \$50,000.

The mandate for the penalty imposed by section 6038D(d)(2) is the failure of the taxpayer to satisfy the requirement of section 6038D(d)(1). As posited above, this requirement can be met at any time. Therefore, how can a notice from the secretary be triggered? If there is no failure described in paragraph (1), how can it continue for 90 days after the mailing of a letter by the secretary?

### The IRS Is Mindful of the Problem

The Treasury Inspector General for Tax Administration issued an audit report on April 7, 2022, that chastised the IRS for its failure to initiate compliance actions against taxpayers that were identified as Form 8938 nonfilers.<sup>19</sup> The report found that the IRS could have assessed more than \$3 billion in late-filing penalties using information that it had readily available, but it failed to do so. This inaction by the IRS is strikingly different from its brutally aggressive treatment of late filers of other international information returns, such as Forms 3520, “Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts,” and 3520-A, “Annual Information Return of Foreign Trust With a U.S. Owner.”<sup>20</sup>

Anecdotally, I am unaware of anyone who has received a notice from the IRS for a late-filed Form 8938 or any instance of the IRS litigating the enforcement of the section 6038D(d)(1) penalty. Certainly, the IRS would not want a taxpayer’s representative to go to court and expose the flaw in section 6038D(a) for the taxpaying public to see.

It seems the IRS is practicing a veteran cab driver technique here — right foot on the gas, left foot on the brake, applying pressure to both at the same time. The gas is the language in the Form 8938 instructions warning us to timely file or face

a \$10,000 penalty. The brake is ignoring instances of noncompliance. The proper approach would be to ask Congress for a legislative fix, and to be honest and transparent with the American taxpayer.

Even if the \$10,000 late-filing penalty cannot be imposed and is not enforced by the IRS, the penalty warning in the Form 8938 instructions can imply huge costs to taxpayers. Compliance-minded individuals who have become aware that they should have filed this form and have failed to do so rely on tax professionals for advice. Typically, those taxpayers are advised to enter an IRS streamlined procedure — either the domestic offshore procedure or the foreign offshore procedure.<sup>21</sup> The costs of engaging a tax professional for this purpose can be daunting. Further, those taxpayers residing in the United States and entering the streamlined domestic offshore procedure are committed to paying the miscellaneous offshore penalty.<sup>22</sup> If the only purpose for entering the streamlined domestic offshore procedure or streamlined foreign offshore procedure is to avoid the Form 8938 late-filing penalty, the additional costs imposed on these taxpayers are unjustified.

### Taxpayer Certainty Is Imperative for Reliable Tax Administration

Is this what taxpayers deserve from the IRS as our premier tax reporting agency? Taxpayer certainty in knowing when a tax form is due and whether a penalty will be imposed for failure to file is a core principle of a fair and reasonable tax regime. Adam Smith in his iconic treatise described the importance of certainty as his second of four maxims of sound tax administration:

The tax which each individual is bound to pay, ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all

<sup>21</sup> See IRS, “Streamlined Filing Compliance Procedures” (last updated July 9, 2024).

<sup>22</sup> This penalty is equal to 5 percent of the “highest aggregate balance/value” of the taxpayer’s foreign financial assets during the covered tax return period, which is up to three years (assuming FBAR filing is compliant). See IRS, “U.S. Taxpayers Residing in the United States” (last updated July 9, 2024).

<sup>19</sup> TIGTA, “Additional Actions Are Needed to Address Non-Filing and Non-Reporting Compliance Under the Foreign Account Tax Compliance Act,” Report No. 2022-30-019, at 11-16 (Apr. 7, 2022).

<sup>20</sup> See national taxpayer advocate, “Annual Report to Congress 2023,” *supra* note 11, at 102-105.

to be clear and plain to the contributor, and to every other person. Where it is otherwise, every person subject to the tax is put more or less in the power of the tax-gatherer, who can either aggravate the tax upon any obnoxious contributor, or extort, by the terror of such aggravation, some present or perquisite to himself.<sup>23</sup>

Section 6038D does not involve the payment of a tax. However, the penalties under section 6038D(d) for failure to file Form 8938, or for filing a late or improperly completed Form 8938, are unusually harsh for what might be a naive and mild infraction. The threat of this penalty reinforces the important proposition that U.S. taxpayers deserve certainty in knowing if (or when) a penalty might apply.

### IRS Commissioner: Please Do the Right Thing

I urge the commissioner to publish a notice announcing that there will be no threat of penalties for late-filed Forms 8938 until the penalty is validated through congressional action to repair section 6038D. The instructions to Form 8938 should also be amended to reflect the notice. Section 6501(c)(8) will continue to suspend the three-year statute of limitations until Form 8938 is filed by the taxpayer.

Erin M. Collins, before becoming the national taxpayer advocate, argued that the IRS's position regarding international information return penalties in general was flawed.<sup>24</sup> This commentary inspired the successful arguments in *Farhy* and *Mukhi* in the Tax Court. In her "Annual Report to Congress 2023," Collins implored the IRS to fix the problem:

The IRS should work with Congress to make all [international information return] penalties subject to deficiency procedures. This would solve the IRS's immediate enforcement problem while representing a substantial benefit for taxpayers. Since taxpayers would be granted a forum in the U.S. Tax Court in

which to seek prepayment judicial review, they would no longer face the potential inequity of being shut out of the court system on account of lack of sufficient financial resources. For the first time, lower- and middle-income taxpayers would have access to the same due process afforded wealthy taxpayers in the context of [international information return] penalties. The IRS would also have an incentive to proceed cautiously in asserting [international information return] penalties, as impacted taxpayers could cost-effectively challenge these penalties.

Additional legislative recommendations, specific to section 6038D, were made in the national taxpayer advocate's "2024 Purple Book," at 16-17 (Dec. 31, 2023):

- Amend section 6038D and 31 U.S.C. section 5314 to eliminate duplicative reporting of assets on Form 8938 when a foreign financial account is correctly reported or reflected on an FBAR, while ensuring continued IRS access to foreign financial asset data for both tax compliance and financial crime enforcement purposes.
- Amend section 6038D to exclude financial accounts maintained by a financial institution organized under the laws of the country of which a U.S. person is a bona fide resident from the specified foreign financial assets required to be reported on Form 8938.
- Authorize the Secretary of the Treasury to issue regulations under titles 26 and 31 to harmonize FBAR and FATCA reporting requirements to eliminate duplication, and direct the Secretary to issue those regulations within one calendar year from the effective date of the legislation.

The commissioner now has one more reason to call on Congress.

The indifference and unfairness exhibited by the IRS regarding Form 8938 penalties reflect the

<sup>23</sup> Adam Smith, *An Inquiry Into the Nature and Causes of the Wealth of Nations*, Part II, at 676 (1776).

<sup>24</sup> See Collins and Garrett Hahn, "Foreign Information Reporting Penalties: Assessable or Not?" *Tax Notes*, July 9, 2018, p. 211.

culture of the agency in handling other international information return penalties.<sup>25</sup> As described by the national taxpayer advocate in her 2023 annual report:

Typically, upon learning of their filing obligation, taxpayers voluntarily file missing information returns — albeit late — only to have their compliance rewarded with a harsh penalty. Upon receipt of a late [international information return], the IRS's computer system automatically assesses the penalty, and the IRS begins its collection procedures. To add insult to injury, many of these penalties bear no relation to any underlying taxable income.<sup>26</sup>

...

To make matters worse, the IRS often does not immediately consider requests for reasonable cause relief for [international information return] penalties. . . . The IRS tells taxpayers that they can submit requests for reasonable cause relief, but that it may not consider those requests, in which case they will have to resubmit them later in the process. This cavalier approach is unfair to taxpayers and inefficient for the tax system.<sup>27</sup>

In recent years an actual industry has risen in the tax community involving international information return penalty abatements. I have worked with over a dozen clients to abate Form 3520 and Form 3520-A penalties<sup>28</sup> — a process that has spanned months, and in some cases years. My clients were simply trying to do the right thing when they discovered that a Form 3520 or a Form 3520-A should have been filed but was not filed on time. They thought they were doing the right

thing by filing the forms late with a reasonable cause letter attached. They were then shocked, angered, and heartbroken upon receiving a penalty notice for \$10,000 or more in response. They discovered that when dealing with the IRS, trying to do the right thing can be the wrong thing to do.

Conscientious, well-meaning, compliance-minded taxpayers are being transformed into angry and resentful activists by their mistreatment at the hands of the IRS. Misguided and counterproductive IRS policies do not bode well for the future of voluntary tax compliance in the United States.

I urge the incoming commissioner<sup>29</sup> to do the right thing and issue the notice. Make it part of a comprehensive appeal to Congress to repair and reform the international information return penalty regime as suggested by the national taxpayer advocate. Going forward, this will help to regain taxpayer trust in the integrity of our tax administration system.<sup>30</sup> ■

<sup>25</sup>“Although the IRS must follow statutory mandates, it has meaningful discretion in how to implement these requirements. Rather than promoting tax compliance through taxpayer education and support, the IRS has opted to flex its administrative muscle and bring down the enforcement hammer on good-faith taxpayers and bad actors alike.” National taxpayer advocate, “Annual Report to Congress 2023,” *supra* note 11, at 102.

<sup>26</sup>*Id.* at 103.

<sup>27</sup>*Id.* at 104.

<sup>28</sup>Those penalties are imposed by section 6677(b) for late filing and are typically \$10,000 per form.

<sup>29</sup>Former IRS Commissioner Daniel Werfel resigned on January 20. President Trump's choice for his replacement, former Missouri Rep. Billy Long, has yet to be confirmed by the Senate.

<sup>30</sup>Werfel had announced that the IRS will stop assessing penalties immediately for late-filed Forms 3520 reporting foreign gifts in Part IV of the form and will look at the reasonable cause statement attached. See Andrew Velarde and Benjamin Valdez, “IRS Signals Major Internal Changes for Foreign Gift Penalties,” *Tax Notes Federal*, Oct. 28, 2024, p. 829. This limited policy shift is a tiny but welcome step in the right direction.