

Examination Updates to International Penalties and Forms

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Frank Agostino, Esq., Principal, Agostino & Associates, P.C.

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International Informational Returns

- Filed with the Forms 1040 and 1120:
 - 926 – *Return by a U.S. Transferor of Property to a Foreign Corporation*
 - 5471 – *Information Return of U.S. Persons With Respect To Certain Foreign Corporations*
 - 5472 – *Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business*
 - 8621 – *Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund*
 - 8833 – *Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)*
 - 8858 – *Information Return of U.S. Persons With Respect to Foreign Disregarded Entities*
 - 8865 – *Return of U.S. Persons With Respect to Certain Foreign Partnerships*
 - 8938 – *Statement of Foreign Financial Assets*

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International Informational Returns

- Filed Separately:
 - 3520 – *Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*
 - 3520-A – *Annual Information Return of Foreign Trust With a U.S. Owner*
 - FBAR – *Report of Foreign Bank and Financial Accounts*

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Consequences for Failing to File

Form	I.R.C. §	Civil Penalties
926	§ 6038B § 6662(j)	\$10% of FMV of the property/transferred, max \$100,000 40% penalty may be imposed on any underpayment resulting from an undisclosed foreign financial asset understatement.
3520	§ 6677	Greater of \$10,000 OR : 35% of the gross value of any property transferred to a foreign trust 35% of the gross value of the distributions received from a foreign trust by a U.S. person and 5% of the gross value of all of a foreign trust's assets treated as owned by a U.S. person under the grantor trust rules (IRC sections 671–679)
3520A	§ 6677	Greater of \$10,000 or 5% of the gross value of the trust. \$10,000 per month continuation penalty
5471	§ 6038	\$10,000 per form; \$10,000 per month continuation penalty max \$50,000
5472	§ 6038A	\$25,000 per year \$25,000 continuation penalty per month

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Consequences for Failing to File

Form	I.R.C. §	Civil Penalties
8621	§ 1298 (f)	No Penalties
8833	§ 6712	\$1,000 per individual treaty based return (\$10,000 Corp)
8858	§ 6038, 6038B	\$10,000 per form, \$10,000 per month continuation penalty max \$50,000
8865	§ 6038	\$10,000 per foreign partnership 10,000 per month continuation penalty max \$50,000
8938	§ 6038D	\$10,000 per form; \$10,000 per month continuation penalty

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New International Campaigns

- On April 16, 2019, Large Business & International has recently identified two new campaigns related to international forms:
 - Offshore Private Banking Campaign; and
 - Loose Filed Forms 5471.

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Offshore Private Banking Campaign

- Withholding and International Individual Compliance:
 - Campaign focuses on tax noncompliance and the information reporting of offshore accounts.
 - IRS will initially address the noncompliance through examination and “soft letter” treatment.

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Loose Filed Forms 5471

- Withholding and International Individual Compliance:
 - Form 5471 must be attached to an income tax return;
 - Taxpayers are filing Form 5471 without attaching it to an income tax return;
 - If Form 5471 was previously filed without being attached to an income tax return then it should be attached to and filed with an amended return;
 - Goal is to improve compliance with requirement to attach Form 5471 to a tax return.

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Penalties

- I.R.C. §§ 6038(b); 6038B(c)
 - \$10,000 per foreign corporation plus a \$10,000 continuation penalty for each 30 day period of continuing failure, up to an additional \$50,000.
- Foreign tax credit reduction- diminution of 10% with continuation diminution:
 - not to exceed the greater of \$10,000 or income from foreign business entity;
 - Credit reduction reduced by penalty imposed;
 - Credit reductions brought via Notice of Deficiency.
- I.R.C. § 6662(j)- underpayment due to undisclosed foreign financial asset-40%.

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Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation

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Form 926, Transfers to Foreign Corps.

- Form 926, Return by a US Transferor of Property to a Foreign Corporation.
- Who?
 - U.S. citizens, corporations, and estates and trusts must report certain transfers of property and cash to foreign corporations.
 - Partnerships are not included.
 - Partners carry the burden to file F926
- When and how to file?
 - U.S. transferor must file Form 926, with their tax return for year of transfer.

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926 Return by a U.S. Transferor of Property to a Foreign Corporation

OMB No. 1545-0048
Form 926 (March 2017) Go to www.irs.gov/form926 for instructions and the latest information. Instructions Form 926-109

Part I U.S. Transferor Information (See instructions)

1. If the transferor was a corporation, complete questions 1a through 1d.
 a. If the transferor was a section 301(a) or (b) transferor, was the transferor controlled (under section 304(b)) by 5 or fewer domestic corporations? Yes No
 b. Did the transferor remain in existence after the transfer? Yes No
 If not, list the controlling shareholders and their identifying numbers.

Controlling shareholder	Identifying number

2. If the transferor was a member of an affiliated group filing a consolidated return, was it the parent corporation? Yes No
 If not, list the name and employer identification number (EIN) of the parent corporation.

Name of parent corporation	EIN of parent corporation

3. Have lease agreements under section 367(a)(2) been made? Yes No

4. If the transferor was a partner in a partnership that was the actual transferor (but is not treated as such under section 367), complete questions 4a through 4c.
 a. List the name and EIN of the transferor's partnership.

Name of partnership	EIN of partnership

b. Did the partner pick up its pro rata share of gain on the transfer of partnership assets? Yes No
 c. Is the partner disposing of its entire interest in the partnership? Yes No

5. Is the partner disposing of an interest in a limited partnership that is regularly traded on an established securities market? Yes No

Part II Transferee Foreign Corporation Information (See instructions)

Name of transferee foreign corporation	EIN (if any)	Reference ID number (see instructions)

6. Country code of country of incorporation or organization (see instructions)

7. Foreign tax identification number (see instructions)

8. Is the transferee foreign corporation a controlled foreign corporation? Yes No

For Paperwork Reduction Act Notice, see separate instructions. (Rev. 03-17-2017) Form 926 (Mar. 17-2017)

Failure to File

- Consequences of failing to file:
 - Loss of favorable tax treatment (property treated as gain);
 - Brought via Notice of Deficiency.
 - Penalty of 10% of fair market value of property at time of exchange (\$100,000 limit on penalty unless due to intentional disregard).

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Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business

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Form 5472, Return of 25%-Foreign Owned US Corporations

- I.R.C. § 6038A requires domestic corporations with 25% foreign ownership to file information returns and to maintain adequate books and records.
- I.R.C. § 6038C requires foreign corporations engaged in trade or business in the U.S. to file information returns and maintain adequate books and records.

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5472 Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business (Under Sections 6038A and 6038C of the Internal Revenue Code)

OMB No. 1545-0046

For tax year ending on or after 12/31/17, see instructions.

Part I Reporting Corporation (see instructions. All reporting corporations must complete Part I.)

1a Name of reporting corporation

1b City or town, state, and ZIP code (if a P.O. box, see instructions)

1c Total assets

1d Principal business activity

1e Total value of gross corporate assets or real estate reported on this Form 5472. See instructions.

1f Total value of gross corporate assets or real estate reported on Form 5472. See instructions.

1g Check box if, at any time during the tax year, any foreign person owned, directly or indirectly, at least 25% of all the total voting power of all classes of the stock of the reporting corporation entitled to vote, or 25% the total value of all classes of stock of the reporting corporation. If checked, see instructions.

1h Check box if the reporting corporation is a foreign-owned domestic disregarded entity (foreign-owned U.S. DE) treated as a corporation for purposes of section 6038C. See instructions.

Part II 25% Foreign Shareholder (see instructions)

2a Name and address of direct 25% foreign shareholder

2b U.S. identifying number, if any

2c Reference ID number (see instructions)

2d Foreign taxpayer identification number (FTIN), if any (see instructions)

2e Principal country of residence, domicile, or incorporation

2f Country of citizenship, organization, or incorporation

2g Check box if shareholder is a resident alien for U.S. tax purposes

2h Check box if shareholder is a resident alien for U.S. tax purposes

2i Check box if shareholder is a resident alien for U.S. tax purposes

2j Check box if shareholder is a resident alien for U.S. tax purposes

2k Check box if shareholder is a resident alien for U.S. tax purposes

2l Check box if shareholder is a resident alien for U.S. tax purposes

2m Check box if shareholder is a resident alien for U.S. tax purposes

2n Check box if shareholder is a resident alien for U.S. tax purposes

2o Check box if shareholder is a resident alien for U.S. tax purposes

2p Check box if shareholder is a resident alien for U.S. tax purposes

2q Check box if shareholder is a resident alien for U.S. tax purposes

2r Check box if shareholder is a resident alien for U.S. tax purposes

2s Check box if shareholder is a resident alien for U.S. tax purposes

2t Check box if shareholder is a resident alien for U.S. tax purposes

2u Check box if shareholder is a resident alien for U.S. tax purposes

2v Check box if shareholder is a resident alien for U.S. tax purposes

2w Check box if shareholder is a resident alien for U.S. tax purposes

2x Check box if shareholder is a resident alien for U.S. tax purposes

2y Check box if shareholder is a resident alien for U.S. tax purposes

2z Check box if shareholder is a resident alien for U.S. tax purposes

For Paperwork Reduction Act Notice, see instructions.

File on 1042-FR Form 5472 (2017)

Reportable Transactions

- These penalties are being systemically assessed on late-filed returns;
- There must be a reportable transaction between related parties to be penalized.
 - Systemic assessment is assessing penalties without regard to reportable transactions.

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Penalties

- Penalties
 - Failure to file/timely file Form 5472 results in \$25,000 penalty per year;
 - Continuation penalty assessed for each 30 days taxpayer fails to remedy failure to file within 90 days of being notified of failure;
 - No cap on continuation penalty;
 - Failure to maintain adequate books and records, \$25,000 (can be concurrent).

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Income Recharacterization

- I.R.C. § 6038A(e)(3) allows Secretary to determine:
 - The allowable deduction for any amounts paid or incurred by the reporting corporation to the related party in connection with any applicable transaction; and
 - The cost to the reporting corporation of any property acquired in such transaction from a related party shall be determined by Secretary.

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Form 5472 and the “Cohan Rule”

- The Cohan rule is based on a Second Circuit decision from 1930. Cohan v. Commissioner of Internal Revenue, 39 F.2d 540 (2d Cir. 1930).
- The court held that the taxpayer’s business expense deductions were not adequately substantiated, but stated that “the Board should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making. But to allow nothing at all appears to us inconsistent with saying that something was spent.”

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Foreign Gift

- IRC § 6039F: “the term ‘foreign gift’ means any amount received from a person other than a United States person which the recipient treats as a **gift or bequest**.”
- Bequest: a gift by will of personal property.

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Gifts from Foreign Partnerships and Corporations

- Over \$16,388(yearly inflation adjustment);
- These gifts are includable in gross income (Treas. Reg. § 1.672(f)-4), unless:
 - Properly reported by donor;
 - All U.S. owners in foreign partnership;
 - Contribution to capital for U.S. corps;
 - Charitable transfers;
 - IRS can still re-characterize if purpose was to avoid taxation;
 - Aggregate gift from related foreign partnership/corps does not exceed \$10,000.

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Penalties

- IRC § 6039F:
 - Tax consequences of the receipt of such gift shall be determined by the Secretary; and
 - 5% of the amount of the foreign gift for each month, not to exceed 25% (continuation penalty).

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Income Recharacterization

- IRC § 6039F(c)(1)(A):
 - “Tax consequences of the receipt of such gift shall be determined by the Secretary”.
- Aside from penalties:
 - Foreign gifts can be deemed gross income;
 - Distributions from foreign trusts can be included as gross income.

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Form 8938, *Statement of Specified Foreign Financial Assets*

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Form 8938, *Statement of Foreign Assets*

- Specified individuals and certain entities must report interests in specified foreign financial assets for tax years after March 18, 2010
- Who must file?
 - “Specified persons” with “specified foreign financial assets” greater than \$50,000 at year-end or \$75,000 at any point during the year
- When & how to file?
 - Attach Form 8938, *Statement of Specified Foreign Financial Assets*, to tax return by due date (with extension)
- Penalties (I.R.C. § 6038D)
 - Generally, ***\$10,000, but may increase up to \$50,000 for failure after notice***; reasonable cause defense available
 - Able to be reviewed in CDP proceedings

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Form 8938, *Statement of Foreign Assets*

- Treasury Regulations under I.R.C. § 6038D finalized on Dec. 12, 2014, adopt a number of changes to Form 8938:
 - Dual resident taxpayers now exempt from filing Form 8938 if, in essence, the individual qualifies as a nonresident alien and claims treaty benefits;
 - Definition of “financial account” now excludes certain accounts that are subject to the reporting requirements of a Model 1 or Model 2 intergovernmental agreement;
 - Jointly owned specifies foreign financial assets must now report the entire value of each jointly owned asset (regardless of marital status); and
 - Nonvested property rights under I.R.C. § 83 must be reported as of the first date the property is substantially vested in the person, unless an I.R.C. § 83(b) election is made, in which case, it must be reported as of the date the property is transferred.

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Form 8938: Penalties

- \$10,000 for failing to file a complete and accurate form by the due date of the tax return (including extensions).
- \$10,000 for each 30-day period (or part of a 30-day period) that the form continues to be not-filed 90 days after a formal notice by the IRS, not exceeding \$50,000.

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Other Relevant International Forms

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Form 8802, *Residency Certification*

- Many U.S. treaty partners require the IRS to certify that the person claiming treaty benefits or a VAT exemption is a U.S. resident for federal tax purposes.
 - The IRS provides this residency certification on a Form 6166, *Certification of U.S. Tax Residency*
- Taxpayers can request a Form 6166 (i.e., a letter of U.S. residency certification) by filing with the IRS Form 8802, *Application for United States Residency Certification*
- When and how to file?
 - File with the IRS in Philadelphia Form 8802, *Application for United States Residency Certification*, along with an \$85 user fee.
 - Application, along with the user fee, should be filed at least 45 days before the date the taxpayer needs the Form 6166.

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Form 8833, *Treaty Positions*

- If a taxpayer takes the position that a treaty overrides or modifies an internal revenue law, the taxpayer must disclose such position on a return or if no return, on such form as the Commissioner prescribes. I.R.C. § 6114
 - Common for dual resident taxpayers (I.R.C. § 7701(b))
- When and how to file?
 - Attach Form 8833, *Treaty-Based Position Disclosure Under Section 6114 or 7701(b)*, to income tax return by due date (with extension)
- Penalties (I.R.C. § 6712)
 - For each failure, **\$1,000 or \$10,000 for a corporation**; reasonable cause available

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International Forms Defenses

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Defenses

- Reasonable cause;
 - All forms.
- Substantial compliance;
 - Forms 5471 and 5472.
- Verification of compliance with IRC § 6751(b);
- Assessability of penalties;
 - Forms 5471, 926, 8938 (IRC §§ 6038, 6038B, 6038D).

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Reasonable Cause

- Reasonable Cause defense applies to most Title 26 international penalties when *“failure is due to reasonable cause and not to willful neglect.”*
- IRS’s position: Taxpayers who conduct business or transactions offshore or in foreign countries *have a responsibility to exercise ordinary business care and prudence in determining their filing obligations and other requirements. It is not reasonable or prudent for taxpayers to have no knowledge of, or to solely rely on others for, the tax treatment of international transactions.* IRM 20.1.9.1.1.(4) (10-24-2013); 20.1.9.2.(15) (11-30-2015) .

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Reasonable Cause (cont’d)

- Taxpayer must be in compliance with all open reporting years before a reasonable cause defense may be considered.
- Based on “facts and circumstances” of the case, including:
 - Experience, knowledge and education of the taxpayer;
 - Extent of efforts to comply;
 - Honest, reasonable misunderstanding of fact or law;
 - Reliance on advisors, etc.
- Foreign jurisdictions imposing penalties for disclosing the required information is not reasonable cause.

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Substantial Compliance

- The term “Substantially Complete” and “Substantial Compliance” are not defined in the IRC or Regulations
 - The Substantial Compliance Doctrine is a judicial doctrine.
 - *Indiana Rolling Mills v. Commissioner*
 - *Beard v. Commissioner*
 - Substance or Essence v. Procedural or Directory
- Substantial Compliance:
 - An imperfect, but substantially complete filing should not result in the imposition of penalties.
 - Treas. Regs. Under IRC 6038 and 6038A applicable only to Form 5471 and 5472
 - Judicial doctrine may be applicable to other information returns (i.e., 3520, 3520-A, etc.)

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IRC § 6751(b)

- No penalty under this title shall be assessed unless the **initial determination** of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination or such higher level official as the Secretary may designate.

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Clay v. Commissioner 152 T.C. No. 13 (Apr. 24, 2019)

- Held that the Revenue Agent Report (RAR) and the 30-day letter constitute the initial determination to assess penalties, which requires managerial approval.
- Collection due process: when is initial determination?
- Premature referrals?
 - Many IIRs are being systemically assessed.

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Summarily Assessable

- Can international penalties be summarily assessed?
- Not in Chapter 68 of Code;
- Most located in Chapter 61;
- Look to see if cross-reference to Chapter 68 or a provision within Chapter 68 or if the statute allows for assessment.

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Code Section & Chapter of Code	Code Authority for Assessment.
6011 (Chapter 61)	Section 6707A(a): "Any person who fails to include on any return or statement any information with respect to a reportable transaction which is required under section 6011 to be included with such return or statement shall pay a penalty in the amount determined under subsection (b)."
527 (Chapter 1)	Section 527(j)(1)(B): "For purposes of subtitle F, the amount imposed by this paragraph shall be assessed and collected in the same manner as penalties imposed by section 6652(c)."
7519 (Chapter 77)	Section 7519(f)(1): "Except as otherwise provided in this subsection or in regulations prescribed by the Secretary, any payment required by this section shall be assessed and collected in the same manner as if it were a tax imposed by subtitle C."
6039F (Chapter 61)	Section 6039F(c)(1)(B): "such United States person shall pay (upon notice and demand by the Secretary and in the same manner as tax) an amount equal to 5 percent of the amount of such foreign gift for each month for which the failure continues (not to exceed 25 percent of such amount in the aggregate)."
6043 (Chapter 61)	Section 6043(d) "For provisions relating to penalties for failure to file—(1) a return under subsection (b), see section 6652(c), or (2) a return under subsection (c), see section 6652(1)."
6046 (Chapter 61)	Section 6046(f): "For provisions relating to penalties for violations of this section, sections 6679 and 7203."
6046A (Chapter 61)	Section 6046A(e): "For provisions relating to penalties for violations of this section, see sections 6679 and 7203."

Code Section	Penalty Provision and Cross References.
6038	<p>Section 6038(b)(1):</p> <p>If any person fails to furnish, within the time prescribed under paragraph (2) of subsection (a), any information with respect to any foreign business entity required under paragraph (1) of subsection (a), such person shall pay a penalty of \$10,000 for each annual accounting period with respect to which such failure exists.</p> <p>Section 6038(f) Cross References: (1) For provisions relating to penalties for violations of this section, see section 7203. (2) For definition of the term "United States person", see section 7701(a)(30).</p>
6038B	<p>Section 6038B(c)(1):</p> <p>If any United States person fails to furnish the information described in subsection (a) at the time and in the manner required by regulations, such person shall pay a penalty equal to 10 percent of the fair market value of the property at the time of the exchange (and, in the case of a contribution described in subsection (a)(1)(B), such person shall recognize gain as if the contributed property had been sold for such value at the time of such contribution).</p>
6038D	<p>Section 6038D(d)(1):</p> <p>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.</p>

Form 5471

- Must be attached to an income tax return;
- Due date is automatically extended with income tax return;
- Must be corrected by filing an amended return;
 - Campaign to correct loose filings.
- No jurat;
- IRC § 6662(j) penalty;
- Reduction of foreign tax credit;
- Keeps SOL open indefinitely.

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Form 8938

- Must be attached to income tax return;
- No separate jurat;
- Does not need to be filed if income tax return is not required;
- Due date of return is automatically extended with the income tax return;
- Miscellaneous Penalty will be reported the IRS Income Tax Return Transcript, if married filing jointly, or on IRS Civil Penalty Transcript, for other individuals;
- Allows for an IRC § 6662(j) penalty based upon income; and
- SOL extends time to assess income tax.

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Form 926

- Filed with income tax return;
- No separate jurat;
 - "shall be verified by signing the income tax return with which the form and attachments are filed." Treas. Reg. § 1.6038B-1(b)(1)(i);
- Recognize gain to contributed property;
- IRC § 6662(j) applies; and
- Keeps SOL open indefinitely.

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