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Unit Name	Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 -- Category 4 & 5 Filers
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Table of Contents

(View this PowerPoint in “Presentation View” to click on the links below)

[Process Overview](#)

[Determination of Process Applicability](#)

[Summary of Process Steps](#)

[Process Steps](#)

[Other Considerations and Impacts to Audit](#)

[Training and Additional Resources](#)

[Glossary of Terms and Acronyms](#)

[Index of Related Issues](#)

Process Overview

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Process Description

Certain U.S. persons (singularly “USP”) are required to file Form 5471 (Information Return of U.S. Persons with Respect to Certain Foreign Corporations) with respect to their ownership interests in certain foreign corporations. Form 5471 is attached to a USP’s income tax return (or, if applicable, partnership or exempt organization return) (e.g., Forms 1040, 1120, 1041, 1065 or 990), and must be filed by the due date (including extensions) for that return. The information reported on a Form 5471 relates to the annual accounting period for the foreign corporation that ends within USP’s tax year.

The instructions to Form 5471 set forth four categories of USPs that are required to file Form 5471. Internal Revenue Code (“IRC”) § 6038 contains the requirement for two categories of filers, and IRC § 6046 contains the requirements for the other two categories of filers. Congress enacted IRC § 6038 to curb tax abuses that occurred because the Internal Revenue Service (“IRS”) was unable to obtain information necessary to evaluate a domestic corporation’s interests in, and transactions with, its foreign subsidiaries. (106 Cong. Rec. 11416, 86th Cong. 2d Sess. (1960)).

Failure to file Form 5471 can result in civil and criminal penalties and an extended statute of limitations period, as well as a reduction in foreign tax credits for certain categories of filers. These penalties also can apply if a Form 5471 is filed late or is timely filed but is not substantially complete. IRC § 6038 provides penalties that apply only to USPs that are required to file under IRC § 6038.

This Practice Unit provides an overview of USPs that are required to file Form 5471 under IRC § 6038, and addresses the monetary penalties that apply under IRC § 6038 when a USP fails to file a Form 5471, files a Form 5471 late, or files a Form 5471 that is substantially incomplete. In addition, this Unit sets forth steps to be taken when USP has failed to properly file a Form 5471.

The requirement to file Form 5471 under IRC § 6046, and additional penalties that may apply to a failure to file Form 5471 under IRC § 6679 are discussed in separate practice units



CONSULTATION: Use your professional judgment and consult with your manager and counsel when making decisions regarding the topics discussed in this Unit.

Determination of Process Applicability

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Certain categories of filers of Form 5471 are required to report information about a foreign corporation. The information required varies by category and penalties apply if the information was not provided. The statute of limitations on assessing and collecting these penalties differs from that for the return to which the Form 5471 was required to be attached.

Criteria	Resources	6103 Protected Resources
<p>If IRC § 6038 penalties are applicable, generally they should be assessed within three years after a substantially complete Form 5471 was filed.</p>		
<p>Categories of Filers</p> <p>The instructions to Form 5471 set forth four categories of filers including:</p> <ul style="list-style-type: none"> ▪ Category 4 filers, which are certain USPs that controlled certain foreign corporations; and ▪ Category 5 filers, which are certain USPs that owned at least 10 percent of certain foreign corporations on the last day of the corporation's tax year. 	<ul style="list-style-type: none"> ▪ Form 5471 ▪ Form 5471 Instructions 	
<p>Category 4 Filer</p> <p>A Category 4 filer is a USP who controlled a foreign corporation for an uninterrupted period of at least 30 days during the annual accounting period of the foreign corporation.</p>	<ul style="list-style-type: none"> ▪ IRC 6038(a)(1) Requirement. In general. ▪ Treas. Reg. 1.6038-2(a) Requirement of return. ▪ Treas. Reg. 1.6038-2(d) U.S. person. 	

Determination of Process Applicability (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Certain categories of filers of Form 5471 are required to report information about a foreign owned corporation. The information required varies by category and penalties apply if the information was not provided. The statute of limitations on assessing and collecting these penalties differs from that for the return to which the Form 5471 was required to be attached.

Criteria	Resources	6103 Protected Resources
<p>Category 4 Filer (cont'd) In general, a USP is a:</p> <ul style="list-style-type: none"> ▪ citizen or resident of the U.S., ▪ domestic corporation, ▪ domestic partnership, or ▪ estate or trust that is not a foreign estate or trust. <p>For purposes of determining whether a person is a USP special rules apply for individuals who reside in certain possessions and for certain nonresident aliens.</p>	<ul style="list-style-type: none"> ▪ IRC 7701(a)(30) United States person. ▪ IRC 7701(a)(31) Foreign estate or trust. ▪ Treas. Reg. 1.6038-2(d)(2) & (3) Special rule. ▪ Treas. Reg. 1.6038-2(b) Control. ▪ IRC 6038(e)(2) Control of corporation ▪ “Document titled: Category 4 Examples of Indirect and Constructive Ownership” 	

Determination of Process Applicability (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Certain categories of filers of Form 5471 are required to report information about a foreign owned corporation. The information required varies by category and penalties apply if the information was not provided. The statute of limitations on assessing and collecting these penalties differs from that for the return to which the Form 5471 was required to be attached.

Criteria	Resources	6103 Protected Resources
<p><u>Control</u>: A USP that owns more than 50% of the combined voting power or value of all classes of stock of a foreign corporation controls the foreign corporation. In addition, when a USP owns controlling interest of a foreign corporation which owns controlling interest in another foreign corporation, the USP is treated as indirectly owning controlling interest in the other foreign corporation.</p> <p><u>Constructive Ownership Rules</u>: When determining control, the constructive ownership rules of IRC § 318(a) apply with some exceptions.</p>	<ul style="list-style-type: none"> ▪ IRC 318(a) Constructive ownership of stock. General rule. 	

Determination of Process Applicability (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Certain categories of filers of Form 5471 are required to report information about a foreign corporation. The information required varies by category and penalties apply if the information was not provided. The statute of limitations on assessing and collecting these penalties differs from that for the return to which the Form 5471 was required to be attached.

Criteria	Resources	6103 Protected Resources
<p>Category 5 Filer</p> <p>A Category 5 filer is a U.S. Shareholder who owned stock in a foreign corporation on the last day of the foreign corporation's tax year when the foreign corporation was a controlled foreign corporation ("CFC") (a) on such day and (b) for an uninterrupted period of 30 days or more during such tax year.</p> <p><u>U.S. Shareholder:</u> A U.S. Shareholder is a USP who owns 10% or more of the combined voting power of all classes of voting stock of a CFC. In addition, a U.S. Shareholder is a USP who owns any interest in a CFC that is a captive insurance company.</p>	<ul style="list-style-type: none"> ▪ IRC 6038(a)(4) Information required from certain shareholders in certain cases. ▪ IRC 951(a)(1) In general. ▪ Form 5471 Instructions ▪ IRC 951(b) United States shareholder defined. ▪ IRC 953(c) Special rule for certain captive insurance companies. ▪ IRC 957(c) United States person. ▪ IRC 957(a) General rule. 	

Determination of Process Applicability (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Certain categories of filers of Form 5471 are required to report information about a foreign corporation. The information required varies by category and penalties apply if the information was not provided. The statute of limitations on assessing and collecting these penalties differs from that for the return to which the Form 5471 was required to be attached.

Criteria	Resources	6103 Protected Resources
<p><u>U.S. Person</u>: USP is defined similar to that for Category 4 with exceptions at IRC § 957(c).</p> <p><u>Controlled Foreign Corporation</u>: A CFC is a foreign corporation in which, on any day of its annual accounting period, U.S. Shareholders own more than 50% of (a) the total voting power of all classes of stock or (b) the total value of stock. In addition, special rules apply to determine whether a captive insurance company is a CFC under IRC § 953.</p>		

Determination of Process Applicability (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Certain categories of filers of Form 5471 are required to report information about a foreign owned corporation. The information required varies by category and penalties apply if the information was not provided. The statute of limitations on assessing and collecting these penalties differs from that for the return to which the Form 5471 was required to be attached.

Criteria	Resources	6103 Protected Resources
<p>Category 5 Filer (cont'd) When determining ownership, direct, indirect and constructive ownership rules apply.</p>	<ul style="list-style-type: none"> ▪ IRC 958(a) Direct and indirect ownership. ▪ IRC 958(b) Constructive ownership. ▪ “Document titled: Category 5 Examples of Ownership by U.S. Shareholders” 	

Determination of Process Applicability (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Certain categories of filers of Form 5471 are required to report information about a foreign owned corporation. The information required varies by category and penalties apply if the information was not provided. The statute of limitations on assessing and collecting these penalties differs from that for the return to which the Form 5471 was required to be attached.

Criteria	Resources	6103 Protected Resources
<p>Joint Return Exception. A Category 4 or 5 filer can be excluded from Form 5471 filing obligations when more than one person is required to furnish the same information. Thus, a Category 5 filer can file on behalf of another Category 5 filer because they are both required to furnish the same information. However, a Category 5 filer cannot file on behalf of a Category 4 filer because Category 4 filers are required to furnish more information.</p> <p>The person on whose behalf a Form 5471 was filed of must attach a statement to its return that:</p> <ul style="list-style-type: none"> ▪ states that the filing has or will be satisfied; ▪ provides the name, address and identifying number of the return to which the Form 5471 was or will be attached; and ▪ identifies the IRS Service Center where the return was or will be filed. 	<ul style="list-style-type: none"> ▪ IRC 6038(d) Two or more persons required to furnish information with respect to same foreign business entity. ▪ Treas. Reg. 1.6038-2(j)(1) Two or more persons required to submit the same information ▪ Treas. Reg. 1.6038-2T(j)(3) Statement required. 	

Determination of Process Applicability (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Certain categories of filers of Form 5471 are required to report information about a foreign corporation. The information required varies by category and penalties apply if the information was not provided. The statute of limitations on assessing and collecting these penalties differs from that for the return to which the Form 5471 was required to be attached.

Criteria	Resources	6103 Protected Resources
<p>Joint Return Exception (cont'd)</p> <p>If the return and Form 5471 were or will be filed electronically, <i>e-file</i> should be indicated on the joint filer statements.</p> <p>Item D on a jointly filed Form 5471 must list the name, address and identifying number of each person on whose behalf the Form 5471 was filed. Also, each person's status as officer, director and/or other must be noted.</p>	<ul style="list-style-type: none"> ▪ Form 5471 Instructions 	

Determination of Process Applicability (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Certain categories of filers of Form 5471 are required to report information about a foreign corporation. The information required varies by category and penalties apply if the information was not provided. The statute of limitations on assessing and collecting these penalties differs from that for the return to which the Form 5471 was required to be attached.

Criteria	Resources	6103 Protected Resources
<p>Constructive Ownership Exclusion. Category 4 and 5 filers who are required to file Form 5471 solely because of stock owned under constructive ownership rules are excluded from filing the form if certain requirements are satisfied.</p> <p>The requirements are:</p> <ul style="list-style-type: none"> ▪ the U.S. person does not directly own an interest in the foreign corporation; ▪ the U.S. person is required to furnish the information solely by reason of attribution of stock ownership from a U.S. person; and ▪ the person from whom the stock ownership is attributed furnishes all of the information required to be reported by the person to whom the stock ownership is attributed. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.6038-2(j)(2)(i) Persons excepted from furnishing information. ▪ Treas. Reg. 1.6038-2(c) Attribution rules. 	

Summary of Process Steps

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 1	Determine if the return (e.g., Form 1120, 1065 or 990) was filed late
Step 2	Identify whether required Forms 5471 were attached to the return
Step 3	Review Forms 5471 attached to the return for completeness
Step 4	Issue a Form 5471 pattern letter
Step 5	Review Forms 5471 submitted in response to the pattern letter
Step 6	Determine if USP's reasonable cause statement met the regulatory requirements
Step 7	Review the definition and factors of reasonable cause
Step 8	Review cases in which reasonable cause was considered
Step 9	Evaluate USP's request for reasonable cause

Step 1

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 1: Determine if the return (e.g., Form 1120, 1065 or 990) was filed late

Monetary penalties under IRC § 6038(b) may apply to a USP that does not timely file a Form 5471.

Considerations	Resources	6103 Protected Resources
<p>For Forms 1120 filed late after December 31, 2008, the Service automatically assesses an initial penalty of \$10,000 for each Form 5471 attached. It's assessed even when a request for reasonable cause was submitted with the Form 1120.</p> <p>If an automatic assessment was made, BMFOLT for the MFT 13 civil penalty module will show the penalty posting with transaction code 240 and penalty reference number 599 (623 for 2009 and prior years). The assessment results in a CP 215 notice issued to USP stating the penalty can be paid in full or United States taxpayer ("UST") can request abatement of the penalty under IRC § 6651 for late filing of Form 1120 due to reasonable cause.</p>	<ul style="list-style-type: none"> ▪ IRM 21.8.2.19.2 - Form 5471 Penalties Systemically Assessed from Late Filed Form 1120 Series of Form 1065 ▪ IRM Exhibit 20.1.9-16 -Sample CP 215 Notice ▪ IRC 6651 Failure to file tax return or to pay tax. 	

Step 1 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 1: Determine if the return (e.g., Form 1120, 1065 or 990) was filed late

Monetary penalties under IRC § 6038(b) may apply to a USP that does not timely file a Form 5471.



Considerations	Resources	6103 Protected Resources
<p>Accounts Management evaluates all reasonable cause requests for penalties that are systemically assessed for failure to file timely. If Accounts Management finds that UST had reasonable cause for the delinquent Form 1120, the penalty is abated. If not, UST can petition Appeals.</p> <p>Even though Accounts Management found that UST had reasonable cause for filing a Form 1120 late, penalties can be assessed if Exam finds that the attached Forms 5471 were filed substantially incomplete.</p>		

Step 1 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 1: Determine if the return (e.g., Form 1120, 1065 or 990) was filed late

Monetary penalties under IRC § 6038(b) may apply to a USP that does not timely file a Form 5471.

Considerations	Resources	6103 Protected Resources
 CAUTION: The CP 215 Notice does not provide adequate information to serve as notice for purposes of beginning the 90-day period regarding the continuation penalty.	<ul style="list-style-type: none"> IRC 6038(b)(2) Increase in penalty when failure continues after notification. 	
Even though the initial penalty was automatically assessed when a Form 5471 was attached to a late filed Form 1120, review the Forms 1120 and 7004 to determine whether they were filed timely. Also, review the Form 7004 for proper completion.		
 DECISION POINT: See Slide 42 and Slide 43 for discussion of the authoritative weight of the IRM.		
When you discover a return (with Forms 5471 attached) was filed late, issue a pattern letter to notify USP of the failure. See Step 4 .		

Step 1 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 1: Determine if the return (e.g., Form 1120, 1065 or 990) was filed late

Monetary penalties under IRC § 6038(b) may apply to a USP that does not timely file a Form 5471.

Considerations	Resources	6103 Protected Resources
<p>When you discover an amended return that:</p> <ul style="list-style-type: none">▪ has a Form 5471 attached and▪ was filed after the due date (including extensions) of the original return <p>the Forms 5471 were filed late. Issue a pattern letter to notify USP of the failure. See Step 4.</p>		

Step 2

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 2: Identify whether Forms 5471 required to be filed were attached to the return

Monetary penalties under IRC § 6038(b) may apply to a USP that fails to file a Form 5471.

Considerations	Resources	6103 Protected Resources
<p>The following items of the exam year(s) are helpful to identify all Forms 5471 that were required, but not filed:</p> <ul style="list-style-type: none"> ▪ Forms 5471; ▪ returns (e.g., Forms 1120), plus those of the two preceding tax years; ▪ Forms 8832 (Entity Classification Election); ▪ tax organization chart, plus those of the two preceding tax years; ▪ legal entity chart, plus those of the two preceding tax years; ▪ Forms 10-K Exhibit 21 (Subsidiaries) filed with the Securities Exchange Commission; ▪ certified English translations of certificates of corporate dissolution, officially stamped by the appropriate foreign government agency; 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.6038-2T(j)(3) Statement required. 	

Step 2

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 2: Identify whether Forms 5471 required to be filed were attached to the return

Monetary penalties under IRC § 6038(b) may apply to a USP that fails to file a Form 5471.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none">▪ joint filer’s statements;▪ investment general ledger accounts; and▪ internet discussion of subsidiaries. <p>How you use the items above to analyze, compare and resolve questions to identify Forms 5471 that were required, but not filed, depends on how many foreign corporations USP owned, the exam time available, your relevant experience and knowledge, and your research and problem solving approaches.</p>		

Step 2 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 2: Identify whether Forms 5471 required to be filed were attached to the return

Monetary penalties under IRC § 6038(b) may apply to a USP that fails to file a Form 5471.

Considerations	Resources	6103 Protected Resources
<p>As you identify Forms 5471 that were required, but not filed, for the exam year(s), consider reviewing whether those forms were required, but not filed, in earlier tax years. Generally, IRC § 6038 penalties should be assessed within three years after a substantially complete Form 5471 was filed. Also, the related income tax returns for the prior years are not required to be under exam to assess penalties under IRC § 6038.</p>		
<p>After reviewing the Information Document Request (“IDR”) responses, prepare a pattern letter to notify USP of the failures for the non filing of Forms 5471. See Step 4.</p>		

Step 3

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 3: Review Forms 5471 attached to the return for completeness

When a return was filed with a substantially incomplete Form 5471 attached, monetary penalties may apply under IRC § 6038(b).

Considerations	Resources	6103 Protected Resources
<p>First, review Forms 5471 for errors apparent on its face</p> <p>IRC § 6038(a) requires USPs to report certain information about their foreign corporations and also authorizes the Treasury to require similar or related information to be furnished. Regulations under IRC § 6038 describe such similar or related information and indicate that Form 5471 (including its instructions) prescribe the manner in which all required information is reportable for each foreign corporation.</p> <p>The information required on Form 5471 must be furnished even though the information required may not affect the amount of any tax due under the IRC.</p>		

Step 3 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 3: Review Forms 5471 attached to the return for completeness

When a return was filed with a substantially incomplete Form 5471 attached, monetary penalties may apply under IRC § 6038(b).

Considerations	Resources	6103 Protected Resources
<p>Review USP's Forms 5471 for the following errors on page one. If such Form 5471 is found, that could be an indication that IRC § 6038 was not "substantially complied" with:</p> <ul style="list-style-type: none">▪ Item B: Category of the filer was omitted or incorrect, thus the Form 5471 schedules required to be completed could not be determined.		

Step 3 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 3: Review Forms 5471 attached to the return for completeness

When a return was filed with a substantially incomplete Form 5471 attached, monetary penalties may apply under IRC § 6038(b).

Considerations	Resources	6103 Protected Resources
<p>First, review Forms 5471 for errors apparent on its face (cont'd)</p> <ul style="list-style-type: none"> ▪ Item C: Percentage owned of voting stock of the foreign corporation was omitted (when no Item B category was indicated) or incorrect (when compared to the Item B category indicated), thus the Form 5471 schedules required to be completed could not be determined. ▪ Item 1a: Name or address of foreign corporation was omitted, thus other information provided on Form 5471 could not be associated with a specific foreign corporation. 		

Step 3 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 3: Review Forms 5471 attached to the return for completeness

When a return was filed with a substantially incomplete Form 5471 attached, monetary penalties may apply under IRC § 6038(b).

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none">▪ Items 1b(1) and 1b(2): Reference ID number was omitted when the Employer Identification Number (“EIN”) was not provided, thus other information provided on Form 5471 could not be associated with a specific foreign corporation. (Note: The Reference ID number is only required for foreign corporation tax years beginning in 2012 and later.)		

Step 3 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 3: Review Forms 5471 attached to the return for completeness

When a return was filed with a substantially incomplete Form 5471 attached, monetary penalties may apply under IRC § 6038(b).

Considerations	Resources	6103 Protected Resources
<p>First, review Forms 5471 for errors apparent on its face (cont'd)</p> <ul style="list-style-type: none"> ▪ Item 1c: Country of incorporation was omitted, thus the information reported on Form 5471 could not be correctly evaluated in conjunction with other information known during early phases of the exam. Same reason for the following omitted or incomplete items: <ul style="list-style-type: none"> – 1d: Date of incorporation – 1e: Principal place of business – 1f: Principal business activity code – 1g: Principal business activity ▪ Item 2d: Name and address of person with custody of foreign corporation's books and records was omitted, when both Items 2a and 2c were omitted, thus efficient and effective planning was impacted during early phases of the exam. 		

Step 3 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 3: Review Forms 5471 attached to the return for completeness

When a return was filed with a substantially incomplete Form 5471 attached, monetary penalties may apply under IRC § 6038(b).

Considerations	Resources	6103 Protected Resources
<p>First, review Forms 5471 for errors apparent on its face (cont'd)</p> <p>Review USP's Forms 5471 for any schedule required (based on the filing category indicated at Item B) but not prepared. (Annual Form 5471 instructions include a chart titled "Filing Requirements for Categories of Filers" that prescribe schedules required by category of filer to be completed.) If the schedules are not found, the USP may not have "substantially complied" with its reporting obligations pursuant to IRC § 6038.</p> <p>Note: "Substantially complied" is used in Treas. Reg. § 1.6038-2(k)(3)(ii), but is not defined in the Code or Regulations.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.6038-2(k)(3)(ii) Reasonable cause. 	

Step 3 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 3: Review Forms 5471 attached to the return for completeness

When a return was filed with a substantially incomplete Form 5471 attached, monetary penalties may apply under IRC § 6038(b).

Considerations	Resources	6103 Protected Resources
<p>Review USP's Forms 5471 for inconsistencies on the face of the returns, for example, differing amounts for net income or loss on Schedules C and H or for current earnings and profits on Schedules H and J. Also review Forms 5471 for math errors such as columns not footing, and rows not cross footing on Schedule J for accumulated earnings and profits. When these errors were significant in amount, the USP may not have "substantially complied" with its reporting obligations pursuant to IRC § 6038.</p>		

Step 3 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 3: Review Forms 5471 attached to the return for completeness

When a return was filed with a substantially incomplete Form 5471 attached, monetary penalties may apply under IRC § 6038(b).



Considerations	Resources	6103 Protected Resources
<p>First, review Forms 5471 for errors apparent on its face (cont'd)</p> <p>Review USP's Forms 5471 for the most common reasons for noncompliance with IRC § 6038:</p> <ul style="list-style-type: none"> ▪ stating that required information will be furnished upon request or audit, ▪ providing computer generated Forms 5471 that were not IRS approved and did not conform to requirements, ▪ failing to provide financial statements for controlled foreign corporations, and ▪ providing consolidated financial statements of two or more foreign corporations. 	<ul style="list-style-type: none"> ▪ IR 90-58 ▪ 2002 NSAR 20167 ▪ FSA 1997 WL 33381431 	

Step 3 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 3: Review Forms 5471 attached to the return for completeness

When a return was filed with a substantially incomplete Form 5471 attached, monetary penalties may apply under IRC § 6038(b).

Considerations	Resources	6103 Protected Resources
 <p>CONSULTATION: Consider discussing the errors apparent on the face of Forms 5471 with the Information Gathering IPN to help determine whether a Form 5471 was substantially incomplete.</p>		
 <p>DECISION POINT: See Slide 42 for discussion of the authoritative weight of Information Releases (singularly “IR”), Non Docketed Service Advice Reviews (singularly “NSAR”), Field Service Advices (singularly “FSA”), Chief Counsel Notices (singularly “CCN”) and Chief Counsel Advices (singularly “CCA”).</p>		

Step 3 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 3: Review Forms 5471 attached to the return for completeness

When a return was filed with a substantially incomplete Form 5471 attached, monetary penalties may apply under IRC § 6038(b).

Considerations	Resources	6103 Protected Resources
<p>Second, review Forms 5471 beyond their face</p> <p>Generally, errors beyond the face of Forms 5471 are noticed after you have researched information and/or obtained documentation while working issues identified on Exam's Risk Analysis.</p> <p>In general, taxpayers must strictly comply with their information reporting requirements. However, Treas. Reg. § 1.6038-2(k)(3)(ii) provides that a USP that files a Form 5471 as required by IRC § 6038 except for an omission of, or an error with respect to, some of the required information will not be subject to penalties if the USP has "substantially complied" with its IRC § 6038 reporting requirements. Other than in the regulation itself, the "substantially complied" phrase has not been the subject of any formal guidance or been analyzed by a court with respect to Form 5471, although there is case law on the doctrine of substantial compliance in other areas.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.6038-2(k)(3)(ii) Reasonable cause 	

Step 3 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 3: Review Forms 5471 attached to the return for completeness

When a return was filed with a substantially incomplete Form 5471 attached, monetary penalties may apply under IRC § 6038(b).

Considerations	Resources	6103 Protected Resources
<p>The phrase has been analyzed in FSAs and CCAs, which provide some insight into the meaning of the phrase, although the advice in FSAs and CCAs cannot be used or cited as precedent. Common to the informal guidance provided in the FSAs and CCAs is an analysis of the significance of the error: (i) in amount; and (ii) in its impact to the Service's ability to obtain the information necessary to conduct effective exams.</p> <p>NOTE: "Substantially complied" is not defined in the Code or regulations. Neither are the phrases "substantially incomplete" or "substantially complete."</p>		

Step 3 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 3: Review Forms 5471 attached to the return for completeness

When a return was filed with a substantially incomplete Form 5471 attached, monetary penalties may apply under IRC § 6038(b).

Considerations	Resources	6103 Protected Resources
<p>Second, review Forms 5471 beyond their face (cont'd)</p> <ul style="list-style-type: none"> ▪ A 1997 FSA addressed whether UST “substantially complied” with IRC § 6038 when significant understatements of related party purchases and/or sales were reported and significant inconsistencies were reported for earnings and profits. The FSA states that Congress did not intend that providing more of the required information than not (an aggregate approach) met substantial compliance. It was more important to determine substantial compliance on a significant item by significant item basis. ▪ A 2004 CCA that addressed Form 5472 provided a seven factor facts and circumstances analysis for “substantially incomplete” in contrast to a strict interpretation of the regulations that any over-reported or underreported transaction amount meant the form was “substantially incomplete.” 	<ul style="list-style-type: none"> ▪ FSA 1997 WL 33381431 ▪ CCA 200429007 ▪ CCA 200645023 	

Step 3 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 3: Review Forms 5471 attached to the return for completeness

When a return was filed with a substantially incomplete Form 5471 attached, monetary penalties may apply under IRC § 6038(b).

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ A 2006 CCA advised that significant pieces of required information included: (i) balance sheet and income statement amounts not in accord with U.S. Generally Accepted Accounting Principles (GAAP); and (ii) income statements and income tax amounts that were not in both functional and U.S. currencies. The CCA concluded that the Form 5471 as filed was not “substantially complete.” ▪ When any change in the information as originally reported on a Form 5471 would change Exam’s Risk Analysis, consider that the Form 5471 may be substantially incomplete. For example, adding a potential issue to a Risk Analysis because interest expense paid was reported as interest income earned. Or, increasing a potential adjustment amount. 		

Step 3 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 3: Review Forms 5471 attached to the return for completeness

When a return was filed with a substantially incomplete Form 5471 attached, monetary penalties may apply under IRC § 6038(b).


Considerations	Resources	6103 Protected Resources
<p>Second, review Forms 5471 beyond their face (cont'd)</p> <p>Obviously, considering the impact to Exam's Risk Analysis is a valuable first step. Then, consider using the informal guidance in the FSA and the CCAs to determine whether an error was significant and whether the Service's ability to gather information necessary to conduct an effective examination was impacted. Both the 1997 FSA and CCA 200645023 focused on the significance of the required information. Depending on the complexity and magnitude of the error, and the explanations provide by USP, an analysis using the seven factors in CCA 200429007 might be advisable to determine if the USP did not substantially comply with IRC § 6038.</p>	<ul style="list-style-type: none"> ▪ FSA 1997 WL 33381431, ▪ CCA 200645023 ▪ CCA 200429007 	

Step 3 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 3: Review Forms 5471 attached to the return for completeness

When a return was filed with a substantially incomplete Form 5471 attached, monetary penalties may apply under IRC § 6038(b).

Considerations	Resources	6103 Protected Resources
 CONSULTATION: Consider discussions with the Information Gathering IPN and Counsel on the application of the Service's guidance to analyze the errors beyond the face of Forms 5471.		
Sometimes, significant transactions occurred during the business wind-up phase of a foreign corporation, even though zero ending balances were reported on a final Form 5471. (Note: Final year is determined by review of the beginning and ending dates at the top of Form 5471.)		

Step 3 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 3: Review Forms 5471 attached to the return for completeness

When a return was filed with a substantially incomplete Form 5471 attached, monetary penalties may apply under IRC § 6038(b).

Considerations	Resources	6103 Protected Resources
<p>Second, review Forms 5471 beyond their face (cont'd)</p> <p>Consider requesting a copy of all exam-year general ledger transactions (pre-year-end adjustment) for all foreign corporations for which final Forms 5471 were filed for the prior two tax years. If a significant transaction occurred after the year for which a final Form 5471 was filed and the transaction was not reported on that Form 5471, consider the informal guidance to determine whether IRC § 6038 was substantially complied with. Also, determine whether the dissolution of the foreign corporation occurred in the year of that Form 5471.</p> <p>Filing requirements apply with respect to a foreign corporation that is dormant, although the summary filing procedure described in Revenue Procedure 92-70 may be used in lieu of filing a complete Form 5471 for each dormant foreign corporation.</p>	<ul style="list-style-type: none"> ▪ Rev. Proc. 92-70 ▪ Rev. Rul. 61-191 ▪ Rev. Rul. 74-462 	

Step 3 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 3: Review Forms 5471 attached to the return for completeness

When a return was filed with a substantially incomplete Form 5471 attached, monetary penalties may apply under IRC § 6038(b).

Considerations	Resources	6103 Protected Resources
<p>Filing requirements do not apply with respect to a foreign corporation that has been dissolved. A foreign corporation may undergo a formal dissolution or a de facto dissolution. Generally, the date stamped on a certification of dissolution issued by a foreign government agency is evidence of a foreign corporation's formal dissolution. A de facto dissolution may occur when a corporation "has disposed of all or most of its operating assets, terminated its regular business activities, and become a mere shell, a corporation in name and semblance only, without real corporate substance, serving no real corporate purpose, and having no valid or compelling business reason for continuing its existence, even though not formally dissolved."</p>		

Step 4

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 4: Issue a Form 5471 pattern letter

The pattern letter notifies USP of a failure to file regarding Form 5471 and is required to assess the continuation penalty.

Considerations	Resources	6103 Protected Resources
<p>As soon as you are aware of a person that did not substantially comply with IRC § 6038, prepare a Pattern Letter for Failure to File Form 5471. Additional pattern letters can be prepared later as needed.</p>	<ul style="list-style-type: none"> ▪ IRM Exhibit 20.1.9-6 - Pattern Letter for Failure to File Form 5471 	
<p>The pattern letter notifies USP that it failed to file a Form 5471 (i.e., filed late or not filed at all), or that the form filed was substantially incomplete. It explains that an initial penalty will be imposed. Also, that a continuation penalty applies for each 30-day period (or fraction thereof) beginning 90 days after the date of the letter until a substantially complete Form 5471 is provided.</p>		
<p>The pattern letter is addressed to the person required to file Form 5471. That person could be a subsidiary that joined in the filing of a consolidated corporate income tax return.</p>		

Step 4 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 4: Issue a Form 5471 pattern letter

The pattern letter notifies USP of a failure to file regarding Form 5471 and is required to assess the continuation penalty.

Considerations	Resources	6103 Protected Resources
The pattern letter should indicate the name of the International Examiner (“IE”) as the person to contact for questions and to send the reply. Also, the IE’s phone number should be included. IEs have the training and experience necessary to determine whether corrected Forms 5471 were substantially complete and to evaluate reasonable cause statements.		

Step 4 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 4: Issue a Form 5471 pattern letter

The pattern letter notifies USP of a failure to file regarding Form 5471 and is required to assess the continuation penalty.

Considerations	Resources	6103 Protected Resources
<p>Include in the body of the pattern letter the complete legal names of each foreign corporation for which a failure occurred. If necessary, a list of these legal names can be attached as page two.</p>		
<p>In the body of the pattern letter, include the tax year(s) of the person required to file Forms 5471. If failures occurred in only one tax year for some foreign corporations and in additional tax years for others, then prepare more than one pattern letter so that the relevant tax years are identified.</p>		
<p>Large Business & International (“LB&I”) IEs are authorized to sign Form 5471 pattern letters.</p>	<ul style="list-style-type: none"> ▪ LMSB DO 193-1 	

Step 4 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 4: Issue a Form 5471 pattern letter

The pattern letter notifies USP of a failure to file regarding Form 5471 and is required to assess the continuation penalty.

Considerations	Resources	6103 Protected Resources
<p>Mail the pattern letter to the person required to file as soon as possible for two reasons. One, to obtain the information early to effectively conduct the exam. Two, issuing the pattern letter starts the 90-day notice period required by IRC § 6038(c)(1). Typically, USPs will provide corrected Forms 5471 as soon as possible after receipt of the pattern letter to avoid accumulating continuation penalties.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.6038-2(k)(1)(ii) Dollar amount penalty. 	

Step 4 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 4: Issue a Form 5471 pattern letter

The pattern letter notifies USP of a failure to file regarding Form 5471 and is required to assess the continuation penalty.

Considerations	Resources	6103 Protected Resources
<p>According to the Regulations, the pattern letter must be mailed to the person required to file, not its representative. Consider using registered or certified mail sent “return receipt requested” to provide evidence that the pattern letter was received.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.6038-2(k)(1)(ii) Dollar amount penalty. 	
<p>Keep a copy of all pattern letters issued, and the certified or registered return receipts, in the case file.</p>		

Step 4 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 4: Issue a Form 5471 pattern letter

The pattern letter notifies USP of a failure to file regarding Form 5471 and is required to assess the continuation penalty.


Considerations	Resources	6103 Protected Resources
<p>After the pattern letter was mailed, do not discuss the pattern letter with a representative who is not authorized for such discussions. Review Form 2848 (Power of Attorney and Declaration of Representative) received to ensure that the representative has the appropriate authorization. For a valid authorization, Form 2848 Item #3 “Description of Matter” should include words similar to “Miscellaneous Penalty Under IRC § 6038.” If not, consider suggesting that USP issue a separate Form 2848.</p>		

Step 4 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 4: Issue a Form 5471 pattern letter

The pattern letter notifies USP of a failure to file regarding Form 5471 and is required to assess the continuation penalty.

Considerations	Resources	6103 Protected Resources
<p>Consider referring USP or its authorized representative to Treas. Reg. § 1.6038-2(k)(3), which sets forth the requirements for a valid reasonable cause statement.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.6038-2(k)(3) Reasonable cause. 	
<p> CONSULTATION: There is no provision under IRC § 6038 for an extension of the 90-day period to comply with a pattern letter. Consider consulting with the Information Gathering IPN and Counsel to determine whether it is reasonable to allow an extension (e.g., for extreme hardship, natural disaster, or other highly unusual situations). If granted, document such extension and the new due date in the case file.</p>		

Step 5

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 5: Review Forms 5471 submitted in response to the pattern letter

Continuation penalties may apply when submitted after the 90-day period beginning with the date of the pattern letter.


Considerations	Resources	6103 Protected Resources
<p>Date stamp Forms 5471 as they are received in response to the pattern letter. If such Form 5471 was substantially correct, that date will determine whether, and how much, continuation penalties apply.</p> <p>Review such Forms 5471 to determine whether they complied with IRC § 6038 (see Step 2 and Step 3). If not, then the continuation penalty periods are still in effect.</p> <p>For such Forms 5471 that were substantially incomplete, consider sending a subsequent letter advising that to the person responsible for filing. That letter will provide support at Appeals and in Court that USP had knowledge that the subsequently submitted Forms 5471 were substantially incomplete.</p>		

Step 5 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 5: Review Forms 5471 submitted in response to the pattern letter

Continuation penalties may apply when submitted after the 90-day period beginning with the date of the pattern letter.


Considerations	Resources	6103 Protected Resources
<p>Consider using language, similar to the following, in the subsequent letter for such Forms 5471 that were substantially incomplete:</p> <p>“This is to notify you that the attached Form 5471 for [name of foreign corporation] was not substantially complete. If you fail to file a substantially complete Form 5471 within 90 days after the date the pattern letter was issued ([date]), an additional \$10,000 penalty will be imposed for each 30-day period (or fraction thereof) until a substantially complete Form 5471 is filed, but in an amount not to exceed \$50,000.”</p>		
<p> CONSULTATION: Consider consulting with the Information Gathering IPN and Counsel regarding language to use in the letter.</p>		
<p>Retain a copy of the subsequent letter in the case file.</p>		

Step 5 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 5: Review Forms 5471 submitted in response to the pattern letter

Continuation penalties may apply when submitted after the 90-day period beginning with the date of the pattern letter.

Considerations	Resources	6103 Protected Resources
Repeat Steps 2 and 3 as necessary.		
 DECISION POINT: For Forms 5471 that were not originally provided and not provided in response to the pattern letter, no need to further advise the person responsible for filing that a substantially complete Form 5471 was not filed.		

Step 6

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 6: Determine if USP’s reasonable cause statement met the regulatory requirements

To show that reasonable cause existed, USP must provide a statement that meets the regulatory requirements.

Considerations	Resources	6103 Protected Resources
<p>The Regulations provide an exception that applies when USP can show that its failure to timely file a substantially complete Form 5471 was due to reasonable cause. In order for the exception to apply, USP must file a statement that must:</p> <ul style="list-style-type: none"> ▪ be in writing ▪ provide all of the facts alleged as reasonable cause, and ▪ contain a declaration that the statement was made under penalties of perjury. <p>If the reasonable cause statement did not include the declaration, advise USP that the statement does not satisfy the requirements of the regulations.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.6038-2(k)(3)(ii) Reasonable cause. 	

Step 6 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 6: Determine if USP's reasonable cause statement met the regulatory requirements

To show that reasonable cause existed, USP must provide a statement that meets the regulatory requirements.

Considerations	Resources	6103 Protected Resources
<p>Determine whether USP is in full compliance with IRC § 6038 reporting and record keeping requirements for all tax years open under the statutes. Request USP to file, furnish, report or maintain the information required under IRC § 6038 before considering any reasonable cause.</p>	<ul style="list-style-type: none"> ▪ IRM Exhibit 20.1.9-5 - Reasonable Cause Relief 	

Step 7

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 7: Review the definition and factors of reasonable cause

The reasonable cause exception has been addressed in court cases and informal guidance.

Considerations	Resources	6103 Protected Resources
<p>Neither IRC § 6038, nor the Regulations thereunder, define “reasonable cause” for the failure to timely file a substantially complete Form 5471.</p> <p>Several sections of the Code provide “reasonable cause” as a defense to penalties. For example:</p> <ul style="list-style-type: none"> ▪ IRC § 6651(a) - Failure to file tax return, ▪ IRC § 6652 - Failure to file certain information returns, and ▪ IRC § 6679 - Failure to file returns including foreign corporations. <p>However, those sections do not define “reasonable cause” either.</p> <p>IRC § 6651(a) provides that the penalty may be avoided if USP demonstrates that the failure was attributed to reasonable cause and not due to willful neglect.</p>	<ul style="list-style-type: none"> ▪ U.S. v. Boyle, 469 US 241 (1985) 	

Step 7 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 7: Review the definition and factors of reasonable cause

The reasonable cause exception has been addressed in court cases and informal guidance.

Considerations	Resources	6103 Protected Resources
<p>In United States v. Boyle, the Supreme Court noted that Treas. Reg. § 301.6651(c)(1) (1984) required UST to demonstrate that it “exercised ordinary business care and prudence but nevertheless unable to file the return within the prescribed time.” And “Thus, the Service's correlation of ‘reasonable cause’ with ‘ordinary business care and prudence’ is consistent with Congress' intent, and over 40 years of case law as well.”</p>		

Step 7 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 7: Review the definition and factors of reasonable cause

The reasonable cause exception has been addressed in court cases and informal guidance.

Considerations	Resources	6103 Protected Resources
<p>FSA 1997 WL 33381431, relying on US v. Nordbrock and Firestone v. Howerton, noted that courts generally agree that similar terms appearing in different sections of a statute should be interpreted the same way.</p> <p>The FSA saw no reason to define reasonable cause under IRC § 6038 differently than exercising ordinary business care and prudence but nevertheless unable to file a substantially complete Form 5471.</p>	<ul style="list-style-type: none"> ▪ U.S. v. Nordbrock, 38 F.3d 440 (9th Cir. 1994) ▪ Firestone v. Howerton, 671 F.2d 317 (9th Cir. 1982) ▪ FSA 1997 WL 33381431 	
<p>The IRM provides factors to consider in determining whether USP exercised ordinary business care and prudence. Examples of what might be reasonable cause include:</p> <ul style="list-style-type: none"> ▪ Erroneous advice or reliance, ▪ Inability to obtain records, and ▪ Death, serious illness, or unavoidable absence. 	<ul style="list-style-type: none"> ▪ IRM 20.1.1.3.2.2.5 - Erroneous Advice or Reliance ▪ CCN 2004-036 ▪ IRM 20.1.1.3.2.2.3 - Unable to Obtain Records ▪ IRM 20.1.1.3.2.2.1 - Death, Serious Illness, or Unavoidable Absence 	

Step 7 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 7: Review the definition and factors of reasonable cause

The reasonable cause exception has been addressed in court cases and informal guidance.

Considerations	Resources	6103 Protected Resources
<p>Ignorance of the law, by itself, is not reasonable cause. However, in conjunction with other factors, it might be. Such other factors to consider include:</p> <ul style="list-style-type: none"> ▪ USP's education ▪ if USP was penalized before, and ▪ if USP could not reasonably be expected to know of recent changes in the tax law or forms, and the level of complexity of a tax or compliance issue. 	<ul style="list-style-type: none"> ▪ IRM 20.1.1.3.2.2.6 - Ignorance of the Law 	

Step 8

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 8: Review cases in which reasonable cause was considered

Reasonable cause exception addressed in court cases and informal advice.

Considerations	Resources	6103 Protected Resources
<p>Generally, the most important factor in determining whether USP had reasonable cause and acted in good faith was the extent of USP's effort to report the proper tax liability.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.6664-4(b)(1) Facts and circumstances taken into account. 	
<p>In Congdon v. U.S., the Court explained what is needed for a reasonable cause analysis regarding Form 5471. The court referred to the IRM and other Sections of the Code and stated, "the elements that must be present to constitute reasonable cause are a question of law, but whether those elements are present in a given situation is a question of fact. To demonstrate reasonable cause, the plaintiff must show that he exercised ordinary business care and prudence."</p>	<ul style="list-style-type: none"> ▪ Congdon v. U.S., 108 AFTR.2d 2011 (E.D. TX 2011) 	
<p>Generally, reliance on the substantive advice of an informed, qualified professional is reasonable. In contrast, the taxpayer's reliance on a professional to carry out ministerial duties not requiring special expertise, such as timely filing a return, is not reasonable.</p>	<ul style="list-style-type: none"> ▪ U. S. v. Boyle, 469 U.S. 241 (1985) ▪ 2002 NSAR 20329 	

Step 8 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 8: Review cases in which reasonable cause was considered

Reasonable cause exception addressed in court cases and informal advice.

Considerations	Resources	6103 Protected Resources
<p>Under exam, the Service determined that UST timely filed three years of Forms 1120. However, instead of completing Schedules A, B, C, E, F, H and J of the three Forms 5471 attached per year, UST provided a statement similar to “information will be furnished upon request or audit.” In response to the Service’s requests, UST provided subsequent Forms 5471 which again contained similar statements. UST asserted that the IRC § 6038 penalties should be waived because it disclosed the existence of the CFCs and that the intent of the statute was to penalize USTs that did not disclosure such identities.</p>	<ul style="list-style-type: none"> ▪ 2002 NSAR 20167 	

Step 8 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 8: Review cases in which reasonable cause was considered

Reasonable cause exception addressed in court cases and informal advice.

Considerations	Resources	6103 Protected Resources
<p>The NSAR determined that reasonable cause did not exist, noting that UST's statement is one of the most common examples of noncompliance discussed in IRS News Release IR-90-58 (03/29/90). Further, UST lacked the significant mitigating factor of an established history of complying with the information reporting requirements. Moreover, partial compliance, such as disclosing that CFCs existed, did not constitute reasonable cause.</p>	<ul style="list-style-type: none"> ▪ 2002 NSAR 20167 	
<p>In FSA 1997 WL 33381431, UST filed separate Forms 5471 for a large number of CFCs. Each Form 5471 reported much of the required information and included numerous pages of detailed financial information regarding financial condition, corporate stock structure, shareholders and results of operations.</p>	<ul style="list-style-type: none"> ▪ FSA 1997 WL 33381431 	

Step 8 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 8: Review cases in which reasonable cause was considered

Reasonable cause exception addressed in court cases and informal advice.

Considerations	Resources	6103 Protected Resources
<p>FSA 1997 WL 33381431 (cont'd)</p> <p>During exam, the Service identified significant understatements of purchases from and/or sales to some CFCs and related third parties (reported on schedule M), and significant inconsistencies in the reported earnings and profits of some CFCs. The Service determined that UST submitted most of the information required by IRC § 6038 and related regulations. Except for the significant understatements, the information reported on Forms 5471 was accurate and/or uncontested by the Service.</p>		

Step 8 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 8: Review cases in which reasonable cause was considered

Reasonable cause exception addressed in court cases and informal advice.

Considerations	Resources	6103 Protected Resources
<p>UST attributed the errors to an unintentional misapplication of an international business report. Also, that the breadth and complexity of the information requested on Form 5471; the language and distance barriers involved when UST dealt with its foreign subsidiaries; and the differences in currencies and accounting practices all contributed to the reporting errors.</p> <p>The Service determined that UST was not entitled to reasonable cause relief. UST could not rely on the faulty business reports to establish reasonable cause. UST historically failed to accurately complete Forms 5471, repeatedly supplying information containing the same type of errors as in the present case. UST was previously advised of those errors during prior examinations. Also, the FSA concluded that distance, language, currency, and accounting practice and systems arguments were unconvincing because most persons required to file Forms 5471 had the same circumstances.</p>		

Step 8 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 8: Review cases in which reasonable cause was considered

Reasonable cause exception addressed in court cases and informal advice.

Considerations	Resources	6103 Protected Resources
<p>FSA 1997 WL 33381431 (cont'd)</p> <p>Finding reasonable cause under such circumstances would excuse virtually every taxpayer from all reporting obligations under IRC § 6038. Further, none of UST's assertions demonstrated the exercise of ordinary business care and prudence when completing the Forms 5471, particularly for the financial and/or economic conditions inaccurately reported for the foreign subsidiaries.</p>		

Step 8 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 8: Review cases in which reasonable cause was considered

Reasonable cause exception addressed in court cases and informal advice.

Considerations	Resources	6103 Protected Resources
<p>UST acquired controlling interest of a foreign parent corporation, which wholly owned the stock of multiple foreign corporations. A tax professional advised UST that it should file Forms 5471 with respect to the foreign corporations. Even though UST did not believe that it was required to file the forms, UST nevertheless timely filed Forms 5471 for certain foreign corporations. However, the forms were incomplete. Specifically, the amounts were not: (a) reported in accord with U.S. GAAP on Schedules C and F and (b) reported in functional and U.S. currency on Schedules C and E. In addition, UST did not attach Schedule O to the Forms 5471. Moreover, UST failed to file Forms 5471 for certain other foreign corporations.</p>	<ul style="list-style-type: none"> ▪ CCA 200645023 	

Step 8 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 8: Review cases in which reasonable cause was considered

Reasonable cause exception addressed in court cases and informal advice.

Considerations	Resources	6103 Protected Resources
<p>CCA 200645023 (cont'd)</p> <p>UST asserted three arguments explaining why it was entitled to the reasonable cause exception. First, UST argued that it was entitled to relief under the reasonable cause exception because it reasonably believed that it did not have an obligation to file. Specifically, UST argued that it believed that it was not required to file with respect to the foreign corporations because it was not treated as the owner of the foreign corporations under either a step transaction or substance over form analysis. The CCA noted that an honest misunderstanding of the law that is reasonable in light of all the relevant facts could suggest reasonable cause. The CCA also noted that a lack of clarity in the law would support a finding of reasonable cause only if UST could show that it reasonably relied upon an erroneous but reasonable interpretation of the law.</p>		

Step 8 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 8: Review cases in which reasonable cause was considered

Reasonable cause exception addressed in court cases and informal advice.

Considerations	Resources	6103 Protected Resources
<p>The CCA concluded that UST failed to demonstrate that its interpretation of the law (i.e., that it was not the owner of the foreign corporations) was reasonable, and further noted that UST was advised by its tax advisors to file the Forms 5471. Thus, the CCA concluded that UST did not reasonably rely on a belief that it was not required to file.</p> <p>Second, UST asserted that the timely filed Forms 5471 were substantially complete because the only substantive deficiency was that the financial statements were not stated in U.S. dollars and not converted to U.S. GAAP, and that it would have been unduly costly for UST to convert the information in the statements to U.S. dollars and U.S. GAAP.</p>		

Step 8 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 8: Review cases in which reasonable cause was considered

Reasonable cause exception addressed in court cases and informal advice.

Considerations	Resources	6103 Protected Resources
<p>CCA 200645023 (cont'd)</p> <p>The CCA stated that the U.S. dollar and U.S. GAAP financial statements that UST failed to provide were significant pieces of required information. In addition, the CCA noted that the cost of converting the financial statements to U.S. dollars and U.S. GAAP would constitute reasonable cause only if the exercise of ordinary business care and prudence would not have allowed UST to make the conversions. UST provided no evidence that, after the exercise of ordinary business care and prudence, the conversion costs would have caused it undue hardship. In fact, UST ultimately filed complete Forms 5471. Thus, the CCA concluded that the timely filed Forms 5471 were not substantially complete.</p>		

Step 8 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 8: Review cases in which reasonable cause was considered

Reasonable cause exception addressed in court cases and informal advice.


Considerations	Resources	6103 Protected Resources
<p>Third, UST argued that it was entitled to relief because of its strong compliance history. UST stated previously it timely filed complete Forms 5471 and 5472 and only once failed to file a Form 5472 due to an inadvertent oversight. The CCA noted that IRM 20.1.1.3.1 identified a strong compliance history as a factor in whether ordinary business care and prudence was exercised. The CCA noted that that an isolated error indicated inadvertence, not intention. However, the CCA concluded that the large number of incomplete Forms 5471 filed by UST did not indicate an isolated oversight. Rather, it indicated an intentional decision to file incomplete Forms 5471. Moreover, that UST's strong compliance history indicated that the failure to file complete Forms 5471 in the present case was not inadvertent.</p>		

Step 9

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 9: Evaluate USP's request for reasonable cause

Initial and continuation penalties apply if reasonable cause is not granted.

Considerations	Resources	6103 Protected Resources
 CONSULTATION: Contact Counsel and the Information Gathering IPN for assistance in evaluating whether USP had reasonable cause.		

Step 9 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 9: Evaluate USP's request for reasonable cause

Initial and continuation penalties apply if reasonable cause is not granted.

Considerations	Resources	6103 Protected Resources
<p>Although Notice Of Proposed Adjustments (singularly “NOPA”) are not prepared for IRC § 6038 penalty cases, for the following reasons consider preparing a NOPA-like memo of whether USP had reasonable cause :</p> <ul style="list-style-type: none"> ▪ to document your consideration of the reasonable cause request, ▪ to assist in the analysis of USP's assertions and related facts and events, ▪ to provide Counsel and the Information Gathering IPN when you request consultation, and ▪ ultimately, to support the Service's position in workpapers, at Appeals or in court. 		

Step 9 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 9: Evaluate USP's request for reasonable cause

Initial and continuation penalties apply if reasonable cause is not granted.

Considerations	Resources	6103 Protected Resources
<p>As you write the facts of the memo, consider issuing IDRs to:</p> <ul style="list-style-type: none">▪ clarify the facts▪ date the facts (in regards to the latest date that reasonable cause existed and the chronology of the facts in relation to each other), and▪ obtain documents supporting the facts.		

Step 9 (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Step 9: Evaluate USP's request for reasonable cause

Initial and continuation penalties apply if reasonable cause is not granted.

Considerations	Resources	6103 Protected Resources
As you write the legal discussion of the memo, consider USP's assertions in light of the definition of, and factors regarding, reasonable cause. Also, whether the assertions are similar to guidance issued by Counsel.		

Other Considerations / Impact to Audit

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Considerations	Resources
<p>The 2012 Offshore Voluntary Disclosure Program allows USPs with undisclosed income from offshore accounts to become current with their tax returns. The program offers certain benefits to encourage the disclosure of foreign accounts.</p> <p>Although USPs must apply for the program and meet certain terms to be accepted, USPs not in the program can qualify for relief from penalties for delinquent Forms 5471 via the procedure outlined in FAQ 18. FAQ 18 requires that a USP submit the delinquent Forms 5471 with an amended return that has no change to income or to tax liability. Also, that "OVDI - FAQ #18" is written at the top of the first page of each delinquent Form 5471. If USP has no underreported tax liabilities and was not previously contacted regarding an income tax examination or requested to provide delinquent returns, the IRS will not impose a penalty for the failure to file delinquent Forms 5471. Effective on or after July 1, 2014, the Service eliminated the 2012 OVDP FAQ 18 automatic penalty relief provision.</p>	<ul style="list-style-type: none"> ▪ 2012 OVDP ▪ 2012 OVDP FAQs
<p>The First Time Abatement rule is an administrative waiver of penalties for the failure to:</p> <ul style="list-style-type: none"> ▪ file under IRC §§ 6651(a)(1), 6698 or 6699; ▪ pay under IRC §§ 6651(a)(2) or 6651(a)(3); or ▪ deposit under IRC § 6656. <p>It does not apply to penalties under IRC § 6038.</p>	<ul style="list-style-type: none"> ▪ IRM 20.1.1.3.6.1 - First Time Abatement (FTA)
<p>Willful failure to file Form 5471 can result in criminal penalties.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.6038-2(k)(4) IRC 7203 Willful failure to file return, supply information, or pay tax.

Other Considerations / Impact to Audit (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Considerations	Resources
<p>The statute of limitations (“SOL”) for assessing tax, regarding an income tax return associated with a substantially incomplete Form 5471, expires three years after the date a substantially complete Form 5471 is provided. The extended SOL applies to any tax return or period to which the information relates. (Thus, this extends the SOL to all items of income and deduction reported on the income tax return.)</p> <p>However, if the failure to provide a substantially complete Form 5471 was due to reasonable cause and not willful neglect, the extended SOL only applies to any items related to the information required to be reported on the Form 5471.</p> <p>These rules are effective for returns filed after March 18, 2010, or returns filed prior to March 19, 2010, provided the SOL was otherwise open on that date.</p> <p>Before the effective date of these rules, the extended SOL only applied to any items related to the information required to be reported on the Form 5471.</p>	<ul style="list-style-type: none"> ▪ IRC 6501(c)(8)(A) Failure to notify Secretary of certain foreign transfers. ▪ IRC 6501(c)(8)(B) Failure to notify Secretary of certain foreign transfers.
<p>Judicial, legislative, and administrative authorities (plus legal commentary) provide what the law is (or should be). These authorities are considered primary or secondary authorities. Primary authorities are source law (e.g., case law, statutes and legislatively authorized regulations). Secondary authorities discuss source law (e.g., law review articles).</p> <p>These authorities have differing weights, some binding (i.e., controlling or precedent setting) and some persuasive. Binding authorities must be followed. Although only primary authorities can be binding, not all are. Determining authoritative weight also involves the proceeding during which the authorities are considered.</p>	<ul style="list-style-type: none"> ▪ BNA Tax Management U.S. Income Portfolio 100-3rd Sec. I

Other Considerations / Impact to Audit (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Considerations	Resources
<p>CCAs, CCNs, FSAs, IRs, and NSARs may not be used or cited as precedent (unless a regulation establishes to the contrary). However, informal advice and other releases may be a useful starting point for research. When reading them, consider whether relevant law has changed since they were issued. Contact counsel if you have any questions.</p>	<ul style="list-style-type: none"> ▪ IRC 6110 (b)(1) Written determination. ▪ IRC 6110(k)(3) Precedential status.
<p>The IRM does not have the force and effect of law (see discussions in Marks v. Commissioner and Pomeroy v. U.S.). The IRM consists of internal operating procedures of the Service that do not create or provide taxpayers with legally enforceable rights. However, judicial decisions in areas other than tax law suggest that the Service's failure to follow the IRM may affect the substantive rights of a taxpayer and, thus, be grounds to quash the Service's actions. (See Montilla v. Immigration and Naturalization Service.)</p>	<ul style="list-style-type: none"> ▪ Marks v. Commissioner, 947 F.2d 983 (Fed Cir. 1991) ▪ Pomeroy v. U.S., 864 F.2d, 1191 (5th Cir. 1989) ▪ Montilla v. INS, 926 F.2d 162 (2nd Cir. 1991)

Other Considerations / Impact to Audit (cont'd)

Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5

Considerations	Resources
<p>In <i>Wheaton v. U.S.</i>, a federal district court addressed the relevance of statutory deficiency procedures to the assessment of penalties under IRC § 6038. The taxpayer had received numerous letters from the IRS informing him of his obligation to file Forms 5471 (for the years 1982 through 1993) and describing the penalties imposed by IRC § 6038(b). Taxpayer also received numerous follow-up letters requesting the filing of those Forms 5471 and, ultimately, Notices of Penalty Charges.</p> <p>Statutory Notices of Deficiency issued, under IRC § 6212, to the taxpayer listed income tax deficiencies for the years 1979 through 1990. The penalties under IRC § 6038(b), for failure to file Form 5471, were not mentioned in the Notices of Deficiencies.</p> <p>In a federal district court, taxpayer claimed his right to challenge the penalty assessments in Tax Court was precluded because the IRC § 6038(b) penalties were omitted from the Notices of Deficiency. Also, his right to a stay of the enforcement proceedings regarding the penalty assessments, pending the final decision of the Tax Court, was precluded.</p> <p>The district court noted the definition of “deficiency” in IRC § 6211 pertains only to income, estate, and gift taxes imposed by subtitles A and B and excise taxes imposed by chapters 41, 42, 43, and 44. Also, IRC §§ 6212(a), 6212(c), and 6213(a) adopted the same definition. Since penalties under IRC § 6038(b) fall under subtitle F, chapter 61, such penalties are not subject to the deficiency notice rules, nor are they within the jurisdiction of the Tax Court. Thus, the taxpayer’s alleged rights were not precluded.</p>	<ul style="list-style-type: none"> ▪ <i>Wheaton v. U.S.</i>, 888 F. Supp. 622 (D.N.J. 1995)

Training and Additional Resources

Chapter 17.3.1 Form 5471 Penalty Provisions

Type of Resource	Description(s) and/or Instructions for Accessing	References
Online treatise	<p>IRC § 6038 discussions of reporting requirements for U.S. persons with interests in foreign corporations.</p> <p>The treatise is included in LB&I's Westlaw subscription in the International resources section. Expand the section to show all resources to find Bittker & Lokken: <u>Federal Taxation of Income, Estates and Gifts</u>. Click on:</p> <ul style="list-style-type: none"> ▪ Table of Contents, ▪ Part 9 (Foreign Income and Foreign Taxpayers), and ▪ Chapter 65 (Introduction and Classification of Individuals and Entities). ▪ ¶ 65.8 (Information Reporting with Respect to Foreign Business Entities) <p>Then scroll to ¶ 65.8.2 (U.S. Persons with Interests in Foreign Corporations)</p>	<ul style="list-style-type: none"> ▪ Bittker & Lokken Fed. Tax'n Inc, Est and Gift Para 65.8.2

Training and Additional Resources (cont'd)

Chapter 17.3.1 Form 5471 Penalty Provisions		
Type of Resource	Description(s) and/or Instructions for Accessing	References
Online treatise	<p>Discussions of reporting requirements for U.S. persons with interests in foreign corporations.</p> <p>The treatise is included in LB&I's Westlaw subscription at the IRS BNA Tab. Click the box for "BNA Tax Management Foreign Income Portfolios" in the International Tax Research section. Then, search using the term "947-1st" and click on the search hit "947 s III."</p> <p>Consider saving the TM-FOR database as a favorite for faster searching.</p>	<ul style="list-style-type: none"> ▪ BNA Tax Management Foreign Income Portfolio 947-1st Sec. III
Online treatise	<p>Discussion of common reasons given as reasonable cause.</p> <p>The treatise is included in LB&I's Westlaw subscription at the IRS BNA Tab. Click the box for "BNA Tax Management Federal Portfolios Combined" in the General Tax Research section. Then, search using the term "634-3rd" and click on the search hit "634 s XI."</p>	<ul style="list-style-type: none"> ▪ BNA Tax Management U.S. Income Portfolio 634-3rd Sec. XI

Training and Additional Resources (cont'd)

Chapter 17.3.1 Form 5471 Penalty Provisions		
Type of Resource	Description(s) and/or Instructions for Accessing	References
Online treatise	<p>BNA discusses understanding and weighing authorities in its portfolio on U.S. Federal Tax Research. The portfolio has sections for:</p> <ul style="list-style-type: none"> ▪ legislation, ▪ administrative pronouncements, ▪ judicial authorities, and ▪ legal commentary. <p>The treatise is included in LB&I's Westlaw subscription at the IRS BNA Tab. Click the box for "BNA Tax Management Federal Portfolios Combined" in the General Tax Research section. Then, search using the term "100-3rd" for search hits for various sections.</p>	<ul style="list-style-type: none"> ▪ BNA Tax Management U.S. Income Portfolio 100-3rd

Glossary of Terms and Acronyms

Acronym	Definition
CCA	Chief Counsel Advice
CCN	Chief Counsel Notice
CFC	Controlled foreign corporation
CIC	Coordinated Issue Case
Code	Internal Revenue Code
EIN	Employer Identification Number
FSA	Field Service Advice
GAAP	Generally Accepted Accounting Procedures
IDR	Information Document Request
INS	Immigration and Naturalization Service
IE	International Examiner
IR	IRS News Release
IRC	Internal Revenue Code
LB&I	Large Business & International
MFT	Master File Transaction
NOPA	Notice of Proposed Adjustment

Glossary of Terms and Acronyms

Acronym	Definition
NSAR	Non Docketed Service Advice Review
SOL	Statute of limitations
USP	U.S. person
UST	U.S. taxpayer

Index of Related Issues

Issue	Associated UIL(s)	References
Failure to File the Form 5471 – Category 4 and 5 Filers – Monetary Penalty	▪ 9433.01_03	
Failure to File the Form 5471 – Category 2 and 3 Filers – Monetary Penalty	▪ 9433.01-02	
Failure to File the Form 926 – Monetary Penalty	▪ 9433.01-02	
Failure to File the Form 8865 – Category 1 and 2 Filers – Monetary Penalty	▪ 9434.01	
Considering penalties when a U.S. partner did not file Form 8865 for a controlled foreign partnership (Under Development)	▪ 9560.02	
Considering a reduction to the foreign tax credits of a U.S. shareholder that did not file Form 5471 for a foreign corporation (Under Development)	▪ 9560.03	
Considering a reduction to the foreign tax credits of a U.S. partner that did not file Form 8865 for a foreign partnership (Under Development)	▪ 9560.04	
Determination of U.S. Shareholder and CFC Status	▪ 9433.01	