

## LB&I Concept Unit Knowledge Base - International

Library Level	Number	Title
Shelf	N/A	Cross-Over
Book	17	Information Gathering and Penalties
Chapter	17.3	6038(b) - Failure to Furnish CFC Information – Monetary
Section	17.3.1	Form 5471 Penalty Provisions
Subsection		

<b>Unit Name</b>	The Meaning of “Substantially Complete” with Reference to International Information Return Penalties	
<b>Primary UIL Code</b>	9560.01	6038(b) - Failure to Furnish CFC Information - Monetary

<b>Document Control Number (DCN)</b>	IGA/C/17_03_01-02
<b>Date of Last Update</b>	05/31/17

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# General Overview

## The Meaning of “Substantially Complete” with Reference to Int’l Information Return Penalties

This Concept Unit discusses the meaning of substantially complete with respect to international information return penalties.

If the filer did not submit a substantially complete return, then penalties under IRC 6038, 6038A and 6046 may apply. Substantially complete and substantially incomplete are not defined in the Internal Revenue Code (IRC) or the regulations. International information returns must be substantially complete in order for the filer to have met its filing requirement.

For those agents examining a U.S. entity with foreign ownership or foreign-owned U.S. businesses, this Concept Unit provides informal guidance on determining whether the required international information return is substantially complete so that the filing requirement is met.

This Unit begins by explaining the substantial compliance doctrine, which is a judicial concept that applies to certain tax returns, elections and the substantiation of certain deductions. In some cases, courts require strict compliance with the statutory or regulatory requirements; in other situations, the courts will accept substantial compliance. While the concept of substantially complete has not been the subject of judicial review, the body of case law concerning the substantial compliance doctrine provides guide posts for how a court may interpret whether an international information return is substantially complete. This background can be applied to supplement existing informal guidance on substantial completeness or, where the Service has not provided specific informal guidance, this background can suggest a general approach for the agent to follow.

After this exploration of the substantial compliance doctrine, the Concept Unit presents analysis of the available IRS informal guidance on substantially complete international information returns. This informal guidance, which consists of a Field Service Advice (“FSA”) and two Chief Counsel Advices (“CCA”), relates to Forms 5471 and 5472.

Finally, we present examples that focus on what is required for a substantially complete international information return.

# Detailed Explanation of the Concept

## The Meaning of “Substantially Complete” with Reference to Int’l Information Return Penalties

Determining whether an international information return is substantially complete is an important step in determining whether any of the relevant penalties apply. Penalties cannot apply if the international information return is considered substantially complete.

### Analysis

### Resources

#### Strict compliance versus substantial compliance

In determining whether a tax return satisfies a reporting requirement or whether a taxpayer has complied with a statute or regulatory requirement, there are two standards that may apply. The first requires strict compliance with the statute or regulatory requirement; the second requires substantial compliance. In analyzing the statute or regulatory requirement, the first step is to determine which standard applies.

When determining which standard applies, courts may consider the following:

- If the particular information or requirement at issue is determined to be related to the “substance or essence” of the statute or regulation, then strict compliance is necessary.
- If, instead, the requirement is seen as “procedural or directory” then substantial compliance can apply.

Let’s consider how the Tax Court has applied this analysis to some statutes and regulations.

- *Indiana Rolling Mills Co. v. Commissioner* - 13 BTA 1141 (1928)

# Detailed Explanation of the Concept (cont'd)

## The Meaning of “Substantially Complete” with Reference to Int’l Information Return Penalties

### Analysis

Compliance with respect to the statutory requirement of filing an income tax return

*Indiana Rolling Mills Co. v. Commissioner* dealt with the required signatures on a domestic corporate tax return. The statute (Section 239 of the Revenue Act of 1918) required that a corporate tax return be sworn to by the president or other principal officer and the treasurer or assistant treasurer. In *Indiana Rolling Mills*, the taxpayer’s corporate return was sworn to by the vice president and secretary. The Service argued that the return was not a valid return for purposes of starting the statute of limitations.

Although the dual signature requirement was repealed, this 1928 case was the first case to apply the substantial compliance doctrine to tax statutes.

The court stated that a general rule of statutory construction is that those provisions that relate to the essence of the thing to be done are mandatory; those provisions that do not relate to the essence of the thing to be done are directory. Here, the essence of the statute was the making of an honest return by the corporation. If the requisite information is “fairly and honestly given in a return sworn to by officers of the corporation who are familiar with its affairs,” then the court determined that the taxpayer has substantially complied with the statute. The fact that the treasurer or assistant treasurer did not swear to the return did not go to the essence of the statute.

In general, the Tax Court has required strict compliance where the requirement goes to the essence of the statute. The Tax Court has required only substantial compliance where the requirement does not go to the essence of the statute.

### Resources

- *Indiana Rolling Mills Co. v. Commissioner* - 13 BTA 1141 (1928)

# Detailed Explanation of the Concept (cont'd)

## The Meaning of “Substantially Complete” with Reference to Int’l Information Return Penalties

### Analysis

### Resources

#### The *Beard* Test

The Tax Court has summarized the requirements for a tax return to be considered valid for purposes of beginning the statute of limitations on assessment:

1. It provides sufficient data to calculate tax liability.
2. The document must purport to be a return.
3. There must be an honest and reasonable attempt to satisfy the requirements of the tax law.
4. The taxpayer must sign the return under penalties of perjury.

A return that meets these four requirements will be considered valid and trigger the running of the statute of limitations even if it contains other inaccuracies or omissions.

- *Beard v. Commissioner* - 82 TC 766, 777 (1984)
- *Beard v. Commissioner* - 793 F.2d 139 (6th Cir. 1986)

# Detailed Explanation of the Concept (cont'd)

## The Meaning of “Substantially Complete” with Reference to Int’l Information Return Penalties

### Analysis

#### Compliance with respect to the statutory requirement of making an election

The substantial compliance doctrine is most commonly applied where a taxpayer attempts to make an election, but does not completely comply with the election requirements.

*Taylor v. Commissioner* dealt with an election that once was available under IRC 1251(b)(4)(B) in regard to gain from the disposition of property used in farming. Neither the taxpayer nor their advisors had read any of the published guidance concerning the making of the election. The court found that when the taxpayers filed their 1970 tax return, they subjectively believed that compliance with the accounting methods prescribed by IRC 1251(b)(4)(A) and the fact that they reported the gain from the sale of farm recapture property as long-term capital gain was an effective election under IRC 1251(b)(4).

The Tax Court examined the statute at issue and determined that IRC 1251 was designed to prevent taxpayers from utilizing certain farm losses to convert ordinary income into capital gain. Such a recharacterization could be accomplished by requiring a portion of previously deducted farm losses to be characterized as ordinary losses on the sale of farm equipment. In order to avoid this re-characterization, a taxpayer had to follow certain accounting rules specified in IRC 1251(b)(4). The taxpayers in *Taylor* had followed these rules, but failed to include the statement required by the statute and regulations indicating that they chose this method.

### Resources

- *Taylor v. Commissioner* - 67 T.C. 1071 (1977)

# Detailed Explanation of the Concept (cont'd)

## The Meaning of “Substantially Complete” with Reference to Int’l Information Return Penalties

### Analysis

#### Compliance with respect to the statutory requirement of making an election (cont'd)

The Tax Court concluded that the essence of IRC 1251(b)(4) is to allow a farmer capital gains treatment if the farmer followed the accounting rules specified in IRC 1251(b)(4). The essence of the statute is that taxpayers compute taxable income from farming by using the methods specified. The election requirements assisted the IRS, but were directive. Therefore, the Tax Court concluded that the taxpayers had substantially complied by following the prescribed accounting methods and reporting the gain as long-term capital gain.

### Resources

- *Taylor v. Commissioner* - 67 T.C. 1071 (1977)



# Detailed Explanation of the Concept (cont'd)

## The Meaning of “Substantially Complete” with Reference to Int’l Information Return Penalties

### Analysis

Compliance with the substantiation requirements in Treas. Reg. 1.170A-13

An example of an issue that has been the subject of numerous cases is the requirement in Treas. Reg. 1.170A-13(c)(2) that a taxpayer claiming a deduction for a charitable contribution of property worth more than \$5,000 obtain a qualified appraisal, attach a fully completed appraisal summary and retain certain information (including the qualified appraisal itself).

*Bond v. Commissioner* is illustrative of such cases. In *Bond*, the taxpayers donated some blimps to charity. Taxpayers had an expert value the blimps and complete the Form 8283, *Noncash Charitable Contributions*, but the expert did not prepare a separate qualified appraisal. After an audit was opened, the expert provided information about his credentials to the IRS. The Tax Court determined that the only required information that was not provided by the taxpayer on the return was the expert’s credentials and this information had been provided, once it was requested by the Service.

The Tax Court examined whether the requirements in the regulations relate to the substance or essence of the statute. The Tax Court found that the purpose of the regulation was to provide information helpful to the Service in the processing and auditing of returns on which charitable contributions are made. The regulation did not relate to the substance or essence of whether a charitable contribution was actually made, but instead alerted the IRS to the charitable contribution and required taxpayers to provide certain information. As a result, the regulatory requirement was held to be directory, rather than mandatory, and the taxpayer was held to have substantially complied.

### Resources

- *Bond v. Commissioner* - 100 T.C. 32 (1993)
- Treas. Reg. 1.170A-13
- Form 8283

# Detailed Explanation of the Concept (cont'd)

The Meaning of “Substantially Complete” with Reference to Int’l Information Return Penalties	
Analysis	Resources
<p><u>Compliance with the substantiation requirements in Treas. Reg. 1.170A-13 (cont’d)</u></p> <p>In cases that followed <i>Bond v. Commissioner</i>, there were varying degrees of noncompliance with the same regulation. In most of these other cases, the taxpayers were held not to have substantially complied because a critical element was missing. Examples include:</p> <ul style="list-style-type: none"> <li>▪ Failing to get an appraisal,</li> <li>▪ Failing to fill out Section B, <i>Donated Property Over \$5,000 (Except Publicly Traded Securities)</i>, of Form 8283,</li> <li>▪ Having someone without the relevant expertise complete the appraisal,</li> <li>▪ Having an appraisal prepared outside the statutory window (including more than 60 days before the gift or after the return was filed),</li> <li>▪ Including insufficient or inappropriate information in the appraisal or appraisal summary.</li> </ul> <p>In <i>Bond v. Commissioner</i>, the court found that the essence of the regulation was to alert the IRS to the charitable contribution. The Court found that the reporting requirements in the regulations were directory, and therefore the applicable standard was substantial compliance.</p>	<ul style="list-style-type: none"> <li>▪ <i>Consol. Investors Group.v. Commissioner</i> - T.C. Memo 2009-290</li> <li>▪ <i>Scheidelman v. Commissioner</i> - 682 F.3d 189 (2<sup>nd</sup> Cir. 2012)</li> <li>▪ <i>Scheidelman v. Commissioner</i> - T.C. Memo 2013-18</li> <li>▪ <i>Hewitt v. Commissioner</i> - 109 T.C. 258 (1997)</li> <li>▪ <i>Mohamed v. Commissioner</i> - T.C. Memo 2012-152</li> <li>▪ <i>Smith v. Commissioner</i> - T.C. Memo 2007-368</li> <li>▪ <i>Van Dusen v. Commissioner</i> - 136 T.C. 515 (2011)</li> <li>▪ Form 8283</li> </ul>

# Detailed Explanation of the Concept (cont'd)

## The Meaning of “Substantially Complete” with Reference to Int’l Information Return Penalties

### Analysis

#### Conclusions about substantial compliance from case law

While the focus of the discussion has been on cases in which substantial compliance applied, the courts have required strict compliance in cases where they determined the requirement related to the essence of the statute or regulation. An example is the requirement in IRC 170(f)(8) that the taxpayer obtain a contemporaneous written acknowledgement of a donation from the donee. Because obtaining this acknowledgement is part of the essence of IRC 170, courts have ruled that taxpayers must strictly comply with this requirement in order to claim the charitable contribution deduction.

Substantial compliance generally applies to regulatory requirements. Strict compliance applies to statutory requirements. The analysis of whether there is compliance in this heavily litigated area is generally based on the facts and circumstances of the specific case.

### Resources

- IRC 170 (f)(8)
- *Henao v. Commissioner* - T.C. Summ. Op. 2016-07
- *French v. Commissioner* - T.C. Memo. 2016-53
- *Cave Buttes v. Commissioner* - 147 T.C. No. 10 (2016).
- *Izen v. Commissioner* - 148 T.C. No. 5 (2017).

# Detailed Explanation of the Concept (cont'd)

## The Meaning of “Substantially Complete” with Reference to Int’l Information Return Penalties

### Analysis

#### Application of substantial compliance doctrine by district courts

Following a 1990 case, *Prussner v. United States*, district courts and federal courts of appeals have generally applied the substantial compliance doctrine in a more restrictive way than the Tax Court. The decision in *Prussner* criticized the tendency of the Tax Court to broaden application of the substantial compliance doctrine wherever the taxpayer was in a sympathetic position. This tendency caused unwanted uncertainty for taxpayers, in the eyes of the *Prussner* court, and several circuits have followed *Prussner* in narrowing application of the substantial compliance doctrine.

### Resources

- *Prussner v. United States* - 896 F.2d 218 (7<sup>th</sup> Cir. 1990)

# Detailed Explanation of the Concept (cont'd)

## The Meaning of “Substantially Complete” with Reference to Int’l Information Return Penalties

### Analysis

#### Difference between an income tax return and an information return for substantial compliance purposes

In General Counsel Memorandum (GCM) 36372 – Application of Section 6652(d) Penalty to Incomplete Forms 990-P and 4848, the Service considered whether section 6652(d)(1) would apply where entities required to file Forms 990-P and 4848 failed to provide all of the information required to be provided on those forms.

In reaching the conclusion that the penalty is applicable under such circumstances, the GCM considers how information returns differ from income tax returns. The memo takes the position that cases concerning incomplete income tax returns are distinguishable from those concerning information returns because the goals of the two types of returns are different. Information reported on income tax returns is necessary to determine tax liability. As such, if a taxpayer omits information that is not necessary to determine tax liability, the return may be considered complete notwithstanding the omission.

By contrast, information returns are required so that the Service can properly administer the revenue laws. If material information is left off an information return, such omission can impede the Service’s ability to perform the duties placed on it by Congress. Because income tax and information returns serve different functions, the memo concludes that different rules should apply in determining whether or not a return is complete.

With this distinction in mind, let’s turn to international information returns.

### Resources

- GCM 36372 – Application of Section 6652(d) Penalty to Incomplete Forms 990-P and 4848
- IRC 6652(d)(1)
- Form 990-P
- Form 4848

# Detailed Explanation of the Concept (cont'd)

## The Meaning of “Substantially Complete” with Reference to Int’l Information Return Penalties

### Analysis

### Resources

#### Substantial compliance with respect to international information returns


Congress’s intent in requiring taxpayers to report the information required to be reported on international information returns was to give the IRS more information about foreign entities with U.S. ties so that the IRS could determine if U.S. tax laws are being properly observed. In that regard, Congress enacted statutes requiring baseline information to be reported and gave the Secretary regulatory authority to determine the additional information required to be reported.

IRC 6038 and 6038A provide penalties, respectively, for the failure to provide information in regard to (a) controlled corporations and partnerships and (b) certain foreign-owned corporations. The regulations under IRC 6038 provide that a taxpayer may be relieved from liability for the penalty if the IRS determines that such taxpayer “substantially complied” with the reporting requirements of IRC 6038. The regulations under IRC 6038A provide that a taxpayer who files a “substantially incomplete” return is subject to penalty. Those regulations also provide that a taxpayer may be relieved from liability for the IRC 6038A penalty if the IRS determines that such taxpayer “substantially complied” with the reporting requirements of IRC 6038A. The regulations do not define the terms “substantially complied” or “substantially incomplete.” However, the Service has issued an FSA and two CCAs that explore these concepts.

Failure to file complete returns may result in penalties.

- FSA 33381431 - IRC 6038 Reporting Requirements
- Joint Committee Taxation Report – General Explanation of the Tax Reform Act of 1986 (P.L. 99-514) (JCS 10-87 No. 15 (I.R.S.))
- Treas. Reg. 1.6038-2(k)(3)(ii)
- Treas. Reg. 1.6038A-4(a)(1)
- IRC 6038
- IRC 6038A
- CCA 200645023 - IRC 6038 and 6046 Reporting Requirements
- CCA 200429007 - Whether Form 5472 was Substantially Complete

# Detailed Explanation of the Concept (cont'd)

The Meaning of “Substantially Complete” with Reference to Int’l Information Return Penalties	
Analysis	Resources
<p><u>Substantial compliance with respect to international information returns (cont'd)</u></p> <p>Regulations issued pursuant to IRC 6038 and 6038A provide specific rules that allow field examiners to consider whether the forms submitted have substantially complied with the reporting requirements (Forms 5471 and 5472) or are substantially incomplete (Form 5472) for purposes of the penalties imposed in those sections. The non-precedential advice that has been issued (and that is discussed below) applies only to these sections.</p> <p>The judicial concept of substantial compliance, as discussed above, may apply to other international information returns (which do not have the same standards as those imposed under IRC 6038 and 6038A). Stated differently, absent a specific regulatory directive, only the judicial concept of substantial compliance would excuse anything less than strict compliance with a reporting requirement.</p> <p> <b>CONSULTATION:</b> There is no available guidance on whether other international information returns are subject to the judicial substantial compliance doctrine. If an examiner believes that the judicial substantial compliance doctrine may apply, then Field counsel should be consulted, who may then consult the Associate Chief Counsel (International).</p>	<ul style="list-style-type: none"> <li>▪ IRC 6038</li> <li>▪ IRC 6038A</li> <li>▪ Treas. Reg. 1.6038-2(k)(3)(ii)</li> <li>▪ Treas. Reg. 1.6038A-4(a)(1)</li> <li>▪ Form 5471</li> <li>▪ Form 5472</li> </ul>

# Detailed Explanation of the Concept (cont'd)

## The Meaning of “Substantially Complete” with Reference to Int’l Information Return Penalties

Analysis	Resources
<p><u>Substantial compliance with respect to international information returns (cont'd)</u></p> <p>A 1997 FSA discusses substantial compliance with respect to Form 5471, <i>Information Return of U.S. Persons With Respect To Certain Foreign Corporations</i>.</p> <p>The FSA warns that even though the majority of the information may have been reported accurately and completely, this does not mean that there has been substantial compliance such that a taxpayer is relieved from liability for the IRC 6038 penalty. In the FSA, the U.S. taxpayer (UST) accurately reported the majority of the information, but it failed to accurately report major transactions with related parties. These types of related party transactions are important information for the IRS to evaluate in determining whether U.S. tax laws have been applied correctly. The FSA rejected the “aggregate approach,” under which a taxpayer would be considered to be in substantial compliance if it accurately reported a certain percentage of the information required to be reported on the Form 5471. Instead, it concluded that substantial compliance is measured on the basis of each significant item of information specified in IRC 6038(a)(1) for each individual Controlled Foreign Corporation (CFC).</p> <p>Failure to accurately provide the information required by IRC 6038 may result in returns that are considered incomplete, even if most of the information on the form is correct. The taxpayer may be subject to penalties unless it can show reasonable cause or substantial compliance.</p>	<ul style="list-style-type: none"> <li>▪ FSA 33381431 - IRC 6038 Reporting Requirements</li> <li>▪ Form 5471</li> <li>▪ IRC 6038</li> </ul>



# Detailed Explanation of the Concept (cont'd)

## The Meaning of “Substantially Complete” with Reference to Int’l Information Return Penalties

### Analysis

### Resources

#### Substantial compliance with respect to international information returns (cont'd)

CCA 200429007 considered the meaning of the term substantially incomplete in regard to Form 5472, *Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business*, and as that term is used in Treas. Reg. 1.6038A-4(a)(1). The 2004 CCA considered whether a taxpayer’s return would be considered substantially incomplete, and therefore subject to penalty, in a variety of different factual scenarios.

The CCA identifies two approaches that could be used to determine whether a return is substantially complete. The first is strict compliance, a rigorous interpretation of the rules that would treat virtually any substantive inaccuracy as rendering the return substantially incomplete. The second is a facts and circumstances approach. The CCA provides a list of seven factors that should be considered in a facts and circumstances analysis:

1. The magnitude of the underreporting, or of the over-reporting, of the erroneous reported transaction(s) in relation to the actual total amount of that reported type of transaction(s).
2. Whether the reporting corporation has reportable transactions other than the erroneous reported transaction(s) with the same related party and correctly reported such other transactions.
3. The magnitude of the erroneous reported transaction(s) in relation to all of the other reportable transactions as correctly reported.

- CCA 200429007 - Whether Form 5472 was Substantially Complete
- Form 5472
- Treas. Reg. 1.6038A-4(a)(1)

# Detailed Explanation of the Concept (cont'd)

The Meaning of “Substantially Complete” with Reference to Int’l Information Return Penalties	
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<p data-bbox="84 382 1201 415"><u>Substantial compliance with respect to international information returns (cont'd)</u></p> <ol style="list-style-type: none"> <li data-bbox="84 436 1286 508">4. The magnitude of the erroneous reported transaction(s) in relation to the reporting corporation’s volume of business and overall financial situation.</li> <li data-bbox="84 529 1348 601">5. The significance of the erroneous reported transaction(s) to the reporting corporation’s business in a broad functional sense.</li> <li data-bbox="84 622 1328 694">6. Whether the erroneous reported transaction(s) occur(s) in the context of a significant ongoing transactional relationship with the related party.</li> <li data-bbox="84 715 1379 786">7. Whether the erroneous reported transaction(s) is (are) reflected in the determination and computation of the reporting corporation’s taxable income.</li> </ol> <p data-bbox="84 808 1390 1029">Overall, these factors give informal guidance on measuring how significant the errors are. Keep in mind that estimates are allowed in completing Form 5472, if actual information is not readily available, but the estimates must be within prescribed limits. (The CCA assumes that the taxpayer did not estimate.) The CCA uses a two-prong test in assessing substantial completeness: the magnitude of the errors and the effect of the noncompliance on the IRS’s ability to efficiently audit the information required by the statute and regulations.</p> <p data-bbox="84 1051 1265 1083">The CCA cautions that no factor is necessarily more important than any other factor.</p>	<ul style="list-style-type: none"> <li data-bbox="1427 386 1918 455">▪ CCA 200429007 - Whether Form 5472 was Substantially Complete</li> <li data-bbox="1427 462 1607 495">▪ Form 5472</li> </ul>

# Detailed Explanation of the Concept (cont'd)

## The Meaning of “Substantially Complete” with Reference to Int’l Information Return Penalties

### Analysis

### Resources

#### Substantial compliance with respect to international information returns (cont'd)

The FSA and CCAs discussed above only provide informal guidance concerning substantial compliance and substantial completeness as those terms are used in the regulations under IRC 6038 and 6038A. As such, they don't apply to international information returns other than Forms 5471 and 5472.

The substantial compliance defense to penalties described in the regulations under IRC 6038 and 6038A is available only to taxpayers who are subject to penalties under those sections. However, a court might apply the generally applicable substantial compliance doctrine discussed earlier to other international information returns, including:

- Form 8865 *Return of U.S. Persons With Respect to Certain Foreign Partnerships*
- Form 8858 *Information Return of U.S. Persons With Respect to Certain Foreign Disregarded Entities*
- Form 926 *Return by a U.S. Transferor of Property to a Foreign Corporation*
- Form 3520 *Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*
- Form 3520-A *Annual Information Return of Foreign Trusts With a U.S. Owner*

- IRC 6038
- IRC 6038A
- Form 5471
- Form 5472
- Form 8865
- Form 8858
- Form 926
- Form 3520
- Form 3520-A



**CONSULTATION:** If an examiner believes that the judicial substantial compliance doctrine may apply, then Field counsel should be consulted, who may then consult the Associate Chief Counsel (International).

# Examples of the Concept

## The Meaning of “Substantially Complete” with Reference to Int’l Information Return Penalties

### Example 1

FSA 33381431

Facts: UST filed separate Forms 5471 for a large number of Controlled Foreign Corporations (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.

During exam, the Service identified significant understatements of purchases from and/or sales to some CFCs and related third parties (reported on Schedule M, *Transactions Between Controlled Foreign Corporation and Shareholders or Other Related Persons*) and significant inconsistencies in the reported earnings and profits of some CFCs.

UST submitted most of the information required by IRC 6038 and related regulations. Other than the significant understatements, the information reported on the Forms 5471 was accurate and/or uncontested by the Service.

Analysis: The information is mostly complete, but that doesn’t mean that UST has substantially complied. The information that is missing or incorrect (to the tune of millions of dollars) is information that is the essence of the filing requirement. The related party information is a very important reason for requiring the Forms 5471. If a taxpayer is allowed to satisfy its filing requirements by accurately providing most of the information, it would have the opportunity to not provide or provide incorrect information with respect to very important categories.

Conclusion: The FSA concluded that the UST did not substantially comply with the IRC 6038 reporting requirements.

# Examples of the Concept (cont'd)

## The Meaning of “Substantially Complete” with Reference to Int’l Information Return Penalties

### Example 2

CCA 200645023

Facts: UST acquired controlling interest of a foreign parent corporation, which wholly owned the stock of multiple foreign corporations, for approximately four months of the tax year. 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 accordance with U.S. generally accepted accounting principles (GAAP) on Schedules C, Income Statement, and F, Balance Sheet, and (b) reported in U.S. currency on Schedules C and E, Income, War Profits, and Excess Profits Taxes Paid or Accrued. In addition, UST did not attach Schedule O, *Organization or Reorganization of Foreign Corporations and Acquisitions and Dispositions of Its Stock*, to the Forms 5471. Moreover, UST failed to file Forms 5471 for certain inactive or dormant foreign corporations.

Analysis: There were a few issues addressed in the CCA. The first is UST's belief that it did not have to file the Forms 5471. That fact does not matter in determining substantial compliance, but may bolster the taxpayer's defense of reasonable cause.

Second, UST failed to file required information, including Schedule O. Similar to Example 1, the information that is not supplied by UST is important. The failure to include Schedule O, by itself, is likely to cause the taxpayer to fail the substantial compliance test. The failure to convert the information into U.S. GAAP and U.S. dollars makes it difficult for the Service to audit. The Service's ability to audit efficiently is part of the goal of these reporting requirements.

Conclusion: The CCA concluded that UST did not substantially comply with the IRC 6038 and 6046 reporting requirements.

# Examples of the Concept (cont'd)

## The Meaning of “Substantially Complete” with Reference to Int’l Information Return Penalties

### Example 3

CCA 200429007

Facts: UST is a reporting corporation as defined in Treas. Reg. 1.6038A-1(c). UST timely filed Form 5472 for transactions with its parent (Parent) for the tax years at issue. All information required by Treas. Reg. 1.6038A-2(b)(1) and (2) was included on the Form 5472 and estimates were not used. However, some transactions were erroneously reported. The CCA looked at whether the taxpayer had substantially complied with its reporting requirements. The magnitude of each erroneously reported transaction is substantial in relation to all other reportable transactions, as well as substantial in relation to UST’s volume of business and overall financial situation.

The CCA addressed four issues as to whether the Form 5472 was substantially complete:

1. UST over-reported amounts in Part IV of the Form 5472, reporting Purchases of Stock in Trade as \$1,000X when the actual number was \$500X.
2. UST reported amounts of intercompany accounts receivables not specifically required to be reported on Form 5472 and later corrected the Form 5472 to remove these amounts.
3. The amount reported on Form 5472 as the ending balance of related party loans did not match the opening balance on the next year’s Form 5472. In addition, the opening balance of a loan was incorrectly reported.
4. UST over-reported one amount and under-reports another amount in Part IV of Form 5472 so that there was a relatively small aggregate difference between the correct total and what was reported.

Analysis: As mentioned above, CCA 200429007 lists seven factors which should be considered in determining whether the taxpayer has substantially complied.

# Examples of the Concept (cont'd)

## The Meaning of “Substantially Complete” with Reference to Int’l Information Return Penalties

### Example 3 (cont'd)

CCA 200429007 (cont'd)

1. Over-reporting constitutes inaccurate information and requires the IRS to determine the correct information. The fact that it is an overstatement, rather than an understatement, does not matter. The incorrect information hinders the IRS’s ability to efficiently audit the Form 5472, if the error is material. Here, the 50% overstatement is of sufficient magnitude to violate the first, third and fourth factors.
2. The question is whether the Form 5472 as originally filed is substantially incomplete. The CCA assumes that \$400X of intercompany receivables is erroneously included in Amounts Borrowed from Parent. The magnitude of the over-reporting is substantial because the overstatement is 40% of the transaction type and is substantial in relation to all other reportable transactions. The error violates the first, third and fourth factors.
3. Similar to 2, above, the magnitude of the over-reporting is 40%, which is significant. In addition, the loan has been in effect for at least two years, so it constitutes part of a significant, ongoing relationship between UST and a related party. This means that the first, third, fourth and sixth factors are violated.
4. In this example, we have relatively large offsetting mistakes, which result in a relatively small mistake on an aggregate basis. However, making multiple mistakes requires analyzing each mistake in isolation, as well as in the aggregate. Each mistake is significant in isolation, even if not in the aggregate, violating the first, third and fourth factors. The CCA concludes that the isolated mistakes cause the Form to be substantially incomplete, even if the Form is not substantially incomplete in aggregate.

Conclusion: In each issue presented in the CCA, the magnitude of the incorrect reporting was substantial, the Form 5472 is substantially incomplete and the penalty should apply, unless UST has reasonable cause.

# Index of Referenced Resources

## The Meaning of “Substantially Complete” with Reference to Int’l Information Return Penalties

*Indiana Rolling Mills Co. v. Commissioner* - 13 BTA 1141 (1928)

*Beard v. Commissioner* - 82 T.C. 766, 777 (1984)

*Beard v. Commissioner* - 793 F.2d 139 (6th Cir. 1986)

*Taylor v. Commissioner* - 67 T.C. 1071 (1977)

*Bond v. Commissioner* - 100 T.C. 32 (1993)

*Consol. Investors Group v. Commissioner* - T.C. Memo 2009-290

*Scheidelman v. Commissioner* - 682 F.3d 189 (2nd Cir. 2012)

*Scheidelman v. Commissioner* - T.C. Memo 2013-18

*Hewitt v. Commissioner* - 109 T.C. 258 (1997)

*Mohamed v. Commissioner* - T.C. Memo 2012-152

*Smith v. Commissioner* - T.C. Memo 2007-368

*Van Dusen v. Commissioner* - 136 T.C. 515 (2011)

*Prussner v. United States* - 896 F.2d 218 (7th Cir. 1990)

GCM 36372 - Application of Section 6652(d) Penalty to Incomplete Forms 990-P and 4848

Joint Committee Taxation Report – General Explanation of the Tax Reform Act of 1986 (P.L. 99-514) (JCS 10-87 No. 15)

FSA 33381431 - IRC 6038 Reporting Requirements



# Index of Referenced Resources (cont'd)

<b>The Meaning of “Substantially Complete” with Reference to Int’l Information Return Penalties</b>
CCA 200645023 - IRC 6038 and 6046 Reporting Requirements
CCA 200429007 - Whether Form 5472 was Substantially Complete
IRC 6038
IRC 6038A
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IRC 6652(d)(1)
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Treas. Reg. 1.170A-13
Treas. Reg. 1.6038-2(k)(3)(ii)
Treas. Reg. 1.6038A-4(a)(1)
Form 8283
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Form 5472

# Training and Additional Resources

The Meaning of “Substantially Complete” with Reference to Int’l Information Return Penalties	
Type of Resource	Descriptions
Articles	<ul style="list-style-type: none"><li>▪ <i>Form 5471: Dispelling Seven Common Myths</i>, 24 Journal of International Taxation 17, 2013 WL 424678</li><li>▪ <i>The Substantial Compliance Doctrine in Tax Law: Equity vs. Efficiency</i>, 40 UCLA Law Review 1587 (1993)</li><li>▪ <i>Dot All ‘I’s And Cross All ‘T’s: Estate of Tamulis v. Commissioner and the Narrowing of The Substantial Compliance Doctrine to the Technical Compliance Doctrine</i>, 62 Tax Lawyer 259 (2008)</li></ul>
Reference Materials – Treatises	<ul style="list-style-type: none"><li>▪ <i>Saltzman - IRS Practice and Proc</i> Para 4.03</li></ul>

# Glossary of Terms and Acronyms

Term/Acronym	Definition
CCA	Chief Counsel Advice
CFC	Controlled Foreign Corporation
FSA	Field Service Advice
GAAP	Generally Accepted Accounting Principles
GCM	General Counsel Memorandum
IRC	Internal Revenue Code
UST	United States Taxpayer

# Index of Related Practice Units

Associated UIL	Related Practice Unit	DCN
9560.01	Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 for Category 4 and 5 Filers	IGA/P/17_03_01_01(formerly IGA/9560.01_03(2014))