

## LB&I International Practice Service Process Unit – Audit

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Volume	17	Information Gathering and Penalties	<b>Level 1 UIL</b>	9560
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<b>Unit Name</b>	Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers
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# Process Overview

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

### Process Description

When a US person owns an interest in a foreign partnership they may be required to file Form 8865 - Return of US Persons With Respect to Certain Foreign Partnerships. The US partner must attach Form 8865 to their income tax return (or, if applicable, partnership or exempt organization return) and file both by the due date of that return, including extensions. If the US partner is not required to file a tax return, they must file Form 8865 separately with the IRS at the time and place they would be required to file an income tax return (or, if applicable, a partnership or exempt organization return). The US partner files Form 8865 for the annual accounting period of the foreign partnership that ends with or within the partner's tax year. [IRC 6038(a)(2)]

Penalties under IRC 6038 may apply when Form 8865 has not been filed, was not filed timely or was substantially incomplete when filed. If any of these failures exist an initial penalty of \$10,000 per form, per year applies. [IRC 6038(b)(1)]

If the failure continues for more than 90 days from the date the Service notifies the US partner of their failure, additional penalties will apply. The Service will impose an additional \$10,000 penalty for each 30 day period (or fraction thereof) that the failure continues. The continuation penalty cannot exceed \$50,000 for each Form 8865 the U.S. partner fails to file. The continuation penalty continues to accrue until the USP cures the failure or the maximum penalty has been incurred. [IRC 6038(b)(2)] In addition to the monetary penalty the Service can reduce the USPs foreign tax credit. [IRC 6038(c)]. The reduction to USPs foreign tax credit will be discussed in another unit.

# Process Overview

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

### Example Circumstances Under Which Process Applies

The Service must analyze the information reported on Form 8865 for identification of potential compliance risks. Potential compliance risks related to foreign partnerships include (but are not limited to) -

- Partnership losses in excess of partner's basis
- Character of income reported by partnership does not match character reported by partner
- Tiered partnership structures
- Special allocations that do not have substantial economic effect
- Transfer Pricing

Form 8865 includes filing requirements for 4 categories of filers. This unit focuses on Categories 1 and 2. Category 3 and 4 filers will be covered in another unit.

The statute of limitations for assessing and collecting IRC 6038 penalties does not expire until 3 years from the date the Service receives a complete and accurate Form 8865 (see IRC 6501(c)(8)).

Examiner's may consult with their managers and local counsel throughout the process of determining whether or not a civil penalty applies for failure to file Form 8865.

# Process Overview

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

### Process Description

Separate IPS units were developed by IBC and IIC. While they have similarities there are several differences that should be noted.

- The most fundamental difference is that this IBC unit focuses on how to determine whether a failure to file Form 8865 penalty is appropriate. The IIC unit is focused on how to handle a case in which the penalty applies.
- The IBC unit helps the IE identify when a penalty is warranted. Most of the IBC unit is focused on what is contained in Step 1 of the IIC unit.
- The IBC unit is focused more on the agent's decision-making while the IIC unit is more focused on the agent's procedural requirements

# Determination of Process Applicability

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

Certain U.S. persons are required to file Form 8865 as an attachment to their income tax return (or, if applicable, partnership or exempt organization return) to report information with respect to certain foreign partnerships. The information and schedules required vary by filing category. Penalties apply if the complete and accurate information is not submitted within the time prescribed. The limitations period on assessment of these penalties may be different from the assessment period for tax that should be reported on a U.S. partner's income tax return.

Criteria	Resources	6103 Protected Resources
Form 8865 is required to be filed by four categories of filers.		
<u>Category 1</u> - a US person who owned a controlling interest in a foreign partnership at any time during the partnership's tax year	<ul style="list-style-type: none"> <li>• IRC 6038(a)(1) Requirement - In general</li> <li>• Treas. Reg. 1.6038-3(a)(1) Controlling 50% partners</li> </ul>	
<u>Category 2</u> - a US person who owned a 10% or greater interest in a controlled foreign partnership at any time during the foreign partnership's tax year	<ul style="list-style-type: none"> <li>• IRC 6038(a)(5) Requirement - Information required from 10-percent partner of controlled foreign partnership</li> <li>• Treas. Reg. 1.6038-3(a)(2) Controlling ten-percent partners</li> </ul>	

# Determination of Process Applicability

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

Certain U.S. persons are required to file Form 8865 as an attachment to their income tax return (or, if applicable, partnership or exempt organization return) to report information with respect to certain foreign partnerships. The information and schedules required vary by filing category. Penalties apply if the complete and accurate information is not submitted within the time prescribed. The limitations period on assessment of these penalties may be different from the assessment period for tax that should be reported on a U.S. partner's income tax return.

Criteria	Resources	6103 Protected Resources
<u>Category 2</u> - a US person who owned a 10% or greater interest in a controlled foreign partnership at any time during the foreign partnership's tax year	<ul style="list-style-type: none"> <li>• IRC 6038(a)(5) Requirement - Information required from 10-percent partner of controlled foreign partnership</li> <li>• Treas. Reg. 1.6038-3(a)(2) Controlling ten-percent partners</li> </ul>	
<u>Category 3</u> - a US person who contributed property to a foreign partnership in exchange for a partnership interest	<ul style="list-style-type: none"> <li>• IRC 6038B / 721 Non-recognition of gain or loss on contribution</li> <li>• Treas. Reg. 1.6038B-2(a) Reporting requirements.</li> </ul>	
<u>Category 4</u> - a US person that had a reportable event per IRC 6046A (acquisition, disposition or change in proportional interest in a foreign partnership)	<ul style="list-style-type: none"> <li>• IRC 6046A</li> <li>• Treas. Reg. 1.6046A-1(a) Return requirement.</li> </ul>	

# Determination of Process Applicability

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

Certain U.S. persons are required to file Form 8865 as an attachment to their income tax return (or, if applicable, partnership or exempt organization return) to report information with respect to certain foreign partnerships. The information and schedules required vary by filing category. Penalties apply if the complete and accurate information is not submitted within the time prescribed. The limitations period on assessment of these penalties may be different from the assessment period for tax that should be reported on a U.S. partner's income tax return.

Criteria	Resources	6103 Protected Resources
<p><u>Definitions with respect to Category 1 filers –</u>  <u>US person -</u></p> <ul style="list-style-type: none"> <li>▪ citizen or resident of the US,</li> <li>▪ domestic corporation,</li> <li>▪ domestic partnership, or</li> <li>▪ estate or trust that is not a foreign estate or trust.</li> </ul> <p><u>Control -</u></p> <ul style="list-style-type: none"> <li>▪ Control of a foreign partnership is ownership of more than a fifty-percent interest in the partnership. When determining control, the constructive ownership rules of IRC 267(c)(1), (2), (4) and (5) apply.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.6038-3(b)(6) Definition of United States person</li> <li>▪ IRC 7701(a)(30) United States person</li> <li>▪ IRC 7701(a)(31) Foreign estate or trust</li> <li>▪ IRC 6038(e)(3)(A) Control</li> <li>▪ Treas. Reg. 1.6038-3(b) Ownership determinations and definitions</li> </ul>	

# Determination of Process Applicability

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

Certain U.S. persons are required to file Form 8865 as an attachment to their income tax return (or, if applicable, partnership or exempt organization return) to report information with respect to certain foreign partnerships. The information and schedules required vary by filing category. Penalties apply if the complete and accurate information is not submitted within the time prescribed. The limitations period on assessment of these penalties may be different from the assessment period for tax that should be reported on a U.S. partner's income tax return.

Criteria	Resources	6103 Protected Resources
<p><u>Definitions with respect to Category 1 filers –</u>  <u>US person (Cont'd) -</u>  <u>50% interest -</u></p> <ul style="list-style-type: none"> <li>▪ 50% of the capital,</li> <li>▪ 50% of the profits, or</li> <li>▪ an interest to which 50% of the deductions or losses are allocated.</li> </ul>	<ul style="list-style-type: none"> <li>▪ IRC 6038(e)(3)(B) 50-percent interest</li> <li>▪ Treas. Reg. 1.6038-3(b)(2) Fifty-percent interest</li> <li>▪ IRC 6038(e)(3) Partnership-related definitions</li> </ul>	

# Determination of Process Applicability

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

Certain U.S. persons are required to file Form 8865 as an attachment to their income tax return (or, if applicable, partnership or exempt organization return) to report information with respect to certain foreign partnerships. The information and schedules required vary by filing category. Penalties apply if the complete and accurate information is not submitted within the time prescribed. The limitations period on assessment of these penalties may be different from the assessment period for tax that should be reported on a U.S. partner's income tax return.

Criteria	Resources	6103 Protected Resources
<p><u>Definitions with respect to Category 2 filers -</u>  <u>10% interest -</u></p> <ul style="list-style-type: none"> <li>▪ 10% of the capital,</li> <li>▪ 10% of the profits, or</li> <li>▪ an interest to which 10% of the deductions or losses are allocated.</li> </ul> <p><u>Controlled Foreign Partnership (CFP) -</u></p> <ul style="list-style-type: none"> <li>▪ a foreign partnership in which US persons (each owning at least a 10% interest) own more than 50% of the interests in the partnership. When determining ownership interest, the constructive ownership rules of IRC 267(c)(1), (2), (4) and (5) apply.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.6038-3(b)(3) 10% interest</li>   <li>▪ IRC 6038(e)(3) Information required from 10-percent partner of a controlled foreign partnership.</li> </ul>	

# Determination of Process Applicability

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

Certain U.S. persons are required to file Form 8865 as an attachment to their income tax return (or, if applicable, partnership or exempt organization return) to report information with respect to certain foreign partnerships. The information and schedules required vary by filing category. Penalties apply if the complete and accurate information is not submitted within the time prescribed. The limitations period on assessment of these penalties may be different from the assessment period for tax that should be reported on a U.S. partner's income tax return.

Criteria	Resources	6103 Protected Resources
<p><u>Controlled Foreign Partnership (CFP) (Cont'd) -</u></p> <ul style="list-style-type: none"> <li>• when a CFP has a controlling 50% partner there are no controlling 10% partners. Therefore, when a controlling 50% partner is required to file Form 8865 as a Category 1 filer, no US 10% partners are required to file Form 8865 as Category 2 filers.</li> </ul>	<ul style="list-style-type: none"> <li>• Treas. Reg. 1.6038-3(a)(2) Controlling ten-percent partners</li> <li>▪ Instructions to Form 8865</li> </ul>	

# Determination of Process Applicability

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

Certain U.S. persons are required to file Form 8865 as an attachment to their income tax return (or, if applicable, partnership or exempt organization return) to report information with respect to certain foreign partnerships. The information and schedules required vary by filing category. Penalties apply if the complete and accurate information is not submitted within the time prescribed. The limitations period on assessment of these penalties may be different from the assessment period for tax that should be reported on a U.S. partner's income tax return.

Criteria	Resources	6103 Protected Resources
<p><u>Joint Return Exception-</u></p> <ul style="list-style-type: none"> <li>▪ When multiple persons are required to file Form 8865 as a controlling 50% partner only one controlling partner must file. It cannot be a person with greater than 50% interest in deductions or losses if another Category 1 filer has a greater than 50% interest in capital or profits. The remaining 50% partner(s) must attach a statement to their return(s) providing information regarding themselves, the partnership, and the 50% partner filing the Form 8865.</li> <li>▪ If the foreign partnership files Form 1065 or 1065-B for its tax year, Category 1 and 2 filers may use the completed Form 1065 or 1065-B schedules in place of the equivalent schedules for Form 8865.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.6038-3(c)(1) Multiple controlling fifty-percent partners</li> <li>▪ Treas. Reg. 1.6038-3(j)</li> <li>▪ Instructions to Form 8865</li> </ul>	

# Determination of Process Applicability

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

Certain U.S. persons are required to file Form 8865 as an attachment to their income tax return (or, if applicable, partnership or exempt organization return) to report information with respect to certain foreign partnerships. The information and schedules required vary by filing category. Penalties apply if the complete and accurate information is not submitted within the time prescribed. The limitations period on assessment of these penalties may be different from the assessment period for tax that should be reported on a U.S. partner's income tax return.

Criteria	Resources	6103 Protected Resources
<p><u>Constructive Ownership Exception</u> -                      A US person that does not own a direct interest in a foreign partnership and is required to file Form 8865 solely by reason of constructive ownership (from a USP) is not required to file Form 8865 if –</p> <p>1.The US person whose interest the indirect partner constructively owns reports all of the required information AND</p>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.6038-3(c)(2) Certain constructive owners excepted from furnishing information</li> <li>▪ Instructions to Form 8865</li> </ul>	

# Determination of Process Applicability

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

Certain U.S. persons are required to file Form 8865 as an attachment to their income tax return (or, if applicable, partnership or exempt organization return) to report information with respect to certain foreign partnerships. The information and schedules required vary by filing category. Penalties apply if the complete and accurate information is not submitted within the time prescribed. The limitations period on assessment of these penalties may be different from the assessment period for tax that should be reported on a U.S. partner's income tax return.

Criteria	Resources	6103 Protected Resources
<p><u>Constructive Ownership Exception (Cont'd) -</u>                      2.The indirect partner files with its income tax return a statement titled “Controlled Foreign Partnership Reporting” containing the following information:</p> <ul style="list-style-type: none"> <li>▪ A representation that the indirect partner was required to file Form 8865, but is not doing so pursuant to the constructive owner exception;</li> <li>▪ The names and addresses of the United States persons whose interests the indirect partner constructively owns;</li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.6038-3(c)(2) Certain constructive owners excepted from furnishing information</li> <li>▪ Instructions to Form 8865</li> </ul>	

# Determination of Process Applicability

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

Certain U.S. persons are required to file Form 8865 as an attachment to their income tax return (or, if applicable, partnership or exempt organization return) to report information with respect to certain foreign partnerships. The information and schedules required vary by filing category. Penalties apply if the complete and accurate information is not submitted within the time prescribed. The limitations period on assessment of these penalties may be different from the assessment period for tax that should be reported on a U.S. partner's income tax return.

Criteria	Resources	6103 Protected Resources
<p><u>Constructive Ownership Exception (Cont'd)</u> -</p> <ul style="list-style-type: none"> <li>▪ The name and address of the foreign partnership with respect to which the indirect partner would have had to have filed Form 8865 but for this exception; and</li> <li>▪ Any additional information that Form 8865 and the accompanying instructions require.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.6038-3(c)(2) Certain constructive owners excepted from furnishing information</li> <li>▪ Instructions to Form 8865</li> </ul>	

# Summary of Process Steps

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

<a href="#">Step 1</a>	Determine if the return was filed late
<a href="#">Step 2</a>	Identify whether all required Forms 8865 were attached to the return
<a href="#">Step 3</a>	Review Forms 8865 to ensure all required information has been submitted
<a href="#">Step 4</a>	Issue the pattern letter for any failures to file a complete and accurate Form 8865
<a href="#">Step 5</a>	Review Forms 8865 submitted in response to the pattern letter
<a href="#">Step 6</a>	Factors to consider for reasonable cause
<a href="#">Step 7</a>	Notify TP of penalty determination

# Step 1

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

### Step 1: Determine if the return was filed late

When a Form 8865 is attached to a return that was filed late, monetary penalties may apply under IRC 6038(b).

Considerations	Resources	6103 Protected Resources
Form 8865 is required to be filed by the due date of the US partner's income tax (or partnership or exempt organization) return, including extensions.	<ul style="list-style-type: none"><li>▪ Treas. Reg. 1.6038-3(i) Time and Place for filing return</li></ul>	
If the US partner's income, partnership or exempt organization return was filed late the attached Forms 8865 were not timely filed. Prepare a pattern letter to notify USP of their failure to file Forms 8865. See Step 4.	<ul style="list-style-type: none"><li>• IRM Exhibit 20.1.9-7, Pattern Letter for Failure to File Form 8865</li></ul>	

# Step 2

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

### Step 2: Identify whether all required Forms 8865 were attached to the return

If a US person fails to file Form 8865 when required the monetary penalty per IRC 6038(b) applies

Considerations	Resources	6103 Protected Resources
<p>The following items are helpful in determining whether all required Forms 8865 were filed:</p> <ul style="list-style-type: none"> <li>▪ US partner's returns for previous and subsequent years;</li> <li>▪ Forms 8832 (Entity Classification Election);</li> <li>▪ Tax organization chart, including previous and subsequent years;</li> <li>▪ Legal entity chart including previous and subsequent years;</li> <li>▪ Joint filer's statements</li> </ul>		
<p>How you use the items above to analyze, compare and resolve questions to identify Forms 8865 that were required, but not filed, depends on how many foreign partnership interests USP owned, the exam time available, your relevant experience and knowledge, and your research and problem solving approaches.</p>		

# Step 2

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

### Step 2: Identify whether all required Forms 8865 were attached to the return

If a US person fails to file Form 8865 when required the monetary penalty per IRC 6038(b) applies

Considerations	Resources	6103 Protected Resources
<p>As you identify Forms 8865 that were required, but not filed, consider reviewing whether those forms were required, but not filed, in prior tax years.</p> <ul style="list-style-type: none"><li>▪ The limitations period for assessing IRC 6038 penalties does not expire before 3 years from the date the Service receives a complete and accurate Form 8865</li><li>▪ The prior year income tax returns do not have to be open and under the control of Exam for the Service to impose the penalty for the failure to file Form 8865 per IRC 6038.</li></ul>		
<p>Prepare a pattern letter to notify USP of their failure to file forms 8865. See Step 4.</p>		

# Step 3

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

### Step 3: Review Forms 8865 to ensure all required information has been submitted

If Form 8865 is not complete and accurate when filed the monetary penalty per IRC 6038(b) applies

Considerations	Resources	6103 Protected Resources
<p><u>Review Forms 8865 for incomplete or inaccurate information -</u>            Treasury Regulation 1.6038-3 details the requirements for category 1 and 2 filers and the instructions for Form 8865 details the information required to be filed for each category of filer.</p> <p>A USP is required to furnish all required information on Form 8865 even though the information required may not affect the amount of any tax due under the Internal Revenue Code.</p>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.6038-3(g) Contents of Return</li> <li>▪ Instructions for Form 8865 - Filing Requirements for Categories of Filers</li> </ul>	
<p>Review USP's Forms 8865 for any schedule required (based on their filing category) but not included when the USP's return was filed.</p>		

# Step 3 (cont'd)

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

**Step 3: Review Forms 8865 to ensure all required information has been submitted**

If Form 8865 is not complete and accurate when filed the monetary penalty per IRC 6038(b) applies

Considerations	Resources	6103 Protected Resources
<p><u>Category 1 filer must file the following schedules</u></p> <ul style="list-style-type: none"> <li>▪ A - Constructive Ownership of Partnership Interest</li> <li>▪ A-1 - Certain Partners of Foreign Partnership</li> <li>▪ A-2 - Affiliation Schedule</li> <li>▪ B - Income Statement - Trade or Business Income</li> <li>▪ K - Partners' Distributive Share Items</li> <li>▪ L - Balance Sheet Per Books</li> <li>▪ M - Balance Sheet for Interest Allocation</li> <li>▪ M-1 - Reconciliation of Income (Loss) per Books with Income (Loss) per Return</li> <li>▪ M-2 - Analysis of Partners' Capital Accounts</li> <li>▪ N - Transactions Between Controlled Foreign Partnership and Related Entities</li> <li>▪ D - Schedule D (Form 1065) Capital Gains and Losses</li> <li>▪ K-1 - Partners' Share of Income, Deductions, Credits, etc.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.6038-3(g) Contents of Return</li> <li>▪ Form 8865 Instructions</li> </ul>	

## Step 3 (cont'd)

### Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

#### Step 3: Review Forms 8865 to ensure all required information has been submitted

If Form 8865 is not complete and accurate when filed the monetary penalty per IRC 6038(b) applies

Considerations	Resources	6103 Protected Resources
<p><u>Review Form 8865 to ensure each required schedule is complete and accurate -</u></p> <ul style="list-style-type: none"> <li>▪ Compare current year Form 8865 to previous year</li> <li>▪ Is Identifying information on Page 1, Item F the same as prior year</li> <li>▪ EIN</li> <li>▪ Reference ID</li> <li>▪ Country under whose laws the entity is organized</li> <li>▪ Principal business activity</li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.6038-3(g) Contents of Return</li> <li>▪ Form 8865 Instructions</li> </ul>	
<p>Compare current balance sheet (Schedule L) beginning year balances to prior year ending balances</p>		
<p>Compare current balance sheet for Interest Allocation (Schedule M) beginning year balances to prior year ending balances</p>		

# Step 3 (cont'd)

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

### Step 3: Review Forms 8865 to ensure all required information has been submitted

If Form 8865 is not complete and accurate when filed the monetary penalty per IRC 6038(b) applies

Considerations	Resources	6103 Protected Resources
<p><u>Review Form 8865 to ensure each required schedule is complete and accurate - (Cont'd)</u></p> <p>Review USP' s Forms 8865 for the most common reasons for noncompliance with IRC 6038:</p> <ul style="list-style-type: none"> <li>▪ stating that required information will be furnished upon request or audit,</li> <li>▪ failing to provide financial statements for controlled foreign partnerships</li> <li>▪ consolidating two or more foreign partnerships onto one Form 8865</li> </ul>		

# Step 4

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

### Step 4: Issue the pattern letter for any failures to file a complete and accurate Form 8865

The pattern letter notifies USP of a failure to file regarding Form 8865 and is required to assess the continuation penalty.

Considerations	Resources	6103 Protected Resources
Once you have determined the reporting requirements of IRC 6038 have not been met, the Service issues the pattern letter for Failure To File Form 8865 to the USP. The pattern letter serves as required notification for the imposition of the continuation penalty, where warranted. It is imperative that the Service serves proper notification. For any questions contact the Information Gathering Technical Specialists.	<ul style="list-style-type: none"><li>▪ Pattern Letter for Failure to File Form 8865</li></ul>	
The Service may issue one pattern letter to the USP for the failure to file multiple Forms 8865, however the Service must list the name of the specific CFPs which it alleges the USP has failed to file.		

# Step 4 (cont'd)

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

### Step 4: Issue the pattern letter for any failures to file a complete and accurate Form 8865

The pattern letter notifies USP of a failure to file regarding Form 8865 and is required to assess the continuation penalty.

Considerations	Resources	6103 Protected Resources
The pattern letter notifies USP that it failed to file a Form 8865 (i.e., filed late or not filed at all), or that the form filed was substantially incomplete. It states that an initial penalty will be imposed and that a continuation penalty will apply if the Service does not receive a complete and accurate Form 8865 within 90 days of notification per IRC 6038.	▪ IRC 6038(b)	

## Step 4 (cont'd)

### Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

#### Step 4: Issue the pattern letter for any failures to file a complete and accurate Form 8865

The pattern letter notifies USP of a failure to file regarding Form 8865 and is required to assess the continuation penalty.

Considerations	Resources	6103 Protected Resources
<p>It is imperative to list the names of the CFPs in the notification letter. The 90 day response period starts on the date the pattern letter is issued to the USP. Contact the Information Gathering Technical Specialists if you have any questions.</p>		
<p>The pattern letter directs USP to Treas. Reg. 1.6038-3(k)(4), for the reasonable cause provision.</p> <p>The pattern letter is addressed to the US partner required to file Form 8865. If the US partner is a subsidiary corporation included in a consolidated corporate income tax return, the Service can address the pattern letter to the partner (US sub) or the parent (US consolidating entity named on the 1120 income tax return).</p>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.6038-3(k)(4) Reasonable cause limitation</li> <li>▪ Treas. Reg. 1.6038-3(c)(3) Members of an affiliated group of corporations filing a consolidated return</li> </ul>	

## Step 4 (cont'd)

### Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

#### Step 4: Issue the pattern letter for any failures to file a complete and accurate Form 8865

The pattern letter notifies USP of a failure to file regarding Form 8865 and is required to assess the continuation penalty.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> <li>▪ The pattern letter should indicate the name of the International Examiner (“IE”) as the person to contact and refer the reply to.</li> <li>▪ Include in the body of the pattern letter the complete legal names of each foreign partnership for which a failure occurred. If necessary, the names can be included as an attachment.</li> <li>▪ The pattern letter should list all tax year(s) for which the failure to file Forms 8865 occurred.</li> </ul>	<ul style="list-style-type: none"> <li>▪ IRM Exhibit 20.1.9-7, Pattern Letter for Failure to File Form 8865</li> </ul>	
<ul style="list-style-type: none"> <li>▪ Large Business &amp; International (“LB&amp;I”) IEs are authorized to sign Form 8865 pattern letters.</li> </ul>	<ul style="list-style-type: none"> <li>▪ LB&amp;I DO 1-23-1 Notification Letters under URC 6038, 6046, and 6046A and Penalties under IRC 6679 Delegation Order</li> </ul>	

# Step 4 (cont'd)

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

### Step 4: Issue the pattern letter for any failures to file a complete and accurate Form 8865

The pattern letter notifies USP of a failure to file regarding Form 8865 and is required to assess the continuation penalty.

Considerations	Resources	6103 Protected Resources
<p>The Service should deliver the pattern letter to USP by either -</p> <ul style="list-style-type: none"> <li>▪ US Mail with a return receipt request OR</li> <li>▪ hand delivered to the USP. IMPORTANT: If hand delivered the Service should have USP sign and date a receipt to show acknowledgement of delivery.</li> </ul>		
<p>The 90 day response period in IRC 6038(c)(1) starts on the date the USP receives notification of their failure. The date shown on the return receipt or the signed acknowledgement would be the start date of the 90 day period.</p>		
<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 Complete and Accurate Form 8865 – Category 1 & 2 Filers

### Step 4: Issue the pattern letter for any failures to file a complete and accurate Form 8865

The pattern letter notifies USP of a failure to file regarding Form 8865 and is required to assess the continuation penalty.

Considerations	Resources	6103 Protected Resources
<p>The pattern letter may be delivered to a representative with a valid Power of Attorney (Form 2848) for the income tax examination of USP.</p> <p>However the Service cannot discuss the specifics of any potential IRC 6038 penalty with a representative that is not specifically authorized for such discussions.</p>		
<p>Certain directly assessable civil penalties are not covered by a valid Form 2848 for the income tax case. A valid authorization for certain civil penalties must include language similar to "Civil Penalties" or "IRC 6038 penalty" or "Chapter 61 penalties" for Item #3 "Description of Matter".</p>		

# Step 4 (cont'd)

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

### Step 4: Issue the pattern letter for any failures to file a complete and accurate Form 8865

The pattern letter notifies USP of a failure to file regarding Form 8865 and is required to assess the continuation penalty.

Considerations	Resources	6103 Protected Resources
Review Forms 2848 (Power of Attorney and Declaration of Representative) received to determine if the representative has such authorization. If not, consider suggesting that USP issue a separate Form 2848.		

# Step 5

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

### Step 5: Review Forms 8865 submitted in response to the pattern letter

The pattern letter notifies USP of a failure to file regarding Form 8865 and is required to assess the continuation penalty.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"><li>▪ Date stamp Forms 8865 when they are received.</li><li>▪ Review the forms submitted to determine whether or not they appear to be complete and accurate.</li><li>▪ If the form appears to be complete and accurate continue with Step 6.</li><li>▪ The 90 day period for the continuation penalty does not stop until the Service receives a complete and accurate Form 8865.</li><li>▪ If USP submits a Form 8865 within the 90 day period that is not complete and accurate the Service should (even though there is no statutory requirement) notify USP, in writing, that the information submitted does not comply with the reporting requirements of IRC 6038 and the penalty will continue to accrue.</li><li>▪ There is no statutory provision under IRC 6038 that would allow for an extension to the 90 day response period for the imposition of the continuation penalty.</li></ul>		

# Step 6

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

### Step 6: Factors to consider for reasonable cause

Reasonable cause was provided as a defense in several statutes and determinative factors were identified in various guidance.

Considerations	Resources	6103 Protected Resources
<p>The IRM provides factors to consider to determine whether USP exercised ordinary business care and prudence. Examples of what might be reasonable cause include:</p> <ul style="list-style-type: none"> <li>▪ Erroneous advice or reliance,</li> <li>▪ Unable to obtain records, and</li> <li>▪ Fire, casualty, natural disaster, etc.</li> </ul>	<ul style="list-style-type: none"> <li>▪ IRM 20.1.1.3.2.2.5 Erroneous advice</li> <li>▪ IRS CCA 200429007 (09/22/04)</li> <li>▪ IRM 20.1.1.3.2.2.3 Unable to obtain records</li> <li>▪ IRM 20.1.1.3.2.2.1</li> </ul>	
<p>Ignorance of the law, by itself, is not reasonable cause. Other factors to consider include:</p> <ul style="list-style-type: none"> <li>▪ USP's education</li> <li>▪ if USP was penalized before</li> </ul>	<ul style="list-style-type: none"> <li>▪ IRM 20.1.3.2.2.6 Ignorance of the law</li> </ul>	
<p>The fact that a foreign jurisdiction would impose a civil or criminal penalty on the taxpayer (or any other person) for disclosing the required information and/or refusal on the part of a foreign trustee to provide information for any other reason, was not reasonable cause.</p>	<ul style="list-style-type: none"> <li>▪ IRM 20.1.9.1.1(4) reasonable cause</li> </ul>	

# Step 6 (cont'd)

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

### Step 6: Factors to consider for reasonable cause

Reasonable cause was provided as a defense in several statutes and determinative factors were identified in various guidance.

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

# Step 7

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

### Step 7: Notify TP of penalty determination

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

Considerations	Resources	6103 Protected Resources
<p>NOPAs are not prepared for IRC 6038 penalty cases. In addition, the penalty does not appear on the Revenue Agent Report. USP does not sign anything to agree or disagree with the penalty.</p>		
<p>Prepare Form 886-A - Explanation of Items - for failure to file Form 8865.</p> <ul style="list-style-type: none"> <li>▪ Form 886-A should contain sections for -               <ul style="list-style-type: none"> <li>- Facts - include all pertinent information</li> <li>- Law</li> <li>- TP's position - including any reasonable cause request</li> <li>- Service's Position - including a detailed determination on reasonable cause</li> </ul> </li> </ul>		
<p>It is important to include all relevant information on Form 886-A. This will be sent to the Campus for the penalty to be assessed and will be sent to Appeals if USP chooses to appeal the penalty.</p>		

# Step 7 (cont'd)

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

### Step 7: Notify TP of penalty determination

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

Considerations	Resources	6103 Protected Resources
If USP has reasonable cause for the failure to file Form 8865 all work papers and forms submitted to the Service are kept in the income tax case file. No further action regarding a penalty is required.		
If the Service determines USP does not have reasonable cause for the failure to file a complete and accurate Form 8865 within the time prescribed, a penalty of \$10,000 per form, per year applies.	<ul style="list-style-type: none"> <li>▪ IRC 6038(b)(1)</li> <li>▪ Treas. Reg. 1.6038-2(k)(1)(i)</li> </ul>	
If USP fails to submit the complete and accurate information within 90 days of notification by the Service, USP shall pay an additional penalty of \$10,000 for each 30-day period (or fraction thereof) during which such failure continues. The continuation penalty shall not exceed \$50,000 per form, per year.	<ul style="list-style-type: none"> <li>▪ IRC 6038(b)(2)</li> <li>▪ Treas. Reg. 1.6038-2(k)(1)(ii)</li> </ul>	
Calculate the total penalty due, per year. The penalty must be assessed separately for each tax period.		

# Step 7 (cont'd)

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

### Step 7: Notify TP of penalty determination

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

Considerations	Resources	6103 Protected Resources
<p>Exam must set up a separate case file for the penalty</p> <ul style="list-style-type: none"> <li>▪ The penalty is -               <ul style="list-style-type: none"> <li>- closed separate from the income tax case file</li> <li>- controlled on ERCS - there are no AIMS controls</li> <li>- assessed to MFT 13 for corporations or MFT 55 for individuals</li> <li>- directly assessable and not subject to deficiency procedures</li> <li>- sent to the Campus for assessment</li> </ul> </li> </ul>		<ul style="list-style-type: none"> <li>▪ Penalty Case File Procedures on PN website</li> </ul>
<p>A copy of Form 886-A should be supplied to USP</p>		

# Other Considerations / Impact to Audit

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

Considerations	Resources
Considering a reduction to the foreign tax credits of a US partner that did not file Form 8865 for a foreign partnership (IPS Unit in production)	
Considering penalties when a US partner did not file Form 8865, Schedule P for assets contributed to a foreign partnership in exchange for a partnership interest (IPS Unit in production)	
Considering penalties when a US partner did not file Form 8865, Schedule O to report their acquisitions, dispositions or change in proportional interest in a foreign partnership (IPS Unit in production)	

# Training and Additional Resources

## Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 & 2 Filers

Type of Resource	Description(s) and/or Instructions for Accessing	References
Reference Materials – Treaties	<ul style="list-style-type: none"> <li>▪ IRC 982 discussions of: admissibility of foreign-based documentation in civil court, substantial compliance, reasonable cause, quash petition, and relevance and materiality.</li> <li>▪ The Bittker &amp; Lokken treatise is included in LB&amp;I' s Westlaw subscription in the International resources section Click on:               <ul style="list-style-type: none"> <li>▪ Table of Contents;</li> <li>▪ Part 9 (Foreign Income and Foreign Taxpayers); and</li> <li>▪ Chapter 65 (International Tax Enforcement).</li> </ul> </li> <li>▪ Then, cursor to ¶ 65.8.3 US Persons with Interests in Foreign Partnerships.</li> </ul>	<ul style="list-style-type: none"> <li>▪ <i>Federal Taxation of Income, Estates and Gifts, Bittker &amp; Lokken.</i></li> </ul>
Other Training Materials	<ul style="list-style-type: none"> <li>▪ This document provides guidance on when to open and how to close a penalty case. Also, it addresses where penalty work papers are placed in case files. It is located in the Reference Materials section of the Information Gathering IPN SharePoint website.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Penalty Case File Procedures</li> </ul>

# Glossary of Terms and Acronyms

Term/Acronym	Definition
AIMS	Audit Information Management System
CCN	Chief Counsel Notice
CFP	Controlled Foreign Partnership
Code	Internal Revenue Code
IBC	International Business Compliance
IE	International Examiner
IIC	Individual International Compliance
IRC	Internal Revenue Code
LB&I	Large Business & International
MFT	Master File Transaction
NOPA	Notice of Proposed Adjustment
PN	Practice Network
TP	Taxpayer
USP	US Partner

# Index of Related Issues

Issue	Associated UILs	References
<p>This unit assists the agent in determining when a Form 8865 is required to be filed for a Category 1 and 2 Filer. It will also provide the penalties that are applicable for failure to file the Form 8865 for such filers, as well as the procedures for pursuing the penalty.</p> <ul style="list-style-type: none"><li>• Failure to File the Form 8865 – Category 1 and 2 Filers – Monetary Penalty</li></ul>	<ul style="list-style-type: none"><li>▪ 9434.01</li><li>▪ 9560.02</li><li>▪ 9560.04</li><li>▪ 9560.07</li><li>▪ 9560.15</li></ul>	<ul style="list-style-type: none"><li>▪ DCN FEN/P/12_01_02_01-01</li></ul>