MANUAL TRANSMITTAL

4.63.5

Department of the Treasury
Internal Revenue Service

MARCH 14, 2023

EFFECTIVE DATE

(03-14-2023)

PURPOSE

(1) This transmits revised IRM 4.63.5, Withholding and International Individual Compliance, International Penalties and Procedures – Individuals.

MATERIAL CHANGES

(1) IRM 4.63.5.1, Updated policy owner to LB&I Policy.

(2) IRM 4.63.5.1.1, Added Background subsection in accordance with IRM 1.11.2.2.5.

(3) IRM 4.63.5.1.5, Updated acronyms table.

(4) IRM 4.63.5.1.6, Updated link to the LB&I WEIIC site.

(5) IRM 4.63.5.2, Updated link to the Knowledge Management International Penalties site.

(6) Updated organization to WEIIC throughout.

EFFECT ON OTHER DOCUMENTS

This IRM supersedes IRM 4.63.5 dated January 18, 2018.

AUDIENCE

LB&I WEIIC employees

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4.63.5
International Penalties and Procedures – Individuals

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4.63.5.1
(03-14-2023)
Program Scope and Objectives

(1) **Purpose** The purpose of this section is to provide examiners and their managers with guidance for assessing penalties on U.S. citizens that have international information return filing requirements. This section addresses specific penalties that pertain to International Individual Compliance (IIC) cases.

(2) **Audience** This IRM applies primarily to IIC examiners.

Note: The term“ IIC examiner” refers to revenue agents, tax compliance officers and tax examiners throughout this IRM. In some cases CCU tax examiners are referred to as tax examiners.

(3) **Policy Owner** LB&I Policy under the Strategy, Policy and Governance office in the Assistant Deputy Commissioner Compliance Integration organization.

(4) **Program Owner** The Director, Withholding Exchange and International Individual Compliance (WEIIC), manages and administers the WEIIC Practice Area.

4.63.5.1.1
(03-14-2023)
Background

(1) The Service maintains an ongoing effort to develop, monitor and revise programs designed to assist taxpayers in complying with legal requirements and to avoid penalties. As indicated in Policy Statement P-20-1, the Service uses penalties to encourage voluntary compliance.

(2) In order to make the most efficient and consistent use of penalties, the IRS designs, administers, and evaluates penalty programs based on how those programs can most efficiently encourage voluntary compliance.

(3) Penalties encourage voluntary compliance by:

a. demonstrating the fairness of the tax system to compliant taxpayers; and
b. increasing the cost of noncompliance.

4.63.5.1.2
(03-14-2023)
Authority

(1) The development, implementation and oversight of the international individual case processing procedures are the jurisdiction of the Director, WEIIC.

(2) IRM 4.10, Examination of Returns, provides the basic procedures, guidelines and requirements for use by revenue agents and tax auditors in conducting income tax examinations. Additional procedures for LB&I cases are found in IRM 4.46, LB&I Examination Process.

4.63.5.1.3
(03-14-2023)
Responsibilities

(1) The Director, WEIIC Practice Area, is the executive responsible for IIC case penalties.

4.63.5.1.4
(03-14-2023)
Program Management and Review

(1) **Program Reports** The Director, WEIIC Practice Area, prepares periodic briefing reports for the LB&I division commissioner focusing on:

- Significant accomplishments and opportunities for improvement
- Changes in procedures that have been implemented
- Identifying future improvements
- Any other key information

(2) **Program Effectiveness** The efficiency of the case procedures is measured through combined business results of the teams that comprise IIC.

4.63.5.1.5
(03-14-2023)
Program Controls

(1) The Director of Field Operations (DFO), International Individual Compliance (IIC), monitors the activities of the territories and administers procedures and updates related to the territories.

(2) The Director, WEIIC, identifies goals and objectives to be achieved by the organization, compiles periodic reports from the DFO and reports to LB&I executive management on a continuous basis via the director's briefings.

4.63.5.1.6
(03-14-2023)
Acronyms

(1) This table lists commonly used acronyms and their definitions:

Acronym	Definition
CCU	Campus Compliance Unit
DFO	Director of Field Operations
IIC	International Individual Compliance
IPS	International Practice Service
IRC	Internal Revenue Code
NRA	Nonresident Alien
PA	Practice Area
Treas. Reg.	Treasury Regulation
UIL	Uniform Issue List
USC	United States Code
WEIIC	Withholding Exchange and International Individual Compliance

4.63.5.1.7
(03-14-2023)
Related Resources

(1) For information regarding the WEIIC international individual compliance programs and services, refer to the WEIIC website at *https://irssource.web.irs.gov/LBI/Lists/LBI_Programs/WEIIC.aspx*.

4.63.5.2
(03-14-2023)
Overview

(1) The examiner will inform the taxpayer as early as possible when and why penalties are being considered. The examiner will provide the taxpayer an opportunity to respond to and/or refute the assertion based on facts and legal application. Examiners must document the manager's involvement on Form 9984, Examining Officer's Activity Record, and in the work papers related to the penalty under consideration. Consult with Counsel and with the subject matter experts in the Penalties Practice Network if needed.

(2) The team manager must be actively involved with the development of all penalty issues. Coordination with Criminal Investigation and specialists may be required. The team manager must approve any penalty asserted and any case where there is a substantial understatement of tax and no penalty proposed. For more information, see IRM 20.1.5.1.6, Penalty Relief.

(3) See IRM 20.1, Penalty Handbook, for a list of common civil tax penalties. This list includes the applicable IRC section, penalty amount and description, penalty reference numbers, detailed explanation and computation methods.

(4) A civil fraud penalty case may be developed based on the facts and circumstances of a civil examination or may occur at the completion of a criminal prosecution case. In either situation, the examiner and team manager must contact their local Fraud Technical Advisor when fraud is suspected. The examiner and Fraud Technical Advisor will jointly prepare Form 11661, Fraud Development Recommendation – Examination. Assertion of a civil penalty is a shared responsibility of the examiner, team manager and Fraud Technical Advisor. All procedures outlined in IRM 25.1.6, Fraud Handbook - Civil Fraud, relative to civil fraud cases must be followed.

(5) International penalties can be found in the Penalty Handbook in IRM 20.1.9. For additional information, the Knowledge Management International Penalties site can be found at *https://portal.ds.irsnet.gov/sites/vl015/lists/international/landingview.aspx*.

(6) Penalties for U.S. citizens failing to satisfy international information return filing requirements include penalties related to the following forms:

Form	Title
926	Return by a U.S. Transferor of Property to a Foreign Corporation
1116	Foreign Tax Credit
1118	Foreign Tax Credit - Corporations
3520	Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts
3520-A	Annual Information Return of Foreign Trust With a U.S. Owner
5074	Allocation of Individual Income Tax to Guam or the Commonwealth of the Northern Mariana Islands (CNMI)
5471	Information Return of U.S. Persons With Respect To Certain Foreign Corporations
5472	Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business
8833	Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)
8854	Initial and Annual Expatriation Statement
8858	Information Return of U.S. Persons With Respect To Foreign Disregarded Entities
8865	Return of U.S. Persons With Respect to Certain Foreign Partnerships
8898	Statement for Individuals Who Begin or End Bona Fide Residence in a U.S. Possession
8938	Statement of Specified Foreign Financial Assets

4.63.5.2.1
(01-18-2018)
Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation

(1) Penalties under IRC 6038B(c) may apply when there is a failure by a U.S. taxpayer to provide information relating to transfers to foreign persons (corporations and partnerships). See IRM 20.1.9.7, IRC 6038B(c)—Failure to Provide Notice of Transfers to Foreign Persons.

(2) Examiners should review a taxpayer's return for attached Form(s) 926 when the taxpayer is under exam and has transferred cash or property to a foreign person(s). If an examiner has indication that a taxpayer has transferred cash

or property to a foreign person(s), and the taxpayer has not filed Form(s) 926, the examiner should request additional information regarding the transfer and non-filing of Form 926.

4.63.5.2.2
(01-18-2018)
Form 1116, Foreign Tax Credit

(1) Penalties under IRC 6689 may apply when a U.S. taxpayer fails to file notice of a foreign tax credit redetermination under IRC 905(c) or IRC 404A(g)(2). See IRM 20.1.9.19, IRC 6689 - Failure to File Notice of Foreign Tax Redetermination.

(2) Examiners should review the Form 1116 for foreign tax credit redeterminations when examiners are aware a taxpayer has a foreign tax credit adjustment from accrued taxes under IRC 905(c), a reduction in foreign taxes paid, or a rebate of foreign taxes.

4.63.5.2.3
(01-18-2018)
Form 1118, Foreign Tax Credit - Corporations

(1) Penalties under IRC 6689 may apply when an individual U.S. taxpayer fails to file a notice of redetermination for foreign tax credits, the individual U.S. taxpayer owns a Controlled Foreign Corporation (CFC) for which they made a IRC 962 election to claim indirect foreign taxes which is generally available if they have Subpart F income, and the CFC had a reduction in their foreign taxes paid or accrued or received a rebate for foreign taxes. The tax credit is computed at corporate rates on the Form 1118. See IRM 20.1.9.19.

(2) Examiners should review Form(s) 1118 for foreign tax credit redeterminations when examiners are aware of a CFC owned by an individual U.S. taxpayer under exam in which the CFC had a reduction in its foreign taxes paid or accrued or received a rebate for foreign taxes.

4.63.5.2.4
(01-18-2018)
Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts

(1) Penalties under IRC 6677 may apply to a U.S. taxpayer who fails to file information, as required by IRC 6048, with respect to ownership of , transfers to, or distributions from a foreign trust. See IRM 20.1.9.13, IRC 6677(a) — Failure to File Information with Respect to Certain Foreign Trusts —Form 3520.

(2) Penalties under IRC 6039F(c) may apply to a U.S. taxpayer who fails to file information required under IRC 6039F relating to certain large gifts or bequests from foreign persons. See IRM 20.1.9.10, IRC 6039F(c)—Large Gifts From Foreign Persons.

(3) Examiners should review the IPS unit Failure to File the Form 3520/3520A - Penalties at *https://www.irs.gov/pub/int_practice_units/FEN9434_02_05R.pdf* when examining a taxpayer who filed a Form 3520, Part I through Part III, or when an examiner has indication that the U.S. taxpayer is treated as owning any portion of a foreign trust under the grantor trust rules (IRC 671-679), has made loans or transfers of cash or property to a foreign trust, and/or has received a distribution, a loan, or uncompensated use of property from a foreign trust.

(4) Examiners should ensure a Form 3520, Part IV, has been filed for a U.S. taxpayer receiving a gift or bequest from a foreign person over the required threshold amount. See IRM 20.1.9.10.1, Reporting and Filing Requirements. If the U.S. taxpayer receiving the gift or bequest from a foreign trust is a beneficiary of a foreign trust, the U. S. taxpayer should report the gift as a distribution from a foreign trust and complete Part III of the Form 3520 in lieu of Part IV.

4.63.5.2.5
(01-18-2018)
Form 3520-A, Annual Information Return of Foreign Trust With a U.S. Owner

(1) Penalties under IRC 6677(b) may apply to a U.S. taxpayer treated as an owner of a foreign trust under grantor trust rules (IRC 671-679) who fails to ensure that the foreign trust files an annual return providing certain information required pursuant to IRC 6048(b) relating to such foreign trust on a Form 3520-A. See IRM 20.1.9.14, IRC 6677(a) and (b)—Foreign Trusts With U.S. Owners—Form 3520-A.

(2) Examiners should review IPS unit "Failure to File the Form 3520 /3520-A - Penalties" at *https://www.irs.gov/pub/int_practice_units/FEN9434_02_05R.pdf* when examining a taxpayer where a Form 3520-A was filed or when examining a U.S. taxpayer where a Form 3520-A was filed, or when a examiner has indication that the U.S. taxpayer is the owner of a foreign grantor trust, a Form 3520-A has not been filed by the trustee of the foreign trust, and the U.S. taxpayer did not file a substitute Form 3520-A.

4.63.5.2.6
(01-18-2018)
Form 5074, Allocation of Individual Income Tax to Guam or the Commonwealth of the Northern Mariana Islands

(1) Penalties under IRC 6688 may apply when any person described in IRC 7654(a) fails to file U.S. possession information. See IRM 20.1.9.18, IRC 6688—Reporting for Residents of U.S. Possessions (U.S. Territories).

(2) Examiners should review an individual U.S. taxpayer's Form 1040 for an attached Form 5074 when the taxpayer is under exam, is not a bona fide resident of Guam or the Commonwealth of Northern Mariana Islands (CNMI), reports adjusted gross income of $50,000 or more, and has gross income from Guam or the CNMI of at least $5,000.

4.63.5.2.7
(01-18-2018)
Form 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations

(1) Penalties under IRC 6038 may apply when a U.S. taxpayer fails to file information relating to CFCs. See IRM 20.1.9.3, IRC 6038—Information Reporting With Respect to Foreign Corporations and Partnerships.

(2) Penalties under IRC 6679 may apply when a U.S. taxpayer fails to report information with respect to acquisitions of interests in foreign corporations under IRC 6046 . See IRM 20.1.9.15, IRC 6679—Return of U.S. Persons With Respect to Certain Foreign Corporations and Partnerships.

(3) Examiners should review Form(s) 5471 filed by a taxpayer for accuracy and completeness. If there is an indication a taxpayer owns a CFC and no Form 5471 has been filed, examiners should first determine if the taxpayer is a Category 2, 3, 4, or 5 filer.

a. Examiners should review the taxpayer's acquisition of foreign corporation stock to determine if the taxpayer met thresholds necessary to be considered a Category 2 filer which would make a Form 5471 filing necessary.
b. Examiners should review the taxpayer's acquisition of foreign corporation stock, foreign stock ownership of a taxpayer becoming a U.S. person, or disposition of foreign stock to determine if the taxpayer met thresholds necessary to be considered a Category 3 filer which would make a Form 5471 filing necessary.
c. If the taxpayer is a category 4 or 5 filer examiners should review IPS unit "Failure to File the Form 5471 – Category 4 and 5 Filers – Monetary Penalty" at *https://www.irs.gov/pub/irs-utl/FEN9433_01_06R.pdf* to determine if a penalty may apply.

4.63.5.2.8
(01-18-2018)
Form 5472, Information Return of a 25% Foreign Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business

(1) Penalties under IRC 6038A(d) may apply when a U.S. taxpayer fails to report information or maintain records with respect to 25% foreign owned corporations. See IRM 20.1.9.5, IRC 6038A(d)—Information Reporting for Certain Foreign-Owned Corporations.

(2) Examiners reviewing a 25% foreign-owned U.S. corporation or a foreign corporation engaged in a trade or business within the United States should ensure a Form 5472 has been filed in regards to reportable transactions with a foreign or domestic related party.

4.63.5.2.9
(01-18-2018)
Form 8833, Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)

(1) Penalties under IRC 6712 may apply when a U.S. taxpayer fails to disclose treaty-based return positions on the Form 8833 as required under IRM 6114 or IRC 7701(b). See IRM 20.1.9.20, IRC 6712 — Failure to Disclose Treaty-Based Return Position.

(2) Examiners should review the relevant income tax return under exam (Form 1040NR, Form 1040NR-EZ, Form 1120-F, etc.) for attached Form(s) 8833 when treaty-based return positions are asserted by taxpayers. If taxpayers have taken treaty-based positions on their returns and no Form 8833 is attached, examiners should request appropriate information to determine if the filing exceptions listed in the regulations under IRC 6114 or on Form 8833 apply, or if a penalty under IRC 6712 applies.

4.63.5.2.10
(01-18-2018)
Form 8854, Initial and Annual Expatriation Statement

(1) Penalties under IRC 6039G(c) may apply if a U.S. citizen or long-term resident who expatriates fails to provide a Form 8854 for the year of expatriation, and for subsequent years in certain circumstances, unless it is shown such failure is due to reasonable cause and not to willful neglect. See IRM 20.1.9.11, IRC 6039G—Expatriation Reporting Requirements.

(2) Different expatriation regimes may apply to expatriates depending on their year of expatriation. Examiners should ensure filing of Form 8854 for any individual U.S. taxpayer under exam that expatriated and should refer to IRM 20.1.9.11 for additional information.

4.63.5.2.11
(01-18-2018)
Form 8858, Information Return of U.S. Persons With Respect to Foreign Disregarded Entities

(1) Penalties under IRC 6038(b) may apply if a CFC or a Controlled Foreign Partnership (CFP) owns a Foreign Disregarded Entity (FDE) and the shareholder or partner, respectively, that is required under IRC 6038 to file Form 5471 or 8865 with respect to that CFC or CFP, fails to file a required Form 8858 or its separate Schedule M with respect to the FDE. See IRM 20.1.9.3, IRC 6038 — Information Reporting With Respect to Foreign Corporations and Partnerships.

(2) Examiners should review a U.S. taxpayer's tax return under exam for a Form 8858 when the taxpayer is a direct owner of an FDE or when the taxpayer is a partner or shareholder of a CFC or CFP that is a tax owner in an FDE.

4.63.5.2.12
(01-18-2018)
Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships

(1) Penalties under IRC 6038 may apply when a U.S. taxpayer fails to file information relating to CFPs. See IRM 20.1.9.3, IRC 6038—Information Reporting With Respect to Foreign Corporations and Partnerships.

(2) Penalties under IRC 6038B may apply when a U.S. taxpayer fails to report information on Form 8865 Schedule O with respect to property transfers to a foreign person. See IRM 20.1.9.7, IRC 6038B(c)—Failure to Provide Notice of Transfers to Foreign Persons.

(3) Penalties under IRC 6679 may apply when a U.S. taxpayer fails to report information with respect to acquisitions of interests in foreign partnerships under IRC 6046A. See IRM 20.1.9.15, IRC 6679 — Return of U.S. Persons With Respect to Certain Foreign Corporations and Partnerships.

(4) Examiners should review Form(s) 8865 filed by a taxpayer for accuracy and completeness. If there is an indication a taxpayer owns a CFP and no Form 8865 has been filed, an examiner should first determine if the taxpayer is a Category 1, 2, 3 or 4 filer.

a. If the taxpayer is a Category 1 or 2 filer, the examiner should review IPS unit "Failure to File the Form 8865 –Category 1 and 2 Filers – Monetary Penalty" at *https://www.irs.gov/pub/int_practice_units/FEN9434_01_10R.pdf*
b. If the taxpayer is a Category 3 filer examiners should review the taxpayer's contribution and interest received in a foreign partnership to determine if a penalty may apply.
c. If the taxpayer is a Category 4 filer examiners should review the taxpayer's reportable event under IRC 6046A to determine if a penalty may apply.

4.63.5.2.13
(01-18-2018)
Form 8898, Statement for Individual Who Begin or End Bona Fide Residence in a U.S. Possession

(1) Penalties under IRC 6688 may apply if individual taxpayers with adjusted gross income thresholds fail to report that they became or ceased to be a bona fide resident of a U.S. possession. See IRM 20.1.9.18.1, Reporting and Filing Requirements.

(2) Examiners should ensure a Form 8898 is filed when a U.S. taxpayer is under exam and takes a position for U.S. tax purposes that they became a bona fide resident of a U.S. possession or who takes the position that they ceased to be a bona fide resident of a U.S. possession.

4.63.5.2.14
(01-18-2018)
Form 8938, Statement of Specified Foreign Financial Assets

(1) Penalties under IRC 6038D(d) may apply when a U.S. taxpayer fails to file information with respect to specified foreign financial assets. See IRM 20.1.9.22, IRC 6038D—Information With Respect to Specified Foreign Financial Assets.

(2) Examiners should review individual U.S. taxpayer's returns under exam for Form 8938 when the examiner has indication the taxpayer owns specified foreign financial assets if the total value of the assets is more than the reporting threshold contained in Treas. Reg. 1.6038D-2.

4.63.5.3
(01-18-2018)
FBAR Reporting

(1) Foreign Bank and Financial Accounts (FBAR) information and procedures can be found in IRM 4.26.16, Report of Foreign Bank and Financial Account (FBAR), and IRM 4.26.17, Report of Foreign Bank and Financial Accounts (FBAR) Procedures.

(2) An FBAR investigation should be considered in WEIIC cases if the examiner has indication that an FBAR Financial Crimes Enforcement Network (FinCEN) Form 114 (formerly TD-F 90-22.1) should have been filed by a taxpayer during a tax examination. See IRM 4.26.17.1, FBAR Procedures Overview. The FinCEN Form 114 is only available online through the BSA E-Filing System website at *http://bsaefiling.fincen.treas.gov/main.html* and must be filed electronically. Taxpayers must use the FinCEN Form 114 for current and past

year FBAR filings after July 1, 2013. Authorized examiners can collect and analyze data regarding FinCEN Form 114 through FinCEN Query after March 31, 2014.

(3) When an FBAR issue arises in an Offshore Voluntary Disclosure Program (OVDP) case, the examiner should use the FBAR procedures for that program. See IRM 4.63.2.14, FBAR Questions.

(4) Form 13535, Foreign Bank and Financial Accounts Report Related Statute Memorandum, is a special related statute memorandum that has been developed for FBAR cases. See IRM 4.26.14.2.2, Related Statute Procedures. An WEIIC examiner should first obtain a related statute memorandum signed by the examiner's manager before asking interview questions or requesting documents that are only relevant to an FBAR examination. See IRM 4.26.17.2, FBAR Procedures Starting the Case - Related Statute Memorandum. An examiner should prepare a Form 5345-D to establish the case on ERCS for proper case tracking upon receiving a signed related statute memorandum.

(5) A waiver of the statute of limitations for a Title 26 (IRC) case will not waive the statute of limitations on an FBAR case. The statute of limitations on assessment of the FBAR penalties is found in 31 U.S.C. 5321(b) (1). The statute is generally six years from the date of the transaction. See IRM 4.26.17.3.1, Working the FBAR Case.