

A faint, light gray world map is visible in the background of the slide, centered behind the text.

# **International Information Returns: Trends and Strategies**

**41<sup>st</sup> Annual International Tax Conference**

January 13, 2023

Miami, FL

# Speakers

- Lawrence J. Chastang, CPA
- Daniel N. Price, Attorney
- Alfredo R. Tamayo, Attorney

# Disclaimer

These slides are shorthand aids to an oral presentation. Neither these slides nor the oral presentation constitute legal or tax advice.

# Agenda

- International Penalties Remain an IRS Priority
- Common Compliance Mistakes
- Penalty Strategies
- Hypotheticals
- Reference- Common International Information Returns and IRS.gov resources

# International Penalties Remain an IRS Priority

# International Penalties Remain an IRS Priority

- IRS is committed to international information return enforcement
- IRS continues to rely on Campus based systemic penalty assessments to generate revenue
  - Form 3520 and Form 3520-A enforcement by Ogden Campus
    - Systemically applied penalties without considering reasonable cause
    - High rate of campus errors and high abatement rates
  - Form 5471 and Form 5472 for business filers
    - Systemically applied penalties without considering reasonable cause
    - High abatement rates (stats published by TAS)

# International Penalties Remain an IRS Priority (cont'd)

- Examiners actively identify international penalty issues
- Specific leads may spark examinations focusing on international penalty issues
  - Whistleblowers
  - [Foreign Account Tax Compliance Act](#) (a.k.a. FATCA)
  - Inter-governmental cooperation
  - Legacy use of [Swiss Bank Program](#) data and leads resulting from new non-prosecution agreements with DOJ Tax Division
  - [LB&I Campaigns](#)
  - John Doe Summonses

# Common Compliance Mistakes



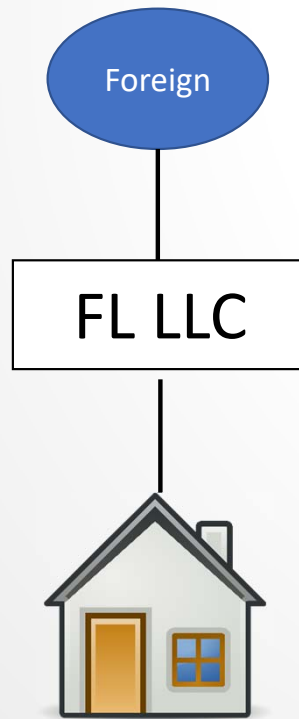
# Common Mistakes

- Form 5471 – Overlooking constructive ownership/attribution rules; mistaking foreign entity default rules; § 965 Transition Tax; not identifying all applicable filer categories; adjusting financials for GAAP
- Form 5472 – Failing to file pro-forma Form 1120 and Form 5472 for foreign owned domestic disregarded entity – *see next slide*
- Form 3520 – Failing to timely report large foreign gifts and inheritances; not disclosing U.S. owner of foreign trust; failure to disclose distributions from foreign trusts(e.g., uncompensated use of trust property, loans that are not qualified obligations)
- Form 3520-A – Failing to timely file because the deadline is not the same as the deadline for Form 1040 unless it is filed as a substitute Form 3520-A

# Common Mistakes (cont'd)

- Form 8938 – Failing to report less common foreign financial assets such as stock in foreign corporations, foreign pensions, promissory notes issued by foreign persons, interests in foreign estates
- Form 8854 – Long term permanent residents surrender green card triggering mark-to-market exit tax
- FBAR – Overlooking certain familial arrangements for foreign bank accounts where taxpayer either has authority over the account or is named as beneficial owner of the account
- Overlooking disaster relief extensions of time to file (Notice 2022-36 extended due to hurricanes)

# Common Pattern- LLC/Disregarded Entity Holding a House



# Form 5472 for Foreign-Owned DEs

1. A foreign owned U.S. disregarded entity (DE) must file Form 5472 for each year during which the foreign owned U.S. DE has reportable transactions with any related party.
2. A foreign-owned U.S. DE is treated as an entity separate from its owner and classified as a corporation under Treas. Reg. § 1.6038A-1(c)(1) for the limited purposes of the requirements under § 6038A
3. Initial penalty for failure to timely file: \$25,000 unless IRS agrees there is reasonable cause
4. Statute of limitation issues: I.R.C. § 6501(c)(8) holds open statute if no Form 5472 filed or is substantially incomplete

# Penalty Strategies

# Compliance Options for Taxpayers with International Information Return Issues

1. Streamlined Filing Compliance Procedures
  - Streamlined Foreign Offshore
  - Streamlined Domestic Offshore
2. Filing Amended/Delinquent Returns (a.k.a. “quiet disclosure”)
3. Prospective compliance (a.k.a. “silent disclosure”)
4. Delinquent FBAR Submission Procedures- still viable if fully tax compliant
5. Voluntary Disclosure Practice

# Typical Process for Systemic Penalties involving Forms 3520 and 3520-A

- Late filing of Form 3520/3520-A with reasonable cause statement
- Penalty assessed at maximum rates; Ogden ignores reasonable cause
- Ogden issues Penalty Notice CP15 “Notice of Penalty Charge”
- Appeal “Notice of Penalty Charge” within 30 days with reasonable cause
- **IRS Collection begins efforts to collect the assessed penalty**
- Ogden issues letter 2644C notifying it needs time to consider submission
- Ogden denies reasonable cause and issues a Letter 854C
- Appeal Letter 854C within 60 days for review by the Independent Office of Appeals (Appeals)
- Case enters queue for Appeals

# Eight Week Band-Aid

- File Form 656-L, Offer in Compromise Doubt as to Liability, asserting reasonable cause or IRS' failure to obtain supervisory approval of penalty
- Upon receipt of Form 656-L, IRS will implement a collection stay
- Collection stay is generally for eight weeks
- Form 656-L will be returned and not considered

Why consider if an Form 656-L is a known loser?

- Quick action to delay collection activity
- Point of contact for additional collection stays
- IRS OIC unit will forward to a "penalty appeal coordinator"



# Appeals Settlement Possibilities for International Penalties

- First Time Abate
- Reasonable cause
- § 6751(b)(1) supervisory approval
- Hazards of litigation
- Penalty mitigation

See generally IRM 8.11.1 "Return Related Penalties in Appeals"

# Policy Statement 8-47 at IRM 1.2.1.9.6

“Appeals will ordinarily give serious consideration to an offer to settle a tax controversy on a basis which fairly reflects the relative merits of the opposing views in the light of the hazards which would exist if the case were litigated. However, **no settlement will be made based upon nuisance value of the case to either party.** If the **taxpayer makes an unacceptable proposal** of settlement under circumstances indicating a good-faith attempt to reach an agreed disposition of the case on a basis fair both to the Government and the taxpayer, the Appeals official generally should give an **evaluation of the case in such a manner as to enable the taxpayer to ascertain the kind of settlement that would be recommended for acceptance. ...”**

# First Time Abate (FTA)

- For general information, see <https://www.irs.gov/payments/penalty-relief-due-to-first-time-abate-or-other-administrative-waiver>
- **General rule:** FTA does not apply to IIR penalties. IRM 8.11.5.1 (12) Note states: “The First Time Abatement (FTA) administrative waiver is not applicable to International Penalties addressed in IRM 8.11.5.”
- **Exception:** IRM 20.1.9.3.5(3) noted that if FTA is provided for the associated Form 1120 or Form 1065, then FTA may be provided for Form 5471 penalties if no similar penalties in the last three years and Form 1120/Form 1065 not filed late in the last three years.

# Reasonable Cause

- Generally all or nothing resolution
- Appeals often considers
  - Taxpayer compliance history
  - Length of time to come into compliance
- Appeals has favorite cases to cite and consider in nearly all reasonable cause disputes

## Reasonable Cause (cont'd)

- United States v. Boyle, 469 U.S. 241 (1985)
  - The timely filing of a tax return is not excused by the taxpayer's reliance on an agent
- Neonatology Assocs., P.A. v. Commissioner, 115 T.C. 43, 98–99 (2000), aff'd, 299 F.3d 221 (3d Cir. 2002)
  1. the advisor is competent
  2. the taxpayer provided necessary and accurate information to the advisor
  3. the taxpayer relied in good faith on the advisor

## Reasonable Cause (cont'd)

I.R.M. 20.1.1.3.2.2.6 (11-25-2011) provides the following factors to consider in the context of mistakes based on ignorance of the law:

(1) In some instances taxpayers may not be aware of specific obligations to file and/or pay taxes. The ordinary business care and prudence standard requires that taxpayers make reasonable efforts to determine their tax obligations. ...

# Reasonable Cause (cont'd)

I.R.M. 20.1.1.3.2.2.6(2) Reasonable cause may be established if the taxpayer shows ignorance of the law in conjunction with other facts and circumstances. For example, consider the following:

- a. The taxpayer's education.
- b. If the taxpayer has previously been subject to the tax.
- c. If the taxpayer has been penalized before.
- d. If there were recent changes in the tax forms or law which a taxpayer could not reasonably be expected to know.
- e. The level of complexity of a tax or compliance issue.

# Drafting Tips Reasonable Cause Statements

- Put effort into the abatement request: identify the issue, include all the facts, summarize the law and policy, and apply the law and policy to the facts
- Write the facts to fit into the theme of “reasonable cause” as developed by caselaw
- Humanize your client and tell a story
- Argue the equities and any other compelling facts to support your reasonable cause request
- Stacy Caplow, *Putting the “I” in Writing: Drafting an A/Effective Personal Statement to Tell a Winning Refugee Story*, 14 Legal Writing: J. Legal Writing Inst. 249 (2008).
  - Draft a moving personal account in the first person
  - Persuade a jaded decision maker to grant relief
  - Article has some good tips on writing a compelling story



## IRC § 6751(b)(1)

Confirm written supervisory approval of penalties.

IRC § 6751(b) states: "No penalty under this title shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the **immediate supervisor** of the individual making such determination or such higher level official as the Secretary may designate."

# IRC § 6751(b)(1) supervisory approval

- Generally all or nothing resolution
- Appeals Officers should verify timing of penalty approval by locating source document in administrative file
  - Not explicit but implicit at IRM 8.11.1.2.1
- For international information return penalties, locating source document may be difficult for Appeals
- Practitioner best practice- explicitly raise supervisory approval in protest

# IRC § 6751(b)(2)

Exceptions to written supervisory approval of penalties under IRC § 6751(b)(2):

(A) any addition to tax under section 6651, 6654, 6655, or 6662 (but only with respect to an addition to tax by reason of subsection (b)(9) thereof); or

(B) any other penalty **automatically calculated through electronic means**

- International information return (IIR) penalties are NOT automatically calculated. The IRS uses the term “systemically” in reference to campus imposed IIR penalties.

# FOIA to Optimize § 6751(b)(1) Presentation to Appeals

- As soon as you anticipate a penalty dispute, send the IRS a FOIA for § 6751(b)(1) documents to support written supervisory approval
- In context of IIRs that are campus assessed, highly likely that IRS will not produce actual record satisfying § 6751(b)(1)
- Appeal the FOIA production
- Appeals rubber stamps FOIA decisions without making independent analysis and without consulting representatives
- In the Appeals protest on the penalties, provide Appeals the records obtained in FOIA to make the Appeals Officer's job easier

# Freedom of Information Act Request Relating to IRC § 6751(b)

- Was supervisory approval documented in writing?
- Was supervisory approval timely?
- Was person who provided written approval a supervisor as required by the IRC?

# Sample FOIA Request – part 1

All documents and information underlying the penalty assessment for 20XX. This request includes but is not limited to the following:

1. All documents, including but not limited to workpapers, notes, case activity records, and the like relating to the penalty determination.
2. All documents relating to written supervisory approval of the penalty determination.
3. All documents and information identifying the person who made the “initial determination” of the penalty assessment for 20XX.
4. The complete “Discovery Directory” entry for the person who made the “initial determination” of the penalty assessment for 20XX.

# Sample FOIA Request – part 2

5. All documents and information establishing that the person who approved the penalty assessment for 20XX was a supervisor. To this end, please provide documents establishing that the penalty was approved by an actual supervisor or acting supervisor. If an acting supervisor approved the penalty, please provide a copy of the document delegating acting supervisor/manager status.
6. All documents indicating that the person who approved (in writing) the penalty assessment for 20XX was a “team lead,” “work lead,” “WRKLDR” and the like.
7. The complete “Discovery Directory” entry for the person who approved (in writing) the penalty assessment for 20XX.
8. If not provided in response to an earlier request, all other documents relating to the Taxpayer for tax year 20XX, including internal documents, memoranda, case activity records, written reports and recommendations, emails, and any other information.


# Where to send FOIA Request

- Best to use FOIA portal or fax to 877-891-6035  
<https://www.irs.gov/privacy-disclosure/freedom-of-information-act-foia-guidelines>
- See <https://www.irs.gov/privacy-disclosure/freedom-of-information-act-foia-guidelines> for general information on filing FOIA requests and appealing IRS responses
- If no acknowledgement within 30 days, contact IRS FOIA Public Liaison at 312-292-3297



# Sample Page from FOIA Response

Navigation

 **Correspondence Imaging System** [? Help](#) [X Logoff](#)

**Case Notes** Case Assigned To: 0433972885  
Case ID: [REDACTED]

Case Notes

[Return to Case](#)

Note Description	Employee	Date
Case closed	0433972885	2021/02/25
Approved to assess F3520 [REDACTED] civil penalty per IRM 21.8.2.19.2, ME, Manager	0433084679	2021/02/11
3520 penalty per IRM 21.8.2.19.2 659 for [REDACTED]	0433972885	2021/02/09
Case marked as statute searched	0433972885	2021/02/09
2MGR command executed by user.	0433972885	2021/02/09
Case Assigned from 0436000005 to 0433972885	0433548082	2021/02/05
Case Assigned	SYSTEM	2019/12/27

# Questions Raised by FOIA Response

Note Description	Employee	Date
Case closed	0433972885	2021/02/25
Approved to assess F3520 [REDACTED] civil penalty per IRM 21.8.2.19.2, ME, Manager	0433084679	2021/02/11
3520 penalty per IRM 21.8.2.19.2 659 for [REDACTED]	0433972885	2021/02/09

- Who approved the penalty?
  - What are the names of the employees involved?
  - What positions with IRS do they hold?
  - Is the “manager” actually a supervisor?
  - Where are the documents underlying the assessment?

# Hazards of Litigation

- IRM 8.11.1.2.7.5 states:
  - (4) The hazards of litigation are the uncertainties of the outcome of the court's decision in the event of a trial.
  - (5) Litigating hazards generally fall into three categories: factual, legal and evidentiary.

Note: Lack of case law should not be considered a hazard of litigation.
- Factual hazards- salient facts are unclear as to whether the taxpayer meets reasonable cause. Examples:
  - Taxpayer claims he was ill at the time a return was due but the facts are inconclusive
  - Taxpayer filed a return 10 days late and the facts are inconclusive regarding whether he timely postmarked his filing.
- Legal hazards- status of case law, law of circuit, etc.
- Evidentiary hazards- (admissibility, willingness/availability of witnesses)

# Hazards of Litigation - Wrzesinski

- Recently filed refund case after Appeals offered a hazards of litigation settlement for a case that appears to have textbook reasonable cause for late reporting of foreign gifts
- Taxpayer received \$800,000 in gifts from mom in Poland after mom hit the Polish lottery. Gift made in 4 transfers in 2010 and 2011.
- Taxpayer relied on EA's advice that gift was not taxable or reportable
- Later discovered requirement to report on Form 3520 and used DIIR to file late Forms 3520
- IRS assessed maximum penalties
- Appeals abated \$70,000 of the \$87,000 penalty assessed for tax year 2010 and \$96,000 of the \$120,000 penalty assessed for tax year 2011
  - 2010 abatement ratio was 80.4% abated v. 19.6% sustained
  - 2011 abatement ratio was 80% abated v. 20% sustained

# The Mystery of Mitigation in Appeals

- Tax Analysts made a FOIA request to the IRS on Appeals' training material on international penalties
- FOIA production shed light on trend observed by practitioners
- **How do I get this Appeals' training material?** See Tax Analysts 2022 TNTF 193-30 (Tax Notes > advanced search > primary source citation) for 367 pages of material released by the IRS. Also hyperlinked in Andrew Velarde's Oct. 6, 2022 article "IRS Appeals Training Materials on Reasonable Cause Bring Worry"

# The Mitigation Trend Observed

- Practitioners have observed Appeals International forcing taxpayers with reasonable cause or highly sympathetic facts to eat 25-40% of assessed penalties in settlements
- Product of Appeals' "review and concurrence" process for certain issues
  - See IRM 8.7.3.4.1 Review and Concurrence
  - Issue coordinators insulated from taxpayer contact, may be overconfident in government's position, or simply jaded
  - When issue coordinators don't approve reasonable cause, Appeals Officers are left with mitigation

# Penalty Mitigation

- Formally adopted in FBAR context by Exam – IRM Exhibit 4.26.16-2
- Minimal or no hazards
- Extenuating circumstances exist
- According to Appeals penalty training material: “Mitigation is available but should be used sparingly.”

# Foundation for Mitigation

- Application of macro-level penalty policy to reduce the severity of the penalty
- IRM 20.1.1.2.1 “Encouraging Voluntary Compliance”

IRM 20.1.1.2.1 (8) The IRS has the obligation to advance the fairness and effectiveness of the tax system. Penalties should do the following:

- Be **severe enough to deter noncompliance**,
- Encourage noncompliant taxpayers to comply,
- Be objectively proportioned to the offense, and
- Be used as an opportunity to educate taxpayers and encourage their future compliance.



## Foundation for Mitigation (cont'd)

- IRM 20.1.1.1.4 - Every function in the IRS has a role in proper penalty administration. It is essential that each function conduct its operations with an emphasis on promoting voluntary compliance. Appropriate business reviews should be conducted to ensure consistency with the penalty policy statement and philosophy
- Policy Statement P-1-18 to enhance voluntary compliance

# Mitigation Statement in Appeals' Training Material

“With respect to these automatic penalties [Form 5471 and Form 5472], there is no prior function that has exercised any independent judgment or assessment made with respect to the applied penalties (unlike field cases such as FBAR where the dollar amount of penalty is carefully considered and for which the IRM provides Exam only the function of mitigation). As a result, it is appropriate for Appeals to incorporate penalty policy in resolutions to ensure that the proposed penalty enhances voluntary compliance and is in accordance with the IRM.”

# Mitigation Hypothetical

Alpha Corp is a small family owned company with some manufacturing operations in Mexico, Alpha Corp relied on a CPA tax preparer to file its tax return extension. Due to a software glitch and oversight of an employee of the CPA firm not noticing the glitch, the electronic extension form was not received by the IRS. The staff at Alpha Corp was not aware of this problem. In fact, they received correspondence from the CPA firm which assured them that the appropriate extension had been filed. Ultimately, Alpha Corp was assessed \$100,000 for 10 delinquent Forms 5471 relating to the operating CFCs in Mexico. Alpha Corp has never been delinquent in filing returns or extensions in the past. Further, the delinquent return was filed within the extension period. Alpha Corp contested the Form 5471 penalties, but the IRS Campus group that considered the abatement request did not grant first time abatement or reasonable cause.

# Mitigation Applied to Hypo

- Appeals would likely mitigate the penalty to 25% to 30% of the assessed penalty, but is that the right answer under the IRS' penalty policy?
- Appeals' Official Training - "**This is not a tool to give the house away!**" – quote from Appeals training material (2022 TNTF 193-30 see slide 36)
- Observed Appeals abatement ranging from 60-80%
- Result: Offering taxpayers settlement requiring taxpayer to pay 20%-40% of penalty assessment
- Use of mitigation theory sidesteps the issue of disfavored nuisance settlements

# Appeals Offers Your Client Mitigation

- You've established reasonable cause, the Appeals Officer hinted that you established reasonable cause, and then after "review and concurrence" the Appeals Officer offers a mitigated penalty. Is it game over?
- Ask for a managerial conference to elevate the disagreement over mitigation
- Managerial conferences in Appeals are discretionary
- See IRM 8.7.3.4.1 about review and concurrence: "If the settlement is not acceptable [to the reviewer], provides a written response (rebuttal) to the Appeals Officer. If agreement is not reached, the respective managers attempt to resolve the dispute. If the Appeals Team Managers (ATMs) cannot resolve the dispute, the ATMs will refer it to ..."
  - Key - beg to get the ATM involved to push back against the reviewer

# Litigation – The Last Resort

- Appeals' unreasonableness on IIRs is forcing more taxpayers into costly district court litigation
  - Pay penalty
  - Request penalty to be refunded (Form 843)
  - Sue for refund
- Issues to consider
  - Liquidity issues to pay penalty
  - Costs of litigation
  - Malpractice claim against CPA and tolling agreement
  - Public record of litigation (especially for Form 3520 penalties, transactions indicating wealth will become known publicly and may jeopardize family members' safety)

# Proposal for the IRS: A Better Approach to Late IIR Penalties

- IRS should formalize penalty relief for all taxpayers who timely filed their income tax returns who submit delinquent IIRs.
- So long as the taxpayers are not under civil examination or criminal investigation the IRS should allow penalty-free late IIR filings.
- Implementing a policy analogous to qualified amended returns in the IIR realm will promote voluntary compliance in correcting past compliance issues relating to IIRs.
- The Commissioner has inherent authority under IRC § 7803 to exercise this type of discretion and implement a penalty policy that incentivizes compliance.
- **What can you do?** Write to the IRS Commissioner on your firm letterhead and CPA/Bar association letterhead requesting a change in penalty administration.

# Hypotheticals



# Foreign Retirement Account

- Mr. Smith, a UK citizen, retired a few years ago. During his working years, he had a modest pension by an employer and later rolled that pension into a self-invested personal pension (SIPP) in the UK. He contributed additional funds to the SIPP beyond the rollover. The SIPP mainly holds foreign mutual funds. Mr. Smith is eligible to take distributions from his SIPP based on his age. The U.K. SIPP just barely exceeds the limits provided for in IRS Rev. Proc. 2020-17 to avoid reporting the SIPP as a foreign trust under IRC sec. 6048.
- Upon retiring, Mr. Smith began volunteering his time with a multi-national non-profit. The non-profit asked him to temporarily move to the U.S. to assist with a project. Mr. Smith arrived in the U.S. and continued volunteering with the non-profit. Mr. Smith became a U.S. person in 2018 as a result of the substantial presence test.
- In 2018, 2019, and 2020 Mr. Smith used what he thought was a qualified and competent tax return preparer to file his Forms 1040. Mr. Smith's return preparer reported his SIPP on Forms 8938 and on FBARs but failed to identify the SIPP as a foreign grantor trust and failed to file Forms 3520 and 3520-A for Mr. Smith.
- Mr. Smith engaged new tax professionals for 2021. While the extended due date for his 2021 return approached, his new professionals identified the UK SIPP reporting issue.
- **What are Mr. Smith's reporting obligations and compliance options?**

# Foreign Gift

- Sammy is from a foreign country and attended university at UCLA. Sammy graduated UCLA, got a job in LA, and obtained a green card. Sammy is about to get married and really wants a house to start a family.
- Mom is a non-US person foreign national and wants to help Sammy and her future daughter-in-law. Mom contacts a U.S. attorney who advises her to form a trust that holds a Nevada single member LLC.
- Mom gives \$2 million to the trust which is classified as a domestic non-grantor trust for U.S. Federal tax purposes. Then, trust forms a Nevada LLC. The Nevada LLC buys a small house in the LA area. Mom also gives \$500,000 directly to Sammy.
- Mom gives all paperwork for the trust, the LLC, and the LLC's bank account to her CPA. Mom discloses her gift to Sammy. CPA prepares the trust's Form 1041 and a Form 1040 for Sammy. CPA reports Mom's direct gift to Sammy on Form 3520 but doesn't report Mom's transfer of \$2 million to the trust.
- **What are the reporting obligations and compliance options in this matter?**

# Recent Arrivals to the U.S.

- Eduardo and Camila were both born and raised in Venezuela. While living and working in Venezuela, Eduardo established a revocable Cayman Islands trust (“Trust”) in 2010 for succession planning purposes; the trust was administered by a professional Cayman Islands trust company (“Trustee”). The Trust established a Cayman Islands company (“Cayco”) to hold and administer the assets that Eduardo transferred to the Trust, U.S. investment accounts.
- Eduardo and Camila moved to Florida and became resident aliens as of January 1, 2018. After moving to Florida, Eduardo and Camila continued to own Venezuelan properties, Venezuelan bank accounts, personal U.S. bank and investment accounts, as well as the Trust and Cayco.
- Eduardo and Camila used Sebastian to prepare their Federal income tax return. Sebastian is not a CPA or enrolled agent but has been preparing individual returns for many years. Eduardo and Camila used Sebastian because he was recommended by a friend and he is bilingual (they prefer to communicate about technical matters in Spanish).
- Sebastian prepared Eduardo’s and Camila’s 2018 Federal income tax return reporting U.S.-sourced income.
- In 2019, and after they filed their 2018 U.S. Federal income tax return, Eduardo and Camila first became aware of potential U.S. tax reporting associated with the Trust after Eduardo and Camila spoke with the Trustee about their move to Florida.
- Eduardo and Camila filed delinquent 2018 Forms 3520 and 3520-A that Sebastian prepared in coordination with the Trustee. Upset about not being informed about Form 3520 and 3520-A, Eduardo and Camila retained another accountant to prepare their 2019 and subsequent Federal tax returns. Their 2019 – 2021 U.S. Federal tax returns have been timely and correctly filed. Eduardo and Camila’s new accountant believes their 2018 U.S. Federal income tax return needs to be amended to include information returns.
- What are the 2018 U.S. Federal tax and reporting obligations of Eduardo and Camila and are there any options available to deal with any non-compliance not already addressed? What can be done about the 2018 Form 3520 and 3520-A penalties?

# Creative Caribbean Attorney

- Ms. Jones (a U.S. citizen) is about to receive \$1 million from the estate of her late mother (non-US person foreign national). The estate is being administered in a foreign country. Ms. Jones wants to protect and hide this money from her boyfriend who has a gambling addiction.
- Ms. Jones directs the foreign estate to wire the inheritance to a client trust account of an attorney in a Caribbean jurisdiction. Ms. Jones asks the attorney to hold the funds for her benefit, and, if she dies, to hold the funds for the benefit of her niece.
- The attorney agrees to charge one-time setup fee and a small fee each year to hold the funds. The funds will be in an interest bearing account in the name of the law firm, and all interest will be credited to Ms. Jones' client account.
- The engagement letter says the funds are the proceeds of a loan and are held in anticipation of Ms. Jones making a foreign investment and that the attorney will advise Ms. Jones of possible investment opportunities.
- Ms. Jones doesn't tell her CPA return preparer about the arrangement, and it is not reported.
- **What are Ms. Jones' reporting obligations and compliance options?**

# “Borderless” Account

- Sarah is a digital nomad. She’s an influencer and consults on web design around the world.
- Sarah opens a borderless “account” with a fintech company named Smart. Smart is not a bank; it’s a money transmitter registered with FinCEN. The account gives her a debit card that allows her to spend in various currencies and receive funds in various currencies. Sarah can add funds to her debit card by transferring from her personal bank accounts or by receiving payments in currencies accepted by Smart. Sarah especially likes being able to be paid instantly as she travels and performs consulting services for businesses across the globe. And Smart allows her to have funds in her account in multiple currencies and move funds from one currency to another.
- What are Sarah’s reporting obligations relating to her Smart account?

For Reference – Some  
Common International  
Information Returns,  
Penalties, and Resources

Form	Code Section	Potential penalties*
<b>Form 926</b> (Return by a U.S. Transferor of Property to a Foreign Corporation)	6038B(c)	10% of the FMV of property transferred to foreign corporation (max. \$100,000)
<b>Form 3520-A</b> (Annual Information Return of Foreign Trust with a U.S. owner)	6677(b)	The greater of \$10,000 or 5% of the gross value of U.S. person's portion of foreign trust assets (measured as of the close of the U.S. person's tax year)
<b>Form 3520</b> (Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts)	6677 6039F	Up to four penalties may apply. <ul style="list-style-type: none"> <li>• For trust contributions, ownership, or distributions, a separate penalty applies for failure to timely report each transaction. Each penalty is equal to the greater of \$10,000 or (1) 35% of the trust contribution, (2) 5% of the gross value of U.S. person's portion trust assets (at close of U.S. person's tax year), or (3) 35% of the trust distribution</li> <li>• For failure to timely report a foreign gift/bequest, a maximum penalty equal to 25% of the FMV of the foreign gift/bequest may apply</li> </ul>
<b>Form 5471</b> (Information Return of U.S. Persons with Respect to Certain Foreign Corporations)	6038	\$10,000 per form
<b>Form 5472</b> (Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in U.S. Trade or Business)	6038A	\$25,000 per form
<b>Form 5713</b> (International Boycott Report)	999	\$25,000, maximum 1 year imprisonment, or both for willful failure to report
<b>Form 8621</b> (Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund)	6501(c)(8)	Statute of limitations for tax year remains open until 3 years after form is filed

\* Additional/increased penalties may apply for intentional disregard of reporting requirements and/or continued noncompliance. The statute of limitations may also remain open indefinitely for failure to file the appropriate form (see Section 6501(c)(8))

Form	Code Section	Potential penalties*
<b>Form 8854</b> (Initial Expatriation Statement)	877A, 6039G	\$10,000 per failure and potential treatment as “covered expatriate” subject to U.S. exit tax
<b>Form 8858</b> (Information Return of U.S. Persons with respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs))	6038(b)	Form 5471, Category 4/5 filers Form 8865, Category 1/2 filers
<b>Form 8865</b> (Return of U.S. Persons with Respect to Certain Foreign Partnerships)	6038(b), 6038B(c), 6046A/6679	Multiple penalties may apply: <ul style="list-style-type: none"> <li>• \$10,000 per failure Category 1, 2, and 4</li> <li>• 10% of FMV of property transferred (capped at \$100,000) per Category 3 failure</li> </ul>
<b>Form 8938</b> (Statement of Specified Foreign Financial Assets)	6038D(d)	\$10,000 per form
<b>Form 8992</b> (U.S. Shareholder Calculation of Global Intangible Low-Taxed Income)	6038(b); Treas. Reg. 1.6038-5	\$10,000 per form
<b>FBAR</b>	31 USC 5321	<ul style="list-style-type: none"> <li>• Up to \$14,489 (after 1/24/2022) for “non-willful” violations</li> <li>• Up to the greater of \$144,886 (after 1/24/2022) or 50% of account balances, plus potential criminal penalties, for “willful” violations</li> </ul>
<b>Section 6662(j): Penalty of 40% of underpayment attributable to transaction involving undisclosed asset under Section 6038, 6038B, 6038D, 6046A, or 6048</b>		

\* Additional/increased penalties may apply for intentional disregard of reporting requirements and/or continued noncompliance. The statute of limitations may also remain open indefinitely for failure to file the appropriate form (see Section 6501(c)(8))



# IRS.GOV resources

Form	IRS.gov resource
Form 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations	<a href="https://www.irs.gov/forms-pubs/about-form-5471">https://www.irs.gov/forms-pubs/about-form-5471</a>
Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business	<a href="https://www.irs.gov/forms-pubs/about-form-5472">https://www.irs.gov/forms-pubs/about-form-5472</a>
Form 8858, Information Return of U.S. Persons With Respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs)	<a href="https://www.irs.gov/forms-pubs/about-form-8858">https://www.irs.gov/forms-pubs/about-form-8858</a>
Form 8938, Statement of Specified Foreign Financial Assets	<a href="https://www.irs.gov/forms-pubs/about-form-8938">https://www.irs.gov/forms-pubs/about-form-8938</a>
Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts	<a href="https://www.irs.gov/businesses/gifts-from-foreign-person">https://www.irs.gov/businesses/gifts-from-foreign-person</a>

# IRS.GOV Resources (cont'd)

Form	IRS.gov resource
Form 3520-A, Annual Information Return of Foreign Trust With a U.S. Owner	<a href="https://www.irs.gov/forms-pubs/about-form-3520-a">https://www.irs.gov/forms-pubs/about-form-3520-a</a>
Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts	<a href="https://www.irs.gov/forms-pubs/about-form-3520">https://www.irs.gov/forms-pubs/about-form-3520</a>
Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts	<a href="https://www.irs.gov/forms-pubs/about-form-3520">https://www.irs.gov/forms-pubs/about-form-3520</a>
FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR)	<a href="https://www.irs.gov/businesses/small-businesses-self-employed/report-of-foreign-bank-and-financial-accounts-fbar">https://www.irs.gov/businesses/small-businesses-self-employed/report-of-foreign-bank-and-financial-accounts-fbar</a>