



March 26, 2013

Mr. Steven Miller
Acting Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Mr. Steven Musher
Associate Chief Counsel (International)
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

RE: Recommendations – Automatic Penalties Assessments Policy with the Late Filing of Form 5471

Dear Messrs. Miller, Wilkins, and Musher:

The American Institute of Certified Public Accountants (AICPA) respectfully submits recommendations regarding the administration by the Internal Revenue Service (IRS) of the penalty provision applicable to Form 5471, Information Return of U.S. Persons with Respect to Certain Foreign Corporations.¹ Our recommendations focus on the need for relief from automatic penalties assessed upon the late filing of Form 5471 in order to promote the fair and efficient administration of the international penalty provisions of the Internal Revenue Code (IRC).² These recommendations were developed by the AICPA Subpart F Task Force of the International Taxation Technical Resource Panel and approved by the Tax Executive Committee.

The AICPA is the world's largest member association representing the accounting profession, with nearly 386,000 members in 128 countries and a 125-year heritage of servicing the public interest. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

¹ All references to Form 5471 in this letter refer to the form issued in December 2012.

² All references in this letter to the Internal Revenue Code are to the Internal Revenue Code of 1986, as amended.

Background & AICPA's Concerns

On January 1, 2009, the IRS began imposing an automatic penalty of \$10,000 for each Form 5471 filed with a delinquent Form 1120 series return.³ When imposing the penalty on corporations in particular, the IRS does not distinguish between: a) large public multinational companies; b) small companies, and (c) companies that may only have insignificant overseas operations, or loss companies.⁴ This one-size-fits-all approach inadvertently places undue hardship on smaller corporations that do not have the same financial resources as larger corporations.

Until February 2007, when the instructions to Form 5471 were revised, two copies of Form 5471 were required to be filed with the IRS (one with the U.S. taxpayer's federal income tax return; and a stand-alone copy with the IRS Service Center in Philadelphia). The revised instructions specify that Form 5471 is only to be filed along with the U.S. taxpayer's federal income tax return (e.g., the Form 1120, U.S. Corporation Income Tax Return) with no separately-filed copy. While this change reduces administrative filing responsibilities, it creates an unintended hardship in certain circumstances for timely filing Form 5471.

Taxpayers may experience situations where they have exercised ordinary business care and prudence but due to circumstances outside of their control, a misunderstanding of the complex area of international tax law, or an inadvertent error, the Form 1120 and related attachments, including any Forms 5471, may not be timely filed. In these circumstances, the Internal Revenue Manual (IRM) Failure to File – Form 5471 Decision Tree⁵ denies reasonable cause abatement in nearly all circumstances except where reasonable cause can be established for failure to timely file Form 1120. These difficulties have become more prevalent as many taxpayers continue to expand their operations outside of the U.S. In many of these cases, taxpayers would be eligible for reasonable cause relief from penalties, including the \$10,000 section 6038 penalty for failure to timely file correct Forms 5471 when required.

The amount of the penalty is significant, and automatically imposed in the same amount, regardless of the size of the U.S. taxpayer or foreign corporation, the reason for the late filing of Form 5471,⁶ or any other factor. For taxpayers who inadvertently violate the

³ Per IRM subsection 21.8.2.21.2 the automatic penalty only applies to the 1120 series of returns.

⁴ For this purpose, we consider "loss companies" as those entities for which transactions reported on the Form(s) 5471 would have no impact on U.S. taxable income either because the U.S. company has a net operating loss position or because the foreign company has no activity that would be currently subject to U.S. taxation.

⁵ IRM 21.8.2.21, Exhibit 21.8.2-1.

⁶ Section 6038(b)(1) provides that a \$10,000 penalty shall apply for each annual accounting period for which the taxpayer has failed to timely file a Form 5471. Note that a Form 5471 is not late to the extent reasonable cause exists for the failure to timely file as per section 6038(c)(4)(B). Also, Treas. Reg. § 1.6038-1(k)(3) provides that reasonable cause may be available to avoid the penalty.

rules, the cost and burden to correct the mistake can be overwhelming, especially for small businesses.

While taxpayers are entitled to appeal the imposition of the penalty, the process is difficult and costly. The process poses a significant burden on many small taxpayers in particular. Additionally, IRS notices cause unnecessary taxpayer confusion. Although a taxpayer is no longer required to pre-pay the penalty prior to appeal,⁷ current penalty notices improperly state that a taxpayer may not appeal the assessment until full payment of the penalty is made.⁸

There are certain situations where a taxpayer who did not file Form 5471 is treated more favorably than a taxpayer who filed Form 5471, albeit untimely. The 2009 Offshore Voluntary Disclosure Initiative (OVDI) provided penalty relief for certain taxpayers with respect to delinquent Forms 5471.⁹ In the frequently asked questions and answers (FAQ) guidance to the OVDI, FAQ #18 provided relief from penalties imposed on delinquent international information returns, such as Forms 5471 and 5472, if the taxpayer had no underreported tax liabilities with respect to the delinquent form.¹⁰ Beginning in 2011, a new OVDI became available and on January 9, 2012, the IRS announced a permanent offshore voluntary disclosure program. Both the 2011 and permanent offshore voluntary disclosure programs contained FAQ #18 penalty relief for foreign information returns nearly identical to the FAQ #18 relief available in the 2009 OVDI.¹¹

FAQ #18 penalty relief applies in situations where a taxpayer filed income tax returns but failed to attach the Form 5471. However, in cases where the penalty is assessed because a Form 5471 was attached to a late-filed Form 1120, even where the taxpayer was under the mistaken belief that the Form 1120 was filed timely, the taxpayer is not eligible for relief under FAQ #18. The difference in rules creates a situation where a taxpayer who did not file Form 5471 is treated more favorably than a taxpayer who filed its return, including Form 5471, albeit untimely. This lack of consistency in application of the penalty relief policy undermines taxpayer's confidence in the penalty system and does not encourage voluntary compliance with the tax laws.

⁷ IRM 20.1.9.1.1(5) revised April 22, 2011, available at http://www.irs.gov/irm/part20/irm_20-001-009.html and IRM 8.11.5 revised August 27, 2010, available at http://www.irs.gov/irm/part8/irm_08-011-005.html.

⁸ IRM Exhibit 20.1.9-17, available at http://www.irs.gov/irm/part20/irm_20-001-009-cont02.html.

⁹ The 2009 OVDI program ended on October 15, 2009.

¹⁰ The 2011 OVDI ended for voluntary disclosures received by the IRS after September 9, 2011.

¹¹ OVDI FAQ available at <http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers>.

Recommendations

The AICPA believes that in many cases the severity of automatically assessing the steep penalty upon the late filing of Form 5471 is disproportionate to the information reporting error or omission. In the interest of sound administration, we urge the IRS and Department of the Treasury (Treasury) to consider penalty relief in this area – particularly for small businesses and loss companies. Specifically, we offer the following recommendations:

- A) In lieu of automatic assertion of the penalty, provide 30 days from the date the IRS provides written notice to the taxpayer, for an entity to make a request for reasonable cause relief.
- B) Promulgate regulations or administrative guidance to provide an automatic six-month extension of time to file Form 5471, similar to the automatic six-month extension provision set forth in Treas. Reg. § 301.9100-2(b). Treas. Reg. § 301.9100-2(b) grants an automatic extension of six months from the due date of a return, excluding extension, to file a statutory or regulatory election the due dates of which are the due date of the return including extension. By allowing Forms 5471 to be filed with an amended federal income tax return, filed after the original due date, but before the extended due date would benefit diligent taxpayers who timely file their returns but discover shortly thereafter an inadvertent omission of Form(s) 5471. Forms 5471 filed pursuant to the automatic six-month extension provision would not be subject to delinquency penalties under section 6038.
- C) Amend official guidance to provide permanent relief similar to the relief provided in FAQ #18 of the current offshore voluntary disclosure program.
- D) Ensure requests for reasonable cause relief are given consistent and adequate consideration upon initial submission to the IRS.
- E) Provide consistent administration of reasonable cause relief based on all stated facts and circumstances. Provide guidance that applies the principles espoused in *U.S. v. Boyle*,¹² CCA200748006,¹³ and other court opinions as well as previously issued informal guidance and information in the IRM.¹⁴

¹² 105 section 687 (1985). See Chief Counsel Advice 200748006, 2007 WL 4217452 (IRS CCA) providing that guidance provided with respect to reasonable cause relief under section 6651 (the subject of *Boyle*) is equally applicable to reasonable cause relief under section 6038(c)(4) (the reasonable cause relief section applicable for late filing of Form(s) 5471).

¹³ [CCA 200748006 -- Code sec\(s\). 6038, 11/30/2007.](#)

¹⁴ The IRM provides a decision tree (Exhibit 21.8.2-1- Failure to File - Form 5471 Decision Tree) to aid the IRS in consistently applying reasonable cause relief to all taxpayers. However, the decision tree is contrary to published court opinions. Compare *Boyle* at 692 with question 7(e) of the reliance section of the decision tree regarding requesting a second opinion. See http://www.irs.gov/irm/part21/irm_21-008-002r-cont02.html#d0e11994.

- F) Redraft Treas. Reg. § 1.6038-2(j)(2) and (3) to conform with the instructions to Form 5471 clarifying that a U.S. shareholder who qualifies as a Category 4 or Category 5 filer of Form 5471 is not required to file a statement with the U.S. shareholder's own tax return where both of the following conditions are met: (1) ownership in the foreign corporation is solely through application of constructive ownership principles; and (2) the U.S. person through which the U.S. shareholder constructively owns an interest in the foreign corporation files Form 5471 reporting all required information.

Currently, Treas. Reg. § 1.6038-2(j)(2) and (3) provide a constructive ownership exception but require Category 4 filers to attach a statement to their tax returns disclosing reliance on the constructive ownership exception. A similar exception is contained in Treas. Reg. § 1.6038-2(l) in cases where the constructive ownership is attributed to a nonresident alien. The instructions to Form 5471 provide the same constructive ownership exception for Category 4 filers (and in the 2012 Form 5471 instructions, for Category 5 filers) but do not include the requirement for the constructive owner to attach a statement to its own return disclosing reliance on the exception. We commend the IRS for recently extending the constructive ownership exception to Category 5 filers, in the instructions to the 2012 Form 5471. Likewise, it should be clarified that for tax years before 2012, the constructive ownership exception in the instructions to Form 5471 should be extended to all Category 5 filers where ownership in the foreign corporation is solely through application of constructive ownership principles and the U.S. person through whom the U.S. shareholder constructively owns an interest in the foreign corporation files Form 5471 reporting all required information. Furthermore, Treas. Reg. § 1.6038-2(j)(2) and (3) should be redrafted to conform with the instructions to Form 5471 (revised December 2012) to clarify that a U.S. shareholder that qualifies as a Category 4 or Category 5 filer of Form 5471 is not required to file a statement with the U.S. shareholder's own tax return where ownership in the foreign corporation is solely through application of constructive ownership principles and the U.S. person through which the US shareholder constructively owns an interest in the foreign corporation files Form 5471 reporting all required information.

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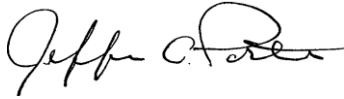
We appreciate your consideration of our recommendations, and welcome further discussion. If you have any questions, please contact Douglas Poms, Chair of the Subpart F Task Force, at (202) 533-5510, or dpoms@kpmg.com; Christine Ballard, Chair of the International Taxation Technical Resource Panel, at (703) 970-0424, or Christine.ballard@dhgllp.com; or Kristin Esposito, AICPA Technical Manager, at (202) 434-9241, or kesposito@aicpa.org.

Messrs. Miller, Wilkins, and Musher

March 26, 2013

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Sincerely,

A handwritten signature in black ink, appearing to read "Jeffrey A. Porter". The signature is fluid and cursive, with a large initial "J" and a long, sweeping underline.

Jeffrey A. Porter, CPA

Chair, Tax Executive Committee

cc: Michael Danilack, Deputy Commissioner (International) IRS Large Business and
International Division

Paul DeNard, Deputy Commissioner (Operations) IRS Large Business and
International Division