

**POINTS TO REMEMBER**

**Taxpayers Facing Large Penalties for Late-Filed Forms 5471 and 5472**

By Michelle Marion\*

Many corporate taxpayers with international affiliates have been getting nasty surprises from the Internal Revenue Service. Failure to timely file certain international information returns triggers penalty assessments at \$10,000 per form. Because some corporations must file dozens of these forms, hundreds of thousands of dollars in penalty assessments can stack up quickly. In this article, I briefly outline penalty relief available to taxpayers faced with these penalties.

**Background**

Certain U.S. and foreign persons are subject to special international information reporting requirements. Specifically, these taxpayers must gather and report information concerning their foreign affiliates on a number of forms, including Form 5471, *Information Return of U.S. Persons With Respect To Certain Foreign Corporations*, and Form 5472, *Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business*. The annual deadline for filing both Form 5471 and Form 5472 is the due date of a taxpayer's income tax return (including extensions).

Form 5471 must be filed by certain U.S. citizens and residents who are officers, directors, or shareholders in foreign corporations—including individuals, corporations, partnerships, and trusts. The Service uses Form 5471 primarily to collect information on foreign corporations with substantial U.S. ownership or control. A taxpayer must attach a separate Form 5471 to its income tax return for each foreign corporation with which the taxpayer maintains the requisite relationship. Form 5472 must be filed by foreign-owned U.S. corporations and foreign corporations with U.S. trades or businesses under certain circumstances. A taxpayer must attach to its income tax return a separate Form 5472 for each related party (foreign or domestic) with which the taxpayer engaged in certain transactions during the taxable year. For example, a taxpayer must state on Form 5472 whether it imported goods from a related party and, if so, whether the basis or inventory cost of the imported goods was greater than their customs value.

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\* KPMG LLP, Boston, MA. The views and opinions are those of the author and do not necessarily represent the views of KPMG LLP. KPMG LLP does not provide legal services.

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## Automatic Penalties for Failure to Timely File Forms 5471 or 5472

When a corporation files an untimely Form 5471 or Form 5472, Internal Revenue Service Center computers automatically assess a \$10,000 penalty per form. The Service also automatically assesses the penalty on untimely Forms 5471 that are attached to late-filed partnership returns. Taxpayers have been told the Service plans to roll out the automated penalty procedures to other types of taxpayers (e.g., individuals), but so far it has limited these procedures to corporations and partnerships. Additional penalties for insufficient information may be assessed on examination.

The Service will abate the automatic penalties under certain circumstances. For instance, if a taxpayer establishes reasonable cause for its failure to timely file, the Service must abate the penalty. The term “reasonable cause” is not defined in the Code or in the regulations applicable to Form 5471 penalties. Reasonable cause generally means that a taxpayer exercised ordinary business care and prudence but nevertheless failed to comply with its tax obligations.

The regulations applicable to Form 5472 penalties contain some guidance on the reasonable cause standard. Specifically, the regulations provide that reasonable cause may include an honest misunderstanding of fact or law that is reasonable considering the taxpayer’s knowledge and experience. The regulations further state that “[r]eliance on an information return, professional advice or other facts... constitutes reasonable cause and good faith, if under all the circumstances, the reliance was reasonable.” For example, a corporation may establish reasonable cause for failure to timely file Form 5472 if the corporation lacked knowledge and reason to know that it was owned by a

25% foreign shareholder and its belief was consistent with other information reported, furnished, or known to the corporation.

Additionally, taxpayers may qualify for automatic penalty relief associated with the 2012 Offshore Voluntary Disclosure Program (2012 OVDP). As applicable here, Frequently Asked Question 18

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(FAQ 18) of the 2012 OVDP states that the Service will not impose a penalty for the failure to timely file international information returns (e.g., Form 5471 and Form 5472) if the taxpayer has no underreported tax liabilities from related transactions and the Service has not already requested the delinquent forms. FAQ 18 advises taxpayers to submit delinquent Forms 5471 or Forms 5472 on an amended return together with a statement explaining why the forms are late. Reasonable cause is not required. The Service now says FAQ 18 relief is not available to taxpayers under examination, but taxpayers are pushing back on that assertion.

In my experience, the Service is less inclined to grant penalty relief under FAQ 18 when a taxpayer files a delinquent Form 5471 or Form 5472 with an original return rather than with an amended return. This counterintuitive tendency springs from the implication in FAQ 18 that the taxpayer files the delinquent Form 5471 or Form 5472 after filing the original return for the period. But FAQ 18 does not condition penalty relief upon a taxpayer filing a timely original return. In any event, the Service may amend or end the 2012 OVDP at any time, with or without prior notice.

A final alternative for penalty relief rests on guidance provided in the *Internal Revenue Manual*. When a taxpayer files a late Form 5471 or Form 5472 with a late-filed Form 1120, *U.S. Corporation Income Tax Return*, the *Manual* instructs Service employees to abate the Form 5471 or Form 5472 penalties when the following two conditions are met:

1. No penalty was assessed on the related Form 1120 (i.e., the Form 1120 reported no tax or the tax was paid timely) or the Service abated penalties on the late-filed Form 1120 under the First Time Abate program; and
2. The Service has not assessed penalties on Form 5471 or Form 5472, as applicable, in the preceding three years.

## Conclusion

Although the Service may assess substantial penalties for failure to timely file international information returns like Forms 5471 and 5472, the Code, 2012 OVDP, and *Manual* set forth numerous grounds upon which the penalties may be abated. Taxpayers failing to meet the requirements for penalty relief outlined above may nevertheless find success in IRS Appeals. ■