

## LIMITED WINDOW OF OPPORTUNITY TO AVOID TAX PENALTIES (“GET HOME FREE TICKET”)

### The IRS Has Approved an Opportunity to Become Compliant with Complex International Informational Tax Reporting Requirements Related to Undisclosed Foreign Companies, Foreign Trusts, Etc.

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The Internal Revenue Service (IRS) announced on February 8, 2011 a special Offshore Voluntary Disclosure Initiative (“OVDI 2011”). The OVDI 2011’s objective is to bring taxpayers that have unreported income in foreign accounts and foreign entities into compliance with US tax laws. The U.S. international tax laws are complex and not well understood.

In short, the OVDI 2011 is focused on U.S. taxpayers who have unreported income. However, the IRS simultaneously announced that U.S. taxpayers who have failed to file foreign informational returns regarding international transactions will not be assessed penalties in certain circumstances. This is the window of opportunity for many U.S. taxpayers who have an ownership or economic interest in a foreign bank account, foreign corporation, foreign partnership, foreign disregarded entity or foreign trust to take advantage of this pronouncement. This window of opportunity only applies to U.S. taxpayers who do not have unreported income. If you have foreign income (which can include “phantom income” from an ownership stake in a foreign company or trust) that has not been reported on a U.S. income tax return, this “get home free ticket” is not for you.

**Please get your Treasury Department Form Treasury Department Form - TD F 90-22.1 – Report of Foreign Bank and Financial Accounts (“FBAR”) and IRS Forms 5471, 3520, 3520-A, 8865, 8858 and 926 forms filed ASAP if you fall into this window of opportunity (by no later than August 2011)!**

#### **IRS Pronouncement – “The IRS will not impose a penalty . . . “**

The IRS expressly announced that these U.S. taxpayers who have no unreported income, but have failed to simply file informational returns, will not be assessed penalties by the IRS. This is a clear pronouncement by the IRS and U.S. taxpayers should take note and advantage of this opportunity. See FAQ 17<sup>1</sup> – “The IRS will not impose a penalty for the failure to file the delinquent FBARs if there are no underreported tax liabilities and the FBARs are filed by August 31, 2011.” Similarly, see FAQ 18 which provides in relevant part – “The IRS will not impose a penalty for the failure to file the information returns if there are no underreported tax liabilities and the information returns are filed by August 31, 2011.”

This is very important, since the law that imposes these tax penalties often provides no express exception from penalties under the law. If a taxpayer neglects to file the form, the statute typically provides a “If any person fails to furnish [such information] . . . such person shall pay a penalty . . . .”<sup>2</sup> Penalty amounts are harsh. The U.S. international tax law typically imposes penalties of at least US\$10,000 for failure to file the forms (e.g., US\$10,000 for each failure to file an informational return). The amounts can even be confiscatory (e.g., up to 25% of the amount of an unreported foreign gift or foreign inheritance or even 35% from certain foreign trust transfers). These penalties have no correlation to the actual amounts of any income tax liabilities owed, but Congress spoke loud and clear when it passed these laws to require U.S. taxpayers to disclose their international transactions and matters to the IRS and Treasury Department.

To better understand these international tax penalties, if a U.S. taxpayer has no unreported foreign income, this implies they would not be liable for any of the following tax penalties that relate to late payment or no payment of income taxes: (i) late payment penalty, (ii) understatement penalty, (iii) negligence penalty, (iv) late filing penalty, (v) fraud penalty, etc. All of these penalties are calculated with reference to the amount of income tax owed. These penalties are common in the domestic tax law arena.

<sup>1</sup> <http://www.irs.gov/businesses/international/article/0,,id=235699,00.html>

<sup>2</sup> See, IRC Section 6038(b)(1).

Interestingly, the law does not seem to provide an express mechanism by which the IRS can effectively “suspend these penalties,” but if they choose not to assess penalties, the U.S. taxpayer wins. Our recommendation is to file the late forms (even if they are multiple years late) if you have been in good faith trying to comply with the law. This can be viewed as your “get home free ticket”!

**Our recommendation is to file the late forms (even if they are multiple years late) if you have been trying, in good faith, to comply with the law.**

There are a number of international transactions and matters where penalties could apply and include the following when U.S. persons are involved:

TYPE OF INTERNATIONAL TRANSACTION	IRS/TREASURY FORM
Ownership or signature authority over a foreign bank account	<b>TD F 90-22.1</b> – Report of Foreign Bank and Financial Accounts (“FBAR”)
Receipt of large gifts from foreign persons (including inheritances from foreign estates)	<b>IRS Form 3520</b> - Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts
Ownership interest in a foreign corporation	<b>IRS Form 5471</b> - Information Return of U.S. Persons With Respect to Certain Foreign Corporations
Ownership interest in a foreign partnership	<b>IRS Form 8865</b> - Return of U.S. Persons With Respect to Certain Foreign Partnerships
Transfers of certain interests in a foreign partnership	<b>IRS Form 8865</b> - Return of U.S. Persons With Respect to Certain Foreign Partnerships
Transfers to a foreign trust	<b>IRS Form 3520</b> - Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts
Distributions from a foreign trust	<b>IRS Form 3520</b> - Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts
Transfers of assets to a foreign corporation	<b>IRS Form 926</b> - Return by a U.S. Transferor of Property to a Foreign Corporation
Officers and directors of certain foreign corporations	<b>IRS Form 5471</b> - Information Return of U.S. Persons With Respect to Certain Foreign Corporations
Ownership interest in and transfer of certain foreign disregarded entities	<b>IRS Form 8858</b> - Information Return of U.S. Persons With Respect To Foreign Disregarded Entities
U.S. citizens who renounce their citizenship and certain lawful permanent residents who abandon immigration status;	<b>IRS Form 8854</b> - Initial and Annual Expatriation Statement
Annual return of activities of a foreign trust with a U.S. owner	<b>IRS Form 3520-A</b> - Annual Information Return of Foreign Trusts with a U.S. Owner

The IRS has detailed the potential penalties a U.S. person could be subject to in the international world and the amounts of each of these penalties can be daunting. See question 5 of the IRS’ FAQs – from 2011 OVDI.

A summary of these potential penalties are set out below, and may help you identify if you might have a transaction or item that should be reported on an informational return:

<b>IRS/TREASURY FORM</b>	<b>POTENTIAL PENALTY EXPOSURE FOR FAILURE TO FILE AND REPORT INTERNATIONAL TRANSACTION</b>
<b>TD F 90-22.1</b> – Report of Foreign Bank and Financial Accounts (“FBAR”)	US\$10,000 for each failure to file  50% of the account balance for failure to file or US\$100,000; civil penalty  Up to \$500,000 and up to 10 years in prison; criminal penalty
<b>IRS Form 3520</b> - Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts	Up to 25% of the value of the tax-free gift or inheritance received from the foreign person
<b>IRS Form 5471</b> - Information Return of U.S. Persons With Respect to Certain Foreign Corporations	US\$10,000 for each failure to file; up to US\$50,000 in total penalties
<b>IRS Form 8865</b> - Return of U.S. Persons With Respect to Certain Foreign Partnerships	US\$10,000 for each failure to file
<b>IRS Form 8865</b> - Return of U.S. Persons With Respect to Certain Foreign Partnerships	US\$10,000 for each failure to file
<b>IRS Form 3520</b> - Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts	Up to 35% of the value of the transfer of properties to the foreign trust (even if the transfers are income tax-free)
<b>IRS Form 3520</b> - Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts	Up to 35% of the value of the distributions of properties received from the foreign trust (even if the distribution is not subject to income tax)
<b>IRS Form 926</b> - Return by a U.S. Transferor of Property to a Foreign Corporation	10% of the value of the property transferred up to US\$100,000 maximum
<b>IRS Form 5471</b> - Information Return of U.S. Persons With Respect to Certain Foreign Corporations	US\$10,000 for each failure to file
<b>IRS Form 8858</b> - Information Return of U.S. Persons With Respect To Foreign Disregarded Entities	US\$10,000 for each failure to file
<b>IRS Form 8854</b> - Initial and Annual Expatriation Statement	Various
<b>IRS Form 3520-A</b> - Annual Information Return of Foreign Trusts with a U.S. Owner	5% of the gross value of the trust assets (even if there is no taxable income)

For a more detailed discussion of how these penalties might apply, please see Procopio’s *Current Trends, Government Focus and Penalties for Informational Reporting: FBARs, IRS Forms 5471, 8865, 8858, 8806, 8854, 3520, 3520-A, etc.* <http://www.procopio.com/userfiles/file/global/6856.pdf>

As was explained above, these penalties are daunting. Now is the time to utilize the IRS pronouncement that they will not impose penalties for a taxpayer’s failure to filing informational returns.

### **Circular 230 Disclaimer**

To ensure compliance with requirements imposed under Treasury Circular 230, we inform you that any U.S. federal tax advice contained in this letter is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

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*Please contact an international tax attorney at Procopio who might assist you, if you think this “get home free” ticket might apply to you.*

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