

CALIFORNIA SOCIETY OF CPAS SAN DIEGO DOWNTOWN DISCUSSION GROUP

October 6, 2011
U.S. Grant Grill
8am – 9am

Foreign Information Reporting Requirements

I. Overview

- A. “Good Old Days” and Financial Statements “Available on Demand”
- B. Tougher Stance as of January 1, 2009 – Automatic Penalty Notices for 5471s
 - 1. UBS Scandal and Hearings – US Taxpayers Hiding Billions Offshore
 - 2. See, <http://www.irs.gov/businesses/corporations/article/0,,id=188039,00.html>
- C. 2009 and 2011 Offshore Voluntary Disclosure Programs
- D. HIRE Act on March 18, 2010
 - 1. FATCA and Disclosure of US Account Holders
 - 2. New Section 6038D for Foreign Financial Assets
 - 3. New Section 1298(f) and Annual Filing for PFIC Shareholders
 - 4. Revision to Section 6501(c)(8) – Entire Tax Return is Open
 - 5. New Section 6662(j) and 40% Penalty for Undisclosed Foreign Asset
 - 6. President’s 2011 Budget – 800 New International Enforcement Personnel
- E. Current Landscape
 - 1. Extreme Pressure for Timely International Reporting Compliance
 - 2. Must Have Understanding of Complex Code Provisions

II. Form 5471 for Foreign Corporations (Sections 6038 and 6046)

- A. Filing Required by:
 - 1. US Officers/Directors Where US Person Acquires 10% (vote/value) of Stock or an Additional 10% of Stock (creeping acquisitions)
 - 2. US Person Who: (i) Acquires 10%; (ii) Disposes Dropping Interest Below 10%; (iii) Becomes US Person While Owning 10% (substantial presence).
 - 3. US Person in Control (>50% vote/value) of Foreign Corporation
 - 4. “US Shareholder” Owning Shares of CFC

=>Treaty Nonresident Position Does Not Excuse Filing – Still US Person
- B. Complex Ownership Attribution Rules
- C. Category of Filer Determines Information That Must Be Reported (schedules)

- D. Multiple Filer Exception: One person may file Form 5471 (and applicable schedules) for persons who have the same filing requirements, and must identify such persons. All persons identified must attach a statement to their income tax return
 - E. 5471 Must Be Attached to Filer's Timely Filed Tax Return
 - F. Over-Reporting and "Substantially Incomplete" Form – CCA 200429007
 - G. Penalties
 - 1. \$10,000 Penalty for Each Foreign Corporation Not Reported
 - 2. FTC Calculation: Foreign Taxes Deemed Paid Reduced by 10%
 - 3. Potential Criminal Penalties
- III. Form 5472 for Domestic Reporting Corporation (Sections 6038A and 6038C)
- A. Reporting Corporation
 - 1. 25% Foreign-Owned U.S. Corporation (direct/indirect/constructive)
 - 2. Foreign Corporation Engaged in a U.S. Trade or Business (net election?)
 - B. Must Report Related Party Transactions
 - 1. Includes Accrued Amounts, e.g., Interest
 - 2. Reasonable Estimates – At Least 75% and Not More Than 125%
 - C. 5472 Must Be Attached to Filer's Timely Filed Tax Return
 - D. Over-Reporting and "Substantially Incomplete" Form – CCA 200429007
 - E. Penalties
 - 1. \$10,000 Penalty for Failure to File
 - 2. \$10,000 Penalty for Failure to Maintain Records
 - 3. Potential Criminal Penalties
- IV. Form 926 Transfers to Foreign Corporations (Sections 6038B and 367)
- A. Transfers of Tangible and Intangible Property
 - 1. Cash Transfers
 - (a) Directly or Indirectly Holds 10% Vote/Value After the Transfer
 - (b) \$100,000 Transferred in Previous 12 Months
 - 2. Intangible Transfers
 - B. 926 Must Be Attached to Filer's Timely Filed Tax Return for Year of Transfer
 - C. Penalties
 - 1. 10% of FMV of Property at Time of Transfer
 - 2. Limit of \$100,000 Unless Failure Due to Intentional Disregard
- V. Form 8865 for Foreign Partnerships (Sections 6038, 6038B and 6046A)
- A. Filing Required by:
 - 1. US Person Who Controls Foreign Partnership ($\geq 50\%$ Interest in Capital, Profits, or Deductions/Losses)
 - 2. US Person Who Owned $\geq 10\%$ Interest While Partnership Controlled by US Persons Owning $\geq 10\%$ Interest

3. US Person Who Contributes Property to Partnership and: (i) Owns \geq 10% Interest After the Transfer; or (ii) Contribution > \$100,000 in 12 Months
4. US Person That Had Reportable Event
 - (a) US Person: (i) Acquiring Direct 10% Interest (creeping); or (ii) Interest Increasing by 10% (redemptions)
 - (b) US Person Disposition: (i) Decreasing Interest Below 10%; or (ii) Decreasing Interest by 10%

=>Treaty Nonresident Position Does Not Excuse Filing – Still US Person

- B. Complex Ownership Attribution Rules
- C. Category of Filer Determines Information That Must Be Reported (schedules); If Partnership Files 1065, Filer May Attach 1065 In Lieu of Schedules
- D. Multiple Filer Exceptions, With Statements for Non-Filers
- E. 8865 Must Be Attached to Filer's Timely Filed Tax Return
- F. Over-Reporting and "Substantially Incomplete" Form – CCA 200429007
- G. Penalties
 1. \$10,000 Penalty for Failure to File
 2. FTC Calculation: Foreign Taxes Deemed Paid Reduced by 10%
 3. Potential Criminal Penalties

VI. Form 8858 for Foreign Disregarded Entities (Sections 6011, 6012, 6031 and 6038)

- A. U.S. Persons That Are "Tax Owners" of Foreign Disregarded Entities ("FDE") or That Own Interests in Foreign Tax Owners of FDEs Must File:
 1. U.S. Persons That Are Tax Owners of FDEs at Any Time During Year
 2. U.S. Persons Required to File 5471 (Categories 4 and 5) for CFC That is Tax Owner of FDE
 3. U.S. Persons Required to File 8865 (Categories 1 and 2) for Controlled Foreign Partnership That is Tax Owner of FDE
- B. Separate 8858 (and all applicable schedules) Required For Each FDE
- C. Multiple Filer Exceptions, With Statements for Non-Filers
- D. 8858 Must Be Attached to Filer's Timely Filed Tax Return
- E. Penalties
 1. \$10,000 Penalty for Failure to File
 2. FTC Calculation: Foreign Taxes Deemed Paid Reduced by 10%
 3. Potential Criminal Penalties

VII. Form 3520 for Foreign Trusts (Section 6048)

- A. Filing Required by:
 1. Responsible Party for Reporting Reportable Event
 - (a) Creation of Foreign Trust by US Person
 - (b) Transfer of Money or Property to Foreign Trust by US Person

- (c) Death of US Person if: (i) Decedent Treated as Owner of Foreign Grantor Trust; or (ii) Portion of Foreign Trust Included in Estate
 - 2. US Person Treated as Owner of Foreign Grantor Trust
 - 3. US Person Received Distribution from Foreign Trust (including uncompensated use of trust property – HIRE Act)
 - 4. US Person Who Received Either: (i) Gift of >\$100,000 from Nonresident Alien or Foreign Estate (including related persons); or (ii) Gift of >\$14,165 from Foreign Corporations or Foreign Partnerships (including related persons)
 - B. Two US Transferors or Grantors of Foreign Trust, or Two US Beneficiaries of Foreign Trust May Jointly File 3520 if They File Joint Income Tax Return
 - C. Schedule B Question
 - D. 3520 Filed in Ogdren by Due Date of Filer’s Income Tax Return
 - E. Penalties for Non-Filing or Incomplete Filing Equal to Greater of:
 - 1. \$10,000
 - 2. 35% of Gross Value of Property Transferred to Foreign Trust for Creation or Transfer to Foreign Trust by US Person
 - 3. 35% of Gross Value of Distributions Received from Foreign Trust by US Person
 - 4. 5% of Gross Value of Trust Assets Treated as Owned by US Person
 - 5. Failure to Report Gifts: 5% of Amount of Gift for Each Month Failure Continues, not to Exceed 25%
- VIII. Form 3520-A for Foreign Trusts (Section 6048(b))
 - A. Filed by Foreign Trust with US Owner
 - 1. Technically Obligation of Trustee
 - 2. Foreign Trustees Do Not Comply; Issue for US Grantor/Owner
 - B. 3520-A Filed in Ogdren by 15th Day of Third Month After Trust’s Tax Year End
 - 1. Foreign Grantor Trust Owner Statement Provided to US Grantor/Owner
 - 2. Foreign Grantor Trust Beneficiary Statement Provided to US Beneficiary
 - C. Penalties for Non-Filing or Incomplete Filing Equal to Greater of:
 - 1. \$10,000
 - 2. 5% of Gross Value of Trust Assets Treated as Owned by US Person
- IX. Form 8938 for Foreign Financial Assets (Section 6038D)
 - A. Filed by US Individual Holding Interest in Specified Foreign Financial Assets With Aggregate Value > \$50,000
 - B. Accounts, Stock/Security, Other Instruments/Contracts, Entity Interests
 - C. Draft Instructions Released September 28, 2011
 - D. Notice 2011-55 – Deferred Reporting Requirement
 - E. 8938 Must Be Attached to Filer’s Timely Filed Tax Return
 - F. Penalty of \$10,000

- X. Form TD F 90-22.1 “FBAR” (31 USC 5314 – Bank Secrecy Act)
 - A. “US Person” with Financial Interest in or Signature Authority Over Foreign Financial Accounts the Aggregate Value of Which > \$10,000
 - 1. Corporation Where US Person Owns > 50% Vote/Value
 - 2. Partnership Where US Person Owns >50% Profits/Capital
 - 3. Grantor Trusts Owned by US Person
 - 4. Non-Grantor Trusts Where US Person has >50% Present Beneficial Interest in Income or Assets
 - B. Exceptions for Accounts Held by Qualified Plans
 - C. Schedule B Question
 - D. 6-Year Statute of Limitations
 - E. Penalties
 - 1. \$10,000 Civil Penalty for Non-Willful (also 5-year recordkeeping)
 - 2. Greater of \$100,000 or 50% of Account for Willful
 - 3. Criminal Penalties
- XI. Addressing Noncompliance
 - A. Reasonable Cause Defense – Advisor Must Fall on Sword
 - B. 5471 and Newly Formed Foreign Corporations
Unqualified Right to Receive Stock? Property Transferred?
 - C. Form 3520 and Agency Position
Mexican Fideicomiso Residential Real Estate Trust
 - D. “Quiet” Disclosures – Pros/Cons

Jon P. Schimmer is a partner at Procopio and focuses his practice on all areas of international, federal, state and local tax and business matters, with an emphasis on tax and business planning for corporations, limited liability companies and partnerships, particularly with respect to formations, acquisitions, mergers and reorganizations, and liquidations. Mr. Schimmer also advises individuals with respect to income, estate, and gift tax issues, and represents businesses and individuals in connection with audit and controversy matters before the Internal Revenue Service, Franchise Tax Board, State Board of Equalization and County Assessor Offices. Mr. Schimmer received his Juris Doctor degree from the University of San Diego School of Law in 2001, where he graduated cum laude. He is admitted to practice in California, the U.S. District Court, Southern District of California and before the United States Tax Court, and he is an adjunct Professor of Law in the Graduate Tax Program at the University of San Diego School of Law. Mr. Schimmer is also licensed by The California Board of Accountancy as a Certified Public Accountant. Reach him at 619.525.3805 or jon.schimmer@procopio.com.