Has the IRS Declared Dead the Substantial Compliance Defense for International Information Returns? Lessons from a New International Practice Unit

*By Hale E. Sheppard**

I. Introduction

As taxpayers become increasingly international, they face a number of complexities, one of which is the need to file convoluted international information returns with the IRS. Errors and oversights frequently occur, of course. These trigger penalties, expansion of the normal assessment-periods, and more. Taxpayers attempt to avoid these negative consequences by taking the position with the IRS that, while not perfect, the international information returns that they filed were at least "substantially compliant" or "substantially complete."

The Large Business and International division of the IRS trains its personnel in various ways, including the issuance of so-called International Practice Units ("IPUs"). They do not constitute legal precedent, but many Revenue Agents give IPUs considerable weight in conducting audits, determining whether penalties apply, *etc*.[1] The IRS previously issued an IPU related to Forms 5471 (*Information Return of U.S. Persons with Respect to Certain Foreign Corporations*), which painted a bleak picture for taxpayers about the effect of the substantially compliant/complete defense on that particular information return.

The IRS has now broadened its analysis, issuing a new IPU in May 2017 directed solely to the applicability of the substantially compliant/complete defense to a long list of *other* international information returns. This article evaluates the new IRS guidance with a critical eye, revealing the significant challenges that taxpayers will confront when trying to convince front-line IRS personnel that penalties and assessment-period extensions should not apply to them.

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II. Previous IRS Guidance About Form 5471 Penalties

In 2015, the IRS released an IPU focused on penalties for Form 5471 violations by certain categories of U.S. persons.[2] It contains a fair amount of information about the circumstances under which the IRS will consider a Form 5471 to be "substantially incomplete" and thus subject to penalties. This earlier guidance is examined here.

A. Overview of Form 5471 Filing Requirement

Four categories of U.S. persons who are officers, directors, and/or shareholders of certain foreign corporations must file an annual Form 5471 with the IRS to report their relationships with the corporations.[3] Form 5471 is filed as an attachment to the person's federal income tax return.[4] If a person fails to file a Form 5471, files a late Form 5471, or files a timely but "substantially incomplete" Form 5471, then the IRS may assert a penalty of $10,000.[5] This penalty increases on a monthly basis, to a maximum of $50,000, if the problem persists after notification by the IRS.[6]

The IRS will not impose penalties, however, if there was "reasonable cause" for a missing or late Form 5471, or if a timely Form 5471 was "substantially complete."[7] The regulations state the following with respect to the substantially compliant/complete defense:

> In the case of a [Form 5471] that has been filed as required by [Section 6038] except for an omission of, or error with respect to, some of the information required, if the person who filed the [Form 5471] establishes to the satisfaction of the [IRS] that the person has *substantially complied* with this section, then the omission or error shall not constitute a failure under this section.[8]

B. Two Types of Incompleteness

The earlier IPU divides defective Forms 5471 into two main categories.

1. First Category—Facially Incomplete

The IPU contains a list of items that represent incompleteness on the very face of Form 5471. These include the following: (i) failure to identify on Page 1 the category (or categories) into which the taxpayer falls or the amount of voting stock that the taxpayer owns in the foreign corporation, without which the IRS cannot determine which Schedules to Forms 5471 the taxpayer must complete; (ii) inclusion of partial data regarding the identity and location of the foreign corporation, which the IRS needs in order to expand an audit to cover related entities and individuals; (iii) failure to complete any required Schedule to Form 5471; (iv) stating that certain information required by Form 5471 will be provided by the taxpayer only upon express request from the IRS; (v) using computer-generated Forms 5471 that have not been approved by the IRS; and (vi) failure to provide proper financial statements for the foreign corporations.[9] These constitute the types of "conspicuous" errors that a front-line worker at an IRS Service Center could immediately detect and then either mark the related tax return for audit or send a notice instructing the taxpayer to rectify the deficiencies with Form 5471.[10]

2. Second Category—More Subtle Incompleteness

A section of the earlier IPU called "beyond their face" cites various IRS pronouncements that shape the IRS's position regarding Form 5471 and the substantially compliant/complete defense. These items, on which Revenue Agents and other IRS personnel likely will base their penalty analysis, are discussed below.

a. CCA 200645023. The taxpayer was a U.S. corporation, which was the parent of a group that conducted global operations through numerous foreign subsidiaries. As part of a complicated transaction, the taxpayer acquired and then controlled for approximately four months a foreign corporation. The taxpayer received tax advice from a U.S. tax professional, indicating that the taxpayer should file a Form 5471 for each of the three foreign subsidiaries held by the foreign corporation. The taxpayer disagreed with this advice, believing that it was not obligated to file Forms 5471 because, under a substance-over-form analysis or the step-transaction doctrine, the taxpayer never really owned the foreign corporation. Nevertheless, the taxpayer filed Forms 5471 in a timely manner. The Forms 5471 were incomplete in that they failed to attach Schedules O (Organization or Reorganization of Foreign Corporation, and Acquisitions and Dispositions of its Stock) and they failed to report certain items in U.S. dollars and in accordance with U.S. generally accepted accounting principles ("GAAP"). The IRS penalized the taxpayer.

The taxpayer argued that the Forms 5471 were substantially complete because (i) they were based on the best data available at the time of filing, and (ii) the only substantive deficiency, not converting foreign financial statements into U.S. dollars and then presenting them using GAAP, was not done because it would have been a "monumental costly task for it to do so."

With respect to the substantially compliant/complete issue, the IRS stated that Schedule C (Income Statement) and Schedule F (Balance Sheet) must be in GAAP, Schedules C (Income Statement) and Schedule E (Income, War Profits, and Excess Profits Taxes Paid or Accrued) must use U.S. dollars, and functional currencies are "significant pieces of required information" and thus "substantial" for purposes of Form 5471.

The IRS then acknowledged, by reference to Code Sec. 6651, that high administrative costs might be a defense, but only if the task at hand (*i.e.*, completing a certain aspect of Form 5471) would cause "undue hardship" for the taxpayer. The regulations under Code Sec. 6651 state that a late-payment will be considered due to reasonable cause where "the taxpayer has made a satisfactory showing that he exercised ordinary business care and prudence in providing for payment of his tax liability *and was nevertheless either unable to pay the tax or would suffer an undue hardship … if he paid on the due date*."[11] The regulations go on to explain that the term "undue hardship" means more than a mere inconvenience; the taxpayer must show that it would suffer a substantial financial loss if it were required to complete the relevant tax duty.[12]

After declining the substantially compliant/complete argument, the IRS characterized a seemingly positive fact for the taxpayer as a negative. The taxpayer contended that its filing of complete, timely Forms 5471 in past years should mitigate penalties for deficient Forms 5471 in the present. The IRS stated its you-should-know-better position in the following manner:

> [T]he fact that [the taxpayer] has a strong compliance history in filing Forms 5471 for its non-U.S. affiliates indicates that the failure to file complete Forms 5471 in this case was not inadvertent because [the taxpayer] was familiar with the proper manner in which to complete Forms 5471 for its non-U.S. affiliates.

b. 2002 IRS NSAR 20167[13]**.** The taxpayer in this case filed timely Forms 1120 and enclosed Forms 5471; however, they were missing certain data. Specifically, the taxpayer had not completed Schedule A (Stock of the Foreign Corporation), Schedule B (U.S. Shareholders of Foreign Corporation), Schedule C (Income Statement), Schedule E (Income, War Profits, and Excess Profits Taxes Paid or Accrued), Schedule F (Balance Sheet), Schedule H (Current Earnings and Profits), Schedule J (Accumulated Earnings and Profits), and Schedule M (Transactions Between Controlled Foreign Corporation and Shareholders or Other Related Persons). Nearly every page of the Forms 5471 stated that the taxpayer would be willing to furnish additional information upon request. The IRS penalized the taxpayer for filing "substantially incomplete" Forms 5471.

The taxpayer argued that the penalties were unwarranted because the incomplete Forms 5471 had no impact on the taxpayer's U.S. tax liability (*i.e.*, all income was properly reported on Form 1120) and the taxpayer disclosed to the IRS the existence of the foreign corporation. Because there was no dispute that the Forms 5471 were incomplete, the IRS rejected the taxpayer's position on grounds that no "reasonable cause" existed for not providing the required data in numerous Schedules to Forms 5471. The IRS also noted that "the fact there is no tax impact here is of no consequence."

c. FSA 33381431. The taxpayer was a large multinational manufacturer that filed timely Forms 5471. The IRS discovered as part of an audit that some of the Forms 5471 contained incomplete or inaccurate information with respect to certain items, such as sales with related companies and intercompany loans.

The IRS penalized the taxpayer, and the taxpayer disagreed. The taxpayer defended itself on two main theories. First, it contended that the Forms 5471 were substantially complete. Second, even if they were not, the taxpayer explained that sanctions would be inequitable in light of guidance from the IRS in News Release 90-58 about Forms 5471.

With respect to the substantially compliant/complete defense, the taxpayer stated that any errors or omissions were minor relative to the large amount of data supplied on Forms 5471. The IRS acknowledged that the taxpayer included most of the required information on Forms 5471 for each of its foreign subsidiaries, it filed timely Forms 5471 as attachments to annual Forms 1120, and it quickly took corrective actions with the IRS when the issues were raised during audit. Despite this, the IRS explained that Form 5471 penalties are appropriate when "significant pieces of required information [are] inaccurately reported or omitted," particularly when the majority of the data shown on Forms 5471 is routine and changes infrequently. The IRS emphasized that the taxpayer failed to accurately report major transactions with related parties, inserting either \$0 or a small figure on Form 5471, when they actually involved millions of dollars. The IRS then rejected what it calls the "aggregate approach" to analyzing Form 5471 compliance because, under that method, a taxpayer could supply two-thirds of the required information (omitting the key one-third) and then claim that it was immune from penalties as a result of the substantially-complete defense. The IRS stated that it was more appropriate to analyze the issue on a "significant item by significant item basis" for each separate Form 5471.

The IRS also discarded the equity argument raised by the taxpayer. News Release 90-58 stated that "taxpayers who fail to file complete and timely Forms 5471 will be notified in writing from the Philadelphia Service Center as to what is needed to avoid being penalized. Taxpayers should send the missing information promptly or establish reasonable cause for failing to do so." The taxpayer construed this to mean that the IRS would contact those filing substantially incomplete Forms 5471 before asserting penalties. Since the IRS never notified the taxpayer of any problems related to his timely Forms 5471, it understood that no news was good news. The IRS characterized this interpretation of the News Release as unreasonable, explaining that the items described by the IRS that would trigger a warning were all "conspicuous errors" that could easily be detected by Service Center personnel and immediately addressed with a taxpayer. According to the IRS, the taxpayer's failures were extensive and not amenable to preliminary detection by Service Center personnel. Moreover, the IRS pointed out that the taxpayer had committed a similar violation in past years, for which it had been penalized. In summary, the IRS concluded that the taxpayer's supposed reliance on News Release 90-58 was unjustified given the "consistency, magnitude, and persistence of such errors over the preceding years."

III. Previous IRS Guidance About Form 5472 Penalties

Although only a small part of the earlier IPU focused on Forms 5471, the IRS has also provided guidance over the years regarding the substantially compliant/complete defense with respect to another important international information return, 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. Brief History of Form 5472 Filing Requirement

Foreign investment and foreign business activity in the United States increased significantly in the 1980s. Congress and the IRS began taking steps to ensure that such items were properly taxed and monitored. One example of these efforts was the enactment of Code Sec. 6038A in 1982. The primary purpose of that legislation was to gather additional information about foreigners to prevent the manipulation of related-party transactions and the resulting decrease in U.S. tax liabilities.[14]

Code Sec. 6038A originally applied to U.S. corporations with significant ownership by foreign persons. It was later expanded to cover foreign corporations engaged in a trade or business in the United States, irrespective of the percentage of foreign ownership.[15] In 1990, Congress enacted Code Sec. 6038C, which essentially split the requirements: U.S. corporations that were foreign-owned would be governed by Code Sec. 6038A, while foreign corporations with U.S. operations would be controlled by Code Sec. 6038C.[16] Despite this statutory separation, the two tax provisions share the same regulations (*i.e.*, those under Code Sec. 6038A), and corporations subject to either provision must supply the IRS with particular information each year in the same manner (*i.e.*, on Form 5472).

B. Analysis of Key Concepts

Form 5472 generally must be filed by a "reporting corporation" in order to disclose to the IRS certain "reportable transactions" between it and "related parties." Thus, taxpayers must analyze each of these three concepts to determine if they are forced to file Forms 5472. These concepts are terribly complicated and technical, even for tax professionals, and a detailed discussion is beyond the scope of this article. However, having a general understanding of the three key terms is important. They are summarized below.

1. What Is a "Reporting Corporation?"

The filing obligations are created by two interrelated tax provisions.

Under Code Sec. 6038A, a "reporting corporation" is a *U.S. corporation* that is at least 25 percent foreign-owned.[17] A U.S. corporation is considered to be a 25-percent-foreign-owned corporation if at least 25 percent of its stock is owned, either directly or indirectly, by one foreign person at any time during the relevant taxable year.[18] In this context, "foreign persons" include any individual who is not a U.S. citizen or U.S. resident, any individual who is a citizen of a U.S. possession, any foreign government, and any partnership, association, company, corporation, trust, or estate that is not domestic.[19]

According to Code Sec. 6038C, a "reporting corporation" is also any *foreign corporation* that operates a U.S. trade or business at any time during the year at issue.[20] The regulations clarify that if a foreign corporation is a resident of a foreign country that has a tax treaty with the United States, then it will not be considered a "reporting corporation," unless is has a so-called permanent establishment in the United States.[21]

2. *What Is a "Related Party?"*

A "related party" is broadly defined to cover (i) any 25-percent-foreign-shareholder of the reporting corporation, (ii) any person who is related to the 25-percent-foreign-shareholder according to certain ownership-attribution rules, (iii) any person who is related to the reporting corporation under the same ownership-attribution rules, and (iv) any entity that is owned or controlled by the same persons as the reporting corporation pursuant to the transfer-pricing rules in Code Sec. 482.[22] The term "related party" does not include any corporation filing a consolidated federal income tax return with the reporting corporation.[23]

3. *What Is a "Reportable Transaction?"*

The term "reportable transaction" encompasses several items, including, but not limited to, sales and purchases of inventory and other tangible property, rents and royalties paid and received, consideration paid for use of all intangible property, consideration paid for services rendered (including technical, managerial, engineering, construction, scientific, and others), commissions paid and received, certain amounts loaned or borrowed, interest paid or received, premiums received for insurance or reinsurance, and the catch-all, other amounts paid to or received from related parties that are taken into account in determining the taxable income of the reporting corporation.[24]

There is one notable exception. A transaction is not considered a "reportable transaction" (and thus not required to be reported on Form 5472) if (i) neither the reporting corporation nor the related party is a U.S. person, (ii) the transaction will not generate in any year gross income from U.S. sources or income effectively connected with a U.S. trade or business, and (iii) the transaction will not generate in any year any expenses, losses, or other deductions that could be allocated or apportioned to such income.[25]

C. Form 5472 Filing Requirement

A reporting corporation must file a separate annual Form 5472 with respect to each related party with which it had any reportable transaction during the relevant year.[26] This, of course, opens the door for taxpayers to violate numerous filing duties and incur numerous penalties. Notably, Forms 5472 must be filed with the IRS, even though the information they contain may not affect the amount of U.S. tax due.[27]

D. Penalties for Form 5472 Violations

A reporting corporation that fails to file timely Forms 5472 is subject to civil penalties.[28] Likewise, a reporting corporation that files timely, yet "substantially incomplete," Forms 5472 will be punished. The regulations state the following in this regard: "The filing of a *substantially incomplete* Form 5472 constitutes a failure to file Form 5472."[29] The IRS generally may impose a penalty of $10,000 for each violation for each year, which can add-up quickly if a reporting corporation fails to file multiple Forms 5472 for an extended period.[30]

E. Exceptions to Form 5472 Penalties

The regulations contain five exceptions to penalties, two of which are examined below.

1. *First Exception—Reasonable Cause Defense*

If the reporting corporation acted in "good faith" and there is "reasonable cause" for not filing a Form 5472 or maintaining proper records, then the initial $10,000 penalty may be waived and the running of the 90-day correction period may be tolled.[31] The reporting corporation must make an affirmative showing of all the relevant facts in a written statement made under penalties of perjury to demonstrate that good faith and reasonable cause exist.[32]

As individuals and entities engage in more cross-border activities, U.S. tax compliance becomes increasingly complex, and violations of international information return duties occur with greater frequency.

The IRS makes its determination of whether the reporting corporation acted reasonably and in good faith on a case-by-case basis, taking into account all the pertinent facts and circumstances.[33] The regulations provide the following guidance in this regard: (i) an honest misunderstanding of fact or law by the reporting corporation may indicate reasonable cause and good faith in light of the experience and knowledge of the reporting corporation; (ii) isolated computational or transcriptional errors are consistent with reasonable cause and good faith; (iii) reliance by the reporting corporation on an erroneous information return, erroneous professional advice, or other erroneous data constitutes reasonable cause and good faith only if such reliance was reasonable under all the circumstances; (iv) a reporting corporation may have grounds for penalty abatement if it has a reasonable belief that it is not owned by a 25-percent-foreign-shareholder;

and (v) reasonable cause may exist in situations where a foreign owner is considered a "related party" solely under the broad principles of the transfer-pricing rules in Code Sec. 482, and the reporting corporation had a reasonable belief that its relationship with the foreign owner did not meet these broad principles.[34]

2. Second Exception—Substantial Compliance Defense

The regulations also contemplate a substantially compliant/complete defense to penalties, which only applies if the reporting corporation filed a timely, but incomplete or inaccurate, Form 5472.[35] Upon introducing this defense in the earliest regulations, the IRS envisioned salvation for many taxpayers: "The [IRS] anticipates that the broad range of estimates and descriptions allowed in [the Section 6038A regulations] will prevent most inadvertent errors from causing a technical violation if the reporting corporation has made a reasonable effort to comply."[36]

F. Various IRS Rulings Regarding Form 5472

When the IRS decides not to assert Form 5472 penalties or ultimately agrees to abate such penalties administratively, written tax/legal precedent generally is not created. It makes sense, then, that most published IRS rulings would be unfavorable to taxpayers. Keeping this in mind, it is still worthwhile to review the few IRS rulings that exist regarding Form 5472.[37]

1. CCA 200429007

This IRS pronouncement deals with Form 5472, but the IRS has directed its personnel to apply the principles to Form 5471 situations, too.[38] The IRS examines four situations in CCA 200429007, concluding each time that the Forms 5472 were not substantially compliant/complete. These situations are summarized below.

a. First Situation—Overstating Amounts. The taxpayer disclosed all relevant items on Form 5472 but inadvertently overstated certain amounts. For example, the taxpayer reported purchases of inventory of $1,000, and the IRS later determined during an audit that the correct number should have been $500. The IRS found that this type of overstatement rendered the Form 5472 substantially incomplete. The IRS reasoned as follows in arriving at this conclusion:

> A taxpayer that underreports, or over-reports, a particular transaction in a substantial amount frustrates the [IRS's] efforts to audit that taxpayer. A taxpayer's error may also compel the [IRS] to conduct a more intensive investigation than would have been necessary had the taxpayer correctly reported the transaction on the Form 5472. *Accordingly, it is the error itself, as opposed to whether the error involves an underreporting or over-reporting, which undermines the ability of the [IRS] to rely upon a taxpayer's reporting of related party transactions.*

The IRS also explained that it applies a seven-factor test in determining whether an error or omission makes an international information return, like Form 5472, substantially incomplete. These factors consist of the following:

- The magnitude of the overstated or understated amounts compared to the actual amounts that should have been reported;
- Whether the taxpayer had other reportable transactions with the same party and correctly reported such transactions;
- The size of the erroneously-reported transaction in relation to all other reportable transactions that were correctly reported;
- The magnitude of the unreported transactions in relation to the taxpayer's volume of business and overall financial situation;
- The significance of the unreported transactions to the taxpayer's business in a broad, functional sense;
- Whether the unreported transactions occurred in the context of a significant, ongoing transactional relationship with a related party; and
- Whether the unreported transactions affect the taxpayer's taxable income.

b. Second Situation—Reporting Excessive Data. The taxpayer reported amounts of intercompany receivables on Form 5472 that were not required to be reported because of an exception to the general rule. In other words, the taxpayer provided excess data, not overstated amounts. When the IRS raised this fact with the taxpayer during an audit, the taxpayer rectified the issue by voluntarily providing a corrected Form 5472. The IRS concluded, nevertheless, that the original Form 5472 was substantially incomplete.

c. Third Situation—Mismatch. The ending-balance of related-party loans on the Form 5472 for the first year did not match the opening-balance on the Form 5472 for the following year. The taxpayer correctly reported the interest income received because of the loan, such that this was solely an "information mismatch" issue, not a tax issue. The IRS concluded that this type of error yielded the Forms 5472 substantially incomplete.

d. Fourth Situation—Small Net Change. The taxpayer over-reported one amount and then underreported another amount on the same Form 5472. For instance, the taxpayer disclosed purchases of inventory of $1,000 instead of $500 and then showed commissions paid of $1,200 instead of $1,600. The net effect was an error of $100. This IRS determined that each of these errors separately, and the two errors together, caused the Form 5472 to be substantially incomplete. Below is a portion of the IRS's reasoning for penalizing the taxpayer in this situation:

> First, it is important to recognize that when a taxpayer has made several errors on a Form 5472 it is necessary to analyze each of these errors in isolation in order to determine whether the error causes the Form 5472 to be "substantially incomplete," *and* to analyze the errors in the aggregate in order to determine whether the total effect of the errors causes the Form 5472 to be "substantially incomplete." It is possible that no single error, among several on a Form 5472, would render that form "substantially incomplete." However, the net effect of those errors, in the aggregate, may cause the Form 5472 to be considered "substantially incomplete." For example, a taxpayer could over-report by $100X each of the following: Purchases of Stock in Trade, Commissions Paid and Rents Paid. Although individually each of these errors may not be significant, the aggregate effect of these errors that result in over-reporting expenses by $300X may be considered significant enough to make the Form 5472 "substantially incomplete." *Accordingly, we believe that if one of the errors in isolation or the aggregate effect of all of the errors causes the Form 5472 to be "substantially incomplete," then the Form 5472 in its entirety is "substantially incomplete."*

2. FSA 200026005

FSA 200026005 dealt with the issue of whether the taxpayer could avoid penalties, thanks to the substantially compliant/complete defense to Form 5472 penalties. The IRS, in concluding that the Form 5472 was indeed substantially complete, provided the following list of facts and circumstances that the IRS might consider in making this determination: (i) the magnitude of the unreported transactions in relation to reported transactions and whether the reporting corporation had other reported transactions with the same related party; (ii) the magnitude of the unreported transactions in relation to the reporting corporation's volume of business and overall financial situation; (iii) the significance of the unreported transactions to the reporting corporation's business in a broad, functional sense; (iv) whether the unreported transactions occurred in the context of a significant, ongoing transactional relationship with the related party; and (v) whether the unreported transactions were reflected in the determination and computation of the reporting corporation's taxable income in the relevant year.

3. CCA 10223

In CCA 10223, the IRS asserted penalties for not filing Forms 5472. The taxpayer, a domestic corporation, submitted a written statement arguing that reasonable cause existed for the following reasons: (i) it was unaware of the need to file a Form 5472; (ii) the foreign ownership was adequately disclosed to the IRS on its Form 1120 anyway; (iii) the failure to attach Form 5472 was an "inadvertent omission"; (iv) the corporation relied on professional advisors for compliance advice; and (v) the corporation had historically complied with the Form 5472 filing requirement.

The IRS rejected the reasonable cause arguments for two main reasons. First, the IRS explained that reliance on substantive advice from an informed, qualified professional is reasonable, but reliance on a professional to carry out a ministerial duty (such as timely filing a return) is not reasonable. The IRS concluded that filing a Form 5472 is "a ministerial act for which the taxpayers cannot be excused of responsibility." Second, the IRS explained that, even if filing a Form 5472 were a substantive act, the taxpayer failed to show acceptable reliance. The IRS pointed to the fact that the taxpayer filed Forms 5472 in previous years; therefore, the existence of Form 5472 and the need to analyze whether Forms 5472 needed to be filed for the year in question should have been apparent to the taxpayer and/or its accountant.

4. CCA 11537

The taxpayer in CCA 11537 failed to file various Forms 5472, got audited by the IRS, and claimed that it had "reasonable cause" for the violations.

With respect to Forms 5472 related to domestic corporations, the taxpayer claimed that it did not file because the IRS's Instructions to Form 5472 were "ambiguous and confusing." Surprisingly, the IRS conceded that the Instructions in existence back in 1999 were ambiguous and recognized that the regulations were equally murky. Thus, the IRS agreed that "reasonable cause" existed to abate the penalties.

Regarding Forms 5472 related to foreign corporations, the taxpayer argued that the violation was attributable to an "inadvertent administrative error" because the parent company had many affiliates all over the world, many of the affiliates are not known to the taxpayer, and it is very difficult to keep track of all the different transactions between them. The IRS rejected claims of reasonable cause for two reasons, the primary of which was that the foreign corporations should have done additional due diligence, particularly since they had previously filed Forms 5472. The IRS stated the following regarding efforts at full tax compliance:

> In two instances, [the taxpayer] failed to file Forms 5472 with respect to related parties for which it had filed Forms 5472 in prior taxable years. In our view, any person making a reasonable effort to comply with the requirements of I.R.C. Section 6038A would, as part of the process of determining whether Forms 5472 are required to be filed in any given taxable year, look at prior years' filings. There is no evidence that [the taxpayer] did so. [This] apparent failure to do so negates any possible finding that the failure to file was based on an honest misunderstanding that was reasonable in light of [the taxpayer's] experience.

5. FSA 33314918

The taxpayer in FSA 33314918 filed a timely Form 1120, which included a Schedule K (Other Information) indicating that foreign persons owned a significant percentage of its stock. The taxpayer attached a Form 5472 to the Form 1120 for an earlier year. Then, for later years, the taxpayer entered "0" in Schedule K about the number of Forms 5472 to be filed. The same accounting firm prepared all the returns for all years, and the same accountant/partner signed the returns each year as the preparer. The taxpayer was audited by the IRS, and it became evident that many required Forms 5472 had not been filed. The Revenue Agent proposed a $10,000 penalty for each violation, and the taxpayer requested abatement.

The taxpayer gave the following justifications for abatement: (i) it had a long history of federal and state compliance since inception of business; (ii) it changed outside accountants at some point during the relevant years, and there was confusion by internal personnel and new outside accountants about the identity of the ultimate foreign owners; (iii) the returns were filed in good faith, even though they were wrong; (iv) the taxpayer was not aware of the errors until the IRS audit began; (v) the taxpayer intended to file Forms 5472 but relied "on a good-faith determination" that it was not necessary; (vi) the taxpayer made best efforts to comply with demands by the Revenue Agent in terms of quickly filing Forms 5472; and (vii) the taxpayer instituted changes such that violations would not occur in the future.

The IRS upheld the Form 5472 penalties for several reasons, the three most important of which are addressed here. First, the IRS determined that the taxpayer failed to provide sufficient proof of reliance on a qualified tax professional. In doing so, the IRS set forth a stringent standard:

> [T]he regulations provide that reliance on professional advice is only one factor to consider among the totality of the facts. The reliance must be reasonable. The person relied upon must be knowledgeable in the particular issues. The person relied upon should expressly provide advice on whether Forms 5472 should be filed, and taxpayer should document such reliance. Moreover, the reliance should generally relate to a technical tax issue, not matters such as filing deadlines which require no special training or effort to ascertain and make sure they are met. Generally, a taxpayer is presumed to be charged with knowledge of the contents of its own tax return. Hence, the ultimate responsibility for a correct return lies with the taxpayer who must furnish the necessary information to the agent who prepared the return. Reliance upon expert advice will not exculpate a taxpayer who supplies the expert, *e.g.*, return preparer, with incomplete and inaccurate information. Thus, a taxpayer may not escape a penalty by simply blaming its tax return preparer. An important factor in determining reasonable cause is the extent of a taxpayer's effort to assess his or her proper tax reporting obligations.

Second, as it did in earlier rulings, the IRS indicated that the ignorance-of-the-law argument is seriously weakened, if not fatally wounded, where the taxpayer properly filed Forms 5472 in previous years. The IRS announced the following in this regard: "If a Form 5472 for a previous tax year was filed, it would be normally difficult for the taxpayer to show reasonable cause unless taxpayer had a reasonable belief that it was no longer owned by a 25-percent foreign shareholder or no related party transactions occurred during the taxable year."

Third, without stating it expressly, the IRS put considerable stock in the position that the IRS will not abate penalties in situations with evidence that the taxpayer was "willfully blind" of the Form 5472 filing requirement. The IRS argued that the explicit cross-reference in Form 1120 to the possible need to file Form 5472 undermines a taxpayer's ignorance-of-the-law argument.

IV. New IRS Guidance About Other International Information Returns

In May 2017, the IRS issued a new IPU, which was designed to provide IRS personnel with guidance about the meaning of substantially compliant/complete in the context of international information returns, *other than* Forms 5471 and Forms 5472.[39] A close reading of this new IPU renders the following analysis.

A. Historical and General Information

The new IPU acknowledges that the concept of substantial compliance is longstanding, with the first case, *Indiana Rolling Mills Co.*, being decided nearly a century ago, in 1928.[40] The main issue in that case was whether the Form 1120 filed by the corporate taxpayer was valid, thereby triggering the running of the assessment period against the IRS. The law in effect at that time required that the Form 1120 be executed by the president, vice-president, or other principal officer, and by the treasurer or assistant treasurer. The IRS argued that the relevant Form 1120 was invalid (and thus the assessment period remained open) because it was executed by the corporation's vice president and secretary, instead of its vice president and treasurer or assistant treasurer.

The court made two important comments when holding in favor of the taxpayer. First, it established the idea of substantial compliance:

> What is the essence of the thing required to be done by this statute? It is, we think, the making of an honest [tax] return by the corporation … in order that the [IRS] may determine the correct amount of its tax liability. If such required information is fairly and honestly given in a [tax] return sworn to by officers of the corporation who are familiar with its affairs, this in our opinion constitutes a substantial compliance with the provisions of the statute.[41]

Second, the court commented on which items warranted strict compliance by taxpayers and which items were satisfied through mere substantial compliance:

> A general rule of statutory construction is that those provisions which do not relate to the essence of the thing to be done, and as to which compliance is a matter of convenience rather than substance, are directory; while those provisions which relate to the essence of the thing to be done, that is, to matters of substance, are mandatory. The fact that the statute provides that the [tax] return 'shall' be sworn to by certain officers of the corporation named does not necessarily require the construction that this provision is mandatory.[42]

After listing and summarizing various cases addressing whether taxpayers had "substantial compliance" in the context of tax returns, tax-related elections, and deductions, the new IPU broadly concludes that substantial compliance normally applies to regulatory requirements, strict compliance applies to statutory requirements, and "[t]he analysis of whether there is compliance in this heavily litigated area is generally based on the facts and circumstances of the specific case."[43]

B. Comments About Limits on Substantial Compliance

The new IPU then introduces a different tone, negative toward taxpayers, based primarily on two items. First, the new IPU cites *L. Prussner*[44] for the proposition that federal district courts and federal courts of appeal generally have applied the substantial compliance doctrine much more narrowly than the Tax Court and that the Tax Court's willingness to loosely apply the doctrine to sympathetic taxpayers has caused unwanted uncertainty for all.[45] According to the court in *Prussner*, "[r]eading the Tax Court's decisions on the subject of substantial compliance is enough to make one's head swim [and] we think that the doctrine should be interpreted narrowly."[46]

Second, the new IPU indicates that there is a major difference between tax returns and international information returns, at least when it comes to substantial compliance. The new IPU cites GCM 36372 to expand on this topic, suggesting that it might not be appropriate to apply the substantial compliance doctrine to information returns and that the absence of any "material" information on an information return triggers the conclusion that substantial compliance is lacking. GCM 36372 states the following:

> Although cases dealing with missing information on tax returns may be helpful in considering cases involving incomplete information returns, we believe they are distinguishable. The purpose of a tax return is to report the information necessary to establish tax liability. The purpose of information returns, such as those under consideration in this case, are to provide information necessary for the [IRS] to properly administer the revenue laws. Accordingly, there may be items requested on a tax return that if left blank would not affect the determination of tax liability regardless of its completeness. On the other hand, if material information requested on an information return is not supplied, the [IRS] will not be able to perform the duties and responsibilities placed on it by Congress. Thus, the rules and tests applied in tax return cases to establish whether the return meets Code requirements should not necessarily be applied to information returns.

C. Distinguishing Forms 5471 and 5472 from Other Information Returns

After discussing many of the IRS pronouncements described earlier in this article, the new IPU explains that the concept of substantial compliance/completeness only applies to penalties for Forms 5471 and Forms 5472, *not* to the large and ever-growing number of other international returns. Then, the new IPU explains to IRS personnel how they should determine if taxpayers can avoid penalties stemming from other international information returns. Below is the express language from the IPU, followed by a candid summary:

1. Express Language from the New IPU

- "Regulations issued pursuant to IRC 6038 and 6038A provide specific rules that allow field examiners to consider whether the forms submitted have substantially complied with the reporting requirements (Forms 5471 and 5472) or are substantially incomplete (Form 5472) for purposes of the penalties imposed in those sections. *The non-precedential advice that has been issued [by the IRS] applies only to these sections*."[47]
- "The [IRS rulings] discussed above only provide informal guidance concerning substantial compliance and substantial completeness as those terms are used in the regulations under IRC 6038 and 6038A. *As such, they don't apply to international information returns other than Forms 5471 and 5472*."[48]
- "The *judicial* concept of substantial compliance [usually involving tax returns, tax-related elections, and deductions] may apply to *other* international information returns (which do not have the same standards as those imposed under IRC 6038 and 6038A). Stated differently, *absent a specific regulatory directive, only the judicial concept of substantial compliance would excuse anything less than strict compliance with a reporting requirement*."[49]
- "*There is no available guidance on whether other international information returns are subject to the judicial substantial compliance doctrine*. If an examiner believes that the judicial substantial compliance doctrine may apply, then Field counsel should be consulted, who may then consult the Associate Chief Counsel (International)."[50]
- "The substantial compliance defense to penalties described in the regulations under IRC 6038 and 6038A is available only to taxpayers who are subject to penalties under those sections. However, a court *might apply* the generally applicable substantial compliance doctrine discussed earlier to other international information returns, including Form 8865 (Return of U.S. Persons with Respect to Certain Foreign Partnerships), Form 8858 (Information Return of U.S. Persons with Respect to Certain Foreign Disregarded Entities), Form 926 (Return by a U.S. Transferor of Property to Foreign Corporation), Form 3520 (Annual Return to Report Transactions with Foreign Trusts and Receipts of Foreign Gifts), and Form 3520-A (Annual Information Return of Foreign Trusts with a U.S. Owner)."[51]

2. Interpretation of the Guidance in the New IPU

Below is an interpretation, pessimistic or realistic depending on one's point of view, of the guidance from the new IPU to the front-line IRS personnel tasked with deciding whether taxpayers should be subjected to international information return penalties:

- The existing IRS rulings regarding the concepts of substantial compliance and substantial completeness *only* apply to situations involving Forms 5471 and Forms 5472 because *only* the regulations for these two returns specifically mention such concepts. In all events, with one exception, all the IRS rulings in this area have concluded that the taxpayer filed a Form 5471 or Form 5472 that was *not* substantially compliant/complete.
- The judicial substantial compliance doctrine, which was created by judges through court decisions, and which usually involves tax returns, tax-related elections, and deductions, might apply to other international information returns.
- There is no guidance yet on whether this is true; therefore, if a Revenue Agent believes that a taxpayer under audit has judicial substantial compliance, he cannot rely on his own discretion, experience, and profound factual knowledge of the situation. Instead, the Revenue Agent must consult the IRS "field" attorneys, who, in turn, will consult the relevant attorneys in the IRS National Office.
- In deciding whether to elevate a potential substantial compliance matter to the IRS attorneys, Revenue Agents will understand that, according to the IPU, *Prussner*[52] demonstrates that federal district courts and federal courts of appeal generally have applied the judicial substantial compliance doctrine much more narrowly than the Tax Court.
- In deciding whether to elevate a potential substantial compliance matter to the IRS attorneys, Revenue Agents will also understand that, according to the IPU, GCM 36372 shows that the judicial substantial compliance doctrine might only apply to tax returns, not information returns.

- If the judicial substantial compliance doctrine were to expand beyond Forms 5471 and Forms 5472, it is unclear to which international information returns, exactly, it would apply. The new IPU lists some international returns, but it omits other common ones, including Form 8938 (*Statement of Specified Foreign Financial Assets*) and FinCEN Form 114 (*Report of Foreign Bank and Financial Accounts*).

V. Why Does the New IPU Matter?

An objective review of the new IPU leads to the conclusion that the concepts of substantial compliance/completeness will not be applied, or will be very narrowly applied, by the IRS with respect to international information returns, other than Forms 5471 and Forms 5472. It is critical that taxpayers and tax practitioners grasp this reality for the reasons addressed below.

A. First-Time Abate Policy Generally Offers No Help

The non-application or narrow application of the substantially compliant/complete doctrine is important in light of the IRS's position that the first-time-penalty-abatement policy does not apply to most international information returns.

This general first-time-penalty-abatement policy states that the IRS will grant abatement with respect to virtually all delinquency penalties in situations where a taxpayer has not been required to file a certain return before, or where the taxpayer has no prior penalties of this type.[53] If the taxpayer meets these criteria, then the IRS normally issues a letter to the taxpayer confirming that waiver is being granted solely on the basis of the first-time-penalty-abatement policy, not because the taxpayer has demonstrated that it had reasonable cause for the violation.[54]

The first-time-penalty-abatement policy is bittersweet, though, because it does *not* apply to (i) "returns with an event-based filing requirement" and (ii) "information reporting that is dependent on another filing, such as various forms that are attached [to an income tax return]."[55] Many IRS personnel simply deny requests for abatement of international information return penalties because they are triggered by an event and/or because they must be enclosed with a tax return.

B. Harsh Reasonable Cause Standards for International Information Returns

Taxpayers tend to raise the following arguments when seeking abatement of international information return penalties. If the relevant return was never filed, the taxpayer often argues that there was "reasonable cause" for the oversight. If the return was filed timely but with some lapses, the taxpayer frequently maintains that the return was substantially compliant/complete and/or that there was "reasonable cause" for the violation.

The IRS does *not* recognize the normal arguments for reasonable cause when it comes to Forms 5471 and Forms 5472. In deciding whether the IRS should waive or abate these penalties, IRS personnel have traditionally followed guidance set forth in special "Decision Trees," which are only found in the Internal Revenue Manual. These standards are much more stringent than those located elsewhere.[56] Below is a summary of the mandates issued to IRS personnel:

- If the taxpayer claims that it was unaware of the filing requirement, the "Decision Tree" instructs the IRS to deny abatement because "ordinary business care and prudence requires taxpayers to determine their tax obligations when establishing a business in a foreign country."
- The "Decision Tree" mandates that penalty abatement be denied where the taxpayer seeks clemency because of financial problems.
- The "Decision Tree" further indicates that the IRS will show no mercy in situations where a taxpayer states that the information return was late because the transaction, tax law, or business structure was complicated.
- If the taxpayer claims that multiple layers of ownership prevent the taxpayer from obtaining all the data necessary to file a timely information return, the "Decision Tree" instructs the IRS not to abate penalties.
- Rejection of the penalty abatement request will also occur, according to the "Decision Tree," when the taxpayer cites challenges in obtaining the necessary foreign data as the excuse for late information returns.
- The "Decision Tree" demands imposition of penalties if the reason for late information returns is that the person with sole authority to file the information return was absent for a reason other than death or serious illness. Moreover, even if death or serious illness of the sole responsible person is claimed, the IRS will only accept this justification if (i) the corporation can provide tangible proof, such as an insurance claim, police report, letters or bills from hospitals, or newspaper clippings describing the event, (ii) the absence was not foreseeable, (iii) the absence occurred before and in close proximity to the filing deadline, and (iv) the taxpayer filed the information return within two weeks of when the absence ended.
- The IRS will not waive penalties under the "Decision Tree" if the taxpayer personally neglected to submit a filing-extension request for the income tax return

with which the information return is enclosed. Likewise, the "Decision Tree" denies abatement where the taxpayer hired a third-party (such as an accounting firm) to prepare returns and believed, erroneously, that such third-party submitted a filing-extension request.

- Abatement requests will also be rejected under the "Decision Tree" if the taxpayer relies on the ignorance-of-the-law defense and the taxpayer was either a U.S. resident or resided outside the United States but failed to hire and get advice from a U.S. tax professional.
- For purposes of seeking penalty abatement, the "Decision Tree" clarifies that reliance on an accountant or attorney might be appropriate in certain situations, but reliance by a taxpayer on the following types of people is not reasonable: Bookkeeper, financial advisor, business associate, information in a tax plan or promotion, and person assisting in establishing the corporation.
- The "Decision Tree" indicates that it might abate penalties based on the reasonable-reliance-on-a-qualified-tax-professional defense if, and only if, the taxpayer relied on an accountant or attorney, the taxpayer provided such tax professional all relevant information, the taxpayer supplied the information before the filing deadline, the tax professional advised the taxpayer that it was not required to file the particular information return, the taxpayer has tangible evidence to prove the preceding facts, and, in the opinion of the IRS, the taxpayer's reliance was reasonable. The "Decision Tree" goes on to state that the taxpayer's reliance will be considered unreasonable (and thus penalties will not be abated) if the taxpayer did not take reasonable steps to independently investigate or the taxpayer did not get a second opinion.

The non-application or narrow application of the substantially compliant/complete defense is particularly important because of the IRS's unique, harsh standards that often lead to rejection of "reasonable cause" in the context of Form 5471 and Form 5472. The guidance in the "Decision Trees" likely influences the thinking of IRS personnel in making penalty-abatement decisions about other international information returns, too. The inability to take advantage of the first-time-penalty-abatement policy, coupled with the IRS's extreme criteria for reasonable cause, looms heavy for taxpayers with international information return problems.

C. Violations Keep Assessment Periods Open

The most significant consequence of not filing international information returns generally is not the monetary penalty; rather, it is time. Specifically, the importance centers on the amount of time that the IRS has to conduct an audit and impose additional taxes, penalties, and interest charges. A relatively obscure procedural provision, Code Sec. 6501(c)(8)(A), contains a powerful tool for the IRS. It generally states that where a taxpayer fails to file in a timely manner a long list of international information returns (*e.g.*, Forms 926, 3520, 3520-A, 5471, 5472, 8621, 8858, 8865, and 8938) the assessment period remains open "with respect to any tax return, event, or period" to which the information return relates, until three years after the taxpayer ultimately files the information return.[57] Thus, if the taxpayer never files the requisite international information return, or files one that is not substantially compliant/complete, then the general three-year assessment period never begins to run against the IRS. This prevents taxpayers with international information return violations from running out the clock on the IRS.

The earlier IPU regarding Form 5471 penalties sheds additional light on this issue, which is applicable to all international information returns. Revenue Agents tend to begin auditing one or two years of income tax returns whose general assessment period remains open. To the extent that the Revenue Agent identifies tax non-compliance during those years, he expands the audit to cover all "open" years. Because of Code Sec. 6501(c)(8), the IPU instructs Revenue Agents to look forward and backward. The IPU states the following in this regard: "As you identify Forms 5471 that were required, but not filed, for the exam year(s), consider reviewing whether those forms were required, but not filed, in earlier tax years."[58] Moreover, the IPU takes the position that Code Sec. 6501(c)(8) holds the assessment-period open indefinitely not only where a taxpayer fails to file an international information return but also in instances where a taxpayer filed a timely but "substantially incomplete" one. The IPU emboldens Revenue Agents to advance the argument that "[t]he statute of limitations for assessing and collecting penalties under IRC § 6038 *expires three years after a substantially complete Form 5471 is filed*."[59]

The non-application or narrow application by the IRS of the substantially compliant/complete defense for all international information returns takes on additional weight given the fact that the IRS will cite to alleged deficiencies in an effort to extend audits to years that would have otherwise been closed long ago.

VI. Conclusion

As individuals and entities engage in more cross-border activities, U.S. tax compliance becomes increasingly complex, and violations of international information return duties occur with greater frequency. This reality is compounded by the new guidance from the IRS about whether penalties should apply and assessment-periods should be expanded. If Revenue Agents were to consult the new IPU, they might come away with the following beliefs: (i) the prior IRS rulings about substantially compliant/complete returns only have relevance to Form 5471 and Form 5472; (ii) the judicial substantial compliance doctrine might apply to other international information returns, but this remains unclear; (iii) Revenue Agents lack authority to independently decide whether the judicial substantial compliance might apply in a particular case, and they must consult at least two levels of IRS attorneys to get the answer; (iv) before deciding to elevate the issue, Revenue Agents should realize that federal courts (other than the Tax Court) have narrowly interpreted the judicial substantial compliance doctrine and that the doctrine might only apply to tax returns, not information returns; and (v) uncertainty remains as to which international information returns, exactly, the judicial substantial compliance doctrine could potentially apply in the first place. In light of the new IPU, combined with the IRS's historic reluctance to abate certain penalties after consulting the ultra-stringent "Decision Tree," a growing number of international information return battles will occur in the future.

ENDNOTES

[*] Hale specializes in tax audits, tax appeals, tax litigation, and international tax disputes and compliance. You can reach Hale by phone at (404) 658-5441 or by email at *hale.sheppard@chamberlainlaw.com*.

[1] Jasper L. Cummings, Jr., *LB&I International Practice Units*, Tax Notes 1077 (Nov. 23, 2015); Kristen A. Parillo & Jaime Arora, *IRS Plans to Release International Training Materials*, Tax Notes 1317 (Mar. 24, 2014).

[2] *Failure to File the Form 5471—Category 4 and 5 Filers—Monetary Penalty*, International Practice Unit (updated as of Oct. 7, 2015).

[3] Code Sec. 6038; Reg. §1.6038-2; Code Sec. 6046; Reg. §1.6046-1; Code Sec. 6679; Reg. §301.6679-1; Instructions to Form 5471.

[4] Code Sec. 6038(a)(2); Reg. §1.6038-2(i).

[5] Code Sec. 6038(b)(1); Reg. §1.6038-2(k)(1)(i); Code Sec. 6046(f); Reg. §1.6046-1(k).

[6] Code Sec. 6038(b)(2); Reg. §1.6038-2(k)(1)(ii); Code Sec. 6046(f); Reg. §1.6046-1(k).

[7] Reg. §1.6038-2(k)(3)(i).

[8] Reg. §1.6038-2(k)(3)(ii). The regulations refer to "substantial compliance" with the rules, while administrative and judicial guidance generally utilizes the concept of "substantial completeness."

[9] *Failure to File the Form 5471—Category 4 and 5 Filers—Monetary Penalty*, International Practice Unit (updated as of Oct. 7, 2015).

[10] *See* IRS News Release, IR-90-58, Mar. 29, 1990.

[11] Reg. §301.6651-1(c)(1); Reg. §1.6161-1(b).

[12] Reg. §301.6651-1(c)(1); Reg. §1.6161-1(b).

[13] 2002 IRS NSAR 20167, 2002 WL 32167873 (May 20, 2002).

[14] Act Sec. 339(a) of the Tax Equity and Fiscal Responsibility Act of 1982 (P.L. 97-248).

[15] Act Sec. 7403 of the Omnibus Budget Reconciliation Act of 1989 (P.L. 101-239).

[16] Act Sec. 11315 of the Omnibus Budget Reconciliation Act of 1990 (P.L. 101-508).

[17] Code Sec. 6038A(a); Reg. §1.6038A-1(c)(1).

[18] Code Sec. 6038A(c)(1); Reg. §1.6038A-1(c)(2),(3).

[19] Reg. §1.6038A-1(f).

[20] Code Sec. 6038C(a); Reg. §1.6038A-1(c)(1).

[21] Reg. §1.6038A-1(c)(5)(i).

[22] Code Sec. 6038A(c)(2); Reg. §1.6038A-1(d). For purposes of determining whether a domestic corporation is considered a "reporting corporation" because it has a 25-percent-foreign-shareholder and whether a person is considered a "related party," the regulations modify the constructive ownership rules of Code Sec. 318, further complicating the analysis. *See* Reg. §1.6038A-1(e)(1).

[23] Reg. §1.6038A-1(d)(3).

[24] Reg. §1.6038A-2(a)(2); Reg. §1.6038A-2(b)(3); Reg. §1.6038A-2(b)(4); Reg. §1.6038A-2(b)(5).

[25] Reg. §1.6038A-2(a)(2). To make matters even more complex, the regulations indicate that the "reportable transactions" in which either a U.S. partnership or a foreign partnership engages will be attributed to any "reporting corporation" whose ownership interest in the partnership (either direct or indirect), combined with the ownership interests of all "related parties" to the "reporting corporation," is 25 percent or more of the total partnership interests. Thus, if a partner is deemed to engage in "reportable transactions" with "related parties" under this special attribution rule, then it must properly disclose on Form 5472. The size of the transactions, though, is limited to the extent of the percentage of the partnership interest held by the "reporting corporation" partner. *See* Reg. §1.6038A-1(e)(2).

[26] Reg. §1.6038A-2(a)(1). The regulations contain various exceptions whereby a reporting corporation is not required to file a Form 5472. *See* Reg. §1.6038A-2(f).

[27] Reg. §1.6038A-2(a)(1).

[28] Code Sec. 6038A(d)(1); Reg. §1.6038A-4(a)(1).

[29] Reg. §1.6038A-4(a)(1).

[30] Code Sec. 6038A(d)(1); Reg. §1.6038A-4.

[31] Code Sec. 6038A(d)(3); Reg. §1.6038A-4(b)(1).

[32] Reg. §1.6038A-4(b)(2)(i).

[33] Reg. §1.6038A-4(b)(2)(iii).

[34] Reg. §1.6038A-4(b)(2)(iii).

[35] Reg. §1.6038A-4(b)(2)(i).

[36] T.D. 8040, 1985-2 CB 291, 50 FR 30160-01 (July 24, 1985), Preamble.

[37] Research also identified one court case that focused on Form 5472 penalties, *Seating Concepts, Inc.*, DC-CA, Case No. 02CV-0774, 002 WL 32692233 (2002). This case was settled before trial, with the taxpayer and the U.S. Department of Justice each conceding 50 percent of the issue/penalty.

[38] *Failure to file the Form 5471—Category 4 and 5 Filers—Monetary Penalty*, International Practice Unit (updated as of Oct. 7, 2015).

[39] IRS, *The Meaning of "Substantially Complete" with Reference to International Information Return Penalties*, updated May 31, 2017.

[40] IRS, *The Meaning of "Substantially Complete" with Reference to International Information Return Penalties*, updated May 31, 2017, at 4.

[41] *Indiana Rolling Mills Co.*, 13 U.S. Board of Tax Appeals 1141, 1144 (1928).

[42] *Indiana Rolling Mills Co.*, 13 U.S. Board of Tax Appeals 1141, 1144 (1928).

[43] IRS, *The Meaning of 'Substantially Complete' with Reference to International Information Return Penalties,* updated May 31, 2017, at 11.

[44] *L. Prussner*, CA-7, 90-1 USTC ¶60,007, 896 F2d 218.

[45] IRS, *The Meaning of "Substantially Complete" with Reference to International Information Return Penalties*, updated May 31, 2017, at 12.

[46] *Prussner*, CA-7, 90-1 USTC ¶60,007, 896 F2d 218, 224.

[47] IRS, *The Meaning of "Substantially Complete" with Reference to International Information Return Penalties*, updated May 31, 2017, at 15.

[48] IRS, *The Meaning of "Substantially Complete" with Reference to International Information Return Penalties*, updated May 31, 2017, at 19.

[49] IRS, *The Meaning of "Substantially Complete" with Reference to International Information Return Penalties*, updated May 31, 2017, at 15.

[50] IRS, *The Meaning of "Substantially Complete" with Reference to International Information Return Penalties*, updated May 31, 2017, at 15.

[51] IRS, *The Meaning of "Substantially Complete" with Reference to International Information Return Penalties*, updated May 31, 2017, at 19.

52 *Prussner*, CA-7, 90-1 USTC ¶60,007, 896 F2d 218.

53 IRM §20.1.1.3.6.1(7) (Aug. 5, 2014).

54 IRM §20.1.1.3.6.1(7) (Aug. 5, 2014).

55 IRM §20.1.1.3.6.1(8) and (9) (Aug. 5, 2014).

56 IRM Exhibit 21.8.2-1—Failure to File or Late-Filed Form 5471—Decision Tree; IRM Exhibit 21.8.2-2—Failure to File or Late-Filed Form 5472—Decision Tree.

57 Code Sec. 6501(c)(8)(B) contains a limitation, stating that the assessment period will remain open only with respect to "the item or items" related to the late Form 5472 if the taxpayer can demonstrate that the delinquency was due to reasonable cause and not due to willful neglect.

58 *Failure to File the Form 5471—Category 4 and 5 Filers—Monetary Penalty*, International Practice Unit (updated as of Oct. 7, 2015).

59 *Failure to File the Form 5471—Category 4 and 5 Filers—Monetary Penalty*, International Practice Unit (updated as of Oct. 7, 2015).