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## Speakers

- **Paul Manning**
  - Principal
  - Practice, Procedure & Administration
  - Washington National Tax
- **Steven M. Friedman**
  - Director
  - Practice, Procedure & Administration
  - Washington National Tax
- **Lauren Roberts**
  - Director
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## Speakers

- **Norlyn Miller, Jr.**
  - Director
  - Practice, Procedure & Administration
  - Washington National Tax
- **Douglas Holland**
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## Agenda

- Introduction
- Penalty Relief for Information Reporting Failures under FAQs 17 & 18 of the IRS Offshore Voluntary Disclosure Program
- Relief for Missed Gain Recognition Agreements & Dual Consolidated Loss Statements
- Curing Missed Elections
- Resolving Forms 1042, W-2, and 1099 Reporting Failures
- Q&A

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**Penalty Relief for  
Information Reporting  
Failures under FAQs 17 &  
18 of the IRS Offshore  
Voluntary Disclosure  
Program**

Lauren Roberts  
Paul Manning  
Steve Friedman

**FAQ Nos. 17 and 18**  
Another Opportunity to Cure Past Omissions

- **2012 Offshore Voluntary Disclosure Program**
  - Announced January 9, 2012
  - New Frequently Asked Questions (FAQs) Released June 26, 2012, including New FAQ Nos. 17 & 18!
- **FAQ Nos. 17 & 18 establish alternative procedure to the 2012 OVDP for eligible taxpayers to obtain an automatic waiver of certain information reporting penalties with respect to foreign bank/financial accounts and assets**

## **New FAQ Nos. 17 and 18**

### **What Is New?**

- **Program open for indefinite period until terminated by IRS.**
- **New restrictions on obtaining automatic penalty relief.**

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## **New FAQ Nos. 17 and 18**

### **What Is the Same?**

- **Reporting provisions covered under new FAQ Nos. 17 & 18: same international-related information returns as under the 2011 FAQ Nos. 17 & 18**
- **Automatic penalty relief – no demonstration of reasonable cause**
- **Eligible participants: individuals and entities (corporations, partnerships, trusts)**
- **Eliminate uncertainty – substantially incomplete information returns**

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### Delinquent FBAR Filings Penalty Relief Opportunity Under FAQ Number 17

- **Available to U.S. persons that reported, and paid tax on, all their taxable income for the years at issue but inadvertently did not file FBARs**
  - Available to U.S. entities or individuals that failed to report a financial interest in a foreign financial account or U.S. individuals with signature or other authority over such an account
  - Filer must not have been previously contacted regarding an income tax examination or a request for delinquent returns (for the year(s) at issue)
  - Under FAQ #17, delinquent FBARs are **not** filed under the OVDP, but rather are filed (in the “normal” manner) with the IRS in Detroit

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### Knowledge Check #1

**Which of the following U.S. persons cannot take advantage of the penalty relief offered by FAQ #17 with respect to an FBAR reporting failure:**

- A. A U.S. individual that had signature authority over 25 foreign financial accounts of his employer
- B. A U.S. partnership that had legal title to a bank account in the Cayman Islands
- C. A U.S. corporation that indirectly owns foreign financial accounts through a controlled foreign corporation
- D. A U.S. corporation that is currently under IRS exam for the calendar year at issue

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### Knowledge Debrief

- **Correct Answer: D**

A U.S. corporation under IRS examination cannot seek penalty relief for the failure to file an FBAR if the calendar year for which penalty relief is sought is currently under IRS exam

- **Answers A, B, & C are incorrect as penalty relief under FAQ #17 is available to U.S. individuals that inadvertently failed to report foreign financial accounts over which they have signature authority, regardless of the number of such accounts, as well as U.S. entities that have a financial interest in foreign financial accounts owned either directly or indirectly.**

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### Delinquent International-Related Information Returns Automatic Penalty Relief Under FAQ No. 18

**Available to U.S. persons who:**

- **Reported, and paid tax on, all taxable income attributable to ownership of, and transactions with, foreign entities and accounts**
- **Recently learned of reporting requirement**
- **Have not been contacted by IRS regarding an income tax examination or a request for delinquent returns**
- **Eligible forms-Penalty relief limited to failure to comply with foreign information reporting rules**
  - Income tax returns do not qualify (e.g., Form 1120-F)

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## **International-Related Information Returns**

### **Automatic Penalty Relief Under FAQ No. 18**

- **Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation**
- **Form 3520, Annual Return to Report Transactions with Foreign Trusts & Receipt of Certain Foreign Gifts**
- **Form 3520-A, Annual Information Return of Foreign Trust with a U.S. Owner**
- **Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations**

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## **International-Related Information Returns – cont'd.**

### **Automatic Penalty Relief Under FAQ No. 18**

- **Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business**
- **Form 8858, Information Return of U.S. Persons With Respect to Foreign Disregarded Entities**
- **Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships**
- **Form 8938, Statement of Specified Foreign Financial Assets**

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### **Delinquent International-Related Information Returns Automatic Penalty Relief Under FAQ No. 18**

- **Consider whether benefit to making a joint FAQ No. 18-  
reasonable cause relief request submission**
  - Implications of Section 6501(c)(8)

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### **FAQ Nos. 17 and 18 Another Opportunity for Automatic Penalty Relief**

- **FAQ Nos. 17 & 18 present a significant opportunity for taxpayers who properly reported, and paid tax on, all their taxable income to obtain automatic penalty for delinquent filings, including opportunity to cure returns which may be considered substantially incomplete.**
- **More important than ever for taxpayers to cure past omissions and errors given:**
  - Increased IRS scrutiny of international transactions and ownership of foreign assets
  - Increased IRS enforcement of international-related information reporting provisions and applicable penalties

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## Knowledge Check #2

**Requests for automatic penalty relief under FAQ No. 18 must be submitted by which of the following dates?**

- A. August 31, 2012
- B. September 30, 2012
- C. December 31, 2012
- D. Currently no ending date for submission under FAQ No. 18

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## Knowledge Debrief

- **Correct Answer: D**  
**(Currently no ending date for submission under FAQ No. 18)**
- **Although there is currently no ending date for a submission under FAQ No. 18, we recommend that it be filed as soon as possible because**
  - The IRS could announce an ending date to this program at any time, or
  - The IRS could contact the taxpayer regarding an income tax examination or make a request for delinquent returns.

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## Relief for Missed Gain Recognition Agreements & Dual Consolidated Loss Statements

Doug Holland

### In General

- **International provisions of the Code and regulations thereunder contain many elections and timely filing requirements**
  - *E.g.*, gain recognition agreements (GRAs); dual consolidated loss (DCL) elections; QEF, MTM and purging elections for PFICs via Form 8621; FIRPTA notices of non-USRPI status and nonrecognition treatment
- **If a regulatory election is not timely filed, baseline fix is “9100 Relief”**
  - Must typically notify IRS before they catch mistake and show reliance on qualified professional; no “hindsight”
  - Must pay user fee and can be involved process
  - Results in a PLR from IRS national office that grants taxpayer permission to file amended return that includes late election
- **Some provisions have their own self-contained “reasonable cause” exceptions for curing missed elections**
  - GRAs, DCLs, FIRPTA (Rev. Proc. 2008-27)

### Reasonable Cause: Common Aspects

- Taxpayer must file amended (no-change) return that includes the document(s) that should've been timely included
- Taxpayer must include a memorandum/document demonstrating that the failure to file was due to reasonable cause and not willful neglect
  - Facts & narrative discussing what that led to missed filing
  - Analogous authorities: case law and Internal Revenue Manual
- Standards can be more stringent than for "9100 Relief"
  - Do you need a better reasonable cause than "my return preparer missed it and I'm telling you before you raise it on audit"?
  - Anecdotal evidence of IRS rejecting some submissions, noting that taxpayer would've satisfied 9100 relief standards but did not satisfy reasonable cause standards

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### GRAs: Background and Context

- GRA's are generally required when U.S. shareholders transfer stock "outbound" to foreign subsidiaries
  - Exception if less than 5% actual & constructive ownership
  - More generally, are commonly implicated in internal restructurings by U.S. multinationals of foreign subsidiaries
  - Complying with GRA satisfies Section 6038B/Form 926 reporting obligation for outbound stock transfer. IRS considering guidance on coordinating penalty issues for missed GRA's.
- GRA document requires extensive information about transferred and foreign transferee corporations, including adjusted U.S. tax basis and fair market value of transferred stock interest.
  - Taxpayers may be unable or unwilling to spend resources to determine this information
  - Long-running saga over "available on request"
  - IRS suggests in preamble to 2009 regs, field advice that it's serious about expecting this data to view GRA as complete

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## GRA Directive

- Issued July 26, 2010
- Applies when taxpayer has timely filed either: (i) a proper GRA and then missed later associated filings, or (ii) timely filed a document “purporting” to be a GRA but which does not satisfy the regulatory standards in 1.367(a)-8.
  - “Available on request”
  - Does not apply if initial GRA (or purported GRA) filing was not timely—still must seek reasonable cause
- Can cure filings in these instances without having to demonstrate reasonable cause by filing amended returns with proper GRA/associated filings and indicating that they are submitted pursuant to directive
- No clear expiration date; IRS officials publicly remind that it won’t last forever [but it still hasn’t been pulled]

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## DCLs: Background and Context

- Generally aimed at preventing “double dipping” of corporate losses, restrict ability to deduct losses incurred by dual resident corporations and “separate units” (interest in hybrid entities and foreign branches) owned by domestic corporations
- DCL rules contain numerous filing obligations, most common of which are “domestic use elections” to avoid deductibility restriction and five years of “annual certifications” thereafter
- Large number of 9100 Relief PLRs issued for missed filings as taxpayers became more aware of DCL rules in early-to-mid 2000’s
- 2007 DCL Regulations finalized a “reasonable cause” procedure for curing missed or deficient DCL filings
  - Rules contained in Treas. Reg. § 1.1503(d)-1(c)
  - Applies to all DCL filings, including those filed under the 1992 DCL regulations, and is the exclusive method for curing

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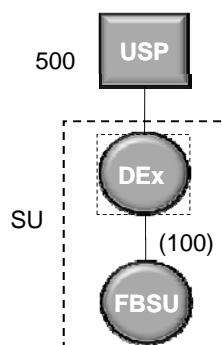
## DCL Reasonable Cause Relief: Mechanics

- Taxpayer must file an amended return for the year of the missed or deficient filing
  - Must include with amended return the proper filing(s) as well as a statement establishing reasonable cause
- If taxpayer is under exam for any taxable year when seeking relief, must provide of copy of entire reasonable cause request to the exam team
- If not under exam, must provide a copy to the local LB&I Director

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## AM 2008-001—DCL Reasonable Cause Relief (Jan. 2008)



- Issue
  - Whether a reasonable cause request under Treas. Reg. § 1.1503(d)-1(c) can be considered with respect to DCLs incurred in a taxable year for which the period for assessment and collection of tax has expired under the rules of section 6501(a)?
- Base Facts
  - Except for Scenario 3, the DCL of <100> is fully absorbed by current year income of the USP home office
  - Period of limitations under section 6501(a) has expired for certain years and has not expired for other years
  - *Note: numbers added for illustration purposes and were not included in Advice Memo*

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**AM 2008-001—DCL Reasonable Cause Relief (January 2008)  
(cont'd.)**

- **Scenario 1: DCL is attributable to Separate Unit in years 1 & 2**

- USP did not timely file domestic use elections or related annual certifications, yet still used both the year 1 DCL and year 2 DCL on its respective U.S. returns
- In year 5, USP requests reasonable cause relief as to all missed filings. At this point, year 1 is closed while years 2 through 4 are open

- **Conclusion:**

- Reasonable cause relief request to file a domestic use election and annual certifications should not be accepted for consideration with respect to the year 1 DCL since that year is closed, but should be accepted with respect to the year 2 DCL (as that year is still open)

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**AM 2008-001—DCL Reasonable Cause Relief (January 2008)  
(cont'd.)**

- **Scenario 2: DCL is attributable to Separate Unit in year 1**

- USP timely filed a domestic use election with respect to the year 1 DCL and used the entire year 1 DCL on its year 1 income tax return
- USP did not timely file annual certifications with respect to the year 1 DCL in years 2 through 5
- USP did not recapture the year 1 DCL in year 2 (or any other year)
- In year 6, USP requests reasonable cause relief for the failure to timely file the annual certifications. At this point, years 1 and 2 are closed while years 3 through 5 are still open

- **Conclusion:**

- Reasonable cause relief request to file annual certifications should not be accepted for consideration because the failure to file the annual certification in year 2 was a triggering event that terminated the domestic use election and agreement (Treas. Reg. § 1.1503(d)-6(j)(1)(iii)), and year 2 is now closed

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### AM 2008-001—DCL Reasonable Cause Relief (January 2008) (cont'd.)

- **Scenario 3: DCL is attributable to Separate Unit in year 2**
  - New facts: USP incurred a <\$800> NOL in Year 1; the SU had 0 net income. In Year 2, USP earned 100 of income which was fully offset on USP's Year 2 return by SU year 2 DCL of <100>
  - USP did not timely file a domestic use election or related annual certifications with respect to the year 2 DCL
  - The year 1 NOL, which is larger than the year 2 DCL, has been carried forward to year 6
  - In year 6, USP requests reasonable cause relief for the failure to timely file the domestic use election for the year 2 DCL and related annual certifications. At this point, year 2 is closed, but years 3 through 5 are open
- **Conclusion:**
  - Reasonable cause relief request should be accepted for consideration because although year 2 is closed, the IRS has authority to adjust an NOL for improper actions in otherwise closed years
  - In year 2, the DCL improperly offset income of the USP group (the 100 of USP income) that would otherwise have been offset by the Year 1 NOL. Therefore, IRS has authority to reduce the NOL carryover in year 6 by the 100 DCL that was improperly used in year 2

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### Knowledge Check #3

- **The July 2010 GRA LMSB Directive is applicable to taxpayers that failed to timely file a GRA with the return for the year of the outbound stock transfer.**
- **True or false?**

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## Knowledge Debrief

- **Correct Answer: False**

The Directive only applies where the taxpayer filed something “purporting” to be a GRA for the relevant year but the filing is deficient, or else does timely file a compliant GRA but then later fails to timely file one of the attendant follow-on requirements (e.g., an annual certification)

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## Curing Missed Elections

Lauren Roberts  
Norlyn Miller, Jr.

## Curing Missed Elections

- **S Corp, Q Sub, ESBT & QSST elections**
  - Rev. Procs. 97-48, 2003-43 & 2007-62
- **Simultaneous S Corp / Check-the-box elections**
  - Rev. Procs. 2004-48 & 2007-62
- **Section 338 elections**
  - Rev. Proc. 2003-33

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## Curing Missed Elections

- **FIRPTA statements & notices**
  - Rev. Proc. 2008-27
- **Aggregation of Rental Real Estate Activities**
  - Rev. Proc. 2011-34
- **Check-the-box elections**
  - Rev. Proc. 2009-41

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### Rev. Proc. 2009-41

- **Granting relief for late entity classification elections pursuant to Reg. sec. 301.7701-3(c) (check-the-box elections)**

- Requirements:

- Treatment consistent with desired classification
- Demonstrate reasonable cause for missed election
- Relief requested within 3 years & 75 days of election's desired effective date

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### Rev. Proc. 2009-41 – Common Filing Errors

- **Inadequate explanation of reasonable cause**
- **Failure to properly identify the affected person(s) and obtain signatures for required declaration**

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### Rev. Proc. 2009-41 – What is “Reasonable Cause”?

- **Demonstrating that taxpayer(s) acted reasonably and in good faith as defined in Reg. sec. 301.9100-3(b)**
  - Intervening event(s)
  - Reasonable diligence yet unaware of election, or
  - Reliance upon tax professional
  - Unless:
    - Section 6662 penalty applicable
    - Chose not to make election, or
    - Uses hindsight

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### Rev. Proc. 2009-41 – Who is an “Affected Person”

- **A person who would have been required to attach a copy of Form 8832 to its federal tax or information return for the tax period that includes the election’s effective date; or**
- **A person who would have been required to attach a copy of Form 8832 to its federal tax or information return for the tax period subsequent to the election’s effective date.**

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#### Knowledge Check #4

**Which of the following IRS revenue procedures is used to request reasonable cause relief for a late entity classification election?**

- A. Rev. Proc. 2003-33
- B. Rev. Proc. 2012-1
- C. Rev. Proc. 2009-41
- D. Rev. Proc. 2008-27

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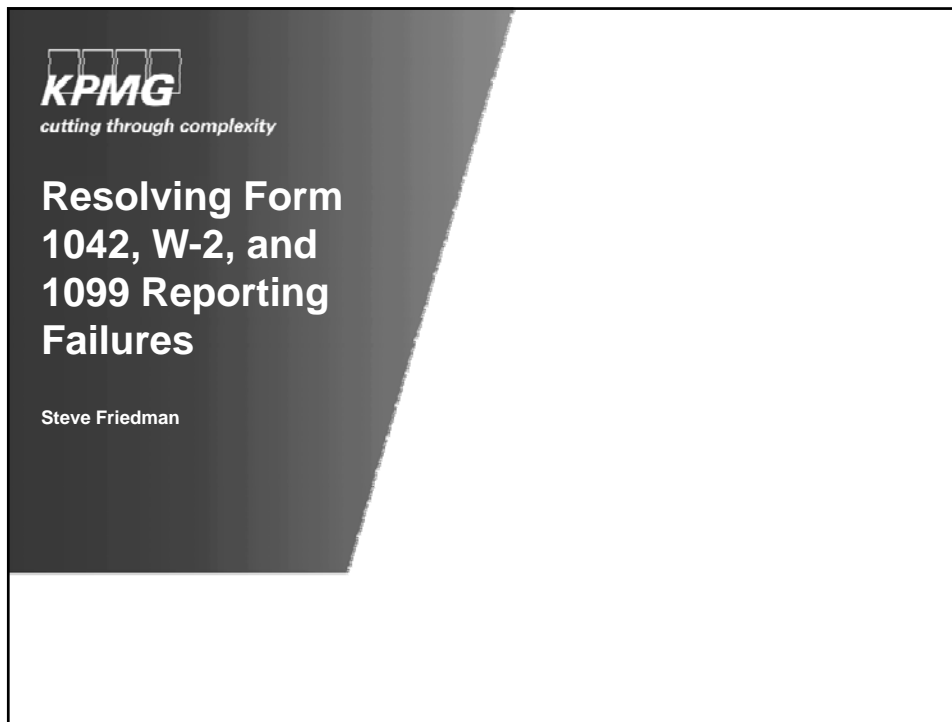
#### Knowledge Debrief

- **Correct Answer: C**

**Rev. Proc. 2009-41 is used to request reasonable cause relief for a late entity classification election under Reg. sec. 301.7701(c)**

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### IRS Now Has Significant Interest in Section 1441 Compliance

- **The IRS is now aggressively pursuing withholding agents' compliance with Form 1042**
  - Internal Revenue Manual audit section
  - Over 2,000 trained IRS examiners
- **Be prepared for IRS review of accounts payable (vendor) payments**
  - License fees, royalties, interest, etc.
  - Payments for services, including bundled services (tied to purchase of an asset)
- **IRS expected to be much tougher in upcoming audits**

## Form 1042 Reporting & Withholding What Could Go Wrong

- **If proper documentation is not obtained**
  - US withholding agent liable for the amount that should have been withheld (generally at the statutory rate of 30%)
  - 20% negligence/substantial understatement of income tax penalty
  - 10% late deposit penalty
  - Interest imposed from original due date of Form 1042
  - \$100 penalties for 1042-S reporting failures

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## Mitigating Form 1042 Exposure Risk

- **Remedy what you can**
  - Obtain retroactive forms for missing or invalid documentation
  - Review documentation and take curative steps (e.g., support for foreign source treatment of services rendered)
  - File amended returns (to mitigate penalties)
- **Consider making a voluntary disclosure to the IRS**

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### Wage Reporting & Withholding What Could Go Wrong

- **Errors in reporting taxable wage payments**
  - Overlooked taxable fringe benefits
  - Non-cash wages – e.g., stock options exercised
    - Must make necessary arrangements for withholding
- **Employer is liable for amount that should have been withheld (generally at the 25% supplemental wage withholding rate)**
- **Form 941 – 20% negligence penalty**
- **Incorrect W-2 forms**
  - \$100 penalty for filing incorrect W-2 forms with IRS (\$1.5 annual max)
  - \$100 penalty for furnishing incorrect forms to employees (\$1.5 annual max)
  - Higher penalties for intentional disregard of reporting requirements

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### Form 1099 Reporting & Withholding What Could Go Wrong

- **Errors in reporting to customers, shareholders, vendors, etc.**
- **Incorrect Forms 1099**
  - \$100 penalty for filing incorrect 1099 forms with IRS (\$1.5 annual max)
  - \$100 penalty for furnishing incorrect forms to payees (\$1.5 annual max)
  - Higher penalties for intentional disregard of reporting requirements
- **Potential liability for backup withholding at current withholding rate of 28%**
- **Form 945 – 20% negligence penalty**

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### **Administrative Requirement of Fixing Form W-2 or Form 1099 Withholding/Reporting Failures**

- **Corrected information returns to the IRS**
- **Copies sent to employees, customers, shareholders, or vendors (with likely explanatory letters)**
- **Corrections/adjustments to Forms 941 or 945**
- **Amended income tax returns may need to be filed by employees, customers, shareholders, or vendors**

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### **Alternative Approaches Can Be Successful**

- **Taxpayer contacts the IRS and makes a voluntary disclosure**
- **An alternative approach to filing corrected information returns and amended income tax returns is proposed**
- **A negotiated settlement can be reached – in some case a closing agreement is entered into with the IRS**
  - Brings finality to the problem
  - Fixes the amount of the settlement payment
  - Resolves potential penalty issues
  - Determines what impact the settlement has on payees

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### **Knowledge Check #5**

- **In addition to penalties for information reporting failures, a payor can be held liable for amounts that should have been withheld from reportable payments.**
- **True or false?**

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### **Knowledge Debrief**

- **Correct Answer: True**  
**A payor can be liable for amounts that should have been withheld from reportable payments**

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### Polling Question

- Would you like a KPMG professional to contact you regarding the topics discussed today?
  - Yes
  - No

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# Q&A

## Q&A (cont'd.)

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