

LB&I International Practice Service Process Unit – Audit

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Sub-Chapter	12.2.2.1	Form 3520/3520-A - Information Return Filing Requirements	–	–

Unit Name	Failure to File the Form 3520/3520-A - Penalties
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Process Overview

Failure to File the Form 3520/3520-A Penalties

Process Description

There are a number of possible reasons for a United States (U.S.) taxpayer to utilize offshore entities and accounts. For example, trusts are used to place assets in the hands of competent managers when there is doubt about the ability of the beneficiaries to effectively manage the assets themselves. Trusts also offers a means to manage a single asset for the benefit of a virtually limitless number of beneficiaries, while keeping the asset intact. The establishment of a foreign trust is a legal way to protect assets, but the failure by certain U.S. persons (USP) to report the establishment of, contribution to, certain obligations in consideration of a transfer, or distributions from a foreign trust, could subject a U.S. taxpayer to stiff penalties for failure to file information returns.

International information return penalties are civil penalties assessed on a USP for failure to timely file complete and accurate international information returns. This practice unit discusses information returns that must be filed when a taxpayer has certain transactions or relationships with a foreign trust: these include Form 3520 – *Annual Return to Report Transactions with a Foreign Trust and Receipt of Certain Foreign Gifts* and Form 3520-A – *Annual Information Return of a Foreign Trust With a U.S. Owner*. The unit also discusses steps to determine if the taxpayer has filed the required information returns, the penalties that may result if returns are not filed, and the procedures for pursuing these penalties.

The first step in determining whether information returns must be filed is to establish whether the entity should be classified as a foreign trust for U.S. tax purposes. The Practice Unit entitled *Defining the Unit – Foreign Trusts*, will assist in making this determination. If the entity is classified as a foreign trust, determine if the USP has any reportable transactions with the foreign trust for which information returns are required.

Process Overview (cont'd)

Failure to File the Form 3520/3520-A Penalties

Process Description

Below is a brief summary of each of the forms covered in this unit and what type of information is reported on each.

Form 3520 - Annual Return to Report Transactions with a Foreign Trust and Receipt of Certain Foreign Gifts

There are four different parts to the Form 3520. Depending on the type of reportable transactions, the taxpayer might need to complete one, two or all parts of the Form 3520.

- Part I** - Completed by a U.S. person who transfers money or other property to a foreign trust during the current tax year.
- Part II** - Completed by a U.S. person treated as the owner of a foreign trust under the rules of IRC §§671 through 679.
- Part III** - Completed by a U.S. person who received distributions or used foreign trust property without providing sufficient compensation for the use of the property.
- Part IV** - Reporting of certain foreign gifts or bequests received by U.S. recipients during the current tax year from foreign persons. Note: The Filing Requirements for foreign gifts and the penalties associated with the Failure to File the Form 3520 regarding foreign gifts will be covered in another Practice Unit.

Form 3520-A – Annual Information Return of a Foreign Trust with a U.S. Owner

The Form 3520-A is an annual return filed by the foreign trust setting forth a full and complete accounting of trust activities and trust operations for the year. The USP treated as the owner of the foreign trust under the rules of IRC §§671 through 679, is responsible for ensuring that the foreign trust annually files this form and furnishes certain information to its U.S. owners and beneficiaries, who responsible for including this information on their Form 3520 filings. If the foreign trust does not file the Form 3520-A, the USP treated as the owner, must file a substitute Form 3520-A.

Since enforcement against foreign entities can be difficult, U.S. tax law often makes a USP accountable for filings and liable for any applicable taxes and/or penalties.

Process Overview (cont'd)

Failure to File the Form 3520/3520-A Penalties

Example Circumstances Under Which Process Applies

This process applies when it has been determined that a U.S. taxpayer had a reportable transaction(s) with a foreign trust for which they failed to file the appropriate information return(s) - Form 3520 and/or Form 3520-A. Some examples of reportable transactions include, but are not limited to, the following:

- Transfers to a foreign trust by a USP for less than fair market value
- Creation of a foreign trust by a USP
- Distributions received by a USP from a foreign trust
- A USP's uncompensated use of a foreign trust's assets
- USP treated as the owner of a foreign trust

Determination of Process Applicability

Failure to File the Form 3520/3520-A Penalties

Criteria	Resources	6103 Protected Resources
<p>Who must file Form 3520?</p> <ul style="list-style-type: none"> ▪ USP who creates a foreign trust. ▪ USP who transfers money or property (either directly or indirectly) to a foreign trust, including by reason of death ▪ USP who transfers property to a related foreign trust in exchange for an obligation of the foreign trust (or of a person related to the foreign trust) and treats the obligation as a “Qualified Obligation” under Notice 97-34 during the current year ▪ The executor of an estate of a U.S. citizen or U.S. resident decedent if at the time of death: <ul style="list-style-type: none"> – The U.S. citizen or resident decedent was treated as the owner of any portion of the foreign trust, or – Any portion of the foreign trust was included in the gross estate of the decedent ▪ USP treated as the owner of a Foreign Trust ▪ USP who receives a distribution (either directly or indirectly) from a foreign trust, or has the uncompensated use of the foreign trust assets 	<ul style="list-style-type: none"> ▪ Form 3520 ▪ IRC 6048(a)(3)(A)(i) ▪ IRC 6048(a)(3)(A)(ii) ▪ Notice 97-34 ▪ IRC 6048(a)(3)(A)(iii) ▪ IRC 6048(b) ▪ IRC 6048(c) 	

Determination of Process Applicability (cont'd)

Failure to File the Form 3520/3520-A Penalties

Criteria	Resources	6103 Protected Resources
<p>Common exceptions to filing Form 3520:</p> <ul style="list-style-type: none"> ▪ Transfer to, ownership of, and distributions from a Canadian registered retirement savings plan (RRSP) or a Canadian registered retired income fund (RRIF) where the U.S. citizen or resident alien holding an interest is eligible to file Form 8891 ▪ Transfers to foreign trusts for fair market value ▪ Transfers to employee plan trusts (including trusts containing deferred compensation) and transfers to charitable trusts. 	<ul style="list-style-type: none"> ▪ Notice 2003-75 , IRC 6048(d)(4) ▪ IRC 6048(a)(3)(B)(i) ▪ IRC 6048(a)(3)(B)(ii) 	

Determination of Process Applicability (cont'd)

Failure to File the Form 3520/3520-A Penalties

Criteria	Resources	6103 Protected Resources
<p>Who must file Form 3520-A?</p> <ul style="list-style-type: none"> ▪ The trustee of the foreign trust must file Form 3520-A in any year in which a USP is treated as the owner of any portion of the foreign trust. See IRC §§671-679 for Grantor Trust rules and other IPS units covering when a U.S. person is treated as the owner of a foreign trust. In addition, see IRM 20.1.9.14.1. ▪ If the Foreign Trust does not complete a Form 3520-A, the U.S. Owner must complete and attach a substitute Form 3520-A to Form 3520, otherwise the U.S. owner may be liable for the penalties under IRC §6677(b). <p>Common Exception to Filing Form 3520-A</p> <ul style="list-style-type: none"> ▪ Canadian registered retirement savings plans (RRSPs) and Canadian registered retirement income funds (RRIFs) are not subject to IRC §6048 reporting and thus are not required to file Form 3520-A with respect to a U.S. citizen or resident alien interest holder who is eligible to file Form 8891, <i>US. Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans</i>. 	<ul style="list-style-type: none"> ▪ Form 3520-A, ▪ IRC 6048(b) ▪ IRC 671 – 679, Grantor Trust Rules ▪ IRC 671, IRC 672, IRC 673 ,IRC 674, ▪ IRC 675, IRC 676, IRC 677, IRC 678, ▪ IRC 679 ▪ IRM 20.1.9.14.1 ▪ IRC 6677(b) ▪ Practice Unit, “Foreign Grantor Trust Determination – Part I – Section 679,” DCN: FEN/9434.02--2 ▪ Practice Unit, “Foreign Grantor Trust Determination – Part II - Sections 671-678,” DCN:FEN/9434.02_07 ▪ Notice 2003-75 	<p>Back to Table Of Contents</p>

Determination of Process Applicability (cont'd)

Failure to File the Form 3520/3520-A Penalties

Criteria	Resources	6103 Protected Resources
<p>Statute of Limitations Consideration:</p> <ul style="list-style-type: none"> ▪ The statute of limitations for assessing IRC §6677(a) and IRC §6677(b) penalties ends three years after a complete and accurate Form 3520 and/or 3520-A is filed. 	<ul style="list-style-type: none"> ▪ IRC 6677(a) ▪ IRC 6677(b) ▪ Director, LB&I-IIC – Memo (1/9/2013) - Statute Of Limitations on Assessment of Foreign Information Return Penalties 	

Summary of Process Steps

Failure to File the Form 3520/3520-A Penalties

<u>Step 1</u>	Verify Failure to File
<u>Step 2</u>	Penalty Case File Controls
<u>Step 3</u>	Penalty Determination
<u>Step 4</u>	Penalty Application/Closing Procedures

Step 1

Failure to File the Form 3520/3520-A Penalties

Step 1: Verify whether the USP filed or failed to file Form(s) 3520 and/or Form(s) 3520-A

You have determined that the taxpayer had a reportable event with a foreign trust as outlined previously. Either the USP is required to file a Form 3520 and/or 3520-A by reason of an IRC section or the USP is considered the owner of a foreign trust. Before commencing a penalty case file, verify whether the taxpayer filed a timely and accurate information return Form 3520 and/or Form 3520-A.

Considerations	Resources	6103 Protected Resources
<p>Form 3520 – Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts – Filing Considerations</p> <ul style="list-style-type: none"> ▪ Due when USP’s income tax return is due, including extensions. Beginning for tax years after December 31, 2015 the due date will be April 15th with a maximum extension of 6 months. ▪ Filed separately from USP’s income tax return: <ul style="list-style-type: none"> – Internal Revenue Service Center, P.O. Box 409101. Ogden, UT 84409 ▪ A joint Form 3520 may be filed by individuals only if they also file a joint Form 1040, <i>U.S. Individual Income Tax Return</i>. ▪ A separate Form 3520 is required for each foreign trust. If Form 3520 is filed by a USP treated as the owner, the Form must have a copy of the owner’s statement from Form 3520-A attached. ▪ Verify filing of these forms using the Integrated Data Retrieval System (IDRS) <ul style="list-style-type: none"> – Begin research with BMFOLI under the Taxpayer Identification Number (TIN) of the USP responsible for filing the return. If the USP is an individual, the TIN will be the SSN + “v” (or “W” if an invalid SSN) – Form 3520 can be identified with Master File Transaction (MFT) 68.posting – Previous civil penalties may have been assessed, research IDRS for MFT 13 (Business Master File - BMF) or MFT 55 (Individual Master File - IMF) modules. 	<ul style="list-style-type: none"> ▪ IRM 20.1.9.13 & IRM 20.1.9.14 ▪ IRC 6048 Information with respect to certain foreign trusts ▪ Form 3520 	

Step 1 (cont'd)

Failure to File the Form 3520/3520-A Penalties

Step 1: Verify whether the USP filed or failed to file Form(s) 3520 and/or Form(s) 3520-A

Considerations	Resources	6103 Protected Resources
<p>Form 3520-A – Annual Information Return of Foreign Trust With a U.S. Owner – Filing Considerations</p> <ul style="list-style-type: none"> ▪ Due on 15th day of 3rd month after the end of the trust’s tax year. ▪ Filed separate from the owner’s income tax return: <ul style="list-style-type: none"> – Internal Revenue Service Center, P.O. Box 409101. Ogden, UT 84409 ▪ The form is filed by the foreign trust (FT), but the US owner is responsible to ensure it is filed timely and accurately. ▪ Form 3520-A includes a balance sheet and income statement for the trust, as well as statements for each person treated as the owner and each beneficiary who received a distribution from the foreign trust during the tax year.. ▪ An extension of time to file can be granted by filing Form 7004 ▪ Verify filing of these forms using the Integrated Data Retrieval System (IDRS) <ul style="list-style-type: none"> – The FT is required to file the Form 3520-A using its own Employer Identification Number (EIN.) – Begin research with BMFOLI under the EIN of the FT. – Form 3520-A can be identified with a MFT 42 posting. – Previous civil penalties may have been assessed against the US owners who are responsible for the proper filing of this form, research IDRS for MFT 13 (BMF) or MFT 55 (IMF) modules. 	<ul style="list-style-type: none"> ▪ IRM 20.1.9.13.1(7) for 3520, Notice 97-34 section IV A ▪ Form 3520-A, ▪ IRM 20.1.9.14.1(8) for Form 3520-A ▪ IRC 6081 	

Step 2

Failure to File the Form 3520/3520-A Penalties

Step 2: Penalty Case File Controls

If it is determined the taxpayer has failed to file a timely and accurate information return, the next step is to establish a penalty case file, and prepare and issue the notice letter.

Considerations	Resources	6103 Protected Resources
<p>Establish a penalty case file</p> <ul style="list-style-type: none"> ▪ Establish controls and prepare a penalty case file. This file must include the information that establishes there is a filing requirement and the Forms 3520 and/or 3520-A have not been filed. ▪ Submit Form 5345-D for managerial approval to establish controls: <ul style="list-style-type: none"> – Check box for “Control Penalty Investigation.” – For Form 3520 – Initial Penalty <ul style="list-style-type: none"> – MFT = PU, Activity Code = 586, Source Code = 99 – Form 3520-A – Initial Penalty <ul style="list-style-type: none"> – MFT = PV, Activity Code = 586, Source Code = 99 – Continuation Penalty for Both Forms 3520 & 3520-A <ul style="list-style-type: none"> – MFT = PQ, Activity Code = 586, Source Code = 99 – Assessment Statute Expiration Date (ASED) will default to 01/31/YY+4. Upon receipt of delinquent information returns, update ASED to three years from receipt date. – Reason for Request is “To control penalty investigations for Form 3520/3520-A-returns not filed” 	<ul style="list-style-type: none"> ▪ IRM 20.1.9.2 – Assessment Procedures for Penalties Not Subject to Deficiency Procedures ▪ Exhibit 20.1.9.1 – Quick Reference Guide to International Penalties 	

Step 2 (cont'd)

Failure to File the Form 3520/3520-A Penalties

Step 2: Penalty Case File Controls

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none">▪ Examiners charge time to the penalty case file.▪ Examiners inform the taxpayer of the requirements to file <u>and</u> the intent to assess the penalty for failure to comply.▪ The examiner requests the returns and proceeds with the first Notice Letter.	<ul style="list-style-type: none">▪ IRM 20.1.9.2 (10)▪ Form 5345-D ▪ IRM 20.1.9.2(11)/ IRM 20.1.9.2(12)	

Step 2 (cont'd)

Failure to File the Form 3520/3520-A Penalties

Step 2: Penalty Case File Controls

Considerations	Resources	6103 Protected Resources
<p>Prepare and issue the Notice letter</p> <ul style="list-style-type: none"> ▪ <u>Letter 3804</u> is an opening notice letter required to be mailed to a taxpayer under the provisions of IRC 6677(a) for both Form 3520 and 3520-A. ▪ Mailed via Certified Mail with Publication 1 and Notice 609 ▪ Issue the notice letters at the earliest date possible. ▪ Letter 3804 informs the taxpayer the following: <i><u>“This letter is your notice that we will charge you an Initial Penalty.”</u></i> In addition it states <i>“We will also charge an additional Continuing Penalty, if you do not submit complete and accurate return(s) within 90 days from the date of this letter.”</i> ▪ Notice letters must be signed by an examination group manager in SB/SE or a revenue agent in LB&I. 	<ul style="list-style-type: none"> ▪ Letter 3804 Notice Required by IRC 6677 ▪ IRM 20.1.9.13.2 Penalty Letters, Notice Letters and Notices ▪ IRM 20.1.9.2(13) Notice Letters ▪ Delegation Order LMSB-193-4 for Form 3520 ▪ Delegation Order LMSB-193-5 for Form 3520-A 	

Step 2 (cont'd)

Failure to File the Form 3520/3520-A Penalties

Step 2: Penalty Case File Controls

Considerations	Resources	6103 Protected Resources
<p>Miscellaneous Penalty Case Considerations:</p> <ul style="list-style-type: none"> ▪ Only one P9 penalty module can be open for a given year. This module may represent multiple civil penalties which will be represented by separate physical case files. ▪ The ASED on Examination Returns Control System (ERCS), should represent the shortest penalty statute. ▪ The penalty ASED can be extended using Form 872 	<ul style="list-style-type: none"> ▪ Form 872 <i>Consent to Extend the Time to Assess Tax</i> ▪ Director, LB&I-IIC – Memo (1/9/2013) - Statute Of Limitations on Assessment of Foreign Information Return Penalties 	

Step 3

Failure to File the Form 3520/3520-A Penalties

Step 3: Penalty Determination

The penalty case file has been established and the Notice Letter has been mailed to the taxpayer. Now, determine what penalties may apply and how they are computed, as well as whether the taxpayer can argue reasonable cause for failure to file.

Considerations	Resources	6103 Protected Resources
<p>Penalty Structure</p> <p>If Form 3520 is not filed on or before the due date (including extensions) of the USP's income tax return or the Form 3520-A is not filed on or before the 15th day of the 3rd month after the end of trust's year (including extensions), or if the applicable form does not include all the information required or includes incorrect information, then Initial and Continuation Penalties may be applicable as follows:</p> <ul style="list-style-type: none"> ▪ <u>Initial Penalty for filings due before 01/01/2010</u> <ul style="list-style-type: none"> – Form 3520 = 35% of Gross Reportable amount (for Parts I and III) – Form 3520-A = 5% of Gross Reportable amount ▪ <u>Initial Penalty for filings due after 12/31/2009</u> <ul style="list-style-type: none"> – Form 3520 = Greater of \$10,000 or 35% of Gross Reportable amount (for Parts I and III) – Form 3520 = Greater of \$10,000 or 5% of Gross Reportable amount (for Part II) – Form 3520-A = Greater of \$10,000 or 5% of Gross Reportable amount 	<ul style="list-style-type: none"> ▪ IRC 6677(a) ▪ IRC 6048 ▪ IRM 20.1.9.13.4 – Form 3520 	

Step 3 (cont'd)

Failure to File the Form 3520/3520-A Penalties

Step 3: Penalty Determination

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ <u>Continuation Penalty (applicable to tax years after December 31, 1995)</u> <ul style="list-style-type: none"> – \$10,000 every 30 days (or fraction thereof), starting 90 days after notice. – Max penalty is the reportable amount (if known). – After 12/31/2009, if penalty amount collected exceeds the gross reportable amount, the excess must be refunded. – Continuation penalty computation is same for Form 3520 and Form 3520-A. <p>Note: An Initial Penalty can be asserted by the examiner without advance notification, however, it is best for examiners inform the taxpayer prior to assessing the penalty.</p>	<ul style="list-style-type: none"> ▪ IRM 20.1.9.14.4 – Form 3520-A ▪ IRC 6677(a) and (b) ▪ IRC 6677(e) 	

Step 3 (cont'd)

Failure to File the Form 3520/3520-A Penalties


Step 3: Penalty Determination

Considerations	Resources	6103 Protected Resources
<p>Gross Reportable Amount</p> <p>As discussed on the prior slide, the penalty is based on the gross reportable amount. The gross reportable amount is defined in the IRC as:</p> <p>(1) the gross value of the property involved in the event (determined as of the date of the event) in the case of a failure per IRC <u>§6048(a)</u>,</p> <p>(2) the gross value of the portion of the trust's assets at the close of the year treated as owned by the USP in the case of a failure per IRC <u>§6048(b)(1)</u>, and</p> <p>(3) the gross amount of the distributions, or the value of the use of property, in the case of a failure per IRC <u>§ 6048(c)</u>.</p> <p>If and when the additional information (or return) is received, adjustments to the original assessments should be made to correct either a decrease or increase in the gross reportable amount. Also, if reasonable cause is denied any additional computation of penalties should be assessed.</p>	<ul style="list-style-type: none"> ▪ IRC 6677(c) ▪ IRC 6048 ▪ Form 3520 total of Line 13(i) ▪ Form 3520-A, Page 3 Line 9 ▪ Form 3520 Line 27 	

Step 3 (cont'd)

Failure to File the Form 3520/3520-A Penalties

Step 3: Penalty Determination

Considerations	Resources	6103 Protected Resources
<p>Reasonable Cause Exception</p> <p>No penalty shall be imposed under IRC §6677 for any failure which is shown to be due to reasonable cause and not due to willful neglect. The fact that a foreign jurisdiction would impose a civil or criminal penalty on the taxpayer (or any other person) for disclosing the required information is not reasonable cause.</p> <p>As previously discussed, there are two different penalties: the Initial Penalty and the Continuation Penalty. While both penalties are described within IRC §6677(a), two different sets of facts for a reasonable cause argument should be considered when considering these penalty cases. While one set of facts will apply to the Initial Penalty, separate facts may apply to Continuation Penalty as it can only be assessed 90 days after the Notice Letter. The taxpayer's actions subsequent to receiving notice should be carefully considered in determining the applicability of Continuation Penalties.</p>	<ul style="list-style-type: none"> ▪ IRC 6677 (d) ▪ IRM 20.1.9.13.5 – Form 3520 ▪ IRM 20.1.9.14.5 – Form 3520-A ▪ <i>James v. United States</i>, 2012 WL 3522610, No.8:11-cv-271-T-30AEP (M.D. Fla. Aug. 14, 2012) 	
 # [REDACTED]		# [REDACTED]

Step 3 (cont'd)

Failure to File the Form 3520/3520-A Penalties

Step 3: Penalty Determination

Considerations	Resources	6103 Protected Resources
<p>Reasonable Cause Exception</p> <p>Once it is determined the taxpayer is in full compliance for all open years, consider any reasonable cause statements provided by the taxpayer. These statements must be in writing. These statements should be evaluated in conjunction with the guidelines, principles relating to reasonable cause based on the facts and circumstances.</p> <p>Reasonable cause statements provided by the taxpayer must include a declaration, "Under penalties of perjury, I declare....." See page 4 of Letter 3804 for the required language.</p> <p>If a representative prepares and signs the statement, Form 3804 contains substitute language the representative must include on the statement. See page 4 of Letter 3804 for the required language.</p>	<ul style="list-style-type: none"> ▪ IRM 20.1.1.3.2. ▪ IRM 20.1.9.13.5 – Form 3520 ▪ IRM 20.1.9.14.5 – Form 3520-A ▪ IRM 20.1.9.2 (15) ▪ IRM 20.1.1.3.1(5) ▪ Letter 3804 Page 4 – Penalties of perjury declarations 	

Step 4

Failure to File the Form 3520/3520-A Penalties

Step 4: Penalty Application/Closing Procedures

[Step 2](#) discusses the issuance of the Notice Letter, [Step 3](#) discussed the penalty determination factors, and the final Step 4 discusses the penalty application or non-application, and case closing procedures.

Considerations	Resources	6103 Protected Resources
<p>Application of Penalties – Initial Penalty</p> <p>Considering the penalty structure and reasonable cause considerations discussed in step 3, this discussion will focus on how these penalties are applied. The first step is to secure documentation to support the USP was required to file the returns. This information must be kept in penalty file. Second, when delinquent Form(s) 3520 or Form(s) 3520-A is secured, the examiner must determine whether it provides all required information and is accurate with respect to each applicable part of the form. If inaccurate or incomplete, the taxpayer must be informed the returns are not considered filed until it is complete and accurate.</p> <p>The Initial Penalty is asserted using Form 8278 <i>Assessment and Abatement of Miscellaneous Civil Penalties</i>. The Penalty Reference Number (PRN) 659 for Form 3520 and PRN 660 for Form 3520-A. The Initial Penalty can be asserted at the time the Notice Letter 3804 is issued.</p> <p>Example: The examiner has conclusive evidence and supporting documentation the taxpayer formed a foreign trust and transferred \$1,000,000 (cash or property) to the foreign trust and did not file Form 3520. The Notice letter was issued requesting the Form 3520 to be filed. <i>How much is the Initial Penalty assessment?</i> Initial Penalty assessment (PRN 659) will be \$ 350,000 (35% of \$1,000,000) and can be assessed at the time Notice Letter 3804 is issued.</p>	<ul style="list-style-type: none"> ▪ Notice 97-34 ▪ IRM 20.1.9.13.1(2) ▪ IRM 20.1.9.13.3 for Form 3520 ▪ IRM 20.1.9.14.3 for Form 3520-A ▪ Exhibit 20.1.9-3 	

Step 4 (cont'd)

Failure to File the Form 3520/3520-A Penalties

Step 4: Penalty Application/Closing Procedures

Considerations	Resources	6103 Protected Resources
<p>Application of Penalties – Continuation Penalty</p> <p>If the taxpayer fails to file complete and accurate Form(s) 3520 and/or Form(s) 3520-A by the response date provided on Letter 3804 (90 day period), the examiner should proceed with charging the Continuation Penalty. These additional penalties are also asserted on Form 8278 using PRN 702 for Form 3520 and PRN 703 for Form 3520-A</p> <p>The Continuation Penalty is \$ 10,000 every 30 days (or fraction thereof), after the initial 90 day period, until the taxpayer submits complete and accurate return(s) or until the total amount of penalties assessed equals the total gross reportable amount.</p> <p>Example: Continuing the example from the previous slide, the taxpayer has failed to respond and it is now 125 days from the date of the notice letter. A Continuation Penalty under PRN 702 for \$ 20,000 could be assessed (\$10,000 for every 30 days or fraction thereof).</p>	<ul style="list-style-type: none"> ▪ IRM 20.1.9.13.4 for Form 3520 ▪ IRM 20.1.9.14.4 for Form 3520-A 	

Step 4 (cont'd)

Failure to File the Form 3520/3520-A Penalties

Step 4: Penalty Application/Closing Procedures

Considerations	Resources	6103 Protected Resources
<p>Form 8278 – Assessment and Abatement of Miscellaneous Civil Penalties</p> <ul style="list-style-type: none"> ▪ The assessment document for international penalties is Form 8278. Failure to file under IRC §6048 has a penalty section on the form under IRC §6677 which covers both the Initial and the Continuation Penalties for both Form 3520 and Form 3520-A. ▪ If a Continuation Penalty is assessed in conjunction with an Initial Penalty, a separate Form 8278 is required for each type of penalty. Enclose a computation of the penalty and the applicable code section for each penalty . ▪ Enter the dollar amount of the penalty on Form 8278 and attach Form 886-A, <i>Explanation of Items</i>. ▪ The taxpayer’s signature is <i>not</i> required with respect to these penalties. ▪ Manager’s signature is <u>required</u> in block 11a to meet the provision of IRC §6751. 	<ul style="list-style-type: none"> ▪ Form 8278 ▪ IRM 20.1.9.2.1 	
<p>Payments</p> <ul style="list-style-type: none"> ▪ Use Form 3244, <i>Payment Posting Voucher</i>, to process a payment. Use Transaction Code (TC) 640 if a payment is received prior to assessment, or use TC 670 if the payment is received after the assessment. Include the appropriate Designated Payment Code per IRM 21.3.4.7.1.3 ▪ The payment will be posted to MFT 55 for Individuals and MFT 13 for Entities 	<ul style="list-style-type: none"> ▪ IRM 20.1.9.2(21) Payments ▪ IRM 21.3.4.7.1.3 	

Step 4 (cont'd)

Failure to File the Form 3520/3520-A Penalties

Step 4: Penalty Application/Closing Procedures

Considerations	Resources	6103 Protected Resources
<p>No filing requirement or accepting the filing without penalties</p> <ul style="list-style-type: none"> If the examiner determines that there is no filing requirement or that reasonable cause exist, do not prepare Form 8278. Document in the civil penalty file case history all reasonable cause provided by the taxpayer for not asserting the penalty. Advise the group secretary that no penalties were asserted and Disposal Code 02 should be used to decontrol the case. 	<ul style="list-style-type: none"> IRM 20.1.9.2.1(3) 	
<p>Miscellaneous Case Closing Considerations</p> <ul style="list-style-type: none"> The case file should contain all work papers, correspondences, an activity record, and Form 8278 and Form 886-A. The case file will be closed separate from the income tax case file using with its own Form 3198, <i>Special Handling Notice for Examination Case Processing</i> The ERCS P9 record may have to remain open if it represents other penalties besides those associated with a Form 3520/3520-A. If so, ensure the earliest expiring penalty statute is reflected in ERCS. 		

Other Considerations / Impact to Audit

Failure to File the Form 3520/3520-A Penalties		
Considerations	Resources	6103 Protected Resources
<p>A separate page of Form 8278 must be prepared for each penalty assessed. This ensures that each penalty will be input separately and that a separate document will be completed with the appropriate input. Some exceptions apply.</p> <p>A manager's signature is required in block 11a of Form 8278 to meet the provisions of IRC §6751.</p> <p>Use Form 8278 to abate a penalty. The appropriate PRN will be input as a negative amount in column (e) and the appropriate Penalty Reason Code (PRC) for making the abatement put in column (f).</p>	<ul style="list-style-type: none"> ▪ Form 8278 ▪ IRM Exhibit 20.1.1-2 Penalty Reason Codes (PRC) chart and explanations ▪ Document 6209 Section 10 Penalties and Interest Provisions 	
<p>Specific Powers of Attorney or Authorization to Disclose Tax Information</p> <p>A Form 2848 <i>Power of Attorney and Declaration of Representative</i> (POA) is required prior to discussing penalty issues with a person other than the USP subject to the IRC §6038 penalty or required to file Form 3520/Form 3520-A returns. The POA secured for the income tax return is <u>NOT valid</u> for the penalty issue. A separate Form 2848 can be secured for the IRC §6038 penalty considerations.</p>	<ul style="list-style-type: none"> ▪ Form 2848 - Under Section 3 "Tax Matters" the Representative will Include the wording "Civil Penalties" for the Type of Tax and Form 3520 and/or Form 3520-A for the Type of Form and relevant tax years under consideration. 	

Other Considerations / Impact to Audit (cont'd)

Considerations	Resources	6103 Protected Resources
Appeal Rights for International Penalties.	<ul style="list-style-type: none"> ▪ IRM 8.11.5 Penalties Worked in Appeals, International Penalties ▪ IRM 8.11.5.2 International Penalty-Accelerated Appeals Consideration 	
What if penalties were previously assessed by the Service Center? Please refer to the instructions located in the IRM 20.1.9.2.3	<ul style="list-style-type: none"> ▪ IRM 20.1.9.2.3 	

Training and Additional Resources

Chapter 12.2.2 Grantor Trust Information Reporting Issues

Type of Resource	Description(s) and/or Instructions for Accessing	References
Westlaw	LB&I's Westlaw subscription in the International resources section. Expand the section to show all resources to find Bittker & Lokken: Federal Taxation of Income, Estates and Gifts. Click on: <ul style="list-style-type: none"> ▪ Table of Contents, ▪ Part 11 (Trusts and Estates), and ▪ Chapter 83 (Foreign Trusts and Foreign Grantors) 	Fed Tax'n Inc, Est and Gift
Westlaw	LB&I's Westlaw subscription in the International resources section. Expand the section to show all resources to find International Income Tax and Estate Planning: Click on: <ul style="list-style-type: none"> ▪ Chapter 6 Trusts 	International Income Tax and Estate Planning
Podcasts / Videos	CPE 2011-Day 1-Pass Through Entities and Foreign Corporations.	

Glossary of Terms and Acronyms

Acronym	Definition
ASED	Assessment Statute Expiration Date
BMF	Business Master File
ERCS	Examination Returns Control System
FT	Foreign Trust
IDRS	Integrated Data Retrieval System
IMF	Individual Master File
IRC	Internal Revenue Code
IRM	Internal Revenue Manual
MFT	Master File Transaction
PRC	Penalty Reason Code
PRN	Penalty Reference Number
TC	Transaction Code
TIN	Taxpayer Identification Number
USP	United States Person

Index of Related Issues

Issue	Associated UIL(s)	References
Defining the Entity - Foreign Trusts		FEN/9434.02_01(2013)
Foreign Grantor Trust Determination– Part I - Section 679		FEN/9434.02_02(2013)
Foreign Grantor Trust Determination Part II - Sections 671-678		FEN/9434.02_07(2013)
Taxation of Foreign Non-Grantor Trusts	9434.03	To be developed
Taxation of Beneficiary of a Foreign Non-Grantor Trust	9434.03	To be developed
Check-The-Box Rules for Foreign Entities	9433.01	To be developed