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Canadian tax alert – U.S. tax update IRS automatically asserts late filing penalties on untimely filed Forms 5472

August 14, 2013

Deloitte's U.S. Tax Services Group would like to highlight a recent change in the IRS' policy with respect assessing statutory late filing penalties related to certain cross-border information forms. Of particular concern to Canadian-based businesses is the revised policy that the \$10,000 penalty may be systematically applied during the initial processing of a Form 5472 that is attached to a late filed Form 1120. Thus, the IRS is now automatically assessing an initial penalty of **\$10,000 for each failure** to timely file a Form 5472. A separate Form 5472 is required to report each related party with which the taxpayer had a reportable transaction during a taxable year. Thus, penalties can multiply quickly. As more fully discussed below, a penalty also applies for failure to maintain records as required under U.S. tax law.

The automatic assessment represents a departure from previous IRS procedure where penalties were assessed at the discretion of an examiner after a return was selected for examination. While the penalty provisions have always been available to the IRS, they have been inconsistently applied in our experience. With a significant number of Canadian companies having cross-border transactions with related parties in the United States, it is likely that the potential exposure for such penalties in the Canadian marketplace is high.

Background

Form 5472, *Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business*, is required as an attachment to Form 1120, *U.S. Corporate Income Tax Return* (and certain other returns), if the reporting corporation had a reportable transaction with a foreign or domestic related party during the tax year. This information reporting requirement is similar to the Canada Revenue Agency's foreign affiliate reporting requirement on Form T1134 (although more detail is requested).

Reporting and filing requirements

The due date for filing Form 5472 with the IRS is the same as the due date of the corporation's Form 1120, including extensions. For purposes of filing Form 5472, a reporting corporation is either a 25% foreign-owned U.S. corporation (i.e., a corporation with at least one direct or indirect 25% foreign shareholder at any time during the tax year) or a foreign corporation engaged in a trade or business within the United States.

A related party is defined as any direct or indirect 25% foreign shareholder of the reporting corporation, or any person (individual, corporation, partnership, or trust) that is related to the reporting corporation within the meaning of U.S. tax law. A separate Form 5472 must be filed for each foreign or domestic related party with which the reporting corporation had a reportable transaction during the tax year. A related party does not include any corporation filing a consolidated U.S. federal income tax return with the reporting corporation.

A reportable transaction is any type of transaction listed in Part IV of Form 5472 (e.g., sales, rents, loans, etc.) for which monetary consideration (including U.S. and foreign currency) was the sole consideration paid or received during the reporting corporation's tax year. A reportable transaction is also a transaction for which any part of the consideration paid or received was not monetary consideration, or less than full consideration was paid or received.

Penalty assertion

If a reporting corporation fails to furnish (within the time prescribed by regulations) any necessary information, or fails to maintain records as required, it is subject to a penalty of \$10,000 for each taxable year with respect to which such failure occurs. The continuation penalty is \$10,000 for each 30-day period (or fraction thereof) during which such failure continues after the expiration of a 90-day period.

U.S. tax law provides that certain failures (including not timely filing Form 5472) may be excused for reasonable cause.

Reasonable cause

A taxpayer may file a penalty abatement request based on reasonable cause after a penalty notice has been received. The taxpayer must, in a written statement containing a declaration that the statement is made under the penalties of perjury, make an affirmative showing of all the facts demonstrating that it had reasonable cause for failure to timely file Form 5472, and prove that it acted in good faith. To show that reasonable cause exists, the reporting corporation must have filed for all open years (excluding the current year on extension). Importantly, reasonable cause does not apply to penalties assessable after the taxpayer was notified of the requirement to file or was requested to provide specific required information.

Treasury Regulations provide a separate reasonable cause exception for small corporations. The provision states that reasonable cause will be applied liberally in the case of a small corporation that had no knowledge of the requirements imposed by Internal Revenue Code Section 6038A, has limited presence in (and contact with) the United States, promptly and fully complies with all requests to file Form 5472, and promptly and fully complies with all requests to furnish books and records relevant to the reportable transaction. A small corporation is defined as corporation whose gross receipts for a taxable year are \$20 million or less.

Voluntary disclosure

The IRS provided guidance under a Frequently Asked Questions (FAQs) format for its 2012 Offshore Voluntary Disclosure Program (2012 OVDP). The 2012 OVDP is an opportunity for taxpayers with unreported income from undisclosed foreign accounts, foreign assets or foreign entities to become current with their federal income tax obligations and pay reduced civil penalties as outlined in the terms of the program. The FAQs appear to provide an opportunity for taxpayers who have delinquent Forms 5472, as well as other cross-border information returns, to file the delinquent forms

without penalties. The applicability of this FAQ is unclear where the corresponding income tax return (e.g., Form 1120) is filed late.

Conclusion

Taxpayers should review their previously filed returns and consult with their tax advisors as necessary to determine whether they are in compliance with the information reporting requirements with respect to foreign corporations in which they may have certain levels of control or reportable transactions. Any outstanding or late Forms 5472 should be filed as soon as possible with a request for penalty abatement, as appropriate, based on reasonable cause.

For the current year, taxpayers should ensure that the U.S. tax return, including Form 5472, is postmarked or electronically filed by the due date (including any extensions) for the return to be considered timely filed.

Please do not hesitate to contact any of our U.S. tax professionals listed above with questions.

Dennis Metzler, National U.S. Tax leader

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