



Treasury Inspector General for Tax Administration Office of Audit

SYSTEMIC PENALTIES ON LATE-FILED FORMS RELATED TO CERTAIN FOREIGN CORPORATIONS WERE PROPERLY ASSESSED, BUT THE ABATEMENT PROCESS NEEDS IMPROVEMENT

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Highlights

Highlights of Report Number: 2013-30-111 to the Internal Revenue Service Commissioners for the Large Business and International Division and the Wage and Investment Division.

IMPACT ON TAXPAYERS

The law requires a U.S. citizen or resident alien to furnish information with respect to certain foreign business entities. Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*, is used to comply with the law and regulations. Further, the law provides a monetary penalty of \$10,000 for each Form 5471 that is filed after the due date of the associated income tax return, including any extensions. The IRS has developed a strategy to help meet the challenges of international tax administration. This has led to increased enforcement efforts on international information reporting requirements and increased assessments of related penalties.

WHY TIGTA DID THE AUDIT

One of the major trends challenging the IRS is accelerating globalization. The overall objective of the review was to determine whether the IRS has improved its penalty-setting process to promote filing compliance for entities with Form 5471 reporting requirements.

WHAT TIGTA FOUND

Overall, controls ensured that systemic penalties for late-filed Forms 5471 were properly assessed and compliance was improved for many taxpayers. While a standardized framework was not used to develop a pilot program for systemically assessing late-filed Form 5471 penalties, the IRS objectives to enhance revenue and improve taxpayer compliance were met.

However, controls are insufficient to ensure the proper abatement of systemically assessed penalties on late-filed Forms 5471. Specifically, in a statistically valid sample of 93 cases, the penalties were incorrectly

abated in 40 cases. Total abatements for these 40 cases amounted to \$1.75 million, resulting in approximately \$31 million in incorrect abatements when projected to the population. In addition, the IRS did not properly process eight filing extensions. This led to \$6.4 million in unnecessary late-filed Form 5471 penalty assessments ultimately being abated, resulting in approximately \$11.6 million in incorrect assessments when projected to the population. Further, in 80 of the 93 sampled cases, IRS employees did not adequately document their decisions to abate these penalties.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS: 1) conduct a study to determine if the automated late-filed Form 5471 penalty-setting process should be expanded; 2) provide refresher training to employees and their managers on the importance of documenting penalty abatement request decisions; 3) require managers to review all late-filed Form 5471 penalty abatements; and 4) ensure that filing extension requests received with a payment are properly coded and timely processed.

In their response, IRS officials agreed with all of our recommendations. The IRS has taken steps to implement two corrective actions and plans to take remaining corrective actions in the future.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

<http://www.treas.gov/tigta/auditreports/2013reports/201330111fr.pdf>.