Internal Revenue Service Advisory Council (IRSAC)
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Room 6526
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Also submitted to pra.comments@irs.gov.

Re: **Comments on Streamlined Filing Compliance Procedures – Per OMB Control Number 1545-2241 Request**

To Whom It May Concern:

The Internal Revenue Service Advisory Council (IRSAC) is pleased to provide comments in response to a request mandated by the Paperwork Reduction Act and posted in the Federal Register for October 21, 2024, regarding information collection requirements related to the Streamlined Filing Compliance Procedures.

The IRSAC serves as an advisory body to the Commissioner of the Internal Revenue Service (IRS) and agency leadership. This group consists of 32 volunteer members appointed by the IRS and represents a broad cross-section of interests and areas of expertise in various aspects of tax compliance and administration. The IRSAC provides an organized forum for discussion of tax administration issues between IRS officials and representatives of the public. The IRSAC reviews existing tax policy and administrative issues and makes recommendations in an annual written report to achieve efficient and effective tax Administration.

The IRSAC members work within five broad subject matter groups. These subgroups are Information Reporting, Large Business & International, Small Business/Self-Employed, Tax-Exempt/Government Entities, and Taxpayer Services (formerly named Wage & Investment).

Our report for 2024 includes an issue paper on Revising and Expanding the Streamlined Domestic Offshore Procedures. Our recommendations in this paper include that the IRS modify the current requirements under the Streamlined Filing Compliance Procedures for taxpayers with income inclusion under Section 965 to only require filing for 2017 and the most recent three years to reduce the tax compliance burden for these taxpayers.

Rather than preparing standalone comments in response to the Request for Comments, we are submitting below "Issue Three" from

the report of the IRSAC's LB&I Subgroup included in the 2024 IRSAC report (also available at https://www.irs.gov/tax-professionals/internal-revenue-service-advisory-council-irsac). We appreciate consideration of this portion of our report for the Request for Comments on the Streamlined Filing Compliance Procedures (per OMB Control Number 1545-2241).

ISSUE THREE: Revising and Expanding the Streamlined Domestic Offshore Procedures

Executive Summary

Since the Tax Cuts and Jobs Act (P.L. 115-97, Dec. 22, 2017), the complexity of international information reporting has dramatically increased, particularly affecting taxpayers with interests in controlled foreign corporations (CFCs). Specifically, Form 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations, imposes a significant burden due to its expanded requirements. The indefinite statute of limitations (SoL) on assessment for failure to file these forms creates anxiety among taxpayers, especially publicly traded companies that must decide the extent to which (if at all) to create a reserve for these liabilities for financial accounting purposes. To address these challenges, the IRSAC recommends expanding eligibility for Streamlined Domestic Offshore Procedures (SDOP), revising its Section 965, Treatment of deferred foreign income upon transition to a participation exemption system of taxation, reporting requirements, and adjusting the Title 26 miscellaneous offshore penalty to provide a more effective pathway for rectifying non-willful non-compliance.

Background

The IRS's Inflation Reduction Act Strategic Operating Plan (SOP) seeks to make tax compliance easier, reducing the burden on taxpayers and allowing the IRS to allocate time and resources more efficiently. Key initiatives include quickly resolving taxpayer issues (2.6) and expanding enforcement on complex, high-dollar non-compliance (3.5).[1]

Ever since P.L. 115-97, the international information reporting compliance area has become significantly more complex, particularly concerning interests in CFCs and Form 5471.

Before 2017, many sophisticated taxpayers considered Form 5471 a relatively straightforward information return. In the absence of a CFC having specific types of low-taxed, passive/moveable income (e.g., Subpart F income) or investments, taxpayers found reporting for U.S. shareholders on Form 5471 not overly burdensome. However, for shareholders of certain foreign corporations, P.L. 115-97 shifted the U.S. from a "worldwide" tax system towards a "quasi-territorial" tax system and introduced the concept of Global Intangible Low-Taxed Income (GILTI). Consequently, nearly all greater than 10% CFC shareholders (including indirect and constructive shareholders) must now recompute a CFC's income according to U.S. tax principles and disclose a wide variety of

[1] See IRS IRA Strategic Operating Plan FY2023 - 2031; https://www.irs.gov/pub/irs-pdf/p3744.pdf.

tax attributes. This increased the form instructions from 18 pages in 2016[2] to 52 pages in 2024, highlighting the increased complexity and burden on taxpayers.

Minority and indirect shareholders face significant challenges in obtaining the necessary information to accurately complete Form 5471. Determining if a reporting requirement exists can be particularly difficult without knowing the other shareholders' details, leading to inadvertent non-compliance. The IRS has recognized these challenges to some extent, as evidenced by the introduction of subcategories of Form 5471 filers and adding Schedules K-2 and K-3 for S-corporation and partnership returns. These changes aim to provide shareholders and partners with the information needed to determine their filing obligations and alleviate some reporting burdens. However, reliance on others for this information remains a significant challenge.

Despite P.L. 115-97's enactment in late 2017, regulations continue to emerge, and Form 5471 has evolved annually, adding to the complexity of international information reporting. Legal uncertainties have further compounded these difficulties. For example, the Supreme Court only recently resolved the mandatory repatriation tax constitutionality under Section 965 in *Moore v. United States*, 599 U.S. ___ (2024), impacting reporting and the taxability of any CFC distributions after 2017. Additionally, in *Farhy v. Commissioner*, in an initial decision, the Tax Court ruled that the IRS did not have the statutory authority to assess penalties under Section 6038, Information reporting with respect to certain foreign corporations and partnerships,[3] a decision which was subsequently overturned by the D.C. Circuit.[4] This period of uncertainty has created (and continued to create) a challenging environment for taxpayers, tax preparers, and the government alike as the complexity and cost of compliance has increased while the potential for penalties remained unclear.

Non-compliance in this area, particularly with Form 5471, takes on heightened importance due to the SoL. Under Section 6501(c)(8), the time for assessment of any tax related to certain required international information returns (e.g., Forms 5471, 5472,[5] 8938[6]) does not expire until three years after the information is provided to the IRS. This effectively means a single missed or incomplete Form 5471 can expose taxpayers to indefinite audit risks, making the compliance process particularly daunting. This provision, combined with the increasing complexity and scope of financial and tax reporting requirements, can create significant anxiety for taxpayers and preparers. This rampant inadvertent noncompliance, coupled with a desire to correct it, underscores the need for a streamlined compliance mechanism to assist all taxpayers in rectifying prior year non-willful errors or omissions and managing these extensive international information reporting requirements.

Furthermore, determining the full scope of non-compliance resulting from the extensive changes post-2017 presents an IRS challenge. The IRS cannot rely heavily on historical data to predict current compliance issues, unlike in other areas where longstanding patterns

[2] Form 5471 for 2016; https://www.irs.gov/pub/irs-prior/i5471--2016.pdf.
[3] *Farhy v. Commissioner*, 160 T.C. No. 6 (Apr. 3, 2023).
[4] *Farhy v. Commissioner*, 100 F.4th 223 (D.C. Cir. 2024); as of the writing of this report, it is expected the taxpayer will file for a writ of certiorari to the U.S. Supreme Court.
[5] Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation engaged in a U.S. Trade or Business.
[6] Statement of Specified Foreign Financial Assets.

can guide enforcement. The indefinite SoL for missing Form 5471 filings exacerbates this issue, and international compliance relies heavily on voluntary reporting. Detecting non-compliance related to foreign activities compared to domestic transactions is inherently more difficult, making robust voluntary compliance mechanisms essential. It is therefore in both the IRS's and taxpayers' interests, for there to be options to resolve non-willful non-compliance.

Current Options for Taxpayers to
File Delinquent International Information Returns

Since the closure of the Offshore Voluntary Disclosure Program (OVDP) in 2018, taxpayers have three ways to rectify past non-compliance and mitigate penalties. First, the taxpayer may pursue the Delinquent International Information Return Submission Procedures (DIIRSP).[7] These procedures apply to taxpayers who have not filed one or more required international information returns, such as Forms 5471, 5472, 8938, 926,[8] 3520, and 3520-A.[9] To qualify for the DIIRSP, taxpayers must not be under civil examination or criminal investigation by the IRS and must not have been contacted by the IRS about the delinquent returns. Each delinquent return may be accompanied by a reasonable cause statement, and many taxpayers do elect to attach this reasonable cause statement to the delinquent international information return. However, the IRS states: "During processing of the delinquent information return, penalties may be assessed without considering the attached reasonable cause statement."[10] This process does not appear consistent with the Internal Revenue Manual (IRM), which instructs IRS personnel to consider reasonable cause statements, requires significant effort for taxpayers who wish to address multiple years of non-compliance, and provides little certainty or practical relief from the concerns of taxpayers with unfiled international information returns.

Alternatively, a taxpayer can make a so-called "quiet disclosure", and file a corrected, amended return without drawing attention to any delinquent international information returns. Presumably the IRS wants to discourage taxpayers from using this approach, but in reality, it can often lead to less assessed penalties and burden for taxpayers compared to the DIIRSP.

Finally, individual U.S. taxpayers or estates of individual U.S. taxpayers can seek relief with the Streamlined Domestic Offshore Procedures (SDOP),[11] if residing within the U.S., or Streamlined Foreign Offshore Procedures (SFOP),[12] if residing outside the U.S. The IRS designed SDOP and SFOP for individual taxpayers with non-willful conduct who failed to report foreign financial assets and income, including interests in CFCs (and the income

[7] DIIRSP; https://www.irs.gov/individuals/international-taxpayers/delinquent-international-information-return-submission-procedures.
[8] Return by a U.S. Transferor to a Foreign Corporation.
[9] Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts.
[10] DIIRSP; https://www.irs.gov/individuals/international-taxpayers/delinquent-international-information-return-submission-procedures.
[11] U.S. taxpayers residing in the United States; https://www.irs.gov/individuals/international-taxpayers/us-taxpayers-residing-in-the-united-states.
[12] U.S. taxpayers residing outside the United States; https://www.irs.gov/individuals/international-taxpayers/us-taxpayers-residing-outside-the-united-states.

arising therefrom), and pay all tax due. These procedures generally require filing amended returns for the last three years, FBARs (Report of Foreign Bank and Financial Accounts) for the last six years and paying any taxes and interest due. However, if taxpayers have missed Section 965 inclusions (transition tax), they must address every year since 2017.[13]

To use the SDOP or SFOP, individual U.S. taxpayers or their estates must meet specific criteria:

1. Residency Requirement: Meet or fail to meet the non-residency requirement.
2. Previous Filings: Have previously filed U.S. tax returns (if required) for each of the most recent three years for which the U.S. tax return due date (or properly applied for extended due date) has passed.
3. Unreported Income: Failed to report gross income from a foreign financial asset and pay tax as required by U.S. law and may have failed to file an FBAR or one or more international information returns (e.g., Forms 3520, 3520-A,[14] 5471, 5472, 8938, 926, and 8621[15]) with respect to the foreign financial asset.
4. Non-Willful Conduct: Such failures must have resulted from non-willful conduct, which includes negligence, inadvertence, mistake, or a good faith misunderstanding of the law.

The requirement that applicants must have unreported gross income from a foreign financial asset is peculiar and unnecessarily restrictive. It effectively forces taxpayers to resolve lower risk non-compliance (i.e. an individual with an interest in a CFC that had a tested loss) through the more burdensome DIIRSP.

Those who use the SDOP specifically also fall subject to the Title 26 miscellaneous offshore penalty.[16] This penalty equals five percent of the highest aggregate balance/value of the taxpayer's foreign financial assets during the years in the covered tax return period and the covered FBAR period. To determine the highest aggregate balance/value, taxpayers are instructed to aggregate the year-end account balances and year-end asset values of all foreign financial assets subject to the penalty for each year in the covered periods and select the highest aggregate balance/value among those years. This penalty covers assets if the taxpayer should have reported them on an FBAR or Form 8938 but did not, or if the taxpayer did not declare gross income from properly reported assets.

These existing options for addressing international tax non-compliance have significant limitations and may deter taxpayers from utilizing them.

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[13]Streamlined filing compliance procedures and Section 965; https://www.irs.gov/individuals/international-taxpayers/streamlined-filing-compliance-procedures-and-section-965.

[14] Annual Information Return of Foreign Trust with a U.S. Owner.

[15] Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund.

[16]Streamlined filing compliance procedures for U.S. taxpayers residing in the United States frequently asked questions and answers; https://www.irs.gov/individuals/international-taxpayers/streamlined-filing-compliance-procedures-for-us-taxpayers-residing-in-the-united-states-frequently-asked-questions-and-answers.

Entities with many years of non-compliance face daunting challenges. Eligible taxpayers under the SDOP do not include most entities, forcing entities (other than certain estates) to use the DIIRSP or make a quiet disclosure. This requires filing each year individually, which can be particularly burdensome (and risky) given the difficulty in obtaining historical information, especially from overseas. Entities might consider filing only the most recent six years of international information returns under Policy Statement 5-133, but this approach has risk (and is therefore sometimes undesirable) due to the indefinite SoL on years outside of the six-year compliance period. By coming forward, entities might increase their exposure and risk without resolving their historical non-compliance comprehensively.

The SDOP can benefit certain individuals (i.e., those with unreported gross income from foreign assets), but it has notable drawbacks:

1. Three-Year Limitation and Section 965 Inclusion: While the SDOP typically requires filing only the last three years, this period extends to every year since 2017 having a Section 965 inclusion. This requirement, aimed at capturing pre-2017 earnings and profits (E&P), diminishes the streamlined nature of the process as more years pass, making it less attractive.
2. Title 26 Miscellaneous Offshore Penalty: The Title 26 miscellaneous offshore penalty can be significant. This penalty equals five percent of the highest aggregate balance/value of the taxpayer's foreign financial assets, including CFC stock, during the covered periods. For instance, an individual with five years of missed Forms 5471 could face a $10,000 penalty per year under normal circumstances, potentially waived with reasonable cause. However, under the SDOP, the five percent penalty on the CFC's highest stock value at its highest over the past three years could be substantially higher, with no possibility of a reasonable cause waiver. This could result in a more onerous financial burden compared to regular non-compliance penalties.

Recommendations

1. *Clarify and expand SDOP eligibility*: Extend the benefits of the SDOP to individuals without unreported gross income and entities, allowing them to rectify multiple years of international tax non-compliance in a more streamlined and manageable manner. This inclusion would provide more taxpayers with a structured pathway to compliance, reducing the burden of filing numerous amended returns and encouraging voluntary disclosure.
2. *Revise the Section 965 Reporting Requirement*: Modify the current requirement for taxpayers with Section 965 inclusions to file every year since 2017. Instead, require filings for 2017 and the most recent three years, making it more accessible and less burdensome for taxpayers.
3. *Adjust the Title 26 Miscellaneous Offshore Penalty*: Narrow the base of the Title 26 miscellaneous offshore penalty (e.g., by excluding assets that did not produce income) and/or cap the penalty so it does not exceed the penalties that would be assessed under the Delinquent International Information Return Submission

Procedures (DIIRSP). Alternatively, allow for reasonable cause waivers and/or penalty relief due to first time abate. This adjustment would make the penalty more equitable and less punitive, aligning it more closely with the actual non-compliance risk, taxpayer ability to pay, and the benefits enjoyed by those eligible for the SFOP.

We appreciate your consideration of these comments and IRSAC members are available to discuss any of them further. You can reach us via the IRS Office of National Public Liaison at publicliaison@irs.gov.

Sincerely,

Annette Nellen
2024 IRSAC Chair