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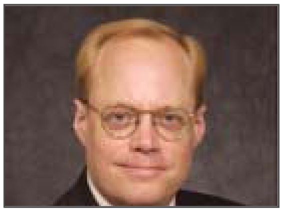

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Scariest Tax Form? Skip It, And IRS Can Audit Forever

Tax lawyers and accountants spend some of their time monitoring exposure, and so should you. Sometimes that means watching the calendar until you are clear of audit. Unless you skip filing taxes entirely, you might assume your risk of audit eventually dissipates.

The IRS normally gets three years to audit. Sometimes, say if you mess up with offshore account reporting, the IRS gets six. Having a foreign bank account and unreported income is tough to resolve. The safest approach is going into the IRS Offshore Voluntary Disclosure Program, although some clients opt for more aggressive approaches.

What many people find surprising is that having a company that holds a foreign account is even more sensitive. Yes, we're talking about controlled foreign corporations, also called CFCs. When a U.S. shareholder holds more than 50 percent of the vote or value of a foreign corporation, the company is a controlled foreign corporation or CFC. A U.S. shareholder is a U.S. person who owns 10 percent or more of the foreign corporation's total voting power.

That triggers reporting, including filing an annual IRS Form 5471. It is an understatement to say this is an important form. Failing to file it means penalties, generally $10,000 per form. A separate penalty can apply to each Form 5471 filed late, and to each Form 5471 that is incomplete or inaccurate.

What's more, this penalty can apply even if no tax is due on the return. That seems harsh, but the next rule—about the statute of limitations—is even more surprising. If you have a CFC but fail to file a required Form 5471, your tax return remains open for audit *indefinitely*. Normally, the statute expires after three or six years, depending on the issue and its magnitude.

This statutory override of the normal statute of limitations is sweeping. The IRS not only has an indefinite period to examine and assess taxes on items relating to the missing Form 5471. In fact, the IRS can make any adjustments to the *entire* tax return with no expiration until the required Form 5471 is filed. You might think of a Form 5471 like the signature on your return. Without it, it really isn't a return.

And don't assume that you have no issue if there is no CFC because U.S. shareholders don't own over 50%. In fact, Forms 5471 are not only required of U.S. shareholders in CFCs. They are also required when a U.S. shareholder acquires stock that results in 10 percent ownership in any foreign company.

The harsh statute of limitation rule for Form 5471 was the result of the HIRE Act passed March 18, 2010. Not coincidentally, this was the same law that brought us FATCA, the Foreign Account Tax Compliance Act. Bottom line: be careful with CFCs and with Form 5471. The possibility that a statute will remain open can ruin more than your day.

This problem is commonly paired with other failings, such as the filing of foreign bank account forms known as FBARs. That means the potential for large civil penalties and perhaps even criminal liability can be palpable.

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.