International Tax Penalties | Ask the Experts Video Transcript

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Michael O'Hara (00:08):

Hi, and welcome to Barnes Dennig Ask the Experts. I'm Michael O'Hara, Tax Manager, along with Lauren Huster, Senior Tax Manager. Lauren, it's been a really challenging year with COVID and the changing forms due to the tax cuts and JOBS Act. Tax reform happened a few years ago, and we have finally been through a full filing season with all the new regulations. What are you seeing in the international arena?

Lauren Huster (00:30):

Yeah, I'll say the biggest thing I'm seeing in the international arena is the IRS just cracking down and trying to generate some revenue. There's no secret that they're looking for revenue and they're hard to get ahold of. So really what they're doing is just sending out blanket letters and assessing penalties and then leaving it up to the taxpayer to have to reduce the penalties, or fight that they aren't applicable. So they're really putting it on the taxpayer just because A, they don't have the time, and B, they don't have the people.

Michael O'Hara (01:01):

Yeah. And you mentioned penalties, what kind of penalties are we talking about?

Lauren Huster (01:05):

They're steep penalties, because they're really trying to encourage people to file on their own and not have to come after them. So each form generally has a $10,000 penalty. But there is a certain type of one that goes up all the way to $25,000 per form.

Michael O'Hara (01:20):

It is my understanding that the penalty is not only apply per each foreign entity, but also each accounting period for that foreign entity.

Lauren Huster (01:28):

Yeah. And that's why I can add up so quickly. Just if I add a foreign corporation that I own and I've had it for 10 years, but I never file anything, that's $10,000 for each year. And then if I had another corporation, that's $10,000 each year, each company. So that's $20,000 a year. It adds up quickly. I know we keep saying it, but it's so true.

Michael O'Hara (01:47):

Yeah. And you brought up the penalty that's more than double the others, the $25,000 penalty. What types of foreign transactions and what do taxpayers need to be cognizant of to avoid this very large penalty?

Lauren Huster (01:58):

Yeah. So this is going to be if you are a US company that's foreign-owned, or if you're a foreign company with US operations and you have related party transactions. And this really encompasses a lot of things. It could be buying supplies from your parent company, or it could be them buying inventory from you, or loans, or interest, or royalties, technical services. Really, anything you can think of, it probably gets captured onto this form. So if you have any operations that have related party transactions, it's probably best to be talking to your accountant about it.

Michael O'Hara (02:30):

Yes. And that seems to mostly happen from reporting transactions with foreign ownership. What if a US business owns a foreign entity?

Lauren Huster (02:40):

Yeah. There's still going to be filing requirements and these are going to be very similar to if you own a US company. Depending on what kind of foreign company you own, there could be a different form, but the information is going to be the same. They're going to want a balance sheet, a profit and loss statement, when the ownership changes, if there's any sales. Anything like that, it's all going to be reported on there.

Michael O'Hara (03:02):

Yeah. So like we talked about before, there's penalties for failure to file for each foreign corp and each accounting period related to that foreign entity. Are there any other penalties that they can access related to these corporations?

Lauren Huster (03:14):

Mm-hmm (affirmative) The one thing I will make sure that we state is that that penalty can also be applied, even if you file the form, but it's inaccurate, or incomplete. So making sure you're doing an accurate and complete form is crucial to avoid that penalty. But other types of penalties that they could assess would be taking away the foreign tax credit, which would make you subject to double taxation, which you hear about a lot. Or something that would be an unrecognizable tax transaction, maybe is recognizable, causing you tax. The IRS has other avenues to implement penalties beyond just the $10,000, and $25,000.

Michael O'Hara (03:53):

That's understandable. We've now talked about different businesses, whether it's foreign-owned company or a US-owned owning a foreign company, but are there other foreign transactions that need to be looked out for?

Lauren Huster (04:06):

Yeah, absolutely. Really, if you have anything foreign going on, it's probably something you need to talk to an accountant about just to make sure you're not missing anything. But some examples, if you have a foreign gift that you've received and that would be just receiving it from someone who's a foreign person, or you give a gift to a foreign person or entity. If you have an estate that's in foreign country, that would count as well.

One thing that probably got the most press a couple of years ago was the foreign bank account report. And it was publicized as if you had over $10,000, you had to file this report with the US. There's no tax to it, but you did need to file it, as informational purposes. And actually what really got missed is that it's all of the bank accounts that you own from a foreign perspective, added up to $10,000, or even one point in a year. So if you had $10,000 in it for 10 seconds and you wired it to the US, that counts and you would have to file this foreign bank account report with the IRS.

Michael O'Hara (05:09):

So Lauren, I have a lot of clients that say they have some sort of international operations, but they're not really sure anything more than that. How do they know they're filing what they should and what steps should they take to get into compliance?

Lauren Huster (05:24):

Yeah, that's a common thing. And I will say that what you used to file two or three years ago before tax reform, is totally different than it is now. Something that used to be two or three pages is now 20 pages. And I would say a second set of eyes, or just talking to your accountant and making sure they're versed in the international arena is really what you're going to want to do. If you have an issue you're going to want to fix it now, before the IRS contacts, you. It's a lot easier and you're not going to have the penalties that you could and you could potentially get it all waived, if you're going forward to the IRS and just trying to get a clean slate. Once you get that letter, it's a lot harder to get the penalties abated.

Michael O'Hara (06:05):

Yes. And that's great advice. I think we can both agree that no one wants a letter in the mail from the IRS stating tens of thousands of dollars being assessed. I think a great takeaway is just to make sure you're in compliance now and not wait for the IRS to come knocking.

Lauren, thank you for being with us and sharing your insights today. If you'd like to know more information, or like to set up a conversation, please visit the Barnes Dennig website and we'll see you next time on Ask the Experts.