February 24, 2023

Andres Garcia
Internal Revenue Service
Room 6526
1111 Constitution Avenue, NW,
Washington, D.C. 20224
pra.comments@irs.gov

RE: Response to Request for Public Comments on Form 3520 and Form 3520-A

Dear Mr. Garcia:

The Texas Society of Certified Public Accountants (TXCPA) is a nonprofit, voluntary professional organization representing more than 28,000 members. One of the expressed goals of the TXCPA is to speak on behalf of its members when such action is in the best interest of its constituency and serves the cause of the CPAs of Texas, as well as the public interest. TXCPA has established a Federal Tax Policy Committee to represent those interests on tax-related matters. The committee has been authorized by the TXCPA Board of Directors to submit comments on such matters of interest to the committee membership. The views expressed herein have not been approved by the Board of Directors or Executive Board and, therefore, should not be construed as representing the view or policies of the TXCPA.

We appreciate the Internal Revenue Services' request for public comments published in the Federal Register on Dec. 16, 2022, concerning Form 3520, *Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts*, and Form 3520-A, *Annual Information Return of Foreign Trust with a U.S. Owner* (OMB Number 1545-0159).

In addition, we appreciate the previously issued IRS Revenue Procedure 2020-17 that states that the Department of Treasury and the IRS will issue proposed regulations to modify the reporting requirements under Internal Revenue Code Section 6048 to exclude individuals from having to report transactions with or ownership in both tax-favored foreign trusts and tax-favored foreign non-retirement savings trusts. These exclusions are particularly important for taxpayers given that the penalty imposed by Section 6677 for the failure to adequately report information on Forms 3520 or 3520-A is the greater of $10,000 or 35% of the gross reportable amount (5% for returns described by Section 6048(b)).

Although the exclusion and associated penalty relief in Rev. Proc. 2020-17 is helpful for taxpayers and tax practitioners, there remain issues with the requirements for Forms 3520 and 3520-A and the penalty framework. We realize that lack of IRS funding and resources may have previously contributed to some of the issues discussed below. TXCPA continues to support a fully funded IRS to serve taxpayers effectively, efficiently and fairly.

Comments

For non-reporting related to certain foreign trusts, a penalty under Section 6677 generally applies if IRS Form 3520 is not timely filed or if the information is incomplete or incorrect. Generally, the initial penalty is equal to the greater of $10,000 or:

- 35% of the gross value of any property transferred to a foreign trust for failure by a U.S. transferor to report the creation of or transfer to a foreign trust, or
- 35% of the gross value of the distributions received from a foreign trust for failure by a U.S. person to report receipt of the distributions, or
- 5% of the gross value of the portion of the trust's assets treated as owned by a U.S. person for failure by the U.S. person to report the U.S. owner information.[1]

Additional penalties are imposed if the noncompliance continues after the IRS mails a notice of failure to comply with the required reporting.[2] In addition, Section 6677(d) states, "No penalty shall be imposed … on any failure which is shown to be due to reasonable cause and not due to willful neglect."[3]

For non-reporting related to certain gifts and bequests received by U.S. persons from foreign persons or estates, a penalty under Section 6039F generally applies if IRS Form 3520, Part IV, is not timely filed or if the information is incomplete or incorrect. Generally, the initial penalty is equal to 5% of the amount of such foreign gift or bequest and this penalty applies for each month for which the failure to report continues (not to exceed a total of 25%).[4] Section 6039(c)(2) states, "No penalty shall be imposed … on any failure which is shown to be due to reasonable cause and not due to willful neglect."[5]

IRS Procedures for Reviewing Reasonable Cause Statements Must Be Substantially Revised

We submit that, in those instances where a taxpayer has submitted a *Delinquent International Information Return Submission* that includes a statement supporting reasonable cause, the IRS procedures for determining whether the taxpayer's failure was due to reasonable cause must be substantially revised. We understand that currently taxpayers are assessed a penalty under Sections 6677 and 6039F before the taxpayer's submission of a "reasonable cause exception" is reviewed. The IRS will then only consider a reasonable cause defense in connection with a refund request or as part of enforced collection action. As a result, some professionals now advise their clients that while they should come into compliance and participate in the delinquent filing program, doing so will result in extraordinary penalties, including, as an example, penalties equal to 25% of an inheritance from a foreign parent that may not be abated administratively and for which there is no prepayment jurisdiction to challenge them before a court. Additionally, if the penalties are high enough to be considered seriously delinquent tax debt (currently $59,000, adjusted for inflation), the taxpayer's passport may be revoked or application denied as a

[1] *See* IRC § 6677.
[2] *See* id., § 6677(a)(2).
[3] *See* id., § 6677(d).
[4] *See* id., § 6039F(c)(1). In addition to the penalty, the IRS may determine the income tax consequences of the receipt of such gift.
[5] *See* id., § 6039F(c)(2).

result of the penalty, which could cause significant harm to a taxpayer's ability to travel for work or personal reasons.[6] Taxpayers who try to comply with this reporting requirement have a challenging time determining the best course of action for previous years given the difficulties the IRS has in considering reasonable cause, and other similar issues in processing, that may delay resolution for years.

This IRS practice seems contrary to the language of the statute in Section 6677(d) and 6039F(c)(2), which state that no penalty may be *imposed* or the penalty *shall not apply* (respectively) if reasonable cause is shown. The statutes use the words "imposed" and "shall not apply" rather than "refund" or "abate," which makes clear that Congress intended for the IRS to review a taxpayer's reasonable cause claim BEFORE imposing the penalty.

Given the excessive amount of the penalty—which at a minimum of $10,000 per year can be devastating for many taxpayers—and the typically long wait times before an agent is assigned to a case, one can understand why Congress intended for taxpayers to receive a meaningful and thorough consideration of their reasonable cause claims before being assessed penalties. Current IRS practice not only contradicts this intent by assessing and collecting penalties first and asking questions later, but also potentially violates a taxpayer's due process rights. Our system of justice presumes innocence until proven otherwise, which necessarily requires governmental agencies to establish guilt before penalizing citizens. In addition, this IRS practice may in fact discourage voluntary compliance, which only further undermines Congressional intent. We therefore believe the current practice of assessing, enforcing and collecting these penalties before considering if they should have been imposed in the first place is not only unconscionable for many taxpayers, but also contrary to the language and intent of the statute.

Taxpayers Should Be Given a Fair and Meaningful Reasonable Cause Review Before Penalties Are Imposed

Given the punitive nature of the penalties, the onerous penalty amounts and the potentially crippling effect they can have on taxpayers, we strongly believe any review of a taxpayer's reasonable cause assertions before penalties are imposed should be thorough, fair and meaningful. At a minimum, the taxpayer and/or the taxpayer's representative must be given the opportunity to participate in those deliberations and IRS personnel should have the proper background and training to undertake such review. Allowing taxpayers to participate should, in part, help avoid inconsistencies. For example, we are aware of a case where the husband and wife equally shared a foreign account and both inadvertently failed to properly disclose the account. Both filed identical appeals professing reasonable cause for their failure. Although the circumstances and appeals were identical, the husband's reasonable cause defense was approved whereas the wife's appeal was denied. This could have potentially been avoided by having the IRS communicate with the taxpayers before assessing the penalties.

In addition, IRS personnel reviewing the reasonable cause assertions should have proper training and background to provide a competent, fair and thorough review. As it stands currently, the IRS has purportedly chosen to use "low-level clerks rather than revenue agents" or more experienced personnel to handle the processing of Forms

[6] We have worked with taxpayers who were unable to travel to weddings of their children because a Form 3520 penalty was assessed, in some cases with the taxpayer not even knowing about the assessment because the IRS penalty notices were never received overseas.

3520 and 3520-A.[7] With the new funding under the *Inflation Reduction Act*, the IRS should instead prioritize assigning more experienced personnel who can meaningfully evaluate the facts and make reasoned decisions. Such individuals should understand, for example, that any ambiguities must be resolved in favor of the taxpayer, given the highly punitive nature of the penalties. We also generally believe that persons with backgrounds in IRS enforcement should not be assigned to such roles, given that their training and mindset would likely be more focused on enforcement rather than determining liability.

Additionally, these forms have an inconsistent treatment compared to other international information return issues within one of the IRS' amnesty programs, the Streamlined Filing Compliance Procedures. There is unclear guidance about whether a taxpayer is permitted to submit Forms 3520 and 3520-A under the streamlined procedures if there are no other foreign or domestic income issues to report (i.e., there is no unreported income to report with the submission). We respectfully request the IRS consider amending the streamlined procedures guidance to specifically allow taxpayers to come into compliance under these procedures whose sole reporting issue relates to the failure to file Forms 3520 and 3520-A without having any income tax issues to remedy.

Many, if not most, U.S. citizens with foreign accounts are living abroad and need these accounts for their day-to-day living requirements. These foreign accounts are not established as a means of avoiding U.S. tax. These forms are informational in nature, and, in many cases, no income is reported as a result of these forms. The IRS must recognize that compliance with these reporting requirements is difficult for these individuals, many of whom already face complications from living overseas and, given the onerous penalty for noncompliance, be open minded and fair in reviewing "reasonable cause" claims.

Finally, we note that the IRS' practice of assessing the penalties may not be in compliance with the law. Penalties for Forms 3520 and 3520-A are systemically assessed penalties, not automatic penalties, which make them subject to Section 6751(b)(1) requiring that the initial determination of the penalty assessment be approved in writing by an immediate supervisor of the agent making the determination. At least one former IRS official has stated that IRS work has not met its own high standards, that work can be "sloppy and that team leads, rather than supervisors, sometimes approve penalty assessments."[8] A meaningful determination that penalties are appropriate and approval in writing by a supervisor should be required to promote both sound administration and compliance with the law.

We Support the Comments Submitted by the American Institute of Certified Public Accountants

We would also like to note that we fully support the separate set of comments submitted by the American Institute of Certified Public Accountants on Feb. 13, 2023.[9]

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[7] Andrew Velardo, "Ex-Official Confirms IRS Ignores Some Reasonable Case Statements," Tax Notes, Feb. 14, 2022.
[8] id., "Ex-Official: International Penalties Need Supervisor Approval," Tax Notes, July 4, 2022.
[9] 56175896-aicpa-comments-on-form-3520-and-form-3520-a-submit-e.pdf

Closing

We appreciate the opportunity to provide the above comments. The Texas Society of CPAs wants to help the IRS in the efficient administration of our tax laws. We would be pleased to discuss them further if you or your staff members believe it would be helpful. Feel free to contact me at 214-749-2462 or at dcolmenero@meadowscollier.com or contact TXCPA Staff Liaison Patty Wyatt at 817-656-5100 or pwyatt@tx.cpa.

Sincerely,

David E. Colmenero, J.D., CPA
Chair, Federal Tax Policy Committee
Texas Society of Certified Public Accountants

Principal responsibility for drafting these comments was exercised by Austin Carlson, J.D., CPA; David Colmenero, J.D., CPA; Leo Unzeitig, J.D., CPA; and Josh Whitworth, CPA, CVA.