# Foreign Operations Reporting

Congress has a split personality over the involvement of Americans in foreign countries. It wants them over there doing business and provides special provisions to encourage foreign trade, such as the Foreign Earned Income Exclusion. But Congress is also concerned Americans will use that business to avoid U.S. income tax, and has enacted laws to curb identified abuses.

The IRS may have a more negative perspective. The IRS Overview-Abusive Tax Schemes web page defines an abusive tax scheme as follows:

> The Abusive Tax Schemes program encompasses violations of the Internal Revenue Code (IRC) and related statutes where multiple flow-through entities are used as an integral part of the taxpayer's scheme to evade taxes. These schemes are characterized by the use of trusts, *Limited Liability Companies (LLCs), Limited Liability Partnerships (LLPs), International Business Companies (IBCs), foreign financial accounts, offshore credit/debit cards and other similar instruments.* [emphasis ours].

Responding to these concerns, Congress authorized, and the IRS implemented, an extensive reporting structure for foreign activities by U.S. individuals and corporations. Nonprofit corporations, religious workers, and churches are not exempt. Coverage of exempt organizations and workers is probably intentional, considering the role of exempt organizations in abusive tax shelters and concerns about terrorist usage of exempt organizations.

### Application to Ministry in Foreign Countries

Often, operations in foreign countries are best done through use of a variety of entities, some of which are business entity types. Use of for-profit entities may be lawful, useful, and even the best option in some educational, charitable, or ministry situations. One expert, however, pointed out that many of the non-complying individuals and companies in the international arena deal in terrorism, drugs, and other criminal activities. Compliance negligence puts an organization in bad company. It requires the wisdom of serpents to keep an organization as innocent as a dove.

One commonly required report of foreign accounts applies to anyone who has signatory authority or ownership over foreign bank or financial accounts with an aggregate value of $10,000 or more on any day of the year. Referred to as FBAR, this report includes both personal and organizational accounts. For instance, a worker with a personal account and signatory authority over organizational accounts in a foreign country might personally have to file. Based on those same accounts, the organization might also have to file. The Foreign Account Reporting Requirements (FBAR) article specifically addresses this common requirement.

U.S. organizations that own foreign business entities or a substantial portion of the entity, and U.S. citizens on the board or occupying officer or director positions, often must file returns, too. An exhibit with more details is below. Penalties ranging from $10,000 to $100,000 may be imposed for negligent failure to file. Negligence would be failure to file as a result of ignorance or carelessness. Intentionally not filing or filing a false return might result in criminal liability, with higher financial penalties and potential jail sentences.

An exempt organization generally could not pay a criminal fine for an officer or director and might not be able to pay their civil fine, because of the excess benefit law (IRC 4958).

In addition to the above general-purpose penalties, exempt organizations are subject to specific excise tax penalties on organizations and organization managers for engaging in abusive tax shelter schemes (IRC 4965).

**Nonprofit corporations, religious workers, and churches are not exempt.**

Where and how some exempt organizations might file one of these forms can be ambiguous. For instance, if the form instructions state it is filed with the tax return, does that mean it is filed with Form 990, and subject to Form 990 disclosure? Regulations associated with several forms specify filing obligations even if the owner does not file a return (churches and many mission agencies do not). Other regulations are not as specific, however, requiring more careful assessment.

Typically, an IRS agent investigating non-filing will not be familiar with a organization's motivation or many good works. They will see an organization breaking the law, in an area where many law breakers are guilty of major tax evasion. It can be expensive and distracting from ministry to be treated as a crook.

**Conclusion**

A four-step analysis can be an effective response to this information:

I. Identify all accounts and activities that are maintained as part of corporate and individual oversight, whether or not you initially think reporting is required.

II. Self-education for at least preliminary assessment could begin with obtaining the forms listed below and the IRS publications cited in their directions.

III. Consult tax or legal counsel if you have questions about filing obligations.

IV. In a chart form:

   (a) list each account or activity with a possible filing obligation,

   (b) state either "no form required" or the form (or forms) that should be filed for the account or operation,

   (c) note the individual and/or organizations that should file the form(s), and

   (d) list the rationale for filing or not filing.

## About CapinCrouse

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**Exhibit A**

### U.S. Tax Forms Required for Foreign Operations

The following forms could be required of any exempt organization. In some cases, they could also be required of employees of an exempt organization if they have signatory authority or own or control the identified foreign item. All these forms are available on the IRS website at irs.gov.

| Form Number/Title | Who Must File? | Negligence Penalty for Not Filing |
|---|---|---|
| **FBAR** / Report of Foreign Bank and Financial Accounts | Owner or signatory of foreign accounts ($10,000 or more aggregate interest) | The maximum penalty would be the amounts in the accounts at the time of violation (but not more than $100,000), or $25,000. |
| **Form 8865** / Return of U.S. Persons with Respect to Certain Foreign Partnerships | Any person in control of a controlled foreign partnership (CFP), making transfers to a CFP, or making changes of CFP ownership interest | $10,000 for not filing, plus $10,000 per month or part of month, starting 90 days after a request for form from IRS |
| **Form 5471** / Information Return of U.S. Persons with Respect to Certain Foreign Corporations | Any officer, director, or shareholder (over 10% owner) of a foreign corporation | $10,000 for not filing, plus $10,000 per month or part of month, starting 90 days after a request for form from IRS |
| **Form 8858** / Information Return of U.S. Persons with Respect to Foreign Disregarded Entities | Tax owner of a foreign disregarded entity (*e.g.,* single member LLC) must report its ownership | $10,000 for not filing, plus $10,000 per month or part of month, starting 90 days after a request for form from IRS |
| **Form 3520** / Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts | Any person creating, owning any part of, or engaged in transactions with a foreign trust | Greater of $10,000, 35% of amount of distribution to U.S. person, or 5% of trust assets owned by U.S. person |
| **Form 3520-A** / Annual Information Return of Foreign Trust with a U.S. Owner | A U.S. owner of a foreign grantor trust or any portion of the foreign grantor trust | Greater of $10,000 5% of amount owned by U.S. person |

For tax reporting and other tax purposes, references in the above table to “person,” “shareholder,” “owner,” or “beneficiary” include U.S. tax-exempt entities.

Compliance efforts can be complicated by unfamiliar terminology with very specific meanings. The form instructions and underlying regulations provide details. Internationally, terminology in a foreign jurisdiction that describes the national entity must be analyzed to assess what type of entity it is under U.S. tax law.