

## Amendments to Internal Revenue Code Statutes of Limitations in the HIRE Act

On March 18, 2010, President Obama signed into law H.R. 2847, the Hiring Incentives to Restore Employment Act (the “Act”). Among other things, the Act amended Section 6501 of the Internal Revenue Code (the “Code”), dealing with statutes of limitations with respect to assessment and collection of tax. Specifically, the Act:

- extends the statute of limitations on tax returns indefinitely when certain required information returns dealing with international transactions are not filed or are not substantially complete when filed, and
- provides a new six-year statute of limitations for certain understatements of income related to foreign financial assets (regarding which the Act also adds a new reporting requirement).

### Indefinite Statute of Limitations in Respect of Certain Information Returns

Section 6501(a) of the Code establishes a general rule that the statute of limitations for imposition of federal tax runs three years from the filing of the return. Section 6501(c)(8) creates an exception to this general rule. Prior to amendment, that Section provided that the statute of limitations on taxes related to foreign transactions required to be reported on enumerated information returns did not expire before the date that was three years after the date on which information required to be reported was furnished. This language was generally read to mean that the statute of limitations for parts of the return not related to these information returns would begin to run when the return was filed.

Section 6501(c)(8) applied to the following information returns:

- Form 926 (transfers by U.S. person to foreign corporations);
- Form 3520-A (transactions with foreign trusts);
- Form 5471 (foreign corporations owned by U.S. persons and organizations, reorganizations and acquisitions of stock of foreign corporations);
- Form 5472 (foreign-owned U.S. corporations);
- Form 8858 (foreign disregarded entities owned by U.S. persons);
- Form 8865 (foreign partnerships owned by U.S. persons, changes in interests in foreign partnerships and transfers to foreign partnerships).

The Act made the following also subject to Section 6501(c)(8):

- Form 8621 (qualifying electing fund elections by passive foreign investment companies (PFICs));
- information required with respect to PFICs under Section 1298(f), as amended by the Act; and
- information required under new Section 6038(D), enacted by the Act with respect to information required with respect to foreign financial assets (described below).

Note that no forms currently exist with respect to the latter two new reporting requirements, which, as indicated, were added by the Act.

Of most significance, the Act creates an indefinite statute of limitations with respect to the taxpayer's entire return if one of the enumerated information returns has not been filed or is not substantially complete when filed.

The foregoing change applies to returns filed after March 18, 2010, and also to returns filed on or before that date if the statute of limitations (determined without regard to the amendments) has yet to run out. That means the statute of limitations on a 2006 federal income tax return filed on September 15, 2007, which would have run out on September 15, 2010, will not run out if an information return has not been filed (or the return was incomplete or inaccurate).

In cases in which Section 6501(c)(8), as amended, applies, any missed foreign information filing or any failure to substantially comply with a relevant information reporting provisions (*i.e.*, failing to report all required information or filing inaccurate information) keeps the statute of limitations open for the entire tax return until complete and accurate information is filed. Thus, for financial reporting purposes, prior year tax reserves cannot be reversed as long as there is any failure to comply. This makes compliance with these reporting requirements particularly crucial. The IRS is apparently considering the implications of this aspect of the Act.

### **Extensions of Statute for Understatements Attributable to Required Reporting of Certain Foreign Financial Assets**

The Act added a new provision, Section 6038D, requiring reporting by individuals of information with respect to interests in “specified foreign financial assets,” if the aggregate value of all such assets exceeds \$50,000. “Specified foreign assets” include:

- depository or custodial accounts at a foreign financial institutions;
- any stock or security issued by a non-U.S. person;
- any other financial instrument or contract held for investment that has a non-U.S. issuer or counterparty; and
- any interest in a foreign entity.

The Act also authorizes the Treasury Department to establish rules requiring U.S. entities to make similar filings if they are formed or availed of for the purpose of holding interests in specified foreign financial assets.

The information to be included on the statement includes identifying information for each asset and its maximum value during the taxable year. A failure to furnish the information will result in a \$10,000 penalty; if the taxpayer fails to furnish the information within 90 days of being notified by the IRS of the failure, an additional penalty will accrue at a rate of \$10,000 for each 30-day period, or fraction thereof, up to a total penalty of \$50,000 for one taxable period. Although no penalty will be imposed if reasonable cause for the failure to file can be shown, the fact that a foreign jurisdiction would impose a civil or criminal penalty if the taxpayer disclosed does not qualify as reasonable cause. This reporting is required for taxable years beginning after March 18, 2010.

The Act provides for a six-year statute of limitations when a taxpayer’s omission of income relates to any asset for which reporting is required under Section 6038D, and the understatement is in excess of \$5,000. This change applies to returns filed after March 18, 2010, and also to returns filed on or before that date if the statute of limitations (determined without regard to the amendments) has not expired. Under prior law, a six-year (rather than a three-year) statute of limitations generally applied only to understatements in excess of 25% of the gross income stated on the return.

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