

Offshore Voluntary Disclosure Workshop

Houston, TX
September 2011



IRS LARGE BUSINESS AND
INTERNATIONAL DIVISION

Instructors

(b) (6)



- Dave Breen, Senior Counsel Attorney
(Philadelphia, PA)



Purpose of Training

- Despite prior initiatives intended to address offshore compliance, unreported offshore income remains a significant area of non-compliance
- Enhanced/vigorous compliance activities have led to a significant increase in voluntary disclosures with offshore issues
- As a result, the Service has developed a new offshore compliance approach

History of OVDI



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Origins of Offshore Voluntary Disclosure Initiative

- Successes of other offshore initiatives has increased likelihood taxpayers with offshore accounts will be detected
- John Doe summons to UBS has demonstrated that secrecy of offshore accounts is no longer a guarantee

John Doe summons served on UBS AG on July 21, 2008

- Based on information developed from an individual who had worked as a private banker for UBS in Switzerland
- Swiss Client Advisors secretly traveled to the US to conduct banking and securities business with US clients and develop new clients on US soil
- Not licensed to provide such services in the US

UBS Conduct

- Qualified Intermediary Agreement with IRS
- Divided their US clients into 2 groups
 - “Declared” ... accounts reported to IRS
 - “Undeclared” ... accounts kept secret from IRS
- Formed sham corporations for US clients and knowingly accepted fraudulently prepared documentation claiming foreign status

Deferred Prosecution Agreement

- Filed February 18, 2009
- Admitted to criminal conduct in conspiring with U.S. taxpayers to violate tax laws
- Permanent restrictions on US cross-border business
- \$780 million settlement
- Disclosure of account information on a small number of U.S. clients

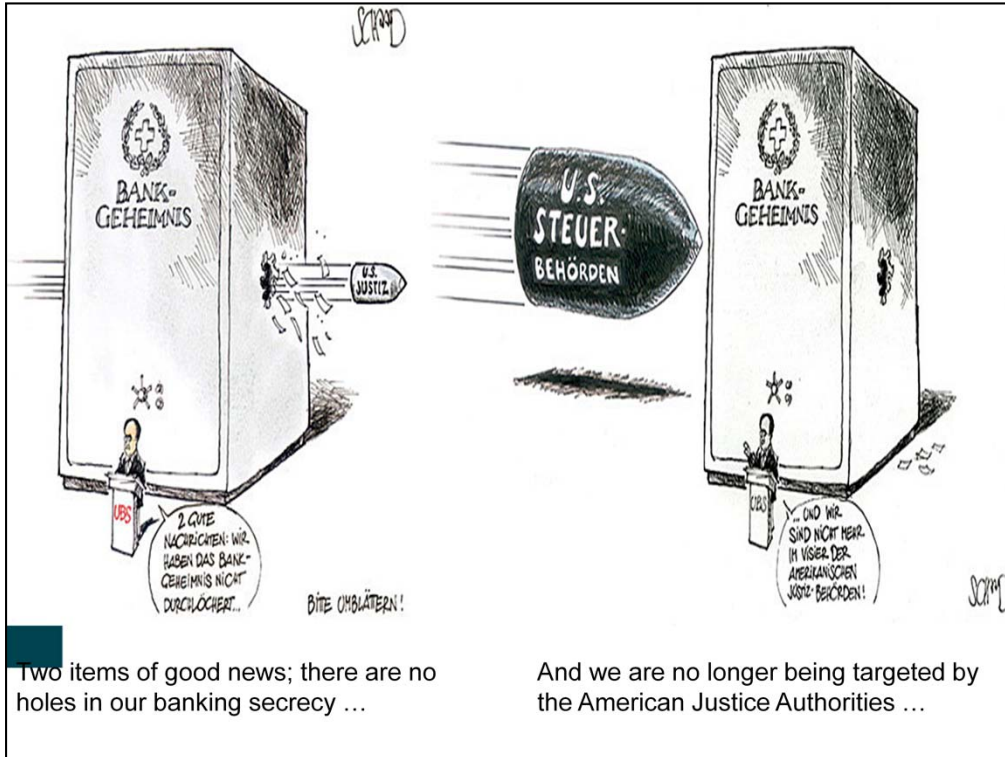
John Doe Summons Enforcement Action

- John Doe Summons Enforcement Action
 - Filed February 19, 2009
 - Court took extraordinary step of scheduling a plenary hearing for July
 - UBS claimed enforcement would force its employees to violate Swiss criminal laws
 - Swiss government filed an amicus brief with the court supporting UBS's position



European Press Reaction





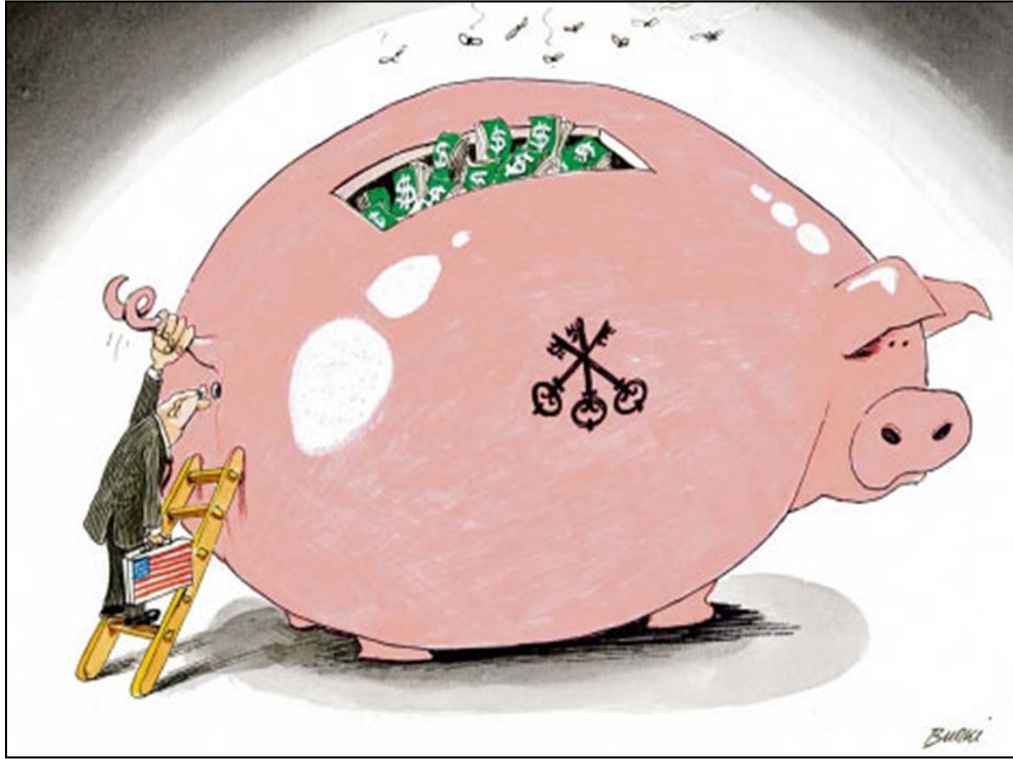
Two items of good news; there are no holes in our banking secrecy ...

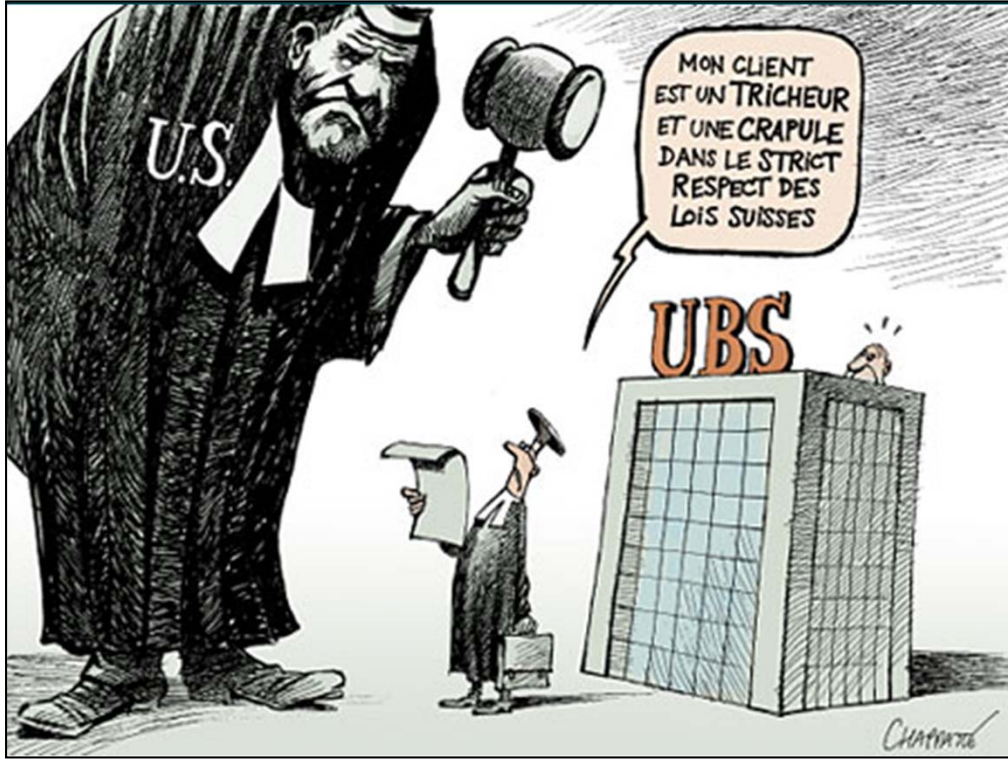
And we are no longer being targeted by the American Justice Authorities ...



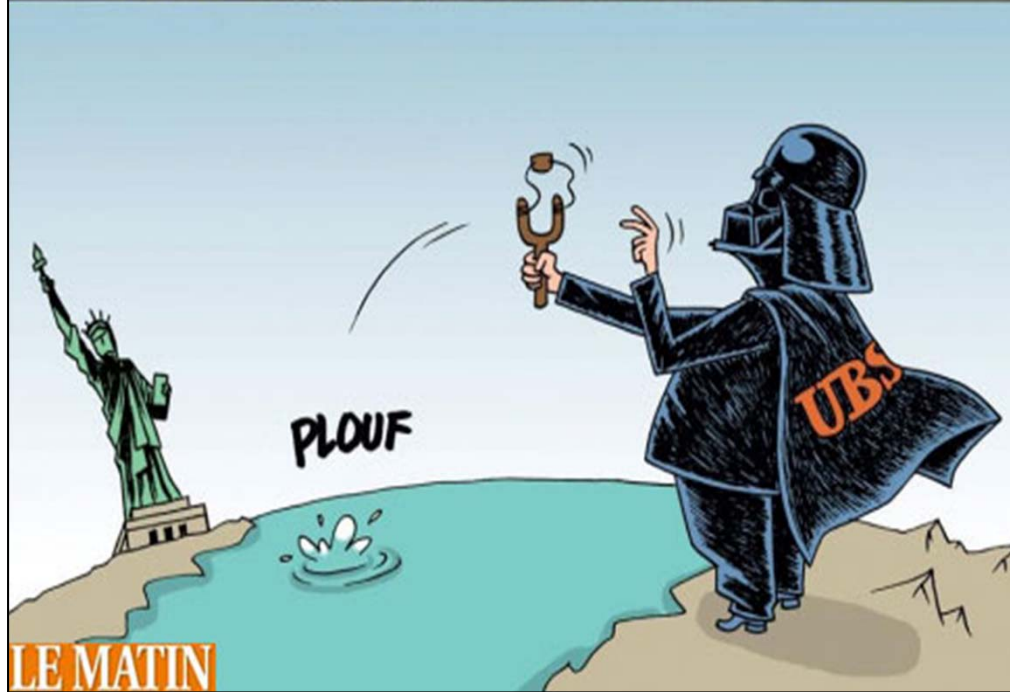








SECRET BANCAIRE : UBS CONTRE-ATTAQUE





Negotiations

- As hearing approached, the Swiss Government requested that we entertain a renewed treaty request in lieu of enforcement
- Swiss initially took hard line and informed the Court they would issue blocking order
- Judge issued order asking US to advise what sanctions it was prepared to seek
- At the court hearing on July 13th, DOJ announced that IRS and Switzerland were trying to negotiate a resolution

Negotiations

Settlement was announced August 13 and formally signed August 19, 2009

- Government to Government agreement to set up framework for more robust information exchange
- Declarations by both Governments
- Agreement between UBS AG and DOJ to settle the summons enforcement proceeding

Agreement Announced August 19, 2009

- Swiss Government agreed to entertain a further “no name” treaty request expected to produce 4,450 accounts
 - Terms of annex to be confidential for at least 90 days
- Swiss Government agreed to apply resources needed to promptly process request and to support exchange in appeal process
- Both parties committed to the signing of the new protocol amending Article 26 of the U.S.-Swiss Tax Treaty, initialed on June 18, 2009, as soon as possible, but no later than September 30, 2009, and to seek early ratification

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Agreement Announced August 19, 2009

- UBS AG agreed to promptly assemble account data responsive to request from SFTA and to meet certain milestones
 - Deliver acct information to SFTA on rolling basis at 60, 180, and 270 days
 - Send notice to clients on rolling basis beginning in 15 days
- UBS agreed to adopt new QI requirements

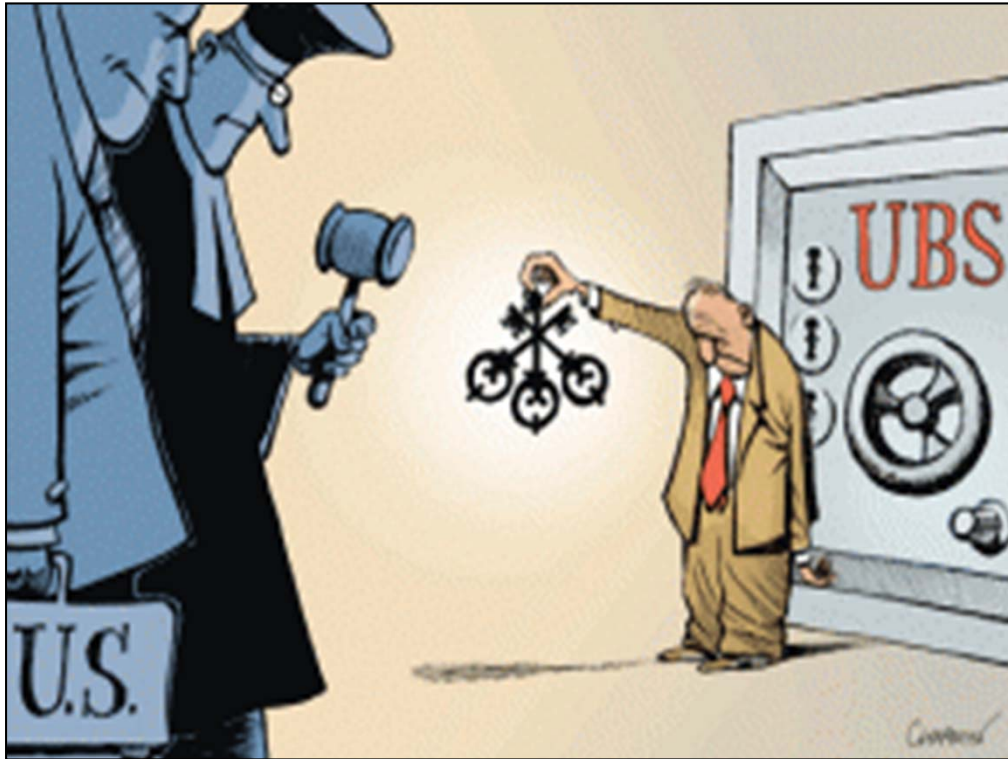
Agreement Announced August 19, 2009

- IRS agreed to:
 - Dismiss the enforcement proceeding on signing
 - Scale back the summons to accounts covered by the treaty request on 12-31-09 if UBS has met its milestones
 - IRS agreed to withdraw the summons on the earlier of:
 - Delivery of the 4,450 accounts anticipated under the treaty
 - Receipt of 10,000 accounts from any source, including voluntary disclosures
- In 370 days if IRS has not received anticipated results, it may “rebalance”

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Agreement Announced August 19, 2009

- Treaty Request filed August 31, 2009
- UBS complied with milestones, and IRS limited the scope of the summons to the 4,450 accounts covered by the treaty request in December 2009
- January 22, 2010 Swiss Court ruled that agreement exceeded what was allowed under Treaty and Swiss law
- Swiss Federal Counsel submitted the question to their Parliament, which voted to adopt the agreement in early July



Sources related cases of UBS

- Wire transfers between US accounts and Swiss accounts
- DPA cases
- Waivers of confidentiality signed
- UBS settlement cases
- Voluntary Disclosures



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Voluntary Disclosure Practice

What is it?
Who is eligible?

Voluntary Disclosures

- First used as far back as 1920 to enable taxpayers who had failed to comply with the tax laws to become compliant and avoid criminal prosecution

Participation

IRM 9.5.11.9

- A voluntary disclosure occurs when the communication is truthful, timely, complete, and when the taxpayer:
 - Shows a willingness to cooperate (and does in fact cooperate) with the IRS in determining correct tax liability and
 - Makes good faith arrangements with the IRS to pay in full, the tax, interest, and penalties

Voluntary Disclosures

- Will not automatically guarantee immunity from prosecution
- May result in prosecution not being recommended
- Never available to taxpayers with **illegal source income**

Requirements of a VDisc

- Timely
- Legally sourced-income
- Complete
- Accurate
- Pays tax, interest, penalties IRS determines are due

Requirements of a VDisc

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- Legally sourced-income
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- Accurate
- Pays tax, interest, penalties IRS determines are due

**CI's
Role**

**Your
Role**

Timeliness



- A disclosure is timely if it is received before IRS has:
 - Initiated a civil examination (or TP notified)
 - Initiated a criminal investigation (or notified)
 - Received information from a third party re: taxpayer
 - Initiated a **related** civil examination or criminal investigation
 - IRS has acquired information directly related to taxpayer

Transmitting the Voluntary Disclosure to SB/SE

Domestic Issues

- If the SAC concurs - memorandum with relevant information is forwarded to PSP for further action
- PSP classifies and assigns cases to the Field requiring review and certification, i.e.
 - Compete
 - Accurate
- If taxpayer is not honest and cooperative – case is referred back to CI (See United States v Crystal, 172 F.3d 1141 (9th. Cir. 1999))

Transmitting the Voluntary Disclosure to SB/SE

Offshore Issues

- If the SAC concurs - memorandum with relevant information received by CI will be forwarded to Philadelphia Offshore Identification Unit (POIU)
- POIU builds cases for RAs with VDP training who certify accuracy and completeness
- If taxpayer is not honest and cooperative – case is referred back to CI
- If taxpayer refuses to agree and pay – IRS will convert the case to full examination

New Offshore Compliance Approach

- Voluntary disclosures received from CI with offshore issues are forwarded to POIU for case building and transferring to Austin Campus
- To ensure consistent treatment of similarly situated taxpayers



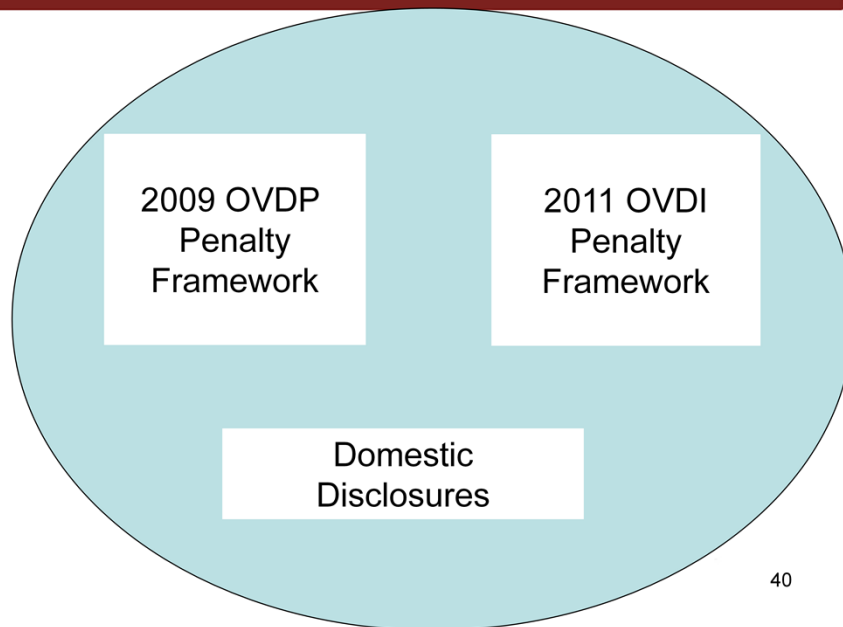
New Offshore Compliance Approach

- OVDP 2009 announced March 23, 2009 and ended October 15, 2009 (after extension from September 23, 2009)
- Post 2009 OVDP cases received after deadline
- OVDI 2011 announced February 8, 2011 and ended September 9, 2011



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CI's Voluntary Disclosure Practice



Recent Memos Concerning Offshore Cases

- IR-2011-84 [Aug. 8, 2011](#)
- Deputy Commissioner [March 01, 2011](#)
- IRS Commissioner [March 26, 2009](#)

New Offshore Compliance Approach

- IRS.gov Voluntary Disclosure [Link](#)
 - Memo's
 - FAQ's
 - Documents Required

Civil Voluntary Disclosure Process IRM X.XX.XX



Civil Voluntary Disclosure

- Participants will be subject to the 20% accuracy-related penalty in addition to a miscellaneous “offshore” penalty that could be either 5%, 12 ½% or 25% of the highest aggregate balance in their offshore account(s) or assets

Terms

- Taxpayer - files ALL amended or delinquent returns for 8 years (2003 – 2010), including all information returns and FBARs
- IRS - will assess:
 - all tax and interest on underpayment
 - IRC § 6662 or IRC § 6651(a) and
 - miscellaneous “offshore penalty”

Bifurcated Approach

**INCOME
TAX
CASE**

MFT 30

**OFFSHORE
PENALTY
CASE**

MFT 55



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Examination Approach Income Tax Component

- Certification of Amended Returns
 - Unreported Income
 - Penalty assessment
- Amended returns vs. Delinquent returns
- Tax & Miscellaneous Offshore Penalty paid in advance
- Opt Out Procedures

"Offshore Penalty"

In lieu of all other "offshore" penalties
(including FBAR and Information Return penalties)

- 25% of the amount in foreign bank accounts or entities in the year with the highest aggregate account/asset value
- 12 ½% if the account balance or asset value is less than \$75,000
- 5% if
 - taxpayer did not open or cause any accounts to be opened
 - Exercised minimal, infrequent contact with account
 - Not withdraw > \$1,000 in any one year
 - Can establish that all applicable taxes have been paid on funds deposited into the account

5 % Penalty

- If a taxpayer raises the issue that a lesser penalty amount should apply and presents evidence to support their position, the examiner should consider mitigating factors and assert lower amounts
- To assure consistency in the application of the lower penalty %, contact your Technical Advisor before you assess the 5% penalty

Offshore Penalty Example

- Taxpayer A held an interest in four accounts in tax years 2003- 2007
- The numbers reflected in the chart represent the highest amount in the account for each taxable year

Offshore Penalty Example

	<u>Highest Balance in Account During the Year</u>				
<u>Acct</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
1	1,000,000	1,200,000	1,200,000	1,100,000	1,150,000
2	60,00,000	6,400,000	6,700,000	6,500,000	8,000,000
3	50,000	30,000	47,000	55,000	65,000
4	9,000,000	11,000,000	13,200,000	11,400,000	11,600,000
Tot.	16,050,000	18,630,000	21,147,000	19,055,000	20,815,000

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Offshore Penalty Example

	<u>Highest Balance in Account During the Year</u>				
<u>Acct</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
1			1,200,000		
2			6,700,000		
3			47,000		
4			13,200,000		
Tot.	16,050,000	18,630,000	21,147,000	19,055,000	20,815,000

Penalty is 25% of \$21,147,000
25% = 5,286,750

Examination of Offshore Voluntary Disclosure Cases

- Voluntary Disclosure Revenue Agents
- Primary Issues:
 - Income
 - Civil penalties
- Closing agreements for all cases
 - Form 906 (MFT 30 Case)
 - Form 8278 (separate case file) for Offshore Penalty (MFT 55 Case)

Our Guiding Light



Our Guiding Light



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Our Guiding Light

FAQ'S

- Convey major procedures and terms of the 2011 OVDI
- Have become the “Code” for OVDI
- Issued February 8, 2011
- Numerous updates thru August, 2011

Some Basics FAQ #7

- What years are covered?
- What returns must a taxpayer submit?
- What other conduct is required?
- What must a taxpayer pay?

Some Basics FAQ #7

- 2003 through 2010
- Fiscal years ending in 2003 through 2010

FAQ #7 – What Returns Must be Provided?

- 1040s and 1040-Xs already filed (copies)
- 1040-Xs or delinquent 1040s reflecting previously unreported offshore income
- Offshore-related information returns (see FAQ 29 for certain dissolved entities)
- TD F 90-22.1 Report of Foreign Bank and Financial Accounts (FBAR)

FAQ #7– What Else Must Taxpayer Do?

- Cooperate
- Provide requested offshore information
- Execute 872s
- Execute extensions for FBAR penalty
- Execute an IRS prepared Form 906

FAQ #7– What Must A Taxpayer Pay?

- Pay tax due on 1040s or 1040-Xs
- Pay IRC § 6662(a) on the full amount of underpayments
- Pay IRC § 6651(a)(1), if applicable;
- Pay IRC § 6651(a)(2), if applicable;
- Pay interest (IRC § 6404(g) inapplicable)
- Pay miscellaneous offshore penalty

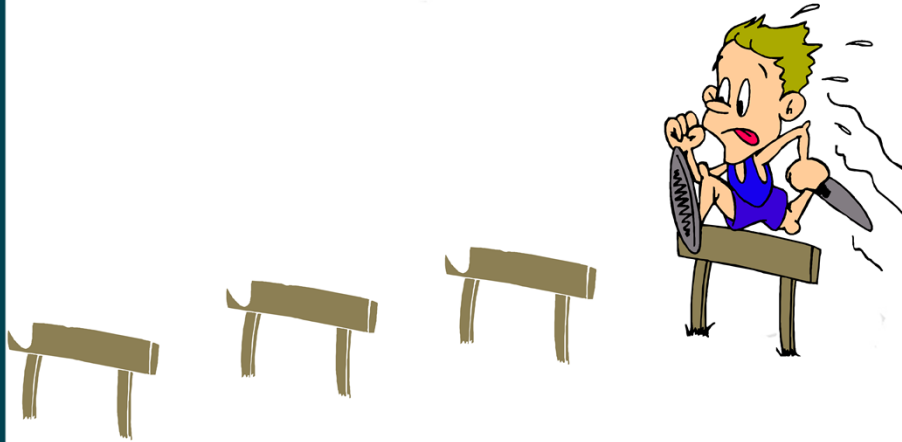
FAQ #7– Miscellaneous Offshore Penalty

- 25% of the highest aggregate balance in foreign bank accounts/entities or value of foreign assets during the period covered by the voluntary disclosure
- 12.5% or 5% reduced penalty available in limited cases (see FAQ 52 and 53)

FAQ #52 – Penalty reduced to 5% for:

- Any taxpayers who meet a 4 prong test (#52.1)
- Foreign residents:
 - who are “Accidental Citizens” (#52.2)
or
 - meet a 3 prong test (#52.3)

“4 Prong Taxpayers”



Penalty reduced to 5%

- (a) did not open or cause the account to be opened (unless the bank required that a new account be opened, rather than allowing a change in ownership of an existing account, upon the death of the owner of the account);**

Penalty reduced to 5%

(b) have exercised minimal, infrequent contact with the account, for example, to request the account balance, or update accountholder information such as a change in address, contact person, or email address;

Penalty reduced to 5%

(c) have, except for a withdrawal closing the account and transferring the funds to an account in the United States, not withdrawn more than \$1,000 from the account in any year for which the taxpayer was non-compliant; and

Penalty reduced to 5%

(d) can establish that all applicable U.S. taxes have been paid on funds deposited to the account (only account earnings have escaped U.S. taxation)

- **For funds deposited before January 1, 1991, if no information is available to establish whether such funds were appropriately taxed, it will be presumed that they were.**

Penalty reduced to 5%

- **Only if all 4 conditions are met will the penalty be reduced to 5%**

Foreign Residents “Accidental Citizens”

- Taxpayers who are foreign residents and who were unaware they were U.S. citizens.
Example: The taxpayer has \$60,000 in a foreign account and was:
 - born in the U.S. to parents of foreign citizenship
 - grew up in a foreign jurisdiction,
 - unaware that she had been born in the U.S
 - has never filed U.S. returns or FBARs.

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Foreign Residents “Accidental Citizens”

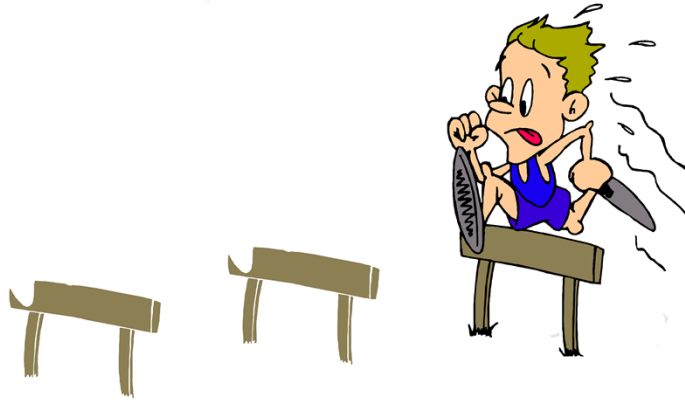
Example:

Taxpayer became aware she was a U.S. citizen when she had to get a birth certificate in order to obtain a passport from the foreign jurisdiction where she resides

Foreign Residents “Accidental Citizens”

Taxpayer gets the 5% penalty provided that subsequent to learning of her U.S. citizenship, taxpayer took no action with respect to her foreign accounts that would disqualify a U.S. taxpayer from the 5 percent penalty under the 4 prong test already described

3 Prong Foreign Resident Taxpayers



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Foreign Resident 3 Prong Test

- 5% also available to taxpayers who are foreign residents who
- (1) reside in a foreign country;
- (2) have made a good faith showing that they have timely complied with all tax reporting and payment requirements in the country of residency; and
- (3) have \$10,000 or less of U.S. source income each year

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Additional Break for Foreign Resident 3 Prong Taxpayers only

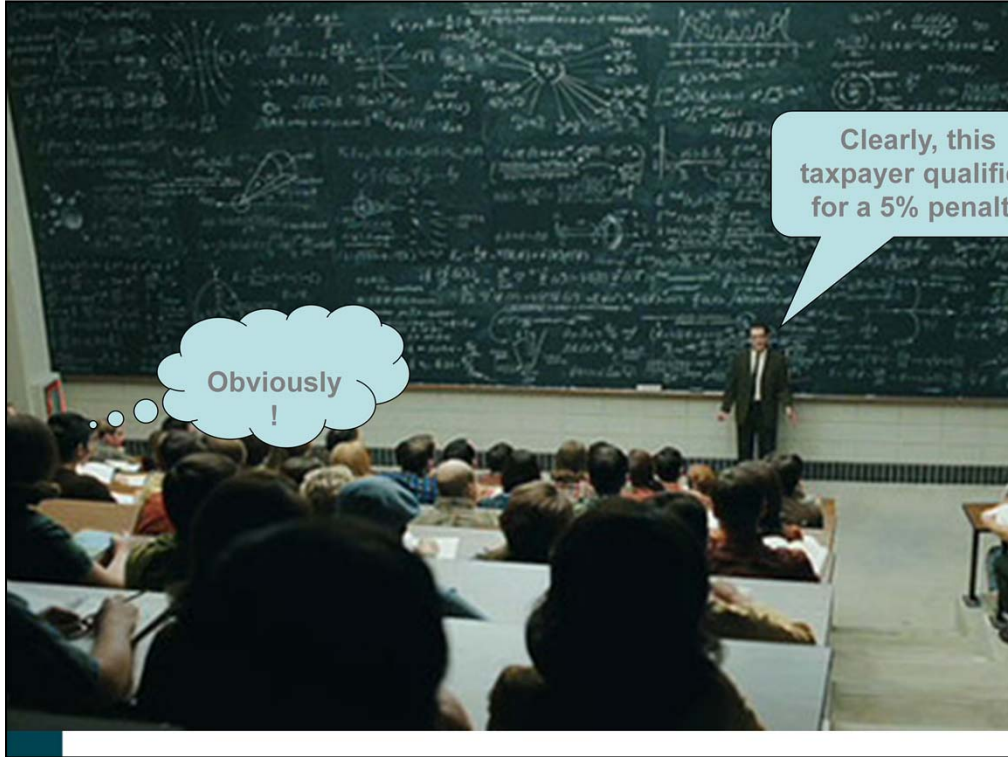
- The offshore penalty will not apply to non-financial assets, such as real property, business interests, or artworks, purchased with funds for which the taxpayer can establish that all applicable taxes have been paid, either in the U.S. or in the country of residence
- This exception only applies if the income tax returns filed with the foreign tax authority included the offshore-related taxable income that was not reported on the U.S. tax return

FAQ # 35 – 12.5% Penalty Criteria

- Highest aggregate account balance in each of the years covered by the 2011 OVDI is less than \$75,000

FAQ # 35 – 12.5% Penalty Criteria

- Highest aggregate account balance includes the fair market value of assets in undisclosed offshore entities and the fair market value of any foreign assets that were either acquired with improperly untaxed funds or produced improperly untaxed income



VDP Procedures

- Amended Returns (8 years)
- IMFOLT
- AIMS/ERCS
- Statute of Limitations
- Certification (not Examination)

VDP Procedures

- 3 Page CI [“Optional Format Letter”](#)
- Offshore Bank Statements (8 years)
- Interview (If necessary)
- Related Offshore Information Returns

VDP Procedures

- FBAR ([Blanket RSM](#))
- Form 906 (Full Pay/No Pay)
- Case File (Title 26)
- Offshore Penalty Case File
- Technical Advisors

Closing Agreements

- **IRM 8.13.1 – Introduction and how to write the Closing Agreement**
- **Job Aid #6 – Form 4549-A VDP Procedures**
- **Job Aid #7 – Closing Agreement Procedures**

Closing Agreements

Field Examiner's Responsibilities

- Prepare 906 Closing Agreement
- Submit to Taxpayer(s) for signature(s)
- Receive and Review signed 906
- Sign as “Receiving Officer”
- Close case as Agreed (DC 08)
- Forward case to Technical Services

Closing Agreements

Secure & Review up to date Transcripts

- Taxable Income Amount
- Tax Liability
- 1040X filings
- Statutes
- Payments

Closing Agreements

Prepare RAR, Form 4549-A to accompany Closing Agreement

- Impute interest 30 days beyond
- Reconcile amounts to Form 906
- Accuracy Related Penalties (20%)
- Verify and Review Computations
- Ensure correct years are addressed
- Make 2 copies (taxpayer and file)

Closing Agreements

Offshore Penalty Amount computed at 25%

- If 5% Penalty case, you must get approval from Offshore Technical Advisor
- Document in Case History or include emails for verification
- Form 906 will not be executed by Technical Services without documented approval

Closing Agreements

Secure 906 from VDP SharePoint

- 2 versions of Form 906: Full Pay or Not Full Paid
- Standard or Dissolution of Foreign Entity
- Major changes to 906 must be approved by Offshore Technical Advisor and Counsel (ie PFIC or FTC)
- Document approval in Case History

Closing Agreements

Prepare and complete 4 copies of the Closing Agreements

- 3 copies for Taxpayer(s) to sign and date
- 1 copy for case for comparison use later

Closing Agreements

If Joint Disclosure:

Enter the Taxpayer's first name & last name, SSN, spouse's first name & last name, SSN and "current address"

If Single Disclosure:

Enter the Taxpayer's first name & last name, SSN, and "current address".

Note: regardless if joint return was filed

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Closing Agreements

Example:

Jon Taxpayer SSN 000-00-0000 and Jane
Taxpayer 000-00-0000, 915 Second Ave,
Seattle, WA 98174

Closing Agreements

Statement 1 – Income Adjustments

- Offshore Unreported Income for all years involved
- Non-Offshore Income Adjustments

Complete header section on Page 2 with taxpayer information (remember to change for next taxpayer if reusing)

Enter Offshore Penalty Amount in Statement 3 of Closing Agreement

Closing Agreement

Formatting Form 906

- Applicable years....
- 2nd Whereas.....[his/her/its]
- Stmt 2 & 3.....[or delinquent-related penalties, as applicable]
- Stmt 8.....[his/her/its]
- Keep Stmt 8 with signature page
- Use Z line if necessary on prior pg

Closing Agreement

Secure Cover Letter from Share Point

Send cover letter, 3 Form 906s and Audit Report Form 4549-A, to taxpayer(s) for signature

Send copy to POA (if POA applicable)

Closing Agreement

- 3 original Forms 906 sent back by taxpayer(s)
 - Original signatures and dated
 - If POA signed instead of taxpayer(s), attach Form 2848 to each 906
 - Check for alterations or erasures
 - Use copy for comparison purposes
 - Contact Offshore Technical Advisor if any change identified

Closing Agreement

On the reverse side, date stamp all pages of each 906

Revenue Agent should sign and date in blue ink as "Receiving Officer"

Prepare Letter 1595-E

- Address to Taxpayer(s)
- Use your own info as contact information
- Do not enter Date and do not Sign.
- For Title after Sincerely, enter "Technical Services Group Manager"
- Secure Letter from Share Point, this includes Title

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Closing Agreement

No Full Payment – Financial arrangement must be resolved with RO before case is to be closed to Technical Services

- 906 will not be executed until collection matter is resolved (i.e. Installment Agreement, OIC, etc)
- Obtain written concurrence of resolution from Revenue Officer

Closing Agreement

Form 3198, Rev. 8/2009

- Check box 906 in Technical Service Section
- Check box Other in Technical Service Section and write in Red ink, Offshore Voluntary Disclosure Program Case
- Complete bottom section on Page 1
- Check box 6404(g) – Does Not Apply
- Check all other appropriate boxes
- Complete Related Taxpayer section with Penalty Casefile information

Closing Agreement

Close both case files, Exam and 8278 Penalty, to your local Technical Services office

- Update to Status Code 21

PFIC

Passive Foreign Investment Company

- Sales of PFIC stock/units subject to special rules per IRC 1291
- OVDI also has special MTM computation

PFIC Objectives

- Determine what is a PFIC
- Determine how to recognize a PFIC
- Describe the different tax regimes under PFIC
- Determine how distributions and dispositions of PFIC stock are taxed under Section 1291
- Determine how the PFIC is identified on the Closing Agreement

Anti-deferral Overview

US persons, such as US citizens and domestic corporations, generally are subject to US income tax on their world-wide income.

In contrast, foreign persons, such as foreign corporations, generally are subject to US income tax only with respect to “US-source income” or income that is “effectively connected with a US trade or business.”

Anti-deferral Overview

Thus, if a US person invests in a foreign corporation that earns foreign income the US generally cannot tax the return on that investment until the foreign corporation distributes a taxable amount to the US shareholder.

Moreover, if the foreign corporation did not make any distributions of its earnings to the US person and the US person sold the shares of the foreign corporation at a gain, the gain would be taxable as a capital gain.

PFICs

Applicable Code Sections

IRC 1291-1298

IRC 1291: Excess Distribution Regime

IRC 1293-1295: QEF Regime

IRC 1296: Mark to Market Regime

IRC 1297: Definition of a PFIC

IRC 1298: Special Rules

PFIC Taxation

Definition of PFIC

DEFINITION: A foreign corporation is a PFIC if the foreign corporation has:

- Passive income that is at least 75% of gross income in any single tax year; or
 - ❖ Passive income generally is anything considered foreign personal holding company income ("FPHCI") at IRC 954(c), with look thrus and exceptions that will be discussed.
- Passive assets represent at least 50% of total assets in any single tax year.
 - ❖ Whether or not an asset is "passive" is determined by whether or not the asset produces passive income or is held for the production of passive income.
 - ❖ The determination of the value of the assets is based on fair market value with respect to (i) publicly traded companies; or (ii) non-publicly traded companies that do not make an election to use adjusted basis.
 - ❖ The determination of the value of the assets is based on adjusted basis with respect to (i) CFCs (within the meaning of IRC 957); or (ii) non-publicly traded companies that elect to use adjusted basis.

PFICs

Definition of Passive Income

- “Passive income” for purposes of determining PFIC status is defined by reference to FPHCI, as set forth in IRC 954(c). Passive income includes:
- Interest, dividends, rents, royalties, and annuities.
 - Net gain from the sale of property that produces IRC 954(c)(1)(A) income or no income.
 - Net gains from certain F/X and commodity transactions that do not arise in the ordinary course of business or out of hedging transactions.
 - Income equivalent to interest.
 - Income from notional principal contracts.
 - Deemed dividends in “repo” transactions.

PFIC

How to Recognize in Offshore Cases

- Taxpayer invests in Investment Funds shown on Offshore Bank Statements
- Purchases shares or Units of the Investment Fund

PFIC Tax Regimes

- Section 1291 Fund.
 - A “section 1291 fund” is subject to the deferred taxation and an interest charge on “excess distributions.”
 -
- QEF Election.
 - The IRC 1295 QEF election requires the PFIC shareholder to be taxed on the shareholder’s portion of the PFIC’s ordinary earnings and net capital gains for the year, very similar to the taxation of IRC 954(c) FPHCI, except long term cap gains can flow thru.
- MTM Election.
 - The IRC 1296 MTM election taxes the PFIC shareholder on the annual increase in the value of the shareholder’s PFIC stock to the extent that the FMV of the stock at the close of the taxable year exceeds the shareholder’s adjusted basis in the stock.
 - The MTM election losses can be deducted to the extent of prior income inclusions in prior years resulting from the IRC 1296 MTM election. (See “unreversed inclusions” at IRC 1296.)

PFIC Taxation

Retroactive Elections

➤ Retroactive QEF Elections

- Reg. Sec. 1.1295-3 allows Retroactive QEF Elections if:
 - Shareholder reasonably believed it was not a PFIC and filed a protective statement.
 - Shareholder is a qualified shareholder (corporation reasonably concluded that it was more likely than not that it was not a PFIC and notified the shareholder who owns less than 2% of the vote or value of the corporation)
 - Special consent is granted the shareholder by the commissioner.
 - Counsel determines whether the shareholder is entitled to make the election.
 - The field reviews the computation
 - Counsel grants the Retroactive QEF Election by entering into a closing agreement (if needed to address tax liability for closed years) and issuing a PLR to the taxpayer.

PFIC Taxation

Definition of Excess Distribution

Excess Distribution Amount -IRC 1291(b), Prop. Reg. 1.1291-2(c)

- Any gain on the sale of PFIC stock represents a current year distribution, which is characterized as an excess distribution.
- Losses cannot be recognized from the disposition of stock of a “section 1291 fund” (Prop. Regs 1.1291-3, and 1.1291-6) unless otherwise allowed by the Code. Losses are therefore recognized under the normal capital loss rules of the Code.

PFIC Taxation

Taxation of Excess Distribution

Prop. Reg. 1291-2(e)

- The excess distribution is allocated pro-rata to each day of the PFIC shareholder's holding period.
 - The portion allocated to the current year is taxed in the current year of the distribution.
 - The portion of the distribution allocated to the PFIC holding period years is subject to the deferred tax at IRC 1291(c).
- Deferred Tax. The deferred tax is:
 - Calculated without any deductions;
 - Calculated at the highest rate applicable (ordinary income); and
 - Added to tax due in the current year, with interest due from the due date of the return for the allocation year until the due date for the current year.

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Example Disposition of Section 1291 Stock

FACTS:

- 1/1/2001: Purchase PFIC Stock for \$10,000
- 12/31/2004: Sale of stock for \$60,000
- Gain on Sale of Stock = \$50,000 Entire amount treated as Excess Distribution

GAIN ON SALE TAXED AS EXCESS DISTRIBUTION:

- Calculation of Deferred tax & Interest:
 - 2001: $\$12,500 \times 39.1\% = \$4,888 + \$791$ (3 years of interest)
 - 2002: $\$12,500 \times 38.6\% = \$4,825 + \$470$ (2 years of interest)
 - 2003: $\$12,500 \times 35.0\% = \$4,375 + \$214$ (1 year of interest)
- Current gross income:
 - 2004: \$12,500 ordinary income

TAX CONSEQUENCES IN 2004:

- Ordinary Income of \$12,500
- Deferred Tax = \$14,088
- Deferred Interest = \$1,475

How to Determine if potential PFIC Computation is Material:

- The amount(s) of the gain on the sale of PFIC stock
- Were the PFIC sale of stock gains offset by capital losses? Losses on the sale of PFIC stock are capital losses and can't offset PFIC gains from the sale of stock –Proposed Regs Section 1.1291-3(a)
- The differential between the capital gains rate and the top rates
- The holding period of the stock –the interest factor increases the longer the stock is held

PFIC Taxation Filing Requirements

Prop. Reg. 1.1291-1(i)

- A US person that is a shareholder in a PFIC must file a Form 8621 with respect to each PFIC of which the person is a shareholder during a year
- Form 8621 is filed by attaching the form to the shareholder's federal income tax return for the year.
- If the PFIC shareholder is not required to file an income tax return, then the Form 8621 must be filed in Philadelphia. ¹¹³

PFIC – Audit Tips

- Look at Statements and look for situations where taxpayer is purchasing “Units” or “Shares” of funds
- Gains on Sales of “Units” or “Shares” are subject to Excess Distribution Treatment under Section 1291

PFIC – Audit Tips

Section 1291 – Excess Distributions

- Allocate Excess Distribution over holding period of stock
- Allocated Gain to Current Year is treated as Ordinary Income
- Allocated Gain to prior years – subject to deferred tax and deferred interest charge

PFIC

OVDI Closing Agreement Language

2. During the period 2003 through 2008, Taxpayer invested in one or more Passive Foreign Investment Companies (PFICs) within the meaning of IRC Section 1297(a). Of the unreported income in paragraph 1 above, the following amounts constituted an excess distribution and/or gain on the disposition of PFIC stock subject to the tax treatment imposed by section 1291.

PFIC income	2003	2004	2005	2006	2007	2008
	\$	\$	\$	\$	\$	\$

3. For taxable years 2003 through 2008, penalties under section 6662 of the Internal Revenue Code [or *delinquency-related penalties under I.R.C. § 6651, as applicable*] apply to the underpayments attributable to the aforementioned unreported income and overstated deductions, and PFIC tax under Internal Revenue Code section 1291.

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How to enter the PFIC and the alternative PFIC MTM into RGS will be discussed in RGS lesson.

PFIC

Closing Agreement Language (Continued)

Amount to include in the table located in paragraph 1 of the 906

“Distributions from Section 1291 Fund”

Total amounts from all Form 8621s for the year –Line 10a

“Gain from the disposition of Section 1291 Fund Stock”

Total amounts from all Form 8621s for the year –Line 10f
(gains only, no losses)

Amount to include in table from the additional PFIC paragraph of the
906 (PFIC Income)

Total amounts from all Form 8621s for the year –Line 10e and
10f (gains only, no losses)

**These amounts are included in the table for the year of the
disposition of the investment and/or dividend paid.**

Alternative PFIC MTM

- Special PFIC MTM for OVDI cases

Objectives

- Determine what is the Alternative PFIC MTM Resolution
- Determine how the Alternative PFIC MTM Resolution is computed
- Understand the components of the MTM Reduction in Tax (RIT) Carryback
- Determine how the Alternative PFIC MTM Resolution and MTM RIT Carryback are identified on the Closing Agreement

Alternative PFIC MTM Resolution

- o A significant number of cases submitted under the 2009 OVDP involved PFIC investments. A lack of historical information on the cost basis and holding period of many PFIC investments made it difficult for taxpayers to prepare statutory PFIC computations and for the Service to verify them.
- o As a result, resolution of voluntary disclosure case were unduly delayed. Therefore, for purposes of this initiative, the Service is offering an alternative to the statutory PFIC computation that will resolve PFIC issues on a basis that is consistent with the Mark to Market (MTM) methodology authorized in IRC Section 1296 but will not require complete reconstruction of historical data.
- o Taxpayers who elect to use the optional method must calculate the gain or loss on every PFIC investment held using this method.
- o The Form 8621 will not be required for the OVDI period for those taxpayers who elect the optional method. The Form 8621 will be required for periods after 12/31/2010.

Alternative PFIC MTM Resolution

If elected, the alternative resolution will apply to all PFIC investments in cases that have been accepted into this initiative.

- o Generally, the first year of the 2011 OVDI application will be for the calendar year ending December 31, 2003.
- o This will require a determination of the basis for every PFIC investment –based upon best available evidence.

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The initial MTM computation of gain or loss under this methodology will be for the first year of the 2011 OVDI application, but could be made after 2003 depending on when the first PFIC investment was made.

Alternative PFIC MTM Resolution

A tax rate of 20% will be applied to the MTM gain(s), MTM net gain(s) and gains from all PFIC dispositions during the OVDI period, in lieu of the rate contained in section 1291(a)(1)(B) for the amount allocable to the current year and section 1291(c)(2) for the deferred tax amount(s) allocable to any other taxable year.

A rate of 7% of the tax computed for PFIC investments marked to market in the first year of the OVDI application will be added to the tax for that year in lieu of the interest charge mechanism described in sections 1291(c) and 1296(j).

Alternative PFIC MTM Resolution

- MTM losses will be limited to unreversed inclusions
- o Generally, unreversed inclusions are previously reported MTM gains less previously allowed MTM losses
 - o During the OVDI period, MTM losses will be treated as ordinary losses (IRC 1296(c)(1)(B)) and the tax benefit is limited to the tax rate applicable to the MTM gains derived during the OVDI period (20%)
 - o Calculated on an share by share basis in the same manner as section 1296

PFIC Mark to Market Computation Determined by Lots

Facts:

1/1/2005: Purchase 100 Shares for \$500 (\$5/share)

6/1/2005: Purchase 100 Shares for \$1,000 (\$10/share)

12/31/2005: FMV is \$8/share

7/1/2006: Sells Lot 2 shares for \$900

PFIC Mark to Market Computation Determined by Lots (continued)

Computation for 2005:

	# of Units	Cost Price	FMV 12/31/05	Realized Gain/Loss	Unreversed Inclusions	Recognized Gain/Loss	Adjusted Basis for Next Year
Lot 1	100	500	800	300	300	300	800
Lot 2	100	1,000	800	-	-	-	1,000

Computation for 2006

7/1/2006 – Sale of Lot 2 shares for \$900

Loss Realized = \$100 (\$900-\$1000)

Ordinary Loss = \$0 – Amount of previous unreversed inclusions

Capital Loss = \$100

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Another example

Facts – Adjusted Basis - \$15,000

Sales Price - \$9,000

Unreversed Inclusions - \$1,000

Loss Realized = \$6,000 (\$9,000-\$15,000)

Ordinary Loss= \$1,000 –Amount of previous unreversed inclusion

Capital Loss= \$5,000

Example

Alternative PFIC MTM Computation

Facts:

ABC Money Fund held prior to 1/1/2003 (so it is subject to 7% interest in 1st year computation)

1/1/1998: Purchase price of fund \$10,000

2/5/2006: Sale of fund for \$50,000

Fair Market Value (FMV): 12/31/2003 \$15,000, 12/31/2004 \$8,000, 12/31/2005 \$18,000

Computations:

Year	Adjusted Basis	Sale or MTM Price	Realized Gain/Loss	Unreversed Inclusions	Recognized Gain/Loss	Adjusted Basis for Next Year
2003	10,000	15,000	5,000	5,000	5,000	15,000
2004	15,000	8,000	(7,000)	-	(5,000)	10,000
2005	10,000	18,000	8,000	8,000	8,000	18,000
2006	18,000	50,000	32,000		32,000	

Example (Continued)

Alternative PFIC MTM Computation

Tax Consequences:

Year	Recognized Gain/Loss	Alternative Tax Rate	Alternative Tax	Alternative Interest - 7% of tax
2003	5,000	20%	1,000	70
2004	(5,000)	20%	(1,000)	-
2005	8,000	20%	1,600	-
2006	32,000	20%	6,400	-

Underpayment interest and penalties on the deficiency are computed in accordance with the Internal Revenue Code and the terms of the OVDI.

For any PFIC investment retained beyond 12/31/2010, the taxpayer must continue using the MTM method, but will apply the normal statutory rules of section 1296 as well as the provisions of sections 1291-1298, as applicable.

MTM Reduction in Tax (RIT) Carryback

- o During the OVDI period, MTM losses will be treated as ordinary losses (IRC 1296(c)(1)(B)) and the tax benefit is limited to the tax rate applicable to the MTM gains derived during the OVDI period (20%) -(MTM Reduction in Tax)
- o The allowable RIT will be limited to Regular Tax + AMT – Total Non-refundable Credits
 - o The RAR line 9 cannot go below zero
- o If in 2010, the MTM RIT cannot be utilized in full due to the total MTM RIT being greater than the allowable MTM RIT, then the unabsorbed MTM RIT should be carried back to prior years in the look-back period that can absorb the RIT
 - o It does not matter what year the MTM RIT carryback is brought to
 - o In years where there is a MTM RIT carryback, you will need to compute a manual penalty – The penalty must be based on the deficiency without the benefit of the MTM RIT carryback

Alternative PFIC MTM Closing Agreement Language

- Please refer to the Alternative PFIC Closing Agreement Language Handouts

Foreign Tax Credit

- Due to the type of cases in this project, FTC will be an issue on many of these cases
- TP files form 1116 that may be incorrect

Who can claim credit

- US Citizens – 901(b)(1)
- Resident Aliens – 901(b)(2)
- Non-Resident Alien – 901(b)(4)
- A partner in a partnership, or a beneficiary of an estate or trust, may claim their proportionate share of the foreign taxes of the partnership, estate or trust – 901(b)(5)
- A shareholder in a Subchapter S Corporation may claim their proportionate share of the foreign taxes

What taxes may be credited?

1. Payment must be a tax – Regs 1.901-2(a)(1)(i)
2. The tax must be paid or accrued to a foreign country or US Possession – Regs 1.901-2(a)(1)
3. Tax must be an income, war profits, or excess profits tax(or must be paid in lieu of such a tax). – Regs 1.901-2 & IRC Section 903

What Foreign Taxes Qualify for the Credit

- Tax Must be the Legal and Actual Foreign Tax Liability - Regs Section 1.901-2(e)(5)
- Taxpayer must determine the amount paid in a manner consistent with a reasonable interpretation of the foreign law, including treaties

What Foreign Taxes Qualify for Credit

- In Lieu of Taxes:
- You are likely going to see this in withholding taxes where the foreign tax is on gross income
- See Regs Section 1.903-1(b)(3) – Example #2

Elections – Section 901

- Must Elect to use foreign tax credits
- Election is Annual – IRC Section 901(a)
- Election can be made or changed at any time before expiration of the period for making a claim for refund or credit
- Section 6511(d)(3) allows 10 years from the date the return is due for claiming a refund of taxes related to foreign tax credits (can't adjust income – Fee v. Commission 81-1 USTC 9355)

Elections – Section 901

- Election is made by actually claiming the credit – no statement or other election required – Regs. 1.901-1(a)

Elections – Section 901

- Taxpayer can elect to take foreign taxes as a deduction
- Taxpayer can't take both a credit and deduction for the same foreign income tax
- If taxpayer elects to take a credit in a taxable year, they are not allowed to take a deduction for foreign income taxes in the same year – Regs 1.901-1(c).

When is a Credit Allowed

- Any taxpayer can determine to use either accrual (regardless of its method of accounting) or cash – IRC 905(a).
- If accrual is elected, then it needs to be used for all subsequent years

Proof of Credits

Regulations Section 1.905-2

- Must provide receipt or return – the original, a duplicate original or a duly certified or authenticated copy
- If return in a foreign language – must provide a certified translation
- We may accept secondary evidence such as a copy of a check, draft or other form of payment only if original is “impossible” to get. Need evidence to show that payment was made for taxpayer’s account.
- If withholding at source, can accept secondary evidence based on taxpayer’s books of accounts and the foreign country and their withholding rates

Foreign Currency and Exchange Rates

- Cash Basis for Foreign Taxes – Temp. Reg. 1.905-3T(b)(2)
 1. Use date paid
 2. For withholding tax – use date tax withheld
- Accrual Method – Use average exchange rate for the tax year to which the taxes relate (IRC Section 986(a)(1))

FTC Audit Issues

- Election – Did taxpayer make an election to take credit?
- **Regulations Section 1.901-2(e)(2) – Tax does not meet definition of creditable foreign tax to extent it is “reasonably certain” that it will be refunded**
- Tax Treaties put limits on tax rate allowed on certain types of income

FTC Table

Instructions for OVDP agents:

Please provide the amount of **foreign taxes paid or accrued (not FTC)** from Form 1116, Part 3, Line 9 (this amount also comes from the last column in Form 1116, Part 2, Line 8) and insert those amounts in the following table. If there were no foreign taxes paid or accrued in a given year, enter "\$0.00" so the Technical Advisor knows that the box was not overlooked.

Foreign taxes paid/accrued	2003	2004	2005	2006	2007	2008
Form 1116, original return	\$ 0.00	\$	\$	\$	\$	\$
Form 1116, amended	\$ 3,500.00	\$	\$	\$	\$	\$
Enter the correct amount of foreign taxes paid/accrued per the Certification (see "Examples" below) **	\$ 1,500.00	\$	\$	\$	\$	\$

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**** Example #1** - TP reported \$3,500 of foreign taxes paid or accrued on \$10,000 of dividends received from Switzerland on the amended return. Since the treaty rate for Swiss dividends is 15%, the actual foreign taxes paid/accrued to Switzerland which is eligible for the foreign tax credit is \$1,500 ($\$10,000 \times 15\%$). The \$3,500 amount reported on the amended Form 1116 was incorrect and represents the 35% withholding tax on Swiss dividends, of which \$ 2,000 is not foreign taxes paid/accrued that is eligible for the foreign tax credit. The foreign taxes paid/accrued that should have been reported on the amended return is \$1,500. This scenario can be illustrated with the filled-in amounts for year 2003 above. (The \$1,500 of foreign taxes paid/accrued is the amount that should be used in the FTC calculation.)

**** Example #2** - TP reported foreign taxes paid or accrued of \$8,500 on the amended return. No changes were made to foreign taxes paid or accrued per the certification (foreign taxes were not increased or decreased). The amount entered on the line for "Form 1116, amended" would be \$8,500; and the amount entered on the line for the "Correct amount of foreign taxes paid/accrued per the Certification" would also be \$8,500.

Name of country to which taxpayer paid or accrued foreign income taxes: _____

Does AMT FTC apply? _____ (if so, added paragraph language for Form 906 is required)

Closing Agreement Language

WHEREAS Paragraph should read as follows: Taxpayer paid or accrued foreign income taxes to (insert country name(s)) during taxable years 2003 through 2008;

(New determination paragraph)

Taxpayer paid or accrued foreign income taxes to (insert country name(s)) eligible for foreign tax credit under section 901 of the Internal Revenue Code as follows:

Item / Year	2003	2004	2005	2006	2007	2008
Foreign income taxes paid or accrued	\$	\$	\$	\$	\$	\$

Examination of Offshore Voluntary Disclosure Cases

- Analysis of Foreign Account Statement

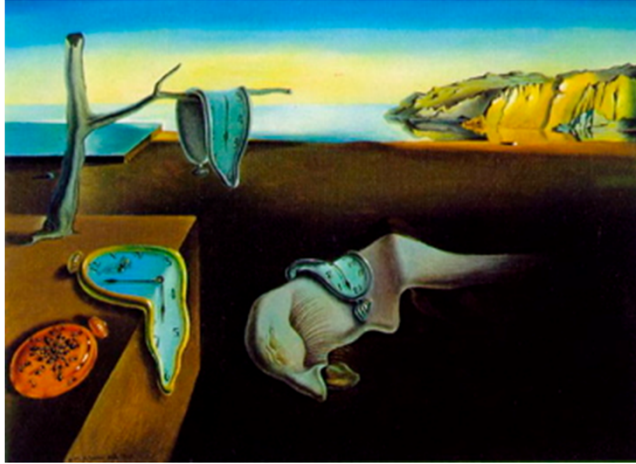
Voluntary Disclosure SharePoint

- You will be added to the Voluntary Disclosure [SharePoint](#) site
 - “Alert Me” feature
- [E-trak VDP](#)
 - Case information entry required by agents
 - Form 5081 to request access
 - Instructions on SharePoint

VDP Payments

- Form 3244-A [Payment Posting Voucher](#)
- [Taxpayer Refunds](#) (erroneous) of VDP Payments
- [Excess Collection](#) (as a result of barred statutes)
- [Moving VDP Payments](#) Between Accounts
- [Collection Contacts](#)

Statutes of Limitation



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IRM

- The Service (you) must protect the statute of limitations on every case

Assessment

- Recording of a taxpayer's liability on the books and records of IRS (IRC § 6201)
- The assessment must be made within the statute of limitations (IRC § 6501)
- We can not make an assessment unless TP receives a statutory notice of deficiency (IRC § 6213)
- There must be an assessment before we can collect a tax (IRC § 6502)

Exception to SND Rule

- Summary Assessment
- If the taxpayer tells us what the tax liability is, no SND has to be issued:
- Original return
- Amended return
- Taxpayer waives receipt of SND (Forms 870; 4549; Manko v Commissioner, 126 T.C. 9 (2006))

General Rule

- IRC § 6501(a) states that tax must be assessed within three years of the later of the due date or date filed
- Typically an assessment of tax on a timely-filed 2009 1040 due on April 15, 2010 must be assessed by April 15, 2013

No SOL if...

- IRC 6501(c) (1)-(3)
- No return
- False/Fraudulent return

Badaracco v. Commr,
464 U.S. 386 (1984)

- The filing of a subsequent non-fraudulent amended return does NOT start the 3 year SOL.

IRC 6501(c)(4)

- Extension by agreement
- 872, 872-A, etc
- IRM 25.6.22

IRC 6501(c)(4)

- Extension must be signed by the parties before the SOL expires
- Therefore, all 872s taxpayers submitted as part of 2011 OVDI must be scrutinized, because they cover 2003-2008 and
- 2003-2007 might be expired!

IRC 6501(c)(7)

- If a return with
- A balance due
- Is received within
- 60 days of expiration date
- SOL is 60 days from date received

IRC 6501(e)

- Taxpayer omits >25% of gross income the SOL is extended from 3 years to 6 years
- A fractional computation must be made: total unreported income over total reported income must be more than 25%

FATCA IRC 6501(e)

- Section 6501(e) amended
- Omission of more than \$5,000 in gross income attributable to specified foreign financial assets
- Provides a 6 year SOL
- Regardless of whether or not the specified foreign financial assets are reported as required under new §6038D, *Information with Respect to Foreign Financial Assets*

FATCA Effective Date

- The amendment to §6501(e) applies to all returns whose SOL was open on March 18, 2010
- Returns filed after March 18, 2010 (2006 and later), or the assessment statute was otherwise still open as of that date and
- more than \$5,000 was omitted from gross income that is attributable to specified foreign financial assets, the statute remains open under § 6501(e) for a total of six years from the date the return was filed.

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Failure to File Offshore Information Returns

IRC § 6501(c)(8)

Applicable Code Sections Forms and Statutes

- Forms 3520 and 3520-A (I.R.C. 6048 (Penalties per I.R.C. 6677));
- Forms 5471 and 5472 (I.R.C. §§ 6035, 6038, 6038A, 6046);
- Form 8865 (I.R.C. §§ 6038, 6038B, 6046A);
- Form 926 (I.R.C. 6038B).

Prior Law SOL is Extended
IRC 6501(c)(8)

- Until the information required to be reported to IRS is furnished, plus 3 years!
- SOL remains open only for items related to the failure to file the information return.

Effective for information due after August 5, 1997

See also,

Chief Counsel Advice 200024051, IRS
CCA Lexis 42:

“...If a U.S. person fails to comply with sections 6038, 6038B...the extended statute of limitations shall relate only to the tax consequences related to the information required to be reported under the relevant reporting section...”

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New IRC 6501(c)(8)

Section 6501(c)(8) was amended to provide that a taxpayer's failure to furnish information required by §6038D, will extend the period for assessment to three years after the date the taxpayer furnishes the required information.

Plus

- In addition, §6501(c)(8) was amended to clarify that this statutory exception to the period of time for assessment, if applicable, applies to the entire return, not just those tax liabilities associated with the information not reported.
- If, however, the failure to furnish information required to be reported is due to reasonable cause and not willful neglect, the §6501(c)(8) extended time for assessment applies only to the item or items associated with such failure.

And

- With limited exception, the amendment to the limitations period under § 6501(c)(8) applies as long as the period of time for assessment of taxes has not expired as of March 18, 2010.

3 SOLs for 2006 Year???

- Tax on original timely filed return must be assessed by 4/15/10 (6501(a))
- Additional tax on 1040-X filed on 4/1/10 must be assessed by 6/1/10 (6501(c)(7))
- Tax attributable to offshore entity reflected on 5471 filed on 5/1/10 expires on 5/1/2013! (6501(c)(8))

Effect of a Closing Agreement on Statutes of Limitation

- Issue:
- To what extent do the provisions of a closing agreement have on the Service's authority to assess tax after expiration of the statute of limitations?

Dubinsky v. Becker,
64 F.2d 601 (8th. Cir. 1933)

Taxpayer and Service made a closing agreement on February 9, 1928 which included that "...the determination and assessment of the taxes and interest for the years... should be final and conclusive as provided by Section 1106 (b)..."

Dubinsky v. Becker

“The statute clearly points out the instances in which the [closing] agreement may be questioned...fraud, malfeasance and misrepresentation. It does not say that such an agreement may be overturned upon a showing that a part, or all, of the taxes paid were assessed after they were barred by limitation...”

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See also,

IRM 8.13.1.7.1 *et seq.* (Closing Agreement Manual) for a discussion of Dubinsky's relevancy today.

RGS & 2011 OVDI

Examiner responsibilities include:

- Perfect Form 872(s), if corrections needed
- Reconcile 1040X
- Move payments to correct tax modules
- PFIC Computations
- RGS
- Form 906, Closing Agreement

NOTE: RGS must reconcile to the transcripts.

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Austin Campus will establish controls, process payments and power of attorney forms, make sure that all documents have been provided, upstate statutes to alpha, sign off on Form 872 unless the Form needs to be perfected, and prepare an instruction sheet for examiners identifying what needs to be completed by the examiner.

Important IDRS Documents to Request

IMFOLI

(active years, module balances, freeze codes and status)

TXMODA

(command code with detailed module information)

EXAMPLE OF IMFOLI

(b)(3) 6103(a)



IMFOLI should be your first step –before controls are requested and RGS.

SHOWS ALLTAX YEARS THAT HAVE BEEN FILED FOR A TAX PAYER

R code means returns are on retention and it will cause a reject when controls on the year are requested. Command Code IMFOLB will bring the module back from retention.

Posted return: ELF, POSTED (means a paper return was filed), SUBST4

If it was ELF, you can get a transcript of it on Employee User Portal (web based versions of TRDBV, IMFOLT and BMFOLT).

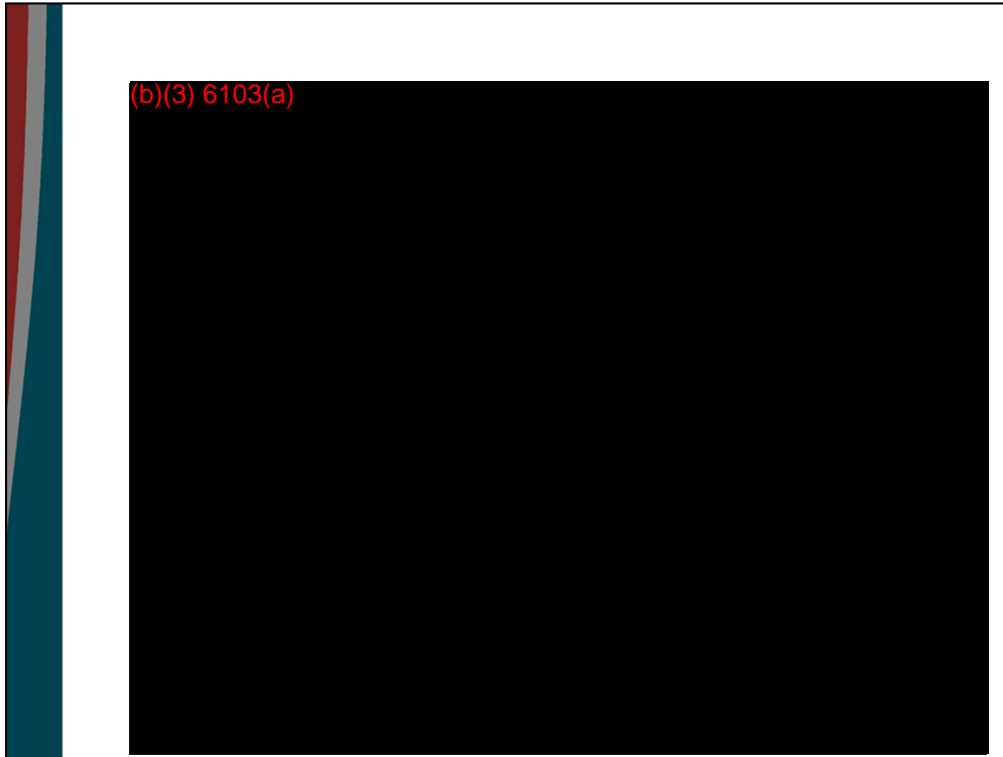
If TIF shows NO, then you will not be able to use command code TXMOD. The command code MFREQC (enter TIN & name control) will bring the entity/tax module on line and can be accessed by TXMOD.

IMFOLI displays all on-line information –TXMODA contains more information than any other command code.

TXMOD Definers

- A- Displays all of TXMOD
- C- Displays controls on account
- L- Displays Pending Transactions
- N- Displays Notice Data
- P- Displays Posted & Pending Transactions
- S- Displays SC & MF Status History Data
- X- Displays Status History & Notice Data
- **Definer "A" is used most often**

The TXMODA screen is divided into five sections: Heading, Transaction, Notice, Case Control & History, and Status History



Heading Section

- Identifies the taxpayer by SSN, MFT, tax period and name control (NM-CTRL)
- The second line is shows the Document Locator Number (DLN) & Business Division Code (BOD-CD)
- SC-STS Service Center
- MF-STS Master file status code
- Last Notice
- The boxed area shows ASED, CSED, RSED dates
- CXBX Indicator of the taxpayer giving authority to preparer
- CS-CTRL-INFO Case control

(b)(3) 6103(a)



Transaction Section

- 1) Return received date
- 2) Identifies amt of tax reported on return –same as TC 150 unless math errors
- 3) Math error notice codes –Doc. 6209 Section 9 (Notices and Notices Code)
- 5) NUM-EXEMPT Number of exemptions 6) AGI 7) Taxable Income
- 8) Identifies estimation of tax liability 9) Est. tax payments reported on return
- 10) Tax posted on original return (TC 150) 11) Federal withholding (TC 806)

Posted Trans Sec –TC, Date trans posted, amount, cycle the trans posted, T identifies type of return filed (G amended, X DLN of admin file, D selected for discriminant function regular), DLN

DU –next to TC means that the transaction has been deleted and should be ignored

TC150 –tax f/ originally filed return, **TC 290** additional tax assessment -1040X

TC 300 addtl tax assessment –RAR, **TC 291** abatement of tax, **TC 301** refund

Per RAR, **TC 846** refund issued to taxpayer, **TC 240** misc penalty assessment

Credits are identified with a minus sign.

Doc 6209 (IRS Processing Codes and Information)

(b)(3) 6103(a)



CIS-IND>1 Identifies that the return was imaged. The CIS# is located in the Control Base and History under the Activity column. The # starts with CIS and is alpha numeric. Your AIMS/ERCS analyst can assist in obtaining the imaging or anyone with Accounts Management access.

TC 290 /Reason Codes (36 –adjustment to tax credit) –**Command Code IMFOLA** provides additional information such as adjustment to Taxable Income 886 and AGI 888 and **IMFOLR** to determine what items were changed.

Notice History Section Notice number, amt of the notice, cycle of the notice, Area Office (AO), and Notice suppression Code, CP022 with a positive amt in the 2011 cycle-chances are they are or will soon get notices for balance due as a result of processed amended returns.

Control Base and History Section

C# is the case number **Status**-A active/assigned, B background, C closed, M monitor, S suspense **ACT-DT** Date the action was taken **ACTION-EMP** the person who updated the history, not necessarily the person assigned the case **ACTIVITY** the action taken on the account **RECVD-DT** the received date of work. The ACT-DT will change with each input; however, the RECVD DT should not change **ASSIGN-TO** This is the person to contact regarding the case, if applicable **CAT** Category codes listed in Section 14

Control Base

Figure 4-4

(b)(3) 6103(a)

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Case Number 1

Status –A Active/assigned

ACT-DAT 4/23/2009 was the date the action was taken

ACTION-EMP There is not a number for the person who updated the history

ACTIVITY Adjustments made for 1040X

RCVD-DT 3/14/2009 was the received date of the work. This date will not change.

CAT (XRET) Definition -1040X or 1120X –Claim

STAUP –Command Code for status update requests, updates are real time

-will interrupt, delay, accelerate or skip

Economic Stimulus Payment (ESP)

ESP is comprised of three parts and all have the TC 766 indicator

- Part 1 – TC 766 with reference number (REF NUM) 338 is \$142
- Part 2 – TC 766 reference number 256 is \$458, the total of these two amounts equals \$600 (a limited amount based on filing jointly)
- Part 3 – TC 766 reference number 257, is \$300 for one qualifying child (or multiples of \$300)

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TC 290, which is usually an additional tax assessment, but with these reference codes and same DLN as the TC 766, indicates the economic stimulus payment.

TC 846 is the rebate amount and reflects the refund mailed to the taxpayer.

Carefully check 2008 returns when taxpayers claim the Recovery Rebate Credit (RRC) on their tax returns, (Form 1040, Line 70 or Form 1040A, Line 42). Examiners must manually input the amounts in the “Included in Line 70” button.

RGS will not display a variance on the variance analysis report even if the detail button is not completed. If the detail button is not completed, RGS may allow a larger credit than the taxpayer is allowed. The Tax Computation summary screen will show the RRC adjustment as ‘special fuels credit.’ However, on the examination report, the adjustment will display on Line 13, “Adjustments to Form 4136, Recovery Rebate Credit, Form 5405.”

If the taxpayer did not claim the correct amount on the original return, and the credit is being adjusted during the examination. On Form 5344, RGS will input *** in Item 15. It is the examiner’s responsibility to determine and input the correct Reference Code(s). IRM 21.6.3.4.2.12.7.

Use the Recovery Rebate Credit calculator on the irs.gov website to compute the correct credit amount.

Helpful IDRS Websites

Website link for IDRS command codes

- http://serp.enterprise.irs.gov/databases/irm-sup.dr/job_aid.dr/command-code.dr/idrs_command_codes_job_aid.htm

TXMOD job aid

- http://serp.enterprise.irs.gov/databases/irm-sup.dr/job_aid.dr/command-code.dr/txmod_imf.htm

Document 6209

- <http://serp.enterprise.irs.gov/databases/irm.dr/current/e6209/e6209home.htm>

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The SERP website (available from the IRWeb home page) contains a searchable IDRS Command Code Job Aid and a searchable Document 6209, IRS Processing Codes and Information, to assist you in analyzing transcripts.

RGS

- TXMODA, IMFOLR, IMFOLA (adjustments made to return information) and IMFOLZ (adjustments made as a result of examination)
- Secure any amended returns filed and reconcile to the transcripts
- Review and update Return Setup for most current information
- Make sure all relevant data is input
- Run a variance analysis for all years –resolve all variances

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The majority of Return Setup is usually completed by CFOL data. CFOL consists of those items transcribed from the original return as filed and any corrections by the Campus at the time of posting. Subsequent changes are not reflected on CFOL.

Do not include “cents” in Return Setup unless return/amended return reflects cents.

Radio button selected for tax computation –FEIT

- Schedule D –Worksheets and refigured amounts are required to be input
 - Form 4952, Line 4g and 4 e
 - Capital Loss Carryovers from prior years starting with 2003
- Form 8801 –Complete even if taxpayer did not file a Form 8801
- Form 6251 –Complete even if taxpayer did not file a Form 6251
 - FTC –Also input on 6251 tab (manually input this amount, RGS does not compute AMT FTC)
- Form 2555 –Input Housing Exclusion or Foreign Earned Income Exclusions amounts on Line 21 AND input in the detail screen for Line 21
 - Input Housing deduction in Line 36 detail screen

If your taxpayer filed an amended return and it was processed by the Campus, you must modify the affected fields in Return Setup. Run a Variance to ensure the accuracy of your changes.

RGS Variances

- **True Variances** –This means an actual error on the return or amount previously assessed.
- **Campus Adjustments**
Check IMFOLA –Reason Codes (Doc 6209 8-110)
Reference Numbers (8-125)
- **Taxable Income/Tax not reconciled**
 - Transcripts don't match RGS return set-up
 - Amended returns were processed but IMFOLR was not updated –Complete and fax Form 3870 to update AGI, Taxable Income and Tax

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Document the reason for a “true” variance and why the variance is valid.

Taxable income per return or as previously assessed, Line 3, Form 4549-A must reconcile to IMFOLR/A or TXMODA

Total tax shown on the return or as previously assessed, Line 12, Form 4549-A must reconcile to IMFOLT/TXMODA

Use Form 3870 to update IMFOLR if TXMOD or IMFOLT show that an amended return or adjustments were processed (TC 290, 291, 300, 301). You would request an update to AGI, taxable income and the tax fields.

SFRs/Delinquent Returns

- If CFOL data import on a SFR
 - Uncheck SFR box in Case Information
 - Access Return Setup
 - Change Exemption number to 0
 - Remove Standard Deduction and Exemption Amounts
 - Return to Case Information and check the SFR box
- Filing Status
- Personal Exemption
- Standard Deduction
- FEIT Computation
- Foreign Tax Credit
- Delinquency Penalties

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Note: Almost all line numbers on a delinquent return must be setup as separate issues and categorized to generate a correct report. For example, items mentioned above in Return Setup on filed returns would need to be setup as separate issues for a correct Form 4549-A on a SFR/Delinquent return.

Filing status –Create an issue for filing status on all SFRs

Personal Exemption –Create a separate issue for personal exemptions

Per return 0, per exam number of personal exemptions claimed

Dependent exemptions are separate issues

Standard Deduction –Do not create an issue for Std Deduction, RGS allows automatically based on the filing status if no itemized deductions

FEIT Computation –RGS will compute using worksheet

Select FEIT worksheet on the tax computation screen for “Tax Method”

Foreign Tax Credit –RGS will not calculate FTC automatically. You will also need an AMT FTC issue.

RGS – PFIC (Statutory) (Amended Return Not Processed)

- 1291(c)(1)(A) Deferred Tax

Form 8621 –Part IV Line 11e

Included as part of regular tax liability (prior to AMT)

RGS Categorization > Taxes > Additional Taxes > Section 1291 Tax

Adjustment will be added into regular tax liability shown on Line 5 of Form 4549-A

- 1291(c)(1)(B) Interest Amount

Form 8621 –Part IV Line 11f

Also considered a tax, but included after the AMT computation

RGS Categorization > Taxes > Other Taxes > Other Taxes

Adjustment will appear on Line 10a of Form 4549-A

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These are the instructions on how to input the adjustments into RGS when the amended return isn't processed.

NOTE: PFIC interest is not subject to the accuracy related penalty. RGS does not reduce the underpayment due to negligence for PFIC interest categorized as Other Taxes. Carefully check penalty computations and compute the penalty manually if RGS does not compute the correct underpayment due to negligence.

There is a third adjustment for current year allocation of gains as ordinary income.

RGS – PFIC (Statutory) (Instructions for Processed Return)

- PFIC Deferred Tax Amount
 - Form 8621 Line 11e
 - In RGS Return Setup, enter the tax amount (regular tax and PFIC tax)
 - Click the box to left of the tax line, a table will appear
 - Enter the Form 8621, Line 11e amount into item labeled “Section 1291”
- PFIC Interest Portion
 - Form 8621 Line 11f
 - Campus is instructed to input this amount into Total Tax
 - In RGS Return Setup, click the box next to the total tax line
 - There are no items for Section 1291 interest
 - Enter the amount in the item labeled Section 1294 Deferred Tax
 - The wording will have to be corrected on the Form 4549-A to Section 1291 Interest

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The instructions are for inputting the items from Form 8621 into RGS Setup if the return (Original or Amended) was already processed.

PFIC Deferred Tax – The preparer should have added this amount to the tax line (prior to AMT).

PFIC –Interest Portion – According to the Form 8621 instructions, this amount should be written on the bottom right margin of the Form 1040, page 1 and labeled as “Sec. 1291 Interest”. The IRM for Submissions Processing instructs the Campus to add this amount into the Total Tax line of the Form 1040. Therefore, on an original return that was processed, this amount should be included as part of the TC 150 posting, and on the amended return this amount should be included as part of the TC 290 posting.

If Submission Processing properly included this Section 1291 Interest amt in the total tax line of the original return or amended return, then in order to match the transcripts, this amount will also have to be added to the RGS Return Setup. RGS has a “Write-In” box for the total tax line, but when you click on the box there are not items for Section 1291 interest. Therefore, to make RGS work, the agent should input the amount in the items labeled ‘Section 1294 Deferred Tax’. This exact phrase will then show up on the Form 4549-A so you will need to change this wording to “Section 1291 Interest” on the RAR.

If the taxpayer filed a Form 8621 with their amended return and it was processed by the Campus, the Campus might have missed the interest portion of the adjustment. If you look at the instruction the taxpayer is suppose to write the interest amount on the front page of the 1040 and indicate it as 1291 interest. The Campus is required to

add this into the other taxes line. If the Campus missed this, then you should make that adjustment on your RAR.

RGS – Alternative MTM method (Amended Return Not Processed)

- MTM Tax
 - RGS Categorization > Taxes > Other Taxes > MTM Tax
 - Negative amounts will not reduce tax after nonrefundable credits to less than zero – any other taxes such as SE tax are not offset by MTM tax
- MTM Interest (first year of MTM election)
 - RGS Categorization > Taxes > Other Taxes > MTM Tax
- MTM Reduction In Tax (RIT) Carryback
 - RGS IMF > Code 61050 – Other Credits not from Form 3800, 8396, 8801, 8859
 - RGS Categorization > Credit > Other Credits > MTM Credit
 - Fill in the amount as a positive amount in the per exam field

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The per exam amounts for MTM Tax and MTM Credit will be displayed on the Form 4549-A on Line 10 (MTM Tax) and Line 8 (MTM Credit). These will also be listed on the related Form 886A-TAX and Form 886A-CR reports, if applicable.

It is important to note that the tax can offset tax after nonrefundable credits, however, it cannot reduce tax after nonrefundable credits to less than zero. Any other taxes such as SE tax, tax on tips, are NOT offset by MTM tax.

The MTM Credit is considered a nonrefundable credit and is limited to tax before nonrefundable credits, with all other nonrefundable credits claimed before MTM credit. **The allowable RIT will therefore be limited to Regular Tax + AMT – Total Nonrefundable Credits.**

In the years where there is a MTM RIT carryback, you will need to compute a manual penalty. The penalty must be based on the deficiency without the benefit of the MTM RIT carryback as the taxpayer cannot get benefit of a reduced penalty for a loss/RIT generating in a future period. TIP –Prepare the RAR without the MTM RIT credit. In 2008, Line 9 of the RAR will reflect the amount that can be absorbed.

The MTM RIT Carryback requires special attention for Forms 4549-A, 5344 and 3198. Form 4549-A Other Information Section include a narrative. For example, 2007 reflects a \$20,000 OVDI alternative MTM method reduction in tax carryback from tax year 2008.

Form 3198 –check Restricted Interest in the Forward to Technical Services Section, then on page 2 in the Special/Restricted Interest Features section, check other and enter: “MTM reduction in tax carryback per OVDI guidelines.”

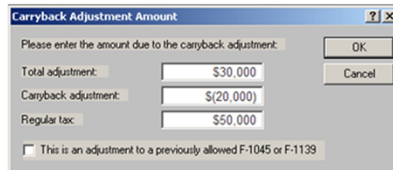
RGS – MTM RIT Carryback Form 5344

- Check the box on the pop up message “All or part of this tax adjustment is the result of a carryback” for any year that there was a MTM RIT carryback, then select OK (Second Tab)



RGS – MTM RIT Carryback Form 5344 (Continued)

- Enter the MTM RIT carryback amount (as a negative number) in the Carryback adjustment field in the next screen



The screenshot shows a dialog box titled "Carryback Adjustment Amount" with a close button (X) in the top right corner. The dialog contains the following text and input fields:

Please enter the amount due to the carryback adjustment:

Total adjustment:

Carryback adjustment:

Regular tax:

This is an adjustment to a previously allowed F-1045 or F-1139

RGS – MTM RIT Carryback Form 5344 (Continued)

- Form 5344 –TC 12/Interest Dates Tab
 - Item 11 is the later of the 2010 return filing due date or when the return was actually filed.
 - Delete the asterisks and the manually computed amount in Item 12
- Form 5344 –RC 15/Claim Tab
 - Enter the Penalty Reference Code 680 and the manually computed accuracy penalty in the next available row if Item 15

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Complete the rest of the Form 5344 setup like normal and validate.

RGS – Alternative MTM Method (Instructions for Processed Return)

- MTM Tax and Interest
 - In RGS Setup, enter the total tax amount (field is after credits)
 - Click the box to left of the total tax line, a table will appear
 - Enter the amount in the MTM Tax field
 - The tax can be entered as a negative amount (limited by unreversed inclusions)

- MTM RIT Carryback
 - In RGS Setup, enter the RIT Carryback amount in the other credit line as a positive amount
 - Click the box to left of the other credit line, a table will appear
 - Enter the amount in the MTM Credit field
 - This is considered a nonrefundable credit and is limited to tax before nonrefundable credits, with all other nonrefundable credits claimed before MTM Credit.

RGS – Form 5344

- For a tax year with no tax (no TC 300), enter \$1 in Item 35
- Overpayment Years Used to Pay Deficiency Years (Barred year refunds cannot be used for this purpose)
 - For deficiency year(s), on Form 5344 Line 7 Hold Code, enter 1
 - For overpayment year(s), on Form 5344 Line 43 Delay Code, enter 1
- For a manually computed accuracy penalty, input the following (IRM 4.4.12 Exhibit 4):
 - In Item 12, TC 12/Interest dates, delete the amount and asterisks that display in Item 12
 - In Item 15, RC 15/Claim, enter the Penalty Reference Code 680 (Accuracy Penalty) with the amount of the penalty

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Overpayment years used to pay deficiency years –OVDI cases

On Form 3198, in Special Features section, please mark Other, enter the statement “Using overpayment to pay deficiency” and highlight in yellow.

Do NOT just write in Codes for 5344, but enter them through RGS

In regards to the Offshore Penalty MFT 55, the process of using allowable refunds from MFT 30 to pay the MFT 55 penalty assessment will be applicable as well.

For this purpose only, agents will need to enter on Form 8278 Hold Code 1 and explain that refunds from MFT 30 is used to pay MFT 55. The SSN’s will not matter should the MFT 30 be primary and MFT 55 be secondary.

In previous guidance, Hold Code 3 was to be entered on all Form 8278. This will remain in effect unless the above offset is being requested, the Hold Code 1 will be used instead.

RGS – Form 5344 (continued)

For Delinquent Returns filed with a campus (not filed as part of the OVDI process)

- If a delinquency penalty was previously assessed (identified by TC 166 or the AMDISA indicates “DEL RET IND”), input a TC 160 with a “0” on Form 5344, Line 12, along with a Penalty Reason Code on Line 2
–Select “45-Other”
- The delinquency penalty **MUST** be addressed on the Form 5344 or the case will be rejected at Centralized Case Processing

RGS –Delinquency Penalties

For Delinquent Returns filed as part of OVDI (processed):

- The FTF penalty applies on the amount due from the return due date (or extended due date) until filed with a maximum delinquency of five months (5% per month, 25% maximum penalty). When the FTF penalty runs concurrent with the ½% per month Failure to Pay (FTP) penalty under IRC 6651(a)(2), the FTF penalty is reduced by any applicable FTP penalty. The maximum monthly combined FTF and FTP penalty is 5% (IRM 20.1.2.2.7.3).
- For delinquent returns, examiners must calculate the previously assessed FTF penalty under IRC 6651(a)(1) and enter that amount in the **Previously assessed failure to file penalty** filed in RGS. The calculation is required due to the difference between the delinquency penalty amount computed in RGS (5% per month for the FTF), and the FTF penalty amount assessed on the IMFOLT/BMFOLT (which is reduced by 0.5% for the FTP penalty). Examiners must assert the FTF at 5% per month. Do not enter the TC 166 delinquency penalty amount from the IMFOLT/BMFOLT as the previously assessed FTF penalty in RGS.

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The Minimum Failure to File (MFTF) applies when the return is filed more than 60 days late after the return due date, or more than 60 days after the extended return due date, and:

-The regular FTF penalty is the lesser of \$135 or 100% of the tax on returns required to be filed after December 31, 2008, or

-The regular FTF penalty is the lesser of \$100 or 100% of the tax on returns filed December 31, 2008 and prior.

RGS – Delinquency Penalties (continued)

To assess the penalty for late filed returns in RGS using the full 5% rate, select the delinquency check boxes in the **Return Related Penalty Details** screen:

<input checked="" type="checkbox"/> Delinquent Return	
<input checked="" type="checkbox"/> Delinquency - 6651 (a)	
<input type="checkbox"/> Failure to pay apportioned	Previously assessed failure to file penalty: <input type="text"/>
<input type="checkbox"/> Fraudulent failure to file	Previously assessed failure to pay penalty: <input type="text"/>
<input type="checkbox"/> Abate the delinquency penalty	Estimated tax payments: <input type="text"/>

The amount to enter as the **Previously assessed failure to file penalty** is calculated as follows:

1. Determine the number of months the return is late, not to exceed five months (any part of a month is considered a full month).
2. Compute the balance due on the original return, including amended returns (TC150 less any withholding, prepayment credits, or payments made by the due date).
3. Multiply the balance due by the number of months late, and multiply the result by 5% (the FTF penalty is 5% of the net amount due per month).
4. Enter the result from step 3 in the **Previously assessed failure to file penalty** field.
5. The **Previously assessed failure to pay penalty** field should remain blank.

Example

The taxpayer filed a 2008 return with a balance due of \$486 on 4/29/09. The transcript reflects a TC 166 (FTF penalty) of \$21.87 and TC 276 (FTP penalty) of \$7.29. The audit resulted in a deficiency. The return is considered one month late, so the computation is $5\% \times \$486 = \24.30 . \$24.30 must be entered in the **Previously assessed failure to file penalty** field as opposed to the TC 166 amount of \$21.87. The **Previously assessed failure to pay penalty** field remains *blank*.

RGS - FTC

- RGS Setup – Make sure you have input amounts on the 6251 tab
- RGS does not calculate the actual amount of Foreign Tax Credit
 - Manually calculate the amount of the credit allowed and input the adjustment as an issue
 - A second adjustment for AMT FTC must be calculated and input for cases with AMT
 - Issue Categorization –Taxes>AMT>Alt Min. FTC

RGS – Other Items

- Work Unit (WU) Code 70 must be added on all OVDI cases
 - Create all years with Work Unit Code 70 on Create Case screen
 - Use Changekey to add WU 70 on existing cases
 - Add WU Code 70 to initial year before creating additional years OR add after ALL years are created to ensure the years are linked together
- Household employment tax (IRM 4.23.10.12.6)
 - The tax is not on the Form 4549-A
 - RGS generates Form 2504-H

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The WU 70 Changekey instructions can be found at the website on the next slide.

RGS Websites

RGS MYSBSE website (training materials, news, FAQs, Quick Reference Guides, etc.)

- <http://mysbse.web.irs.gov/exam/rgs/default.aspx>

RGS training for AMT

- <http://mysbse.web.irs.gov/exam/rgs/training/14677.aspx>

Computational spreadsheets

- <http://mysbse.web.irs.gov/exam/rgs/sa/default.aspx>

Open Forum



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VDP Case File Review



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