

Instructors

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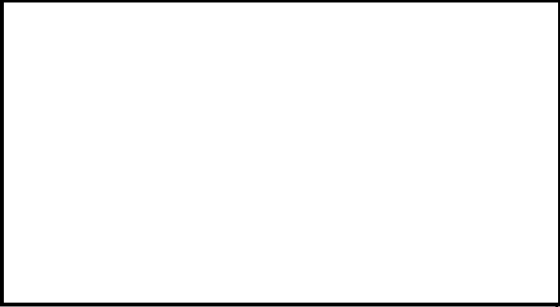
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VDP Technical Specialists

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VDP Coordinators



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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

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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

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Voluntary Disclosure Practice

What is it?
Who is eligible?

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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

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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

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Voluntary Disclosures

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

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Requirements of a V Disc

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

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Requirements of a VDisc

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

CI's Role

Your Role

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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

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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.
 - Complete
 - 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))

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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

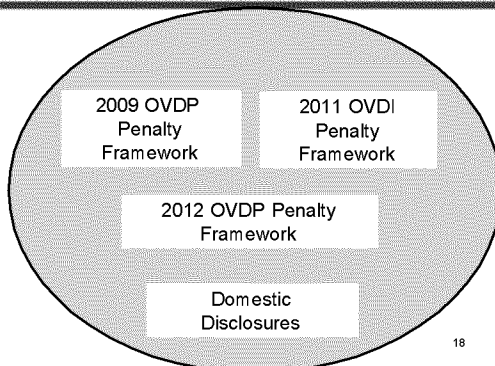
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New Offshore Compliance Approach

- OVDP 2009 announced March 23, 2009 and ended October 15, 2009 (after extension from September 23, 2009)
- OVDI 2011 announced February 8, 2011 and ended September 9, 2011
- OVDP 2012 announced January 9, 2012 with no end date at this time

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CI's Voluntary Disclosure Practice



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Voluntary Disclosure Practice

Questions??

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New Offshore Compliance Approach

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

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IRS.GOV

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

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Civil Voluntary Disclosure Process IRM X.XX.XX



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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

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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"

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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

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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

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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 5%, contact your Technical Advisor before you assess the lower penalty

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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

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Offshore Penalty Example

Highest Balance in Account During the Year					
Acct	2003	2004	2005	2006	2007
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

Highest Balance in Account During the Year					
Acct	2003	2004	2005	2006	2007
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) Offshore Penalty (MFT 55 Case)

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Voluntary Disclosure Practice

Questions??

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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

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Some Basics FAQ #7

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

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Some Basics FAQ #7

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

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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)

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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

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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

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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)

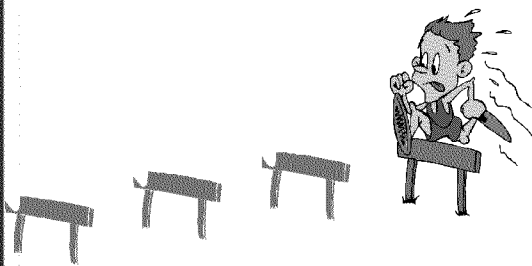
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FAQ #52 – Penalty reduced to 5% for:

- 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)

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“4 Prong Taxpayers”



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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);

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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;

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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

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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.

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Penalty reduced to 5%

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

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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

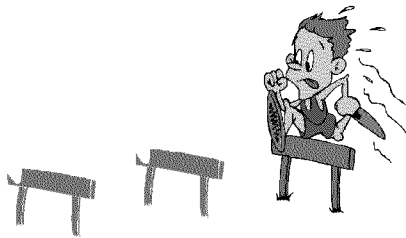
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Foreign Residents “Accidental Citizens”

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

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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

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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

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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

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FAQs

Questions??

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VDP Procedures

- ¾ Amended Returns (8 years)
- ¾ IMFOLT
- ¾ AIMS/ERCS
- ¾ Statute of Limitations
- ¾ Certification (not Examination)

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VDP Procedures

- ¾ 3 Page CI “Optional Format Letter”
- ¾ Offshore Bank Statements (8 years)
- ¾ Interview (If necessary)
- ¾ Related Offshore Information Returns

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VDP Procedures

- ¾ FBAR (Blanket RSM)
- ¾ Form 906 (Full Pay/No Pay)
- ¾ Title 26 Case File
- ¾ Offshore Penalty Case File
- ¾ Technical Specialists & Coordinators

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VDP Procedures

Questions??

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Closing Agreements

- IRM 8.13.1 – Introduction and how to write the Closing Agreement.
- Form 906 – Closing Agreement on Final Determination Covering Specific Matters

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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(s) using D/C 08
- Forward case to Technical Services

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Closing Agreements

- 8 year package – unless some years do not apply (no offshore account) or years are compliant
- Generally, 2003 thru 2010
- 2008 Amended Return with short Statute should have quick assessment done unless statute extension was obtained

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Closing Agreements

Secure & Review up to date Transcripts

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

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Closing Agreements

Prepare RAR, Form 4549-A to accompany Closing Agreement

- ¾ Impute interest 30 days beyond
- ¾ Accuracy Related Penalties (20%)
- ¾ Delinquency Penalty
- ¾ Ensure correct years are addressed
- ¾ Make 2 copies (taxpayer and file)

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Closing Agreements

Offshore Penalty Amount computed at 25%, 12.5% or 5%

- ¾ If 5%, you must get approval from Offshore Technical Advisor
- ¾ Document in Case History or include emails for verification
- ¾ Form 906 will not be executed by Technical Services without documented approval

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Closing Agreements

Secure 906 from OVDP SharePoint

- ¾ There are 2 versions of Form 906; Full Pay or Not Full Pay
- ¾ Standard or Dissolution of Foreign Entity
- ¾ If using Dissolution 906, you must include Dissolution Statement signed by taxpayer under penalty of perjury

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Closing Agreements

Secure 906 from OVDP SharePoint

- ¾ Deviations to 906 must be approved by Offshore Technical Advisor
 - i.e. PFIC, FTC
- ¾ Document approval in Case History or email from Technical Advisor

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Closing Agreements

Prepare and complete 4 copies of the Closing Agreements

- ¾ 3 copies for taxpayer to sign & date
- ¾ 1 copy for comparison later
- ¾ Suggestion: On the back of each page, lower right hand corner, place your initials

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Closing Agreements

- If Joint Disclosure:

¾Enter Taxpayer's first name & last name, SSN, spouse's first name & last name, SSN and "current address"

¾If Single Disclosure:

¾Enter Taxpayer's first name & last name, SSN, and "current address"

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Closing Agreements

Example:

¾Jon Doe, SSN 123-45-6789 and Jane Doe, SSN 987-65-4321, 520 Bellevue Way, WA 98004

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Closing Agreements

Statement 1 – Income Adjustments

¾Unreported Offshore Income for all years involved

¾Unreported Domestic Income Or Increases to Taxable Income Adjustments for barred years

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Closing Agreements

- Complete header section on Page 2 with taxpayer information (remember to change for next taxpayer if reusing)
- Enter Offshore Penalty Amount in Statement 3 (generally) of Closing Agreement

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Closing Agreement

Formatting Form 906

- ¼Applicable years....
- ¼3rd Whereas.....[his/her/its]
- ¼Stmt 2 & 3.....[or delinquent-related penalties, as applicable]
- ¼Stmt 8.....[his/her/its]
- ¼Keeping last Stmt with signature page
- ¼Renumber as necessary
- ¼Use "Z" Line for gaps

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Closing Agreement

7. Failure to disclose that the Taxpayer received illegal source income during 2003 through 2010 or failure to fully and accurately provide information or material requested by the Internal Revenue Service in writing prior to execution of this closing agreement with respect to the Taxpayer's offshore financial arrangements constitutes a misrepresentation of a material fact under section 7121 of the Internal Revenue Code.

Z

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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)

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Closing Agreement

No Full Payment – Financial arrangement must be resolved with RO or (Field) Installment Agreement, before case is to be closed to Technical Services

- ¾ 906 will not be executed until collection matter is resolved (i.e. Installment Agreement, OIC, etc)
- ¾ Obtain written concurrence of resolution from Revenue Officer

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Closing Agreement

3 original Form 906 back from taxpayer(s)

- ¾ Original signatures and dated
- ¾ If POA signed instead of Taxpayer(s), attach Form 2848 to each 906
- ¾ Check for alterations or erasures
 - Use copy for comparison
 - Check your initials on back
 - Contact Offshore Technical Advisor if any changes

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Closing Agreement

- On the reverse side, date stamp all pages of each 906
- Revenue Agent should sign and date, preferably in blue ink, as "Receiving Officer"

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Closing Agreement

Prepare Letter 1595-E

- ¾Address to Taxpayer(s)
- ¾Use your own info as contact information
- ¾Do not enter Date and do not Sign
- ¾For Title after Sincerely, enter "Technical Services Group Manager"
- ¾Secure Letter from Share Point (including Title)

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Closing Agreement

Form 3198, Rev. 7/2011

- ¾ Check box 906 in Technical Service Section
- ¾ Check box "Other" in Technical Service Section and write in Red ink, Offshore Voluntary Disclosure Program Case
- ¾ Complete bottom section on Page 1
- ¾ Check box 6404(g) – Does Not Apply
- ¾ Check all other appropriate boxes
- ¾ Complete Related Taxpayer section with Penalty Casefile information

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Closing Agreement

Close both case files, Title 26 Exam and Form 8278 Penalty, to local Technical Services office

- ¾ Update to Status Code 21
- ¾ Update RGS to Technical Services

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Closing Agreement

Questions??

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**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

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PFIC

OVDI & PFIC (Passive Foreign Investment Company)

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Anti-deferral Overview

Generally, US persons (US citizens, US residents and domestic corporations) are subject to US income tax on their world-wide income.

In contrast, generally, foreign persons (NRA and foreign corporations) 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."

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Anti-deferral Overview

When 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.

If the foreign corporation does not make any distributions of its earnings (dividends) to the US person and the US person sells the shares of the foreign corporation at a gain, the gain would be taxable as a capital gain.

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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 Sec 1291
- Determine how the Sec 1291 PFIC is presented on the Closing Agreement

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PFIC Applicable Code Sections

PFIC was enacted in 1986

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

Once a PFIC, always a PFIC

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PFIC Taxation Definition of PFIC – IRC 1297

Income Test: *Passive income that is at least 75% of gross income* in any single tax year:

™ 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.

OR

Asset Test: *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.

Foreign Mutual Funds, Foreign Holding Companies, Real Estate held for production of passive income will likely qualify as PFICs.

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PFICs- Definition of Passive Income

¾ "Passive income" for purposes of determining PFIC status is defined by reference to FPHCI, as set forth in IRC 954(c). Passive income includes:

- f Interest, dividends, rents, royalties, and annuities.
- f Net gain from the sale of property that produces IRC 954(c)(1)(A) income or no income.
- f Net gains from certain FX and commodity transactions that do not arise in the ordinary course of business or out of hedging transactions.
- f Income equivalent to interest.
- f Income from notional principal contracts.
- f Deemed dividends in "repo" transactions.

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PFIC How to Recognize in Offshore Cases

™ Review Offshore Bank Statements

- Taxpayer invests in Investment "Funds" as shown on bank or investment statements, typically listed as shares or "units"

™ Review Schedule D and Form 1040 Line 21 Other Income

™ Form 8621 Filed

- One for each PFIC asset owned
- Bottom Margin of Form 1040 - A statement referencing PFIC Interest is required. Sometimes it is not processed by the Service Center because the font is so small, an RGS adjustment will be needed.

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PFIC - Tax Regimes

¾ Section 1291 Fund.

- f A "section 1291 fund" is subject to the deferred taxation and an interest charge on "excess distributions." 1291 is the default taxing regime.

¾ QEF Election.

- f 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.

¾ MTM Election.

- f 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.
- f 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.)

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**1291 PFIC Taxation -
Definition of Excess Distribution
IRC 1291(b), Prop. Reg. 1.1291-2(c)**

1) Distributions made to shareholders.

- f Computation required to determine if there is excess
- f Beyond the scope of this presentation.
- f Rare that you will see this on OVDI cases.

2) Gains on Disposition

- f Any gain on the sale of PFIC stock represents a current year distribution, which is characterized as an excess distribution.

Losses on Disposition

- f 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.
- f Losses are therefore recognized under the normal capital loss rules of the Code.

No netting of gains and losses under Sec 1291.

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1291 PFIC Taxation of Excess Distribution

**What to do when you have a 1291 Gain
(Prop. Treas. Reg. 1291-2(e))**

¾ The excess distribution is *allocated pro-rata* to each day of the PFIC shareholder's holding period.

- f The portion allocated to the current year is taxed in the current year of the distribution as ordinary income.
- f The portion of the distribution allocated to the PFIC holding period years is subject to the deferred tax at IRC 1291(c).

¾ Deferred Tax is:

- f Calculated without any deductions;
- f Calculated at the highest rate applicable (ordinary income); and
- f 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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**Simple 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 (\$50,000 / 4 yrs = \$12,500 per year)

GAIN ON SALE TAXED AS EXCESS DISTRIBUTION:

- Calculation of Deferred tax & Interest:

Allocable Share X Highest Tax Rate = Tax	+ Interest on Tax
2001: \$12,500 x 39.1% = \$4,888	+ \$791 (3 yrs of interest)
2002: \$12,500 x 38.6% = \$4,825	+ \$470 (2 yrs of interest)
2003: \$12,500 x 35.0% = \$4,375	+ \$214 (1 yr of interest)
\$14,088	\$1,475

- Current gross income:
2004: \$12,500 ordinary income

TAX CONSEQUENCES IN 2004:

- \$12,500 Ordinary Income (Form 1040 added to Other Income Line 21)
- \$14,088 Deferred Tax (Form 1040 added to Regular tax before AMT)
- \$ 1,475 Deferred Interest (Form 1040 added to total tax)

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F8621 Part IV

Part IV Distributions From and Dispositions of Stock of a Section 1291 Fund (See page D of instructions.)
 Complete a separate Part IV for each excess distribution (see instructions).

100	Enter your total distributions from the section 1291 fund during the current tax year with respect to the applicable stock. If the holding period of the stock begins in the current tax year, see instructions.	
101	Enter the total distributions included by the portfolio of each distribution that were taxable distributions but not included in income under section 1291(a)(2)(B) made by the fund with respect to the applicable stock for each of the 3 years preceding the current tax year (or if shorter, the portion of that shareholder's holding period before the current tax year).	
102	a. Divide line 100 by 3. (See instructions if the number of preceding tax years is less than 3.)	
103	b. Multiply line 101 by 125% (1.25).	
104	c. Subtract line 102 from line 103. The amount, if any, that you enter is the excess distribution with respect to the applicable stock. If zero or less and you did not dispose of stock during the tax year, do not complete the rest of this Part IV. See instructions if you received more than one distribution during the current tax year. Also, see instructions for rules for reporting a nonexcess distribution on your income tax return.	
105	d. Enter gain or loss from the disposition of stock of a section 1291 fund or former section 1291 fund, if a gain. Otherwise, line 11, if a loss, where it is bracketed and do not complete line 11.	50,000.00
110	Attach a statement for each distribution and disposition. (Show your holding period for each share of stock or block of shares held. Allocate the excess distribution to each day of your holding period. Add all amounts that are allocable to days in each tax year.)	
111	e. Enter the total of the amounts determined in line 11a that are allocable to the current tax year and for years before the holding period begins as PFIC (see PFIC) tax years. Enter those amounts on your income tax return as offset income.	12,500.00
112	f. Enter the aggregate increases in tax liability resulting for each tax year in your holding period (other than the current tax year and pre-PFIC years). (See instructions.)	
113	g. Foreign tax credit. (See instructions.)	14,088.00
114	h. Subtract line 113 from line 112. Enter the amount on your income tax return as "additional tax." (See instructions.)	1,475.00
115	i. Determine interest on each net increase in tax determined on line 114 using the rates and methods of section 6621. Enter the aggregate amount of interest here. (See instructions.)	

Note: Loss is reported on Schedule D subject to capital loss limitations.

How do you determine if potential PFIC computation is material:

- **What is the amount of the gain?**
 - Would it be material in a regular exam
- **Did the TP net or offset PFIC gains with other PFIC losses or regular 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)
- **What is the difference between the capital gains rate and the top ordinary income rates?**
 - Capital Gains are 15/20% where ordinary income is around 35% - consider what tax bracket the taxpayer is in
- **What is the holding period of the stock?**
 - The longer the stock is held, the higher the interest factor

1291 PFIC – Summary

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 is subject to deferred tax and deferred interest charge
- Make sure no PFIC losses are offsetting PFIC gains.

*****THE ENTIRE GAIN IS RECORDED IN THE YEAR OF SALE!*****
C/Y PORTION SHOWS UP AS ORDINARY INCOME AND PRIOR YEARS PORTION IS ADDED DIRECTLY TO TOTAL TAX

1291 PFIC OVDI CLOSING AGREEMENT LANGUAGE

2. During the period 2003 through 2010, 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.

	2003	2004	2005	2006	2007	2008	2009	2010
PFIC income	\$	\$	\$	\$	\$	\$	\$	\$

3. For taxable years 2003 through 2010, penalties under section 6662 of the Internal Revenue Code [or delinquency-related penalties under I.R.C. § 6655, as applicable] apply to the underpayments attributable to the aforementioned unreported income and overated deductions, and PFIC tax under Internal Revenue Code section 1291.

1291 PFIC Closing Agreement Language (Continued)

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

- "Gain from the disposition of Section 1291 Fund Stock"
This is the total amounts of gains only, no losses on Line 10f from all Form 8621s for the year
- "Distributions from Section 1291 Fund"
This is the total amounts from Line 10a from all Form 8621s for the year. Typically you will not see amounts on line 10a for distributions.

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

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

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PFIC

Questions??

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"Alternative" PFIC MTM

Special
Mark To Market PFIC rules for
OVDI certifications

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MTM PFIC 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

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Alternative PFIC MTM Resolution FAQ#10

WHY HAVE AN ALTERNATIVE METHOD?

™ Many OVDI returns involve PFIC investments.

™ Minimize Delays.

™ Lack of historical information on the cost basis and holding period make it difficult for taxpayers to prepare statutory PFIC computations and for the Service to verify them.

™ Alternative resolves PFIC issues on a basis consistent with MTM authorized in IRC Section 1296 but will not require complete reconstruction of historical data. Determinations will be made based upon the best available data.

™ 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.

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FAQ#10 Alternative PFIC MTM Resolution

Taxpayers who **ELECTS** to use the optional method must calculate the gain or loss on **EVERY** PFIC investment held using this method.

MTM is calculated on an share by share basis— gains and losses must be tracked by "lots". There is not cost averaging.

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.

An interest rate of 7% on 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).

MTM losses are limited to unreversed inclusions. Generally, unreversed inclusions are previously reported MTM gains less previously allowed MTM losses (losses in excess of cost basis are suspended until stock is disposed of). Unreversed inclusions are reset to zero at the end of OVDI period.

Losses in excess of cost basis are treated as capital losses.

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MTM Differences – OVDI v. IRC 1296

Under OVDI:

- If MTM is elected, it must be applied to all PFIC stock.

- Tax on gains from appreciation in value and losses (limited to unreversed inclusions) is computed flat 20% rate, it is not taxed as ordinary income.

- If the asset was held prior to 2003, all prior years appreciation is taxed in the 2003 year.

- Interest applies to MTM Tax in first year 2003, at a flat 7% rate, only for stocks that were held prior to 2003.

- The unreversed inclusions reset to zero at the end of the OVDI period. Under the Tax Benefit Doctrine Rule, this prevents the TP from the benefit of offsetting future ordinary income with losses resulting from absorbing MTM unreversed inclusions that were taxed at a lower 20% rate.

- 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 1291-1296, as applicable.

Under IRC 1296:

- MTM is elected by investment.

- Tax on Gains from appreciation in value and losses (limited to unreversed inclusions) is computed as ordinary income.

- If the MTM Election is made in a year subsequent to acquisition the 1291 taint must be purged in election year.

- There is no interest charge.

- The unreversed inclusions are not reset

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OVDI MTM PFIC EXAMPLE

FACTS

JFK Money Fund						FMV 12/31/03	\$16,000
Date Purchased	12/31/2002	Sale Date	3/5/2006			FMV 12/31/04	\$8,000
Purchase Price	\$10,000	Sale Proceeds	\$50,000			FMV 12/31/05	\$18,000

PFIC MTM Computations:	Year	Adjusted Basis	FMV Y/E or Sale Price	Realized Gain/Loss		Unreversed Inclusions	Recognized Gain/Loss	Adjusted Basis Carryforward
				Gain	Loss			
	2003	10,000	16,000	5,000	5,000	5,000	15,000	
	2004	15,000	8,000	(7,000)	-	(5,000)	(5,000)	10,000
	2005	10,000	18,000	8,000	8,000	8,000	8,000	16,000
	2006	18,000	50,000	32,000			32,000	

Tax Computation	Year	Recognized Gain/Loss	OVDI 20% Tax Rate	OVDI 7% Interest Rate	Under Regular MTM PFIC (Net OVDI)
	2004	(6,000)	(1,000)		\$5k ordinary loss
	2005	8,000	1,600		\$8 k ordinary income
	2006	32,000	6,400		\$2k ordinary income

Items to Note about Example

- In 2004, realized loss is limited to previously recognized gains
- Every year a MTM computation is done until year sold

"Regular" PFIC Mark to Market Computation Determined by Lots

Regs 1.1296-1(c)(7) Example 6 - Adapted

FACTS:

US Corp A purchased two lots of shares of foreign FX Corp
 PFIC election was made timely
 FMV at 12/31/2005 is \$8 per share (and for this example assume it is \$9 for 12/31/2006)
 Lot 2 shares sold on 7/1/2006 for \$900

Tax Computation 2005:

Date	#	Cost Per Share	Cost or Adjusted	Sale Price or FMV at 12/31/2005	Realized Gain/Loss	Adjusted Basis	Unreversed
1/1/2005	100	\$8	\$800	\$800	\$300	\$900	\$300
6/1/2005	100	\$10	\$1,000	\$800	(\$200)	\$1,000	\$0

2005 Report Ordinary Income of \$300 for the increase in FMV of Lot 1 shares. No loss is recognized on Lot 2 shares as there are no unreversed inclusions resulting from previous gains being included in income.
 Note: You may not net the Gains and Losses of different lots of PFIC purchases.

Tax Computation 2006:

Lot 1			\$800	\$900	\$100	\$900	\$400
Lot 2	SOLD		\$1,000	\$900	(\$100)		

2006 Report Ordinary Income of \$100 for increase in FMV of Lot 1 shares and report capital loss of (\$100) for the realized and recognized loss on the sale of Lot 2 shares.

"OVDI Alternative" PFIC Mark to Market Computation Determined by Lots

Regs 1.1296-1(c)(7) Example 6 - ADAPTED FOR OVDI ALTERNATIVE MTM

FACTS:

US Corp A purchased two lots of shares of foreign FX Corp
 PFIC election was made timely
 FMV at 12/31/2005 is \$8 per share (and for this example assume it is \$9 for 12/31/2006)
 Lot 2 shares sold on 7/1/2006 for \$900

Tax Computation 2005:

Date	#	Cost Per Share	Cost or Adjusted	Sale Price or FMV at 12/31/2005	Realized Gain/Loss	Adjusted Basis	Unreversed Inclusions	Tax Effect	Interest
1/1/2005	100	\$8	\$800	\$800	\$300	\$900	\$300	\$60	n/a
6/1/2005	100	\$10	\$1,000	\$800	(\$200)	\$1,000	\$0	\$0	n/a

2005 Only Lot 1 has appreciated. The gain will be taxed at flat 20% (\$300 20% = \$60) the interest is n/a even though it is the first year because the asset was not held prior to 2003. If it was then 7% of the tax (\$60 x 7%) = \$4 and the total due would be \$64.
 No loss is recognized on Lot 2 shares as there are no unreversed inclusions resulting from previous gains being included in income.
 Note: You may not net the Gains and Losses of different lots of PFIC purchases.

Tax Computation 2006:

Lot 1			\$800	\$900	\$100	\$900	\$400	\$20	n/a
Lot 2	SOLD		\$1,000	\$900	(\$100)			\$0	n/a

2006 Only Lot 1 has appreciated. The gain will be taxed at flat 20% (\$100 20% = \$20) there is no interest.
 2006 Lot 2 is sold for a loss. Since there are no unreversed inclusions the entire loss (\$100) is reported as a capital loss on Sch D.

Alternative MTM PFIC Closing Agreement Language

WHEREAS: 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);

2. Taxpayer hereby makes, and the IRS agrees to accept, a late election under section 1296 to adopt the mark to market method for calculating tax on all PFIC investments held during the period 2003 through 2010.

3. In addition to the unreported income and deductions in paragraph 1, the following amounts represent additional income and deductions related to the PFIC investments:

	2003	2004	2005	2006	2007	2008	2009	2010
PFIC Income	\$	\$	\$	\$	\$	\$	\$	\$

The tax on the income from the PFIC investments, including PFIC interest, is as follows:

	2003	2004	2005	2006	2007	2008	2009	2010
PFIC Tax	\$	\$	\$	\$	\$	\$	\$	\$

The tax on the PFIC investments (including PFIC interest) is in addition to the income tax to be calculated on the remainder of the unreported income in paragraph 1, above.

As of the end of taxable year 2006, there are no unreversed inclusions as defined by I.R.C. section 1296(d) with respect to the PFIC investments.

4. 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 overpaid deductions, and PFIC tax and interest in paragraph 3 above. (Substitute for standard paragraph 2)

MTM Reduction in Tax (RIT) Carryback

™ 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)

™ The allowable RIT will be limited to Regular Tax + AMT – Total Non-refundable Credits

™ The RAR line 9 cannot go below zero

™ 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

™ It does not matter what year the MTM RIT carryback is brought to

™ 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

™ Sharepoint has detail MTM RIT Carryback instructions found in:

📄 Closing Agreement Form 906

📄 Closing Agreement Special Language For PFIC and FTC

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Alternative MTM PFIC RIT Closing Agreement Language

In addition to regular MTM PFIC language.....

The tax on the income from the PFIC investments, including PFIC interest, is as follows:

	2003	2004	2005	2006	2007	2008	2009	2010
PFIC Tax	\$	\$	\$	\$	\$	\$	\$	<\$ >

The tax on the PFIC investments (including PFIC interest) is in addition to the income tax to be calculated on the remainder of the unreported income in paragraph 1, above.

As of the end of taxable year 2010, there are no unversed inclusions as defined by I.R.C. section 1296(d) with respect to the PFIC investments.

4. Of the \$_____ PFIC reduction in tax (RIT) in the 2010 year as stated in paragraph 3, \$_____ is not fully absorbed in that year. The amount not absorbed will be carried back to prior years. The underpayment in the year to which the unabsorbed reduction in tax is carried back will be subject to penalties as described in paragraph 5 *without regard to the carryback*, and interest described in paragraph 7 will be calculated under the provisions of IRC section 6110(f)(1). The 2010 unabsorbed reduction in tax will be carried back to the following years in the following amounts:

	2003	2004	2005	2006	2007	2008	2009	
Carryback of unabsorbed RIT	\$	\$	\$	\$	\$	\$	\$	

5. For taxable years 2003 through 2008, penalties under section 6662 of the Internal Revenue Code (or *delinquency-related penalties under I.R.C. § 6657, as applicable*) apply to the underpayments attributable to the aforementioned unreported income and overstated deductions, and PFIC tax and interest in paragraph 3 above. (Substitute for standard paragraph 2)

Sec 1291 and MTM PFIC Computation Tools

™ To aid in the certification of TP/Rep's PFIC computations, excel tools are available on the SharePoint site. Go to:

📄 2011 Voluntary Disclosure Program

📄 2011 PFIC Computation

™ There is a recorded Centra session on PFIC that addresses PFIC per the code (not OVDI) called:

"Passive Foreign Investment Company 43481"
(QPQ975372)

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PFIC MTM

Questions??

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FTC

OVDI & FTC
(Foreign Tax Credit)

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General Rule – Foreign Tax Credit

The purpose of the foreign tax credit is to *provide relief of double taxation* when foreign income is taxed by both the U.S. and foreign country where the income is derived

The credit cannot be used offset U.S. tax generated by U.S. source income; there must be foreign source income.

It is available to:

- 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

Limitations may apply: Lesser of

- Foreign tax paid or
- U.S. tax on foreign income

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Claiming Foreign Tax Credit: 4 Tests

In order to be claimed as a credit, the following must occur:

1. The tax must be imposed on the taxpayer
2. The taxpayer must have paid or accrued the tax
3. The tax must be a legal and actual foreign tax liability
4. The tax must be an income tax, or a tax in lieu of an income tax

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FTC Elections – Section 901

- Taxpayer must elect to use foreign taxes as a credit or deduction. Not both.
 - 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).
- 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
 - Statute: 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)

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OVDI and FTC

Due to the type of cases in this project, FTC will be an issue on many of these cases

- **FTC may be limited by Treaty for certain types of income** (interest, dividends, capital gains).
 - Reference chart in Pub 901 page 36 for limitations
- **Prepare OVDI FTC Workpaper** called:
 - "Foreign Taxes Paid or Accrued Table 2 – Paragraph for Agents to Complete" found on sharepoint:
- **Prepare Specialized Language for Form 906**

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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

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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))

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“Foreign Taxes Paid or Accrued Table 2 – Paragraph for Agents to Complete” FTC Table

Instructions for OVDP agent:

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 6) and insert those amounts in the following table. If there were no foreign taxes paid or accrued in a given year, enter “\$0” so the TS knows the box in the table was not overlooked.

Name of Taxpayer: _____

SSN: _____

Foreign taxes paid/accrued	2003	2004	2005	2006	2007	2008	2009	2008	2008
Form 1116, original return	\$	\$	\$	\$	\$	\$	\$	\$	\$
Form 1116, amended	\$	\$	\$	\$	\$	\$	\$	\$	\$
Enter the correct amount of total foreign taxes paid/accrued per the certification. <small>*Also enter this amount in the Form 906 FTC (Special language only)</small>									

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

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

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Example #1 OVDI FTC

** 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 x 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 below. (The \$1,500 of foreign taxes paid/accrued is the amount that should be used in the FTC calculation.)

Foreign taxes paid/accrued	2003	2004
Form 1116, original return	\$ 0.00	\$
Form 1116, amended	\$ 3,500.00	\$
Enter the correct amount of total foreign taxes paid/accrued per the Certification. <i>*Also enter this amount in the Form 906 FTC Special language grid.</i>	\$ 1,500.00	\$

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Example #2 OVDI FTC

** Example #2 - For 2003, 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 nor decreased). The amount entered in the second line for "Form 1116, amended" would be \$8,500; and the amount entered on the third line as the "Correct amount of foreign taxes paid/accrued per the certification" would also be \$8,500. Assume in 2004 originally filed return showed \$1,000.00 taxes paid and \$9,500.00 on the amended.

Foreign taxes paid/accrued	2003	2004
Form 1116, original return	\$ 0.00	\$ 1,000.00
Form 1116, amended	\$ 8,500.00	\$ 9,500.00
Enter the correct amount of total foreign taxes paid/accrued per the Certification. <i>*Also enter this amount in the Form 906 FTC Special language grid.</i>	\$ 8,500.00	\$ 9,500.00

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FTC Closing Agreement Language

WHEREAS Taxpayer paid or accrued foreign income taxes to (insert country name(s)) during taxable years 2003 through 2008;

2. 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	2009	2010
Foreign Income Taxes Paid or Accrued	\$	\$	\$	\$	\$	\$	\$	\$

In the grid above you will enter the total foreign taxes paid or accrued per certification.

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FTC AMT Closing Agreement Language

Additional Closing Agreement Language for AMT FTC:

3. During tax years 2003 through 2010, Taxpayer was entitled to foreign tax credit under section 901 of the Internal Revenue Code for foreign income taxes paid or accrued to a foreign country or U.S. possession. During tax years 2003 through 2010, Taxpayer was subject to the alternative minimum tax under section 55 of the Internal Revenue Code. Since Taxpayer was subject to the alternative minimum tax during tax years 2003 through 2010, and was entitled to foreign tax credit for foreign income taxes paid or accrued to a foreign country or U.S. possession during tax years 2003 through 2010, a separate foreign tax credit for the alternative minimum tax was determined. Taxpayer agrees to the alternative minimum tax foreign tax credit as determined under this agreement for tax years 2003 through 2010.

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Disallowance in Full FTC Closing Agreement Language

Closing Agreement Language for FTC Disallowed In Full:

2. For taxable years 2003 through 2010, the taxpayer is not entitled to claim the foreign tax credits, pursuant to 26 U.S.C. 901, with respect to the items of income included in paragraph 1 of this agreement.

* There is no Whereas Clause when the foreign taxes paid or accrued are disallowed in full.

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FTC

Questions??

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Analysis of Foreign Account Statement

- FAQ#25 – Should not be interpreted to mean that statements should not be requested and reviewed to certify the TP's numbers. It just means they do not have to submit them to Austin with their application.
- Every bank's statements look different
 - Some banks have multiple statements (Stmt of Assets/Income Strmts/Capital Gains & Loss)
- Look at the Statement...Look at it again...and again.
 - Would you expect there to be income? Does it make sense?
 - What statements have you been provided?
 - What are they telling us they earned and does it agree to what the statements say?
- You may not contact the foreign banks directly.
 - Request TP provide the statements, use of summons if necessary.
 - Consult with Tax Attaché/EOI

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Statute of Limitations

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

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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)

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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))

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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

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No SOL if...

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

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

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

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IRC 6501(c)(4)

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

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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!

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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

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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%

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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*

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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)

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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).

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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

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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.

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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.

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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?

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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)..."

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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.

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Statute Of Limitations

Questions??

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2011 OVDI

RGS and OVDI Issues

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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.

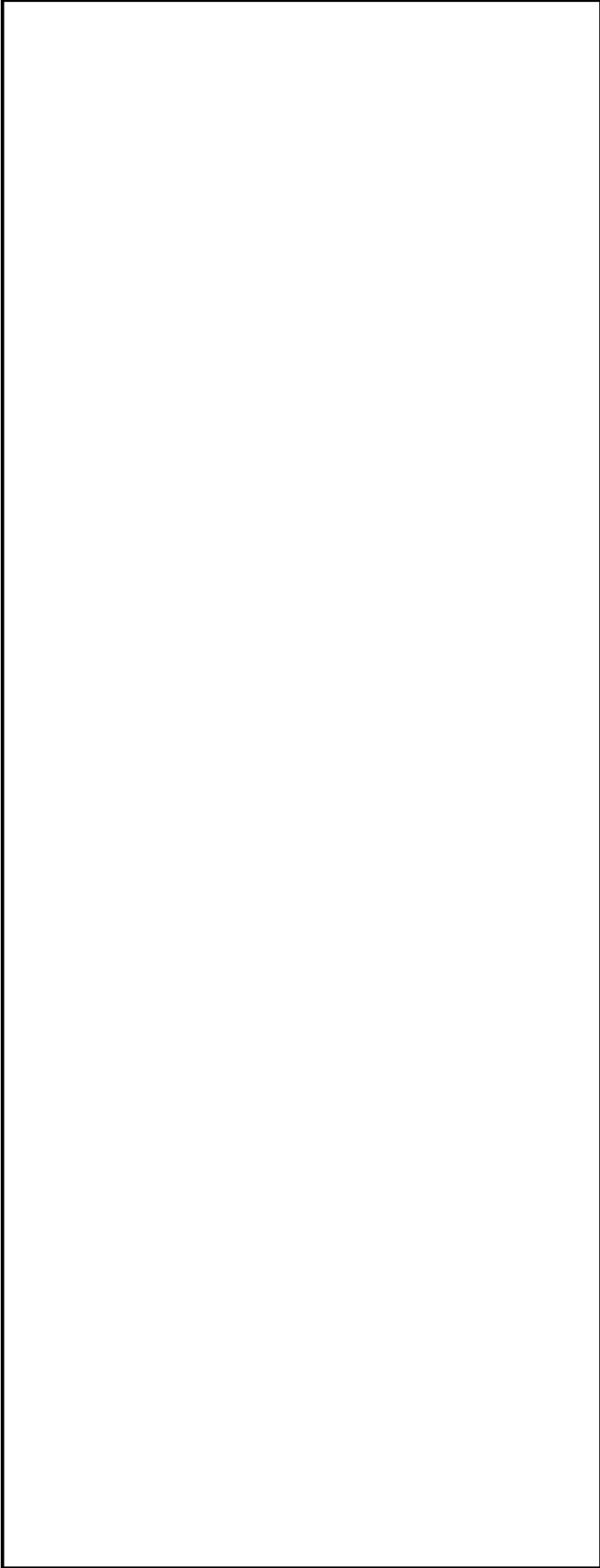
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Important IDRS Documents to Request

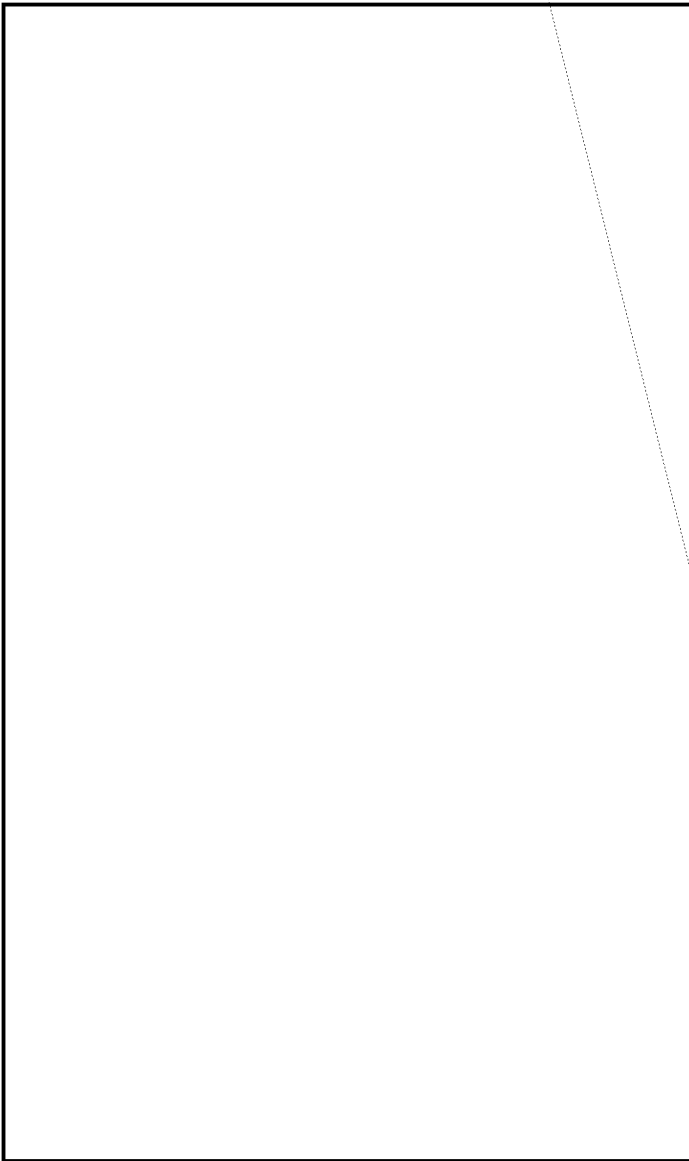
- **IMFOLA**
 - adjustments made to return information
- **IMFOLI**
 - Identifies active years, module balances, freeze codes and status
- **IMFOLR**
 - determine what items changed
- **IMFOLZ**
 - adjustments made as a result of examination
- **TXMODA**
 - detailed module information

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(b)(3)/26 USC 6103



Horizontal lines for writing, consisting of 20 parallel lines extending across the right side of the page.



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)

RGS

- Secure any amended returns filed
 - reconcile to the transcripts
- Review and update Return Setup
- Make sure all relevant data is input
- Run a variance analysis for all years
 - resolve all variances

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RGS Variances

- True Variances
- Campus Adjustments
- 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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SFRs/Delinquent Returns

- If CFOL data imports 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
- Items in RGS for SFR/Delinquent Returns
 - Filing Status
 - Personal Exemption
 - Standard Deduction
 - FEIT Computation
 - Foreign Tax Credit
 - Delinquency Penalties

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**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
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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**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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**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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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)



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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



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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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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.

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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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RGS –Delinquency Penalties

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

- 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 Failure to Pay (FTP) 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 and enter that amount in the **Previously assessed failure to file penalty** filed in RGS.
 - 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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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:

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

- Determine the number of months the return is late, not to exceed five months (any part of a month is considered a full month).
- Compute the balance due on the original return, including amended returns (TC150 less any withholding, prepayment credits, or payments made by the due date).
- 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).
- Enter the result from step 3 in the **Previously assessed failure to file penalty** field.
- 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% x \$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.

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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

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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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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>

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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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RGS

Questions??

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Opt Out - Removal

Two Additional Processes for Resolving Voluntary disclosure Cases

- Opt Out – Irrevocable election by TP to have case handled as normal audit
- Removal – determination by IRS personnel to remove a taxpayer from the civil settlement VDP structure
- Procedures are set forth in a memo from Steve Miller dated June 1, 2011

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Opt Out - Removal

- Opt Out is a viable option available to the taxpayer during the VDP process
 - Taxpayers should not be treated in a negative fashion just because they chose to Opt Out
- Removal is normally the result of a taxpayer who will not cooperate in the VDP process
- Opt Out and Removal will result in the application of normal examination standards, the service will ensure to best interests of the government and maintain the integrity of the VDP process
- Agents are required to refer potential Opt Out or Removal cases to a joint SB/LB committee
- The committee must approve the option and will recommend audit steps to begin this process

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Opt Out - Removal

- Opt Out Letters
 - Letter 4728 must be mailed to the taxpayer providing the status of the VDP and documents necessary to complete certification
 - Taxpayers are given 30 days to respond to this letter
 - Letter 4564 issued to fully explain the irrevocable result of their election to Opt Out
 - Taxpayer request to Opt Out must be in writing
 - Taxpayers are given 20 days to respond to this letter
 - Summary of case is submitted to review committee for approval
 - Both letters must be mailed to the taxpayer and appropriate response time must be allowed for each letter

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Opt Out - Removal

- Removal Letters

- Letter 4729 must be mailed to the taxpayer providing the status of the VDP and documents necessary to complete certification
- Taxpayers are given 30 days to respond to this letter but an extension of 60 additional days can be allowed
- Letter 4566 issued to fully explain the service's intent to remove the taxpayer from the VDP process
- Taxpayer may request a review by the Territory Manger
- Taxpayers are given 30 days to respond to this letter
- Summary of case is submitted to review committee for approval
- Both letters must be mailed to the taxpayer and appropriate response time must be allowed for each letter

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Opt Out - Removal

- Opt Out/Removal Committee

- Joint SB/LB group that reviews requests by agents for either Opt Out or Removal
- Normal examination procedures, statute protection, interviews etc should be followed
- Once taxpayer opt out or are removed, they cannot take advantage of the settlement initiative under VDP
- Information Return penalties (FBAR, 5471, 3520, etc) should be pursued as appropriate
- The Opt Out removal guide is published on IRS.GOV

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Opt Out & Removal

Questions??

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VDP Case File Review



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