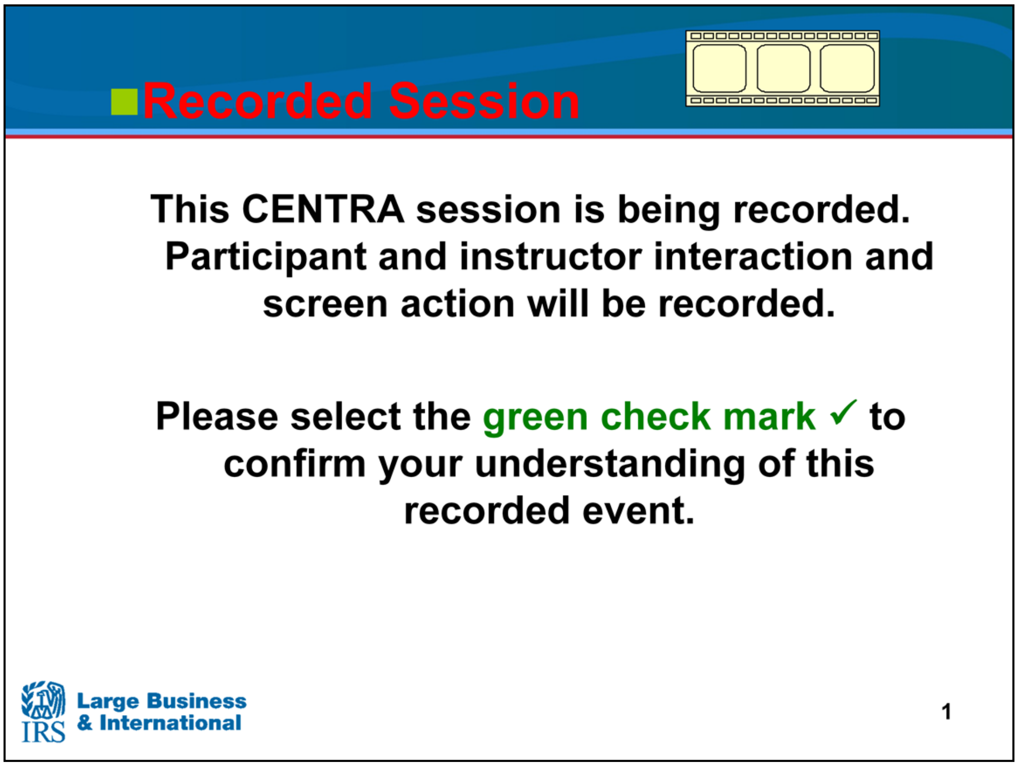

[Speaker]

This event is being recorded and will be available for playback.

Can you please select the green check mark to confirm you understand that this event is recorded.

[Once participants have acknowledged, press the record button]

Welcome to part one of a three part series focused on offshore arrangements.

This first part will focus on a the basic structures established to conceal beneficial ownership of foreign accounts and other assets.

Parts II and III will expand on this concept by providing information on relevant aspects of offshore work including investigative techniques, statutes, interviewing, summons and potential penalties.

Presenters

- This presentation was prepared by the Offshore Arrangements International Practice Network Team
- Your presenters for this session are:

(b) (6) [redacted]

This event was prepared by a team in conjunction with the Offshore Arrangements IPN. In no particular order, the team members are:

(b) (6) [redacted]

Disclaimer

- There are legitimate or non-tax motivated reasons a U.S. Taxpayer would engage in offshore transactions, including, but not limited to:
  - Asset Protection (Malpractice, Ex-Spouses)
  - Diversification Investments
  - Active International Business Operation
  - Living Overseas/Family Connections
- This presentation makes the assumption that the taxpayer's involvement in offshore arrangement is for tax avoidance or evasion purposes. We will focus on tax motivations.

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This slide is a disclaimer .

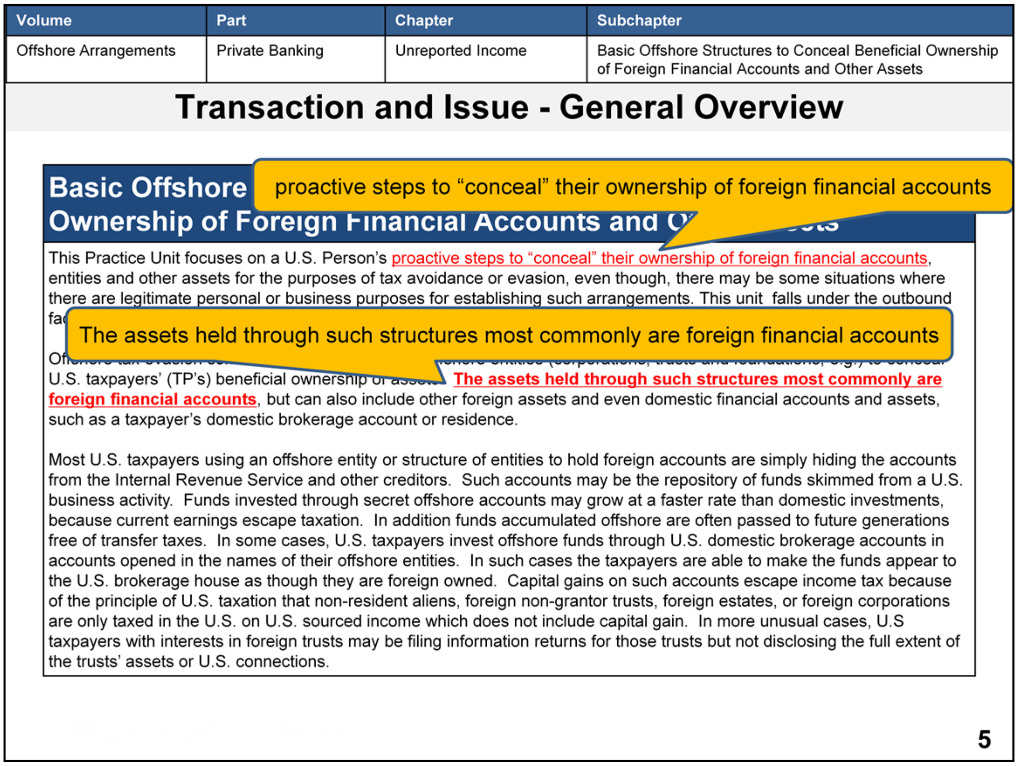
There are legitimate reasons a U.S. Taxpayer would engage in offshore transactions, including, but not limited to:

Asset Protection and Diversification

Active International Business

Family Connections

However, this presentation makes the assumption that the taxpayer's involvement in offshore transactions is for tax avoidance or evasion purposes.



The next two slides are excerpt directly from the Offshore Arrangement's IPS Practice Unit called Basic Structures to Conceal Beneficial Ownership of Foreign Financial Accounts and Other Assets. They are the slides 4 and 5 which provide a general overview of what an offshore arrangement is.

As you can see we have some call out boxes to emphasize what we think are the important attributes of an offshore arrangement.

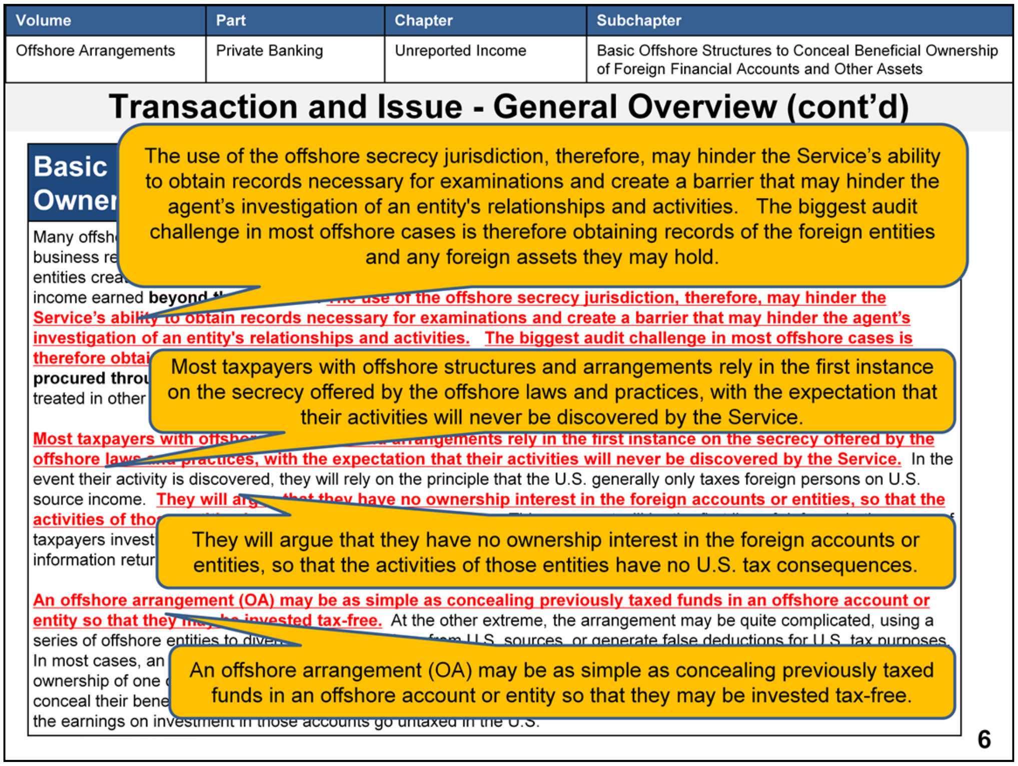
The focus of this Unit is on a U.S. Persons' proactive steps to "conceal" their ownership of foreign financial accounts, entities and other assets for the purposes of tax avoidance or evasion.

Offshore issues often come down to a determination of substance versus form. The arrangements create the appearance of international legitimacy by disguising actual beneficial ownership. All the while the US person retains personal control, use and enjoyment of the income and assets.

The underlying concept for Offshore Arrangements is that Control + Personal Use = Ownership

When we specifically talk about Abusive tax schemes, we are referring to transactions promoted for the promise of tax benefits with no meaningful change in the taxpayer's control over or benefit from the taxpayer's income or assets. These transactions typically have no economic purpose other than reducing taxes.

Taxpayers are not only creative to get the assets and income offshore untaxed, but also when they need to access the funds for use, they are equally creative in repatriating the funds tax free. Arrangements may involve the use of multiple layers of domestic and foreign pass-through entities to conceal the true ownership of the assets. The more complex the structure the harder it is to follow.



Yes. This slide looks very busy but we want to focus on the call outs.

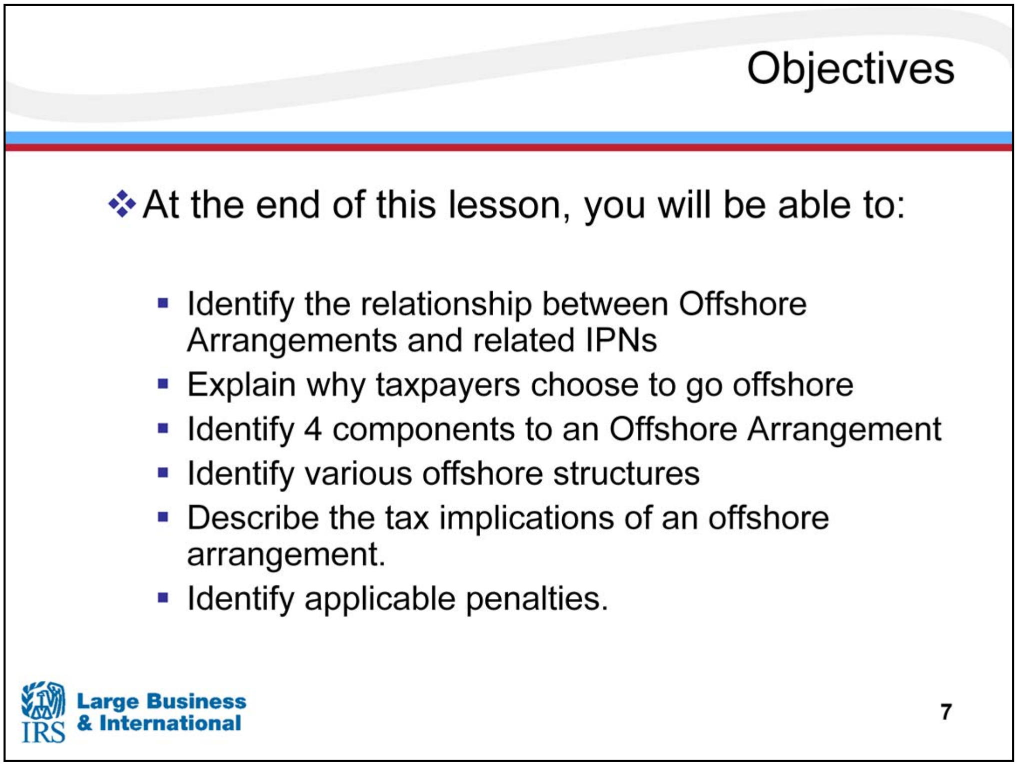
The first one emphasizes the use of the offshore secrecy jurisdiction, which may hinder the Service's ability to obtain records necessary for examinations and create a barrier that may hinder the agent's investigation of an entity's relationships and activities. The biggest audit challenge in most offshore cases is therefore obtaining records of the foreign entities and any foreign assets they may hold.

Financial Secrecy jurisdictions are foreign countries that provide financial secrecy laws so as to prevent revealing the true beneficial ownership of entities and assets. They may provide low or no tax on the conduct of business "outside" their shores. This is a key point. The business is established in the offshore jurisdiction but the actual activities take place outside of that jurisdiction.

Most taxpayers with offshore structures and arrangements rely in the first instance on the secrecy offered by the offshore laws and practices, with the expectation that their activities will never be discovered by the IRS. In the event their activity is discovered, then they will rely on the principle that the U.S. generally only taxes foreign persons on U.S. source income. They will argue that they have no ownership interest in the foreign accounts or entities, so that the activities of those entities have no U.S. tax consequences.

However, it is very important to point out that an offshore arrangement can be conducted with an offshore jurisdiction that is not considered a "secrecy" jurisdiction. The United States has even been used as a tax haven for foreigners.

An offshore arrangement (OA) may be as simple as concealing previously taxed funds in an offshore account or entity so that they may be invested tax-free. At the other extreme, the arrangement may be quite complicated, using a series of offshore entities to divert or "skim" earnings from U.S. sources, or generate false deductions for U.S. tax purposes



Here are our objectives for this session. At the end of the lesson you will be able to:

Identify the relationship between Offshore Arrangements and related IPNs

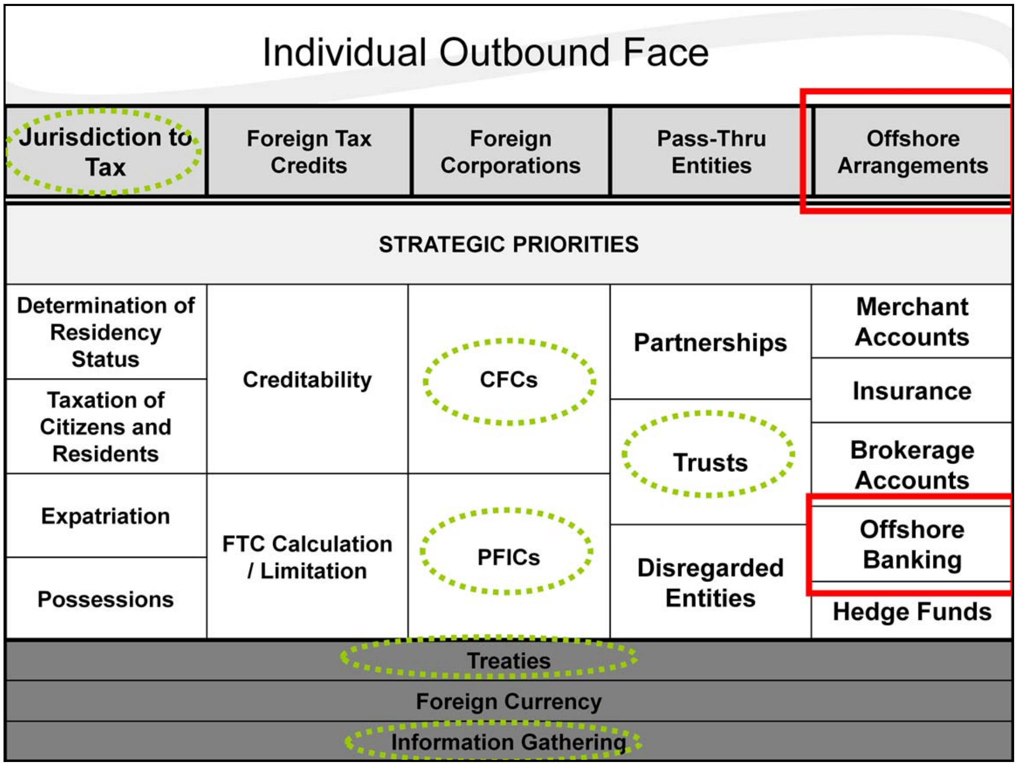
Explain why taxpayers choose to go offshore

Identify 4 components to an Offshore Arrangement

Identify various offshore structures

Describe the tax implications of an offshore arrangement.

Identify applicable penalties.



Here is the new updated version of the International Matrix. As you can see that Offshore Arrangements is now represented in the last column. On the earlier version of the Matrix it was the second IPN, just in-between JTT and Foreign Corps. Another change to the matrix, is that "Private" banking is now referred to as "Offshore" Banking. This strategic priority is boxed in red.

In all three parts of these Basic Structures Sessions, we will be focusing on Offshore Banking but many of the concepts can be applied to any offshore arrangement. Many projects currently being developed and worked in IIC will fall under this Offshore Banking strategic priority.

A high level overview of what an offshore arrangement is can be found in the "Overview Building Block" called "Issues Associated with Offshore Bank Accounts" that is posted to the IPS library.

OA's primary issue boils down to unreported income which can come in many shapes and sizes.

And because of the variations to the different schemes , OA is heavily dependent on other IPNs, not only for tax law but for investigative techniques.

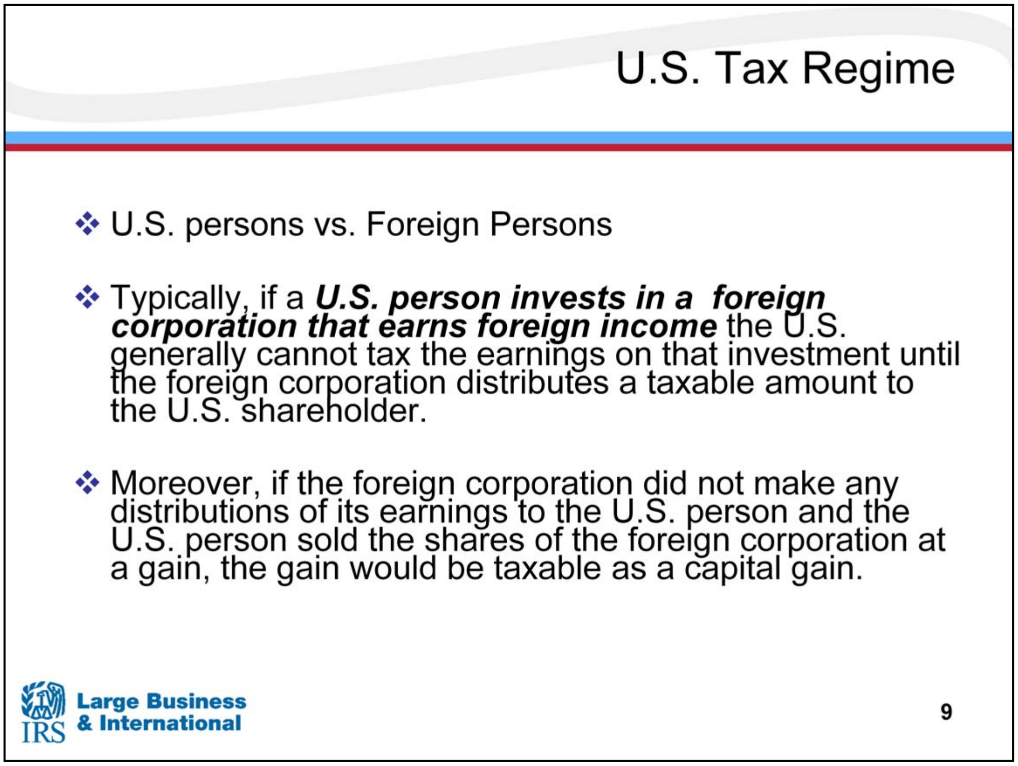
First, there is the JTT IPN. We need to know if the U.S. has jurisdiction over the TP. When looking at the arrangement we need to be asking if the TP involved is disguising their relationship with foreign entities and their beneficial ownership or if the taxpayer really is a foreign person with foreign sourced income.

Next, we have the Foreign Entities IPN. Most often we see international business companies, referred to as IBC's, and foreign trusts used as the vehicles to establish the abusive arrangements. Most often these entities are generating the income and conducting the transactions and that is why OA relies upon the Foreign Entities IPN in developing tax law arguments. The entities hold assets offshore, which generate income, such as interest dividends and cap gains, including PFIC which is a special taxing regime on foreign passive income. Many of these related issues fall under FE and have been covered in earlier training sessions.

OA's focus or primary argument is generally that substance over form prevails and that there is no business purpose for the transaction. We look to the US individual taxpayer as the beneficial owner of the offshore assets and entities, thus the related tax consequences. On occasion, we look to the other IPNs to apply alternative code based arguments.

We also have two overlying IPNs, which you can see at the bottom of the matrix – Treaties and Information Gathering. They help us determine treaty impact, as well as, provide assistance in gathering information held abroad. Via treaties and TIEAs. Banking secrecy can be lucrative for tax professionals, not only in facilitating the establishment of the abusive structures but also managing the investments afterwards. Compliance initiatives, like

OVDI, and new tax law, like FATCA, are breaking down the walls or as it is commonly referred to, piercing the veil of secrecy.



In the US taxing regime, U.S. persons are taxed in the U.S. on their worldwide income. Foreign persons, (nonresident aliens and foreign corporations), are generally only taxed by the U.S. on income originating in the U.S.   We learned about this in the earlier Jurisdiction to Tax Session.

In addition, foreign persons are not taxed by the U.S. on certain types of investment income originating in the U.S., such as interest income earned on bank deposits and U.S. non-business capital gains (other than gains on real property).

U.S. companies typically pay out dividends that are taxed as ordinary income when earned, while foreign companies typically do not make distributions. So if there are no foreign distributions there would be no foreign ordinary income for the U.S. taxpayer to report. Thus, the earnings accumulate in the foreign corporation making the stock value appreciate and the income will not be recognized until the stock is actually sold. And guess what...it will be classified as a capital gain rather than ordinary income. Generally, most taxpayers that park their investments offshore have significant other income and will most likely be in a higher tax bracket than the capital gains rate.

In the 1960s under Kennedy, CFC and Subpart F was introduced. It came about to combat the deferral of income when a U.S. person invested in a foreign corp. Americans were parking their money in foreign entities, which may have been for many purposes – defer income, hide from a spouse or a business partner, etc. The abuses to the CFC rules are the reason PFIC was introduced in the 80's, to create a level playing field for those investing in the US and abroad.

In the event an arrangement is discovered, taxpayers will rely on the principle that the U.S. generally only taxes foreign persons on U.S. source income. This is why, in offshore arrangements, U.S. persons attempt to structure their income earning activities through foreign entities, hoping to take advantage of the differences in the way we tax U.S. persons as compared to foreign persons.

Volume/ Part/ Chapter/ Sub-Chapter
13/13.4/Offshore Arrangements (Individual Outbound)/Offshore Banking

Definitions

Issues Associated with Offshore Bank Accounts
Description
Beneficial Owner: the true owner of an entity or asset, contrary to the stated ownership provided in documents or oral representations. It is common practice in offshore arrangements to interpose entities, individuals, or both as nominee owners for the beneficial owner. Generally, the beneficial or true owner is contractually acknowledged in side agreements, statements or by other devices.
International Business Company (IBC): A company formed under the corporate legislation of a financial secrecy jurisdiction. IBCs are not authorized to do business in the country of formation (incorporation) but can have offices that manage global operations. In addition to the usual benefits accruing from incorporation, such as limited liability, IBCs also enjoy banking and corporate secrecy, rapid formation, low cost, little or no taxation, and minimal filing and reporting requirements. Some tax havens also allow nominee shareholders and directors.
Offshore Bank: a bank located outside the country of residence of the depositor; typically in a low tax jurisdiction that provides financial and legal advantages. These advantages typically include: greater privacy, low or no taxation, easy access to deposits, protection against local, political, and financial instability and asset protection since these accounts may offer protection from collection on domestic lawsuits in the individual's home country.
Summons: an IRS summons is a notice to a taxpayer or third-party, such as a bank, demanding records and information relevant in an IRS civil or criminal tax investigation. The summons power includes the authority to take testimony, under oath, of the summoned person.
Exchange of Information Process: allows information located in a country with which the United States has a tax treaty or tax information exchange agreement (TIEA) to be obtained from the tax administration of that country and provided to the IRS through the exchange of information (EOI) process. The EOI process can be used to obtain documents or to conduct interviews of foreign personnel.

10

This slide comes directly from the IPS Overview Building Block on Issues Associated with Offshore Banking Accounts. It has some of the basic definitions and concepts related to Offshore Arrangements.

We will look at the first three definitions, which are the building blocks of an offshore arrangement.

First, Beneficial Owner: the true owner of an entity or asset, contrary to the stated ownership provided in documents or oral representations. It is common practice in offshore arrangements to interpose entities, individuals, or both as nominee owners for the beneficial owner. Generally, the beneficial or true owner is contractually acknowledged in side agreements, statements or by other devices.

Second, International Business Company (IBC): A company formed under the corporate legislation of a financial secrecy jurisdiction, such as the Bahamas, Panama, Turks & Caicos. IBCs are not authorized to do business in the country of formation (incorporation) but can have offices that manage global operations. In addition to the usual benefits accruing from incorporation, such as limited liability, IBCs also enjoy banking and corporate secrecy, rapid formation, low cost, little or no taxation, and minimal filing and reporting requirements. Some tax havens also allow nominee shareholders and directors.

Lastly, Offshore Bank: a bank located outside the country of residence of the depositor; typically in a low tax jurisdiction that provides financial and legal advantages. These advantages typically include: greater privacy, low or no taxation, easy access to deposits, protection against local, political, and financial instability and asset protection since these accounts may offer protection from collection on domestic lawsuits in the individual's home country.

Some Assumptions for the "OA" Sessions

- Intent is to Conceal Beneficial Ownership
- Intent is to Avoid/Evade Tax
- Foreign Entities
  - No business purpose
  - IBC are usually CFC's
  - Grantor Trusts

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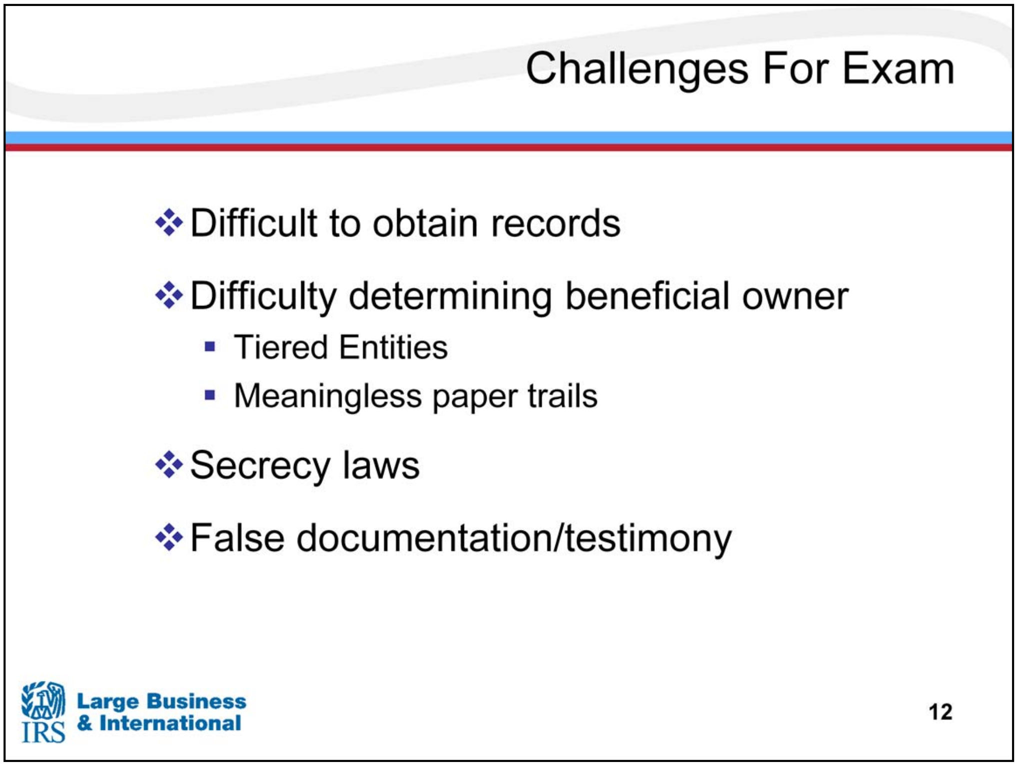
These are some assumptions that we use when dealing specifically with OA.

As we said earlier in our disclaimer, these assumptions are not true for all international activities because there are some legitimate tax reasons for TP to have offshore accounts and entities such as pooling of financial resources (partnerships) or actually running a business and some nontax reason including ,

- hide assets from creditors, asset protection in lawsuits, or self insurance for professionals which is common with doctors;
- Diversification of Investments;
- Connection to a foreign country, maybe they previously resided there or currently have family there;
- Inheritance;

However, generally, once the structure has been established the taxpayer may not disregard it due to unfavorable tax consequences.

Where OA is focused on Abusive Schemes where generally the purpose is to evade tax by concealing beneficial ownership, through the creation of entities that have no real business purpose, such as IBC and/or foreign trusts.



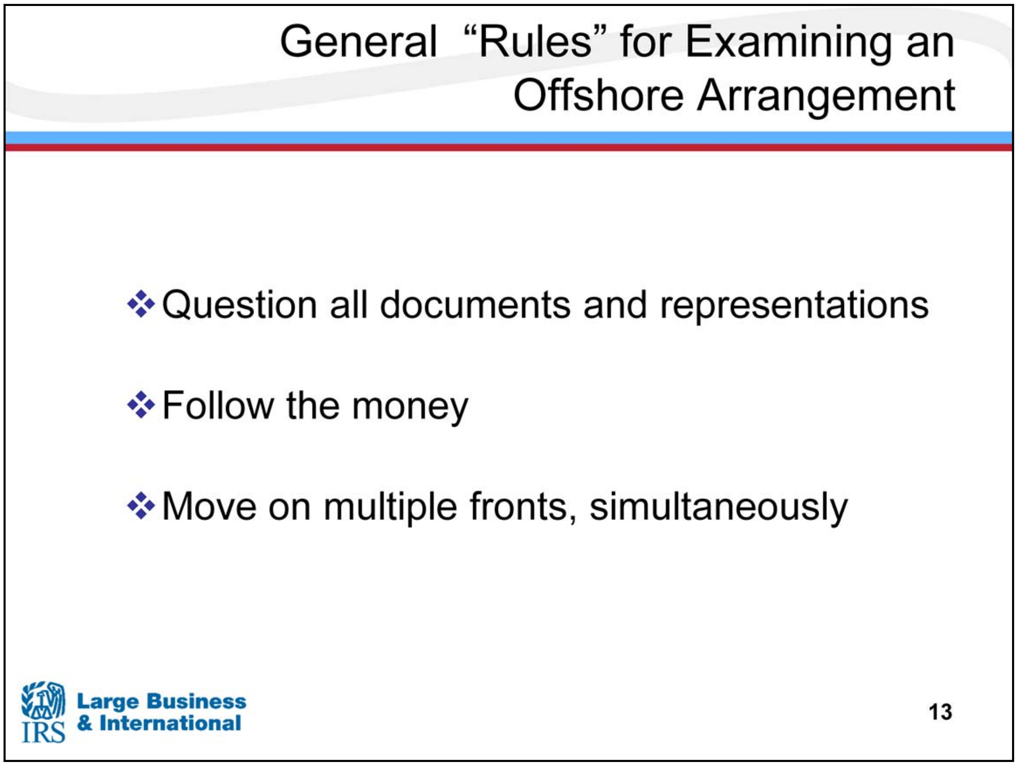
Examination of Offshore Arrangement type cases present many challenges. Because these type of arrangements generally make use of tiers of various types of entities, many times created in more than one offshore jurisdiction, which may have their own financial and/or bank secrecy rules or laws (currently some foreign jurisdictions are repealing or changing those secrecy laws or they are becoming null and void as a result of the reporting requirements under FATCA) taxpayer's assume that their actions, and the true relationships among entities and their beneficial ownership will be hidden from IRS inquiry. Additionally, some taxpayers try to inhibit an agent's investigation, making if very difficult to obtain the records needed to conduct a thorough examination . Some taxpayer's are even willing to create false documents to disguise the nature of transactions, once again believing that we will be unable to get the information needed to reveal their truth about their relationship to the offshore structure and the true transaction.

However, agents must keep in mind that it is the taxpayer and their activities that they are auditing, not just their tax return and accounting records. Agents must put themselves in the taxpayer's shoes, understand their motivation for going offshore, and judge the reasonableness of their explanations for a specific transaction in that light. Agents must be willing to go behind invoices, other records and oral testimony, they would accept at face value in a routine audit to verify transactions in a multitude of ways.

You may compare information in the form of documents and testimony provided by the taxpayer with that provided by the Whistleblower's Office or provided through a Tax Treaty and already included in the case file. For instance, if the TP denies the existence of an offshore account, which you know of from information obtained through a Tax Treaty during the case building process, you should consider as part of your exam strategy contacting EOI to see if and what information you can divulge to the taxpayer.

Taxpayers looking to conceal their ownership and control of entities and assets may also use nominees or registered agents. As an example, often times, a TP will say that they do not control the trust , accounts and other assets involved in a transaction. They will insist that it is the trustee who controls them and, that they are merely the beneficiary. However, there may be additional documents, such as Letters of Wishes, that is a supplemental document to the trust agreement, which identifies that the taxpayer still maintains control. Another example could be where a TP signs a POA thereby authorizing another to act on their behalf. Nevertheless, they are still essentially in control over their entities and assets.

In Part II of this series, we will talk about investigative techniques to meet these challenges.



When examining Offshore Arrangement cases there are some general rules to keep in mind:

Question all documents or representations given to you with respect to an offshore arrangement. Examiner must be skeptical of any document until proven credible.

It is imperative that the examiner questions each and every document that is presented with respect to any offshore arrangement and follow up on oral testimony.

Additionally, in the beginning of the exam, it is important that the examiner not be overwhelmed and consumed with the complex structure of the offshore scheme. At first, understanding the total picture and the taxpayer's motive is more important than understanding each step in the transaction.

In devising an offshore arrangement, the promoter or advisor has constructed a path or trail that they want you, the examiner, to follow using traditional auditing methods. This path plays on the strengths of an offshore arrangement in terms of hiding the identity of the beneficial owner and the owner's offshore financial transactions. The examiner commonly contacts the persons listed as officers of offshore entities only to be told a person other than the U.S. taxpayer is the owner. Offshore corporate records will also fail to indicate any involvement of a U.S. taxpayer with an offshore entity despite the appearance of questionable transactions involving that entity that appear to have the fingerprints of the U.S. taxpayer. This path of inquiry and response has been planned out by the offshore professional assisting the U.S. taxpayer. Often examiners and managers become frustrated at this point and unclear as how to proceed. Keep digging, keep asking and don't be accepting of the documentation upfront if it doesn't pass the smell test. The documents provided look legitimate but you need to determine if the transaction make business sense? Why does the US business need to interact with a foreign corporation? Why does the taxpayer need to obtain a loan from a foreign entity when previously all the loans were obtained from their neighborhood bank? Are the answers provided consistent? Don't stop until you are satisfied that the reasonableness of the taxpayer's explanations make sense given all the other information you have.

Offshore Rule 2: *Follow the money.*

Generally, these offshore arrangements will result in a circular flow of funds tying the domestic and foreign relationships.

Following the flow of money will inevitably show who is benefiting from the transactions and who is most likely in control.

Finally, you want to strategically move on multiple fronts, simultaneously. Once you get a lead follow it. Don't wait to finish one step before you start the next step. For example you may issue a formal document request to the taxpayer for foreign based records, but don't necessarily wait to get those records before pursuing interviewing third party witnesses or obtaining documents to corroborate the taxpayer's testimony. Consider interviewing multiple third parties, and issuing all the summonses and information document requests you need to obtain the information necessary to develop the issue. You can take multiple actions at one time.

4 Components of an Offshore Arrangement

1. Devise overall plan
2. Transfer funds offshore
3. Control offshore funds
4. Access offshore funds

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Generally, there are four parts to an Offshore Arrangement. They are 1) Devise an overall plan, 2) Transfer funds offshore, 3) Control those offshore funds while they are offshore and finally 4) Access offshore funds

During each one of these four components the taxpayer must perform some action. That is, the taxpayer must do something to carry out that particular component.

For instance, devising an overall plan is usually accomplished with the help of a financial advisor, private banker and/or promoter. The TP generally will sit down with the promoter/advisor to discuss their financial situation, what they want to accomplish, for example pay no tax on large amount of gain regarding sale of some appreciated property. They will also discuss their comfort level with respect to what the promoter's recommendations.

The plan will typically identify the assets or funds to be transferred, and specifically how to accomplish that. Sometimes it is as simple as taking receipts from certain select clients, essentially skimming the income earned from those clients and not reporting those sales in the US books and records and depositing those receipts directly into the offshore bank account.

The plan will generally describe how the TP will retain control over the assets while offshore, such as through a power of attorney or letter of wishes. The plan will likely also provide for how the TP will be able to access these assets should they need to use them. Some methods of repatriating offshore funds can involve: carrying cash, which can be difficult. , Other methods involve credit cards tied to the offshore account, assets purchased by the foreign entity but for personal use by the TP in the US, or perhaps payments sent directly from the offshore account to be used for college tuition for TPs dependent.

As a result, these four components should be incorporated into your audit plan. You, as the examining agent, should determine:

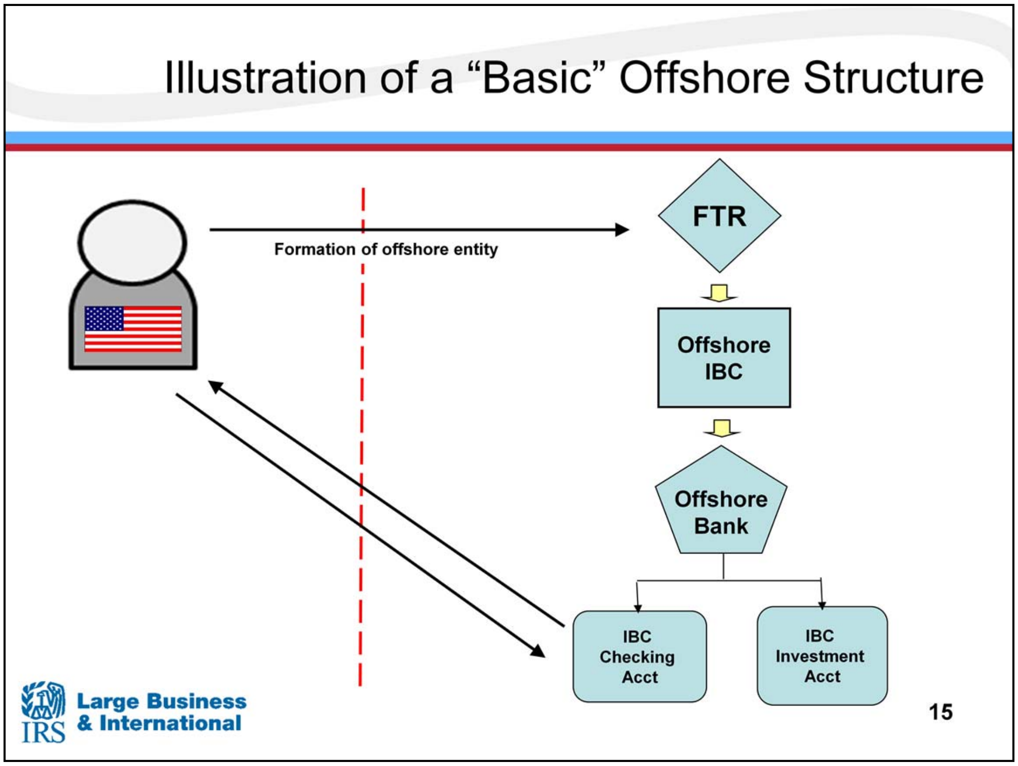
1) Who advised the taxpayer to enter into the transaction and how the taxpayer became involved

2) Who provided the promotion materials and you should obtain copies of all of them (this will help you understand the arrangement)

3) Determine the methods TP used to

- transfer funds/assets offshore
- control them while offshore and
- then repatriate those assets for use.

If you can do this you will be able to show that your taxpayer is the beneficial owner and is liable for the U.S. tax with respect to those funds and assets located offshore.



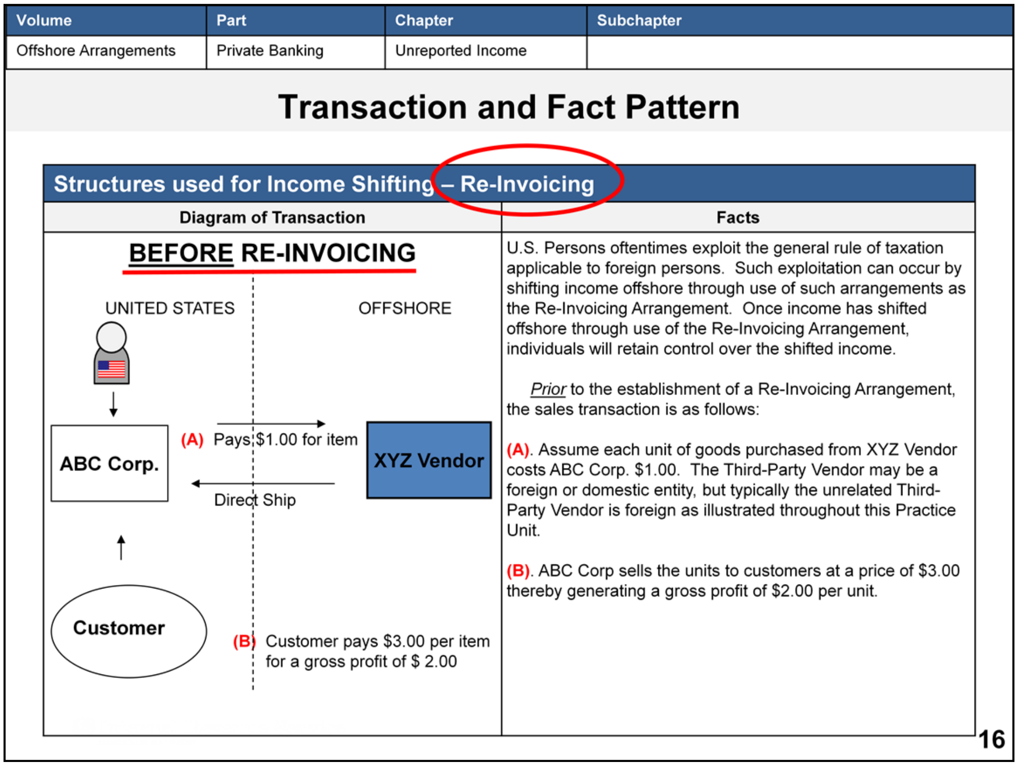
Here is an illustration of the basic offshore structure.

We have a US person that creates a foreign entity or maybe even entities. Typically taxpayers will hold offshore bank accounts through the foreign entity or entities. In essence, the foreign entity opens a bank account which is that taxpayer in disguise. The assets deposited into the accounts may be pre or post U.S. tax.

As the bank account holds the assets offshore, the assets generate income that escapes US taxation.

When needed, the TP beneficially enjoys the funds in the accounts through repatriation.

There are many variations which expand on this basic structure, for example a re-invoicing structure. This one method in which a taxpayer moves the funds offshore.



We are now going to walk through a Re-Invoicing Arrangement step by step, both before and after, the arrangement is put in place.

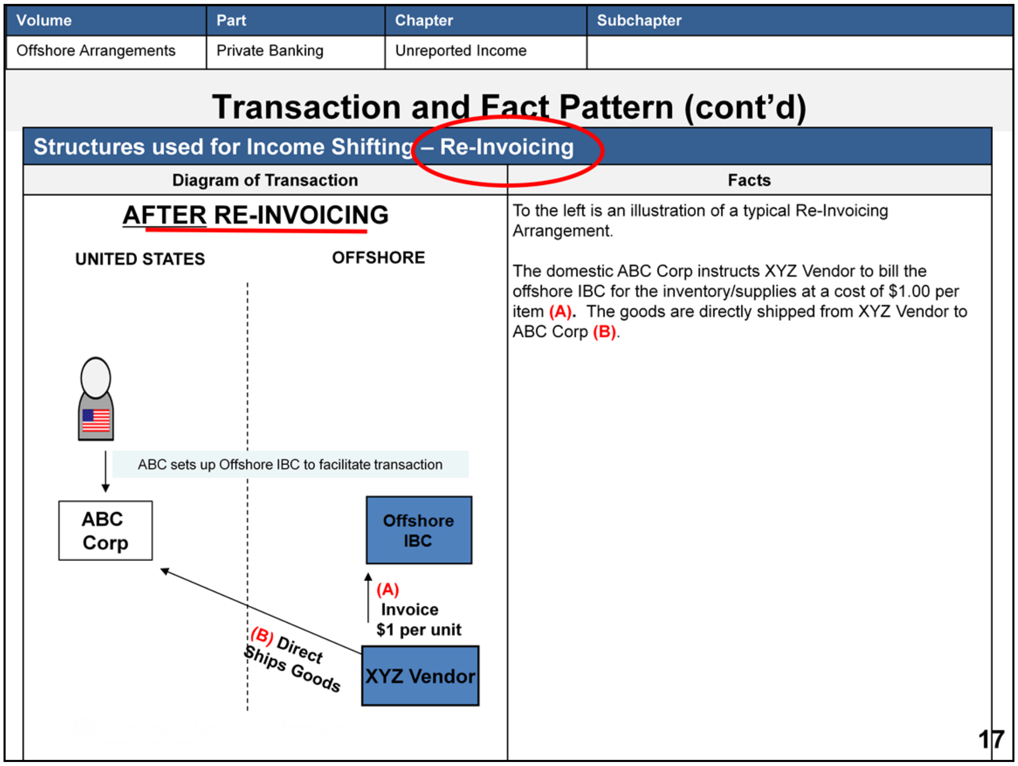
These slides depicts the actual illustrations that can be found in the IPS Unit on Re Invoicing.

You will notice that the Letters in parentheses in red font in the left box will correspond to the letters in red font in the written description box on the right .

First lets look at the transaction before the Re-invoicing arrangement is put in place.

OK. We have a US taxpayer with a US business called ABC. ABC buys their inventory from a foreign vendor XYZ who ships the product directly to ABC. ABC pays $1 for the goods and sell them to their customer for $3 dollars resulting in a Gross profit of $2.

Pretty simple. Now let's add the offshore abusive arrangement.



The first thing that happens is the Domestic Corp ABC sets up an Offshore IBC. The IBC's only purpose is to facilitate moving the money offshore

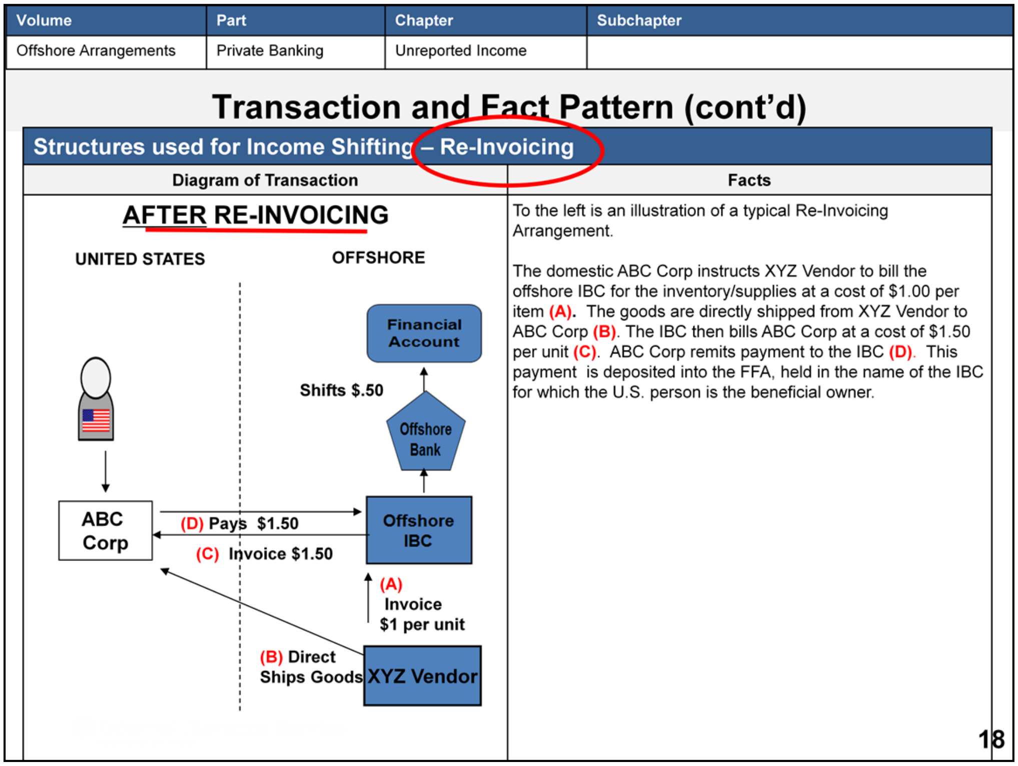
In a typical Re-Invoicing Arrangement, an taxpayer with a domestic entity will enter into an arrangement, with an unrelated Third-Party Vendor to invoice the taxpayers newly created IBC for the purchase of inventory/supplies rather than bill the individual's domestic U.S. Business. This arrangement can either be oral or written, but from my experience it is usually oral so there is no paper trail.

Once the arrangement is in place lets look at how it works step by step.

Step (A) the domestic corporation places an order with the foreign vendor XYZ for which XYZ will issue the invoice to the IBC for $1 per unit.

However, In step (B) the goods will still be shipped directly to the domestic ABC.

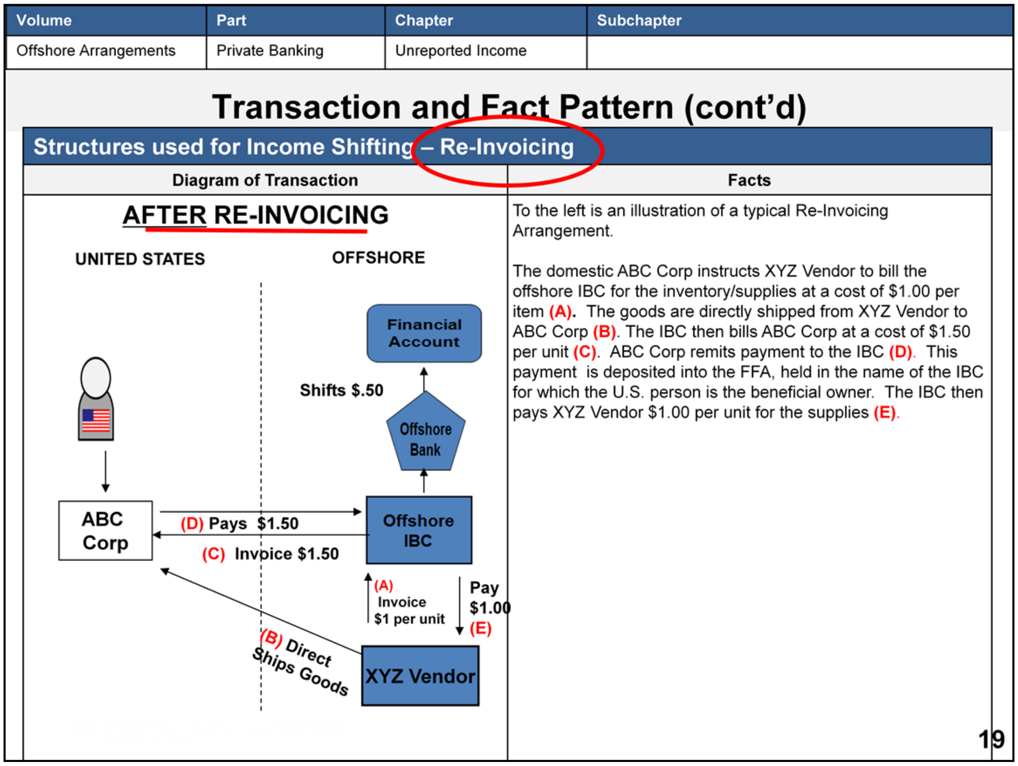
In other words, ABC tells XYZ to ship the goods to ABC but bill the new IBC. Essentially, ABC has the goods but hasn't paid anything for them.



The new offshore IBC is going to bill the related domestic ABC for an inflated $1.50 (C), not the $1 charged by XYZ, the true cost.

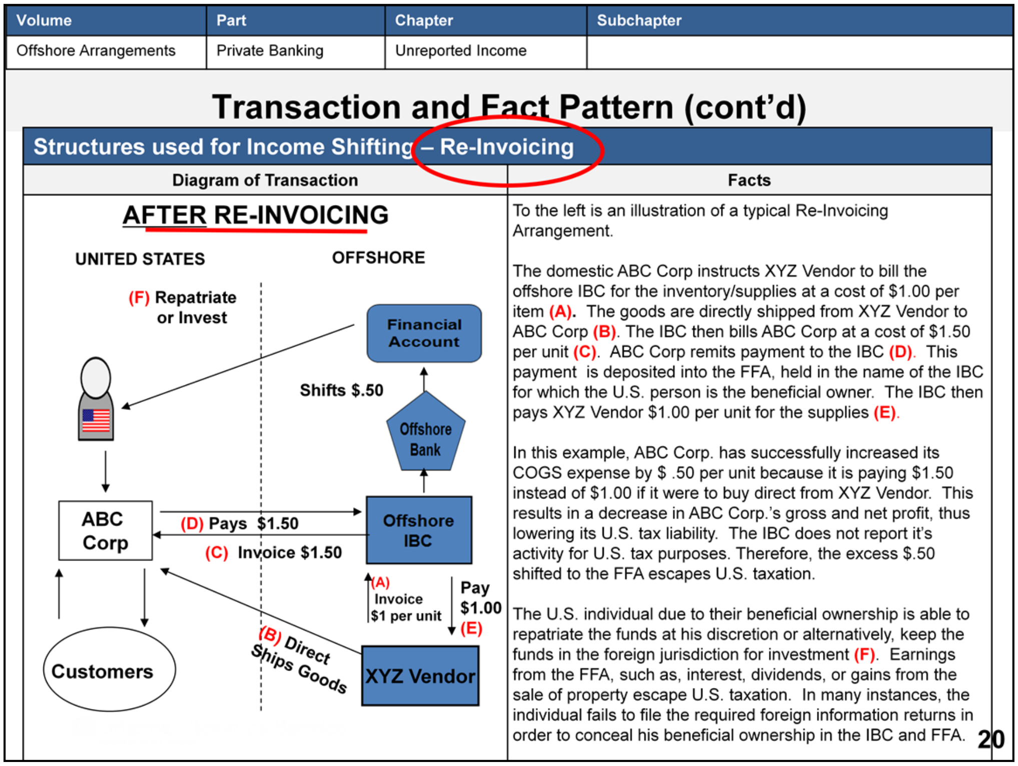
ABC will pay the invoice issued by the IBC. The $1.50 will be deposited in the Foreign Financial Account (D), which is held in the name of the IBC.

ABC will also take a cost of goods sold deduction on their US tax return for $1.50



Now the IBC has the funds to pay the foreign vendor the $1 for the goods that were sent to ABC (E).

So not only has ABC inflated its cost of goods sold by $.50, they have also effectively moved $.50 into the offshore bank account.



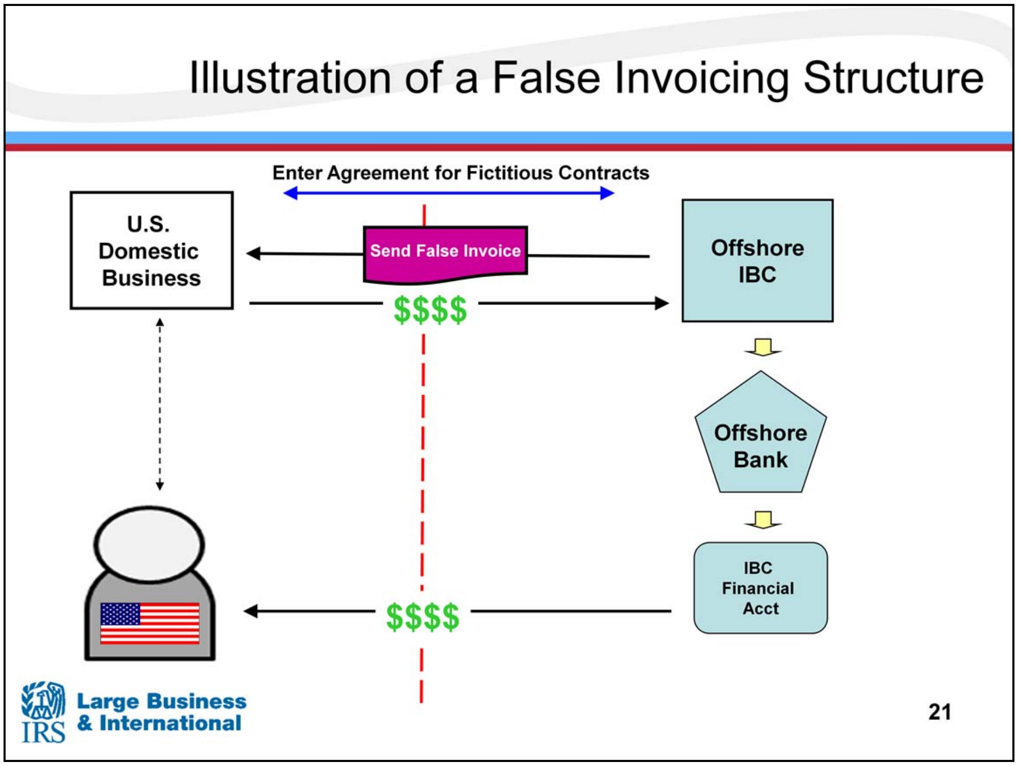
In this example, ABC Corp. has successfully increased its COGS expense by $ .50 per unit because it is paying $1.50 instead of $1.00 if it were to buy direct from XYZ Vendor. This results in a decrease in ABC Corp.'s gross and net profit, thus lowering its U.S. tax liability. The IBC does not report it's activity for U.S. tax purposes. Therefore, the excess $.50 shifted to the FFA escapes U.S. taxation.

Because the U.S. individual is the true or beneficial owner of the assets moved offshore, they are able to repatriate the funds when needed. In some cases we have even seen, the taxpayer move the funds to another offshore bank account when the funds reaches a certain threshold, maybe when the balance hits $50,000 or transfer the assets on a periodic basis, for example each quarter they will make a sweep.

There may be earnings generated on the offshore bank account, such as, interest, dividends, or gains from the sale of property also escape U.S. taxation.

These accounts may be handed down from generation to generation avoiding estate and gift taxes.

Finally, in many instances, the individual fails to file the required foreign information returns in order to conceal his beneficial ownership in the IBC and FFA.



Similar to a Re-Invoicing structure, we have a variation called False Invoicing. This arrangement is a little simpler but what we want to emphasize…is that there can be many slight variations of how a basic offshore structure is actually implemented. Every promoters sells a slightly different product. Maybe they inflate deductions, have kickback or just flat out fabricate expenses. Sometimes they have one or multiple IBCs or foreign trust or a combination there of.

So here is a False Invoicing Arrangement. In essence it is a fake or fabricated expense.

Again an individual with a domestic business of some type forms an offshore IBC. It is set up to appear as an arms length transaction between a foreign entity that is completely unrelated to the individual and their domestic business The US business enters into a fictitious contract to purchase goods or services from the IBC. Then, the IBC sends a false invoice to the U.S. Business for goods never to be delivered or for services never to be performed. The U.S. Business pays the false invoice and deducts such an amount as an expense on its U.S. income tax return.

Then the IBC puts the proceeds from the false invoice into an FFA held with an offshore bank.

Again, the individual may decide to invest the funds in the FFA, where the earnings escape US taxation or the US TP can repatriate the money when needed.

I actually worked a case that was similar to the two example we just presented. I am going to tell you about it because I want to emphasize how these arrangements can slight nuances. My TP had a domestic business that purchased goods from China. The domestic business probably had 20-30 vendors, but the 5 largest vendors had an oral agreement with the taxpayer. This arrangement was only known to the Owner of the company, and his successor President and the vendors. Per the agreement, what would happen is the domestic entity would place the order and foreign vendor would automatically increase the purchase order by 5%. The invoice would also be prepared for the inflated amount. The records received by both the purchasing and Accounts payable department reconciled. The controller was shocked when he during the examination when he found out what was going on, he had been employed by the company for 30 years.. This scheme even went undetected for years from Big 4 accounting firm that was certifying their financial statements.

Getting back to the scheme, so the domestic entity would pay the inflated invoice. The vendor would keep their share for the actual cost of the goods shipped and send the inflated 5% to an offshore bank account held in the name of the IBC. At the end of each quarter, the IBC had hired a management company that would sweep the funds 90% to another offshore account in a different country, and 10% to an account the President had in a third foreign country. Both the Owner and the president managed their offshore funds differently. The Owner had created a foreign trust that he would visit once a year. He did make several withdrawals when needed. The president had a much smaller account and when on vacation each year to check on his assets.

The leads for this case were provided by a whistleblower. Without that information, this oral arrangement could have gone on indefinitely without detection. We'll give you more about the case throughout these training sessions.

Unreported Income

- Unreported U.S. Source Income
  - Diverted Income from Domestic Sources
  - Inflated Deductions from Domestic Sources
- Unreported Foreign Source Income
  - Interest, Dividends, Rental, Gross Receipts from Business Activity Outside of U.S. Controlled Foreign Corporations
  - Passive Foreign Investment Companies
  - Controlled Foreign Partnerships
  - Foreign Grantor Trusts
- Transfer Taxes (i.e. Estate & Gift)

IRS Large Business & International

22

As we mentioned in our opening, the primary issue for OA is unreported income.

Once we have determined the beneficial owner, we are going to attribute the income to them. They are US persons taxed on worldwide income.

Remember in the Re-Invoicing example we showed how $.50 per unit was shifted offshore tax free and COGS was inflated on the domestic business entity.

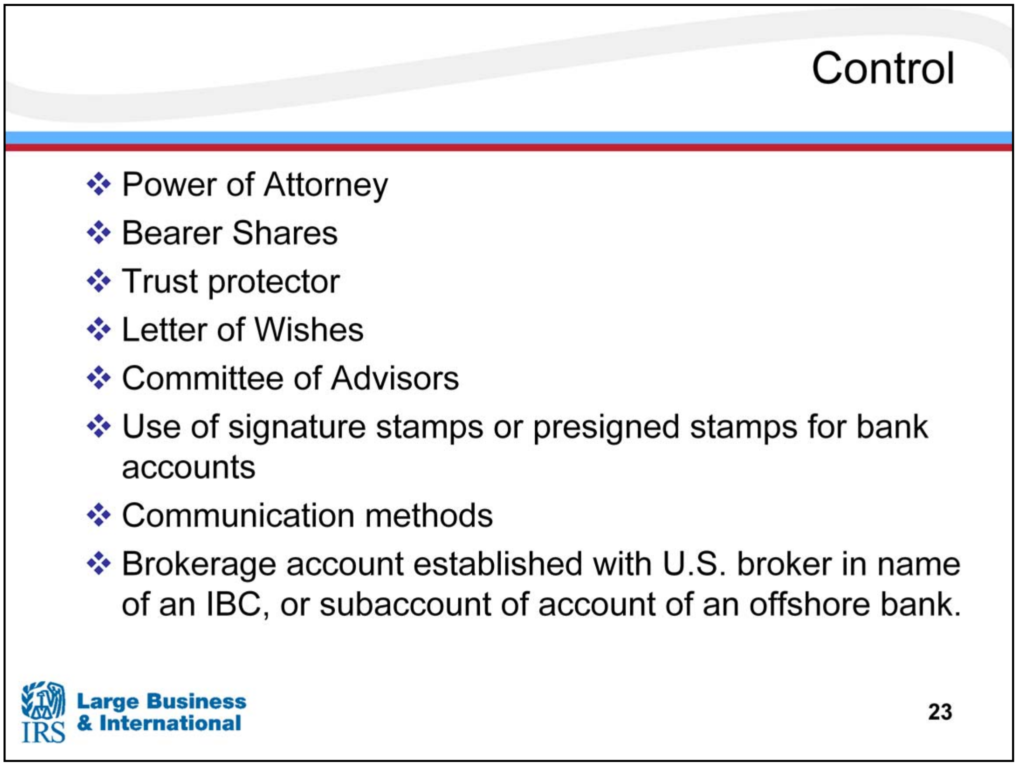
Then, we have the foreign earning on the offshore assets, possibly interest, dividends, cap gains which could be impacted by the PFIC taxing regime.

There may also have receipts from business activities that are conducted outside of the US.

All of these types of income are now taxable to US person as the beneficial owner since US persons are taxed on worldwide income.

Again, OA is heavily dependent on related IPNs, especially, Foreign Entities IPN which can provide alternative positions for taxing the US person.

There is another component to consider. Many taxpayers who engage in these types of offshore arrangements are so wealthy that they do not need to repatriate the funds. The funds can sit offshore accumulating. The assets also are not reported on estate and gift returns and are passed down from generation to generation.



The offshore industry would not survive if beneficial owners were not assured of control. Would you put millions of dollars in an offshore account without having any way to claim it?

This slide shows some ways that TP is able to maintain control of their assets.
They authorize others to act on their behalf via POAs.
Bearer Shares are synonymous with beneficial ownership.
Trust documents usually appoint a Trust Protector has the ability to control the trustees acting on behalf of the Beneficial Owner
There are letter of wishes, which is a side document that accompanies the trust giving all the details of what the beneficial owner wants usually in the case of disbursing assets upon the Beneficial Owners death.
There can be committee of advisors
The TP may have signature stamps that can be used to access the funds, make payments for goods etc
•Communication methods are usually defined. They establish protocol for authenticating who is making the contact, authorization for requests and also may eliminate a paper trail. Some may include:
•Toll free phone numbers
• Fax
• Internet e-mail
• Encrypted messages
• Mail
• Stand alone and prepaid telephone cards
• Offshore mail box drops
• Offshore remailing services
• U.S. address mail drops (Mail Box Etc.)
• Answering services
• Through the taxpayer's U.S. accountants, attorneys or agents

(b)(3) 6103(a) [redacted]

Finally, we have Brokerage account established with U.S. broker in name of an IBC, or subaccount of account of an offshore bank
This is not an all inclusive list and some of the items, if not already, may be outdated by all the advancements with technology.

Repatriation

- ❖ Taxable vs. Non-Taxable
- ❖ Covert vs. Overt Repatriation
- ❖ How to identify if repatriation is occurring?
- ❖ Is repatriation required?

IRS Large Business & International

24

Once the money is moved offshore, in the overall plan, there will likely be an established way to have access to the funds if there is a need for it.

There are taxable and nontaxable ways to repatriate the funds..

Some of the taxable ways are Overt, such as, wages, consulting fees for "services" or gambling winnings , which are most likely fictitious; sale of nonexistent goods; sale of inflated prices

So basically, the TP would be reporting income that was not really earned. These taxpayers are not typically concerned with tax crimes, but may have another motive to conceal an illegal activity.

Nontaxable ways are either COVERT meaning hidden or OVERT. Some covert ways are:

- smuggling cash, gems or other precious assets and personal property;
- buying the asset in the name of the IBC for use in the United States, such as homes or yachts;
- direct payments from correspondent bank accounts for personal expenses, which could be college tuitions and everyday expenses,
- this is also similar to offshore debit and credit cards , where you can even make a cash withdrawal
- paypal
- false loans such as a mortgage

OVERT methods meaning they are out in the open include:

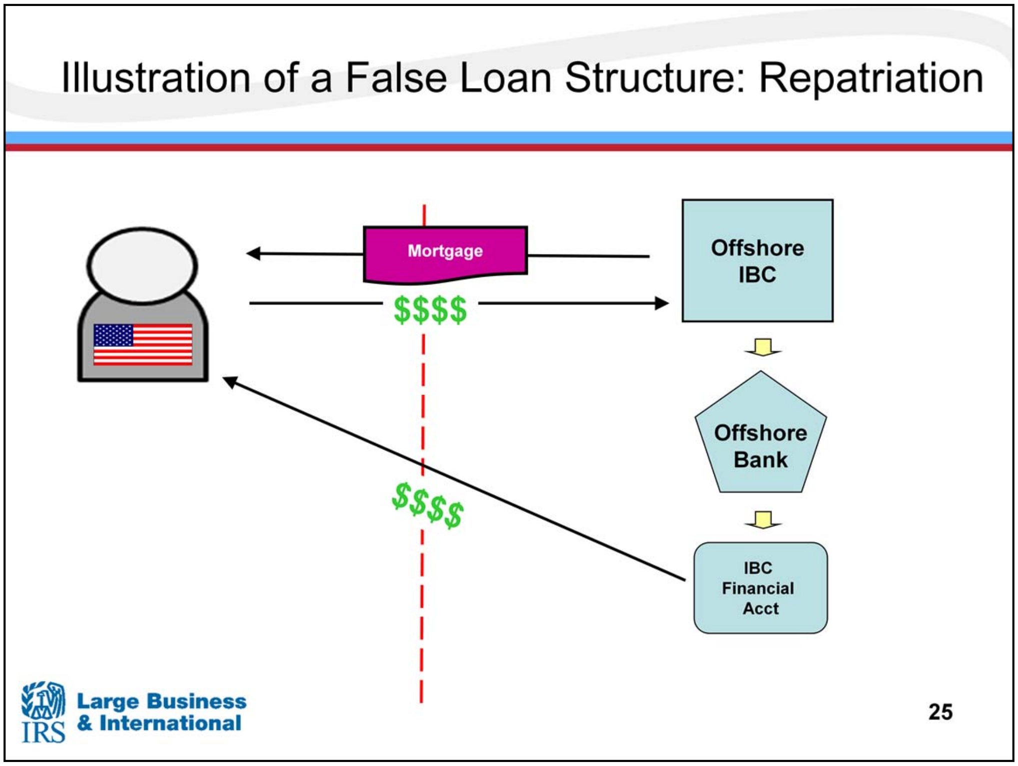
- Gifts and Scholarships
- and sometimes the bank accounts used in the arrangement are actually held in the name of the IBC but in a US domestic bank rather than an offshore bank.

Some tips on revealing these repatriation techniques include

- Look for gaps in taxpayer spending – do records indicate travel but there is no payment for airfare or hotels
- are some categories of expenses conspicuously absent meaning is there something you would expect to see that you are not, if they are not paying for their expenses like a car or home, how are they paying for it.
- And are there significant periods of time unaccounted for. Be suspicious of any loan with a foreign entity or person, why wouldn't you use a US lender, and are the terms and interest rates reasonable.
- (b) [redacted] STORY OF SALESMAN GETTING COMMISSIONs told the foreign company to hold on to the money and he would collect it ONCE A YEAR when he traveled to Europe. Then he would spend the money. Another hint was that his utility bills dropped for the month that he was traveling and there were no travel expenses being paid.

In many cases the TP have no need to repatriate because they have significant wealth available and do not need to tap into the funds held secretly offshore.

Transfer of funds offshore and the repatriation can occur over a number of years, it does not have to happen in the same year.



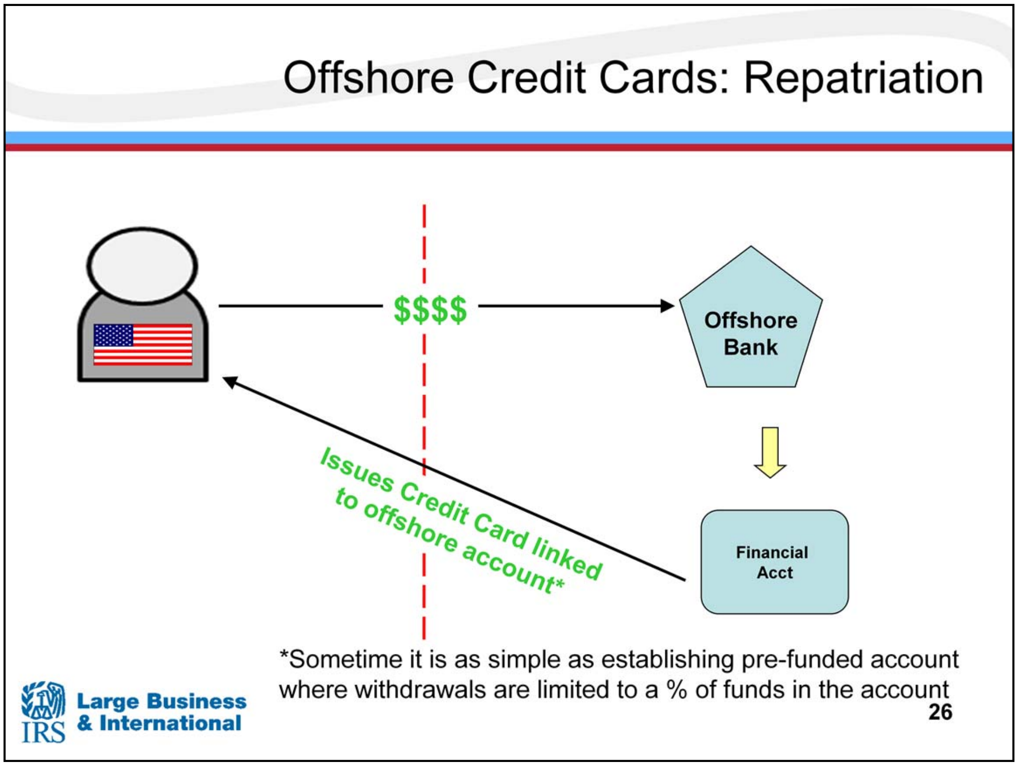
False loans is a combination of repatriating and also moving additional funds offshore.

In structure for false loans, the twist is the TP needs to have funds already transferred or diverted offshore.

Once they have funds offshore, the TP will enter into a loan agreement with their IBC, commonly a mortgage. The loan pays off the existing mortgage with an unrelated domestic lender. Now, each month the TP will make a mortgage payment to the IBC, which in essence is the taxpayer.

Quite often the money will be repatriated disguised as a legitimate transaction, such as a loan, including a mortgage secured by the US taxpayer's personal residence. As with other payments to foreign entities, this will accomplish a number of benefits for the TP: 1) enables the TP to repatriate funds previously transferred offshore; 2) enables TP to move additional funds offshore in form of interest and/or principal payments; and 3) reduces US taxable income in the form of an interest expense (ie mortgage interest) or as interest paid on a business loan.

So examiners need to scrutinize payments to foreign entities and loan agreements further.



Another common way to repatriate is through offshore credit cards.

TP applies for and open offshore credit card which is tied to an offshore financial account which they are already the beneficial owner of. They use the offshore credit card like any other card for purchases and atm cash withdrawals.

The offshore bank account is automatically debited for the charges incurred.

Some banks require a separate security account be maintained at the bank issuing the credit card. So the twist is that generally they must keep funds in the bank account in the amount of 150% of the amount they want to spend. They are not being extended credit by the credit card company. So it is really more like a prepaid credit card. They have to secure the credit limit with their own funds.

5 Minute Stretch Break

Foreign Information Forms & Penalties

- The I.R.C. requires filing foreign information returns related to ownership and control of foreign entities and assets.
- Common Information Returns related to Offshore Arrangements:
  - Form 3520 & 3520A - Foreign Trust Information Returns
  - Form 5471 & 5472 - Relationships with Foreign Corporations
  - Form 926 -Transferor of Property to a Foreign Corporation
  - Form 8865 - Relationships with Foreign Partnerships
  - Form 8938 – Statement of Specified Foreign Financial Assets
- Penalties for failure to file can be severe
  - Reasonable Cause Arguments
  - Congress intended the penalties to be severe because without self reporting detection is extremely difficult for the Service.

IRS Large Business & International

28

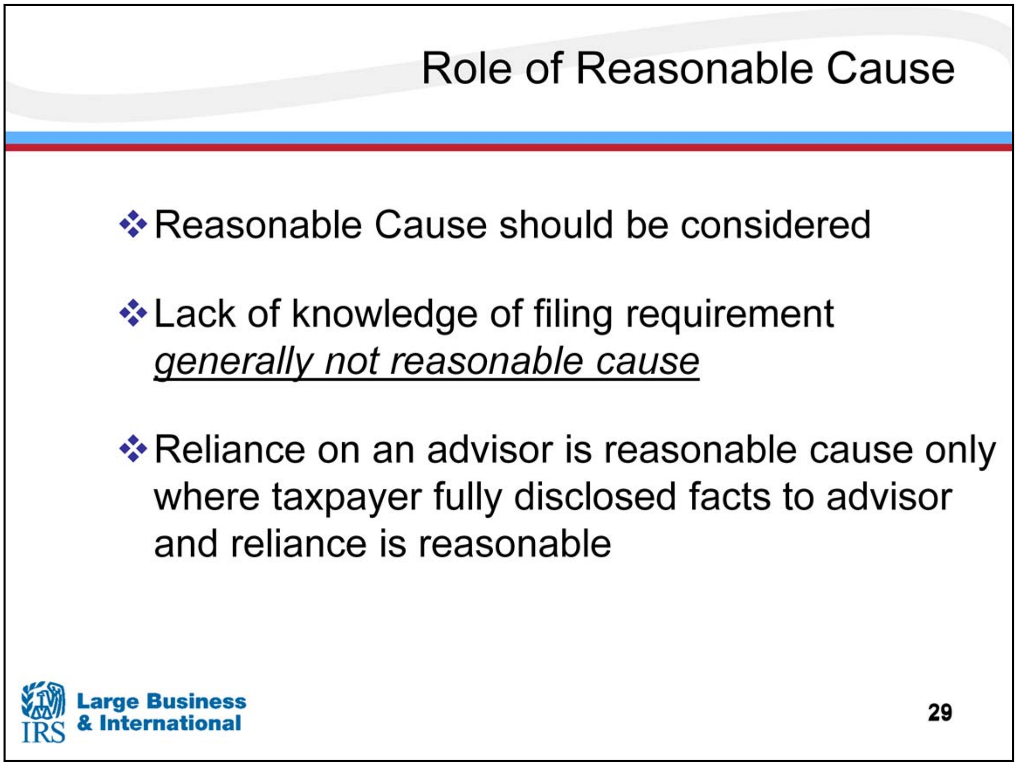
The Internal Revenue Code requires filing of foreign information returns by US persons with offshore transactions. The returns were typically related to a US person's ownership interest or transactions with foreign entities, like Controlled Foreign Corporations, Controlled Foreign Partnerships and Foreign Grantor trust. Recently FATCA expanded these requirements to include the new Form 8938 required for Foreign Financial assets which expands to reporting for bank and brokerage accounts under the Code.

The key purpose for these information returns is that the US person is required to reveal their ownership and control of various foreign assets which we wouldn't normally know of without this reporting requirement.

Congress intended for the penalties for failure to file to be severe.

> Taxpayer can provide Reasonable Cause Arguments to penalty assertions. It is important to develop the facts and circumstances of the case to understand whether reasonable cause exists.

There are several separate training sessions and IPS units developed to discuss some of the requirement for filing these forms plus the application of these penalties in detail.



The IRS always bears the "burden of production" on penalties. The IRS must show it is appropriate to impose the penalty.

IRC § 7491(c)

Higbee v. Commissioner, 116 T.C. 438, 446 (2001).

In context of an FBAR penalty, government must establish by a preponderance of the evidence. US v. Williams, No. 1:09-cv-437, 2010WL 347331 (ED VA Sept 1, 2010) rev'd other grounds, 489 Fed. Appx. 655(4th Cir. 2012).

Once the IRS shows the penalty is appropriate, it will apply unless the taxpayer shows reasonable cause.

United States v. Boyle, 469 U.S. 241 (1985).

To avoid penalty, taxpayer must show he acted with "reasonable cause" and in "good faith."

I.R.C. § 6664(c)(1).

"Reasonable cause" requires the taxpayer to exercise ordinary business care and prudence to the disputed item.

"Good faith" has no precise definition but means an honest belief and intent to perform all lawful obligations.

For fraud or criminal willfulness we use a subjective test-- "what was in this taxpayer's mind?"

But for reasonable cause we use an objective test—"what should a normal person have known/done?" We ask, "Did this taxpayer act like an ordinary, reasonable, prudent person?"

Reasonable cause is established on a case-by-case basis.

Review all pertinent facts and circumstances.

Review the taxpayer’s knowledge and experience.

Consider if there is an honest mistake of fact or law.

Consider the taxpayer’s efforts to assess the proper liability.

One way a taxpayer can establish reasonable cause is to show reliance on the advice of an independent professional such as a tax advisor, lawyer, accountant or the IRS.

The advice can be written or oral. However, oral advice from the IRS does not guarantee penalty relief. See IRM 20.1.1.3.3.4.2.

There are distinct, objective showings that the taxpayer must establish.

The taxpayer must first show that “advice” on the disputed item was given.

Advice must be based on all pertinent facts and circumstances and the law as it relates to those facts and circumstances. Treas. Reg. § 1.6664-4(c)(i)

Advice may not be based on unreasonable factual and legal assumptions or unreasonably rely on facts supplied by third parties. Treas. Reg. § 1.6664-4(c)(ii)

Advice is any communication “setting forth the analysis or conclusion” of the advisor upon which the taxpayer relies with respect to the I.R.C. § 6662 penalty. Treas. Reg. § 1.664-4(c)(2)

(The regulation sets forth additional criteria for tax shelters and section 482 cases.)

Leaving an item off a return without any analysis is not “advice” of the preparer.

Woodsum v. Commissioner, 136 T.C. 585 (2011).

Preparing a tax return is not by itself evidence that a CPA opined on any or all of the line items.

Neonatology Associates, P.A. v. Commissioner, 115 T.C. 43, 100 (2000).

Not preparing a return can be implied advice that nothing is required if the taxpayer provided all critical facts to an expert and asked him to prepare whatever forms are required.

Hatfried v. Commissioner, 162 F.2d 628 (3rd Cir. (1947).

But if you know a return is required you can’t just hand your information to a professional and rely on him to file on time.

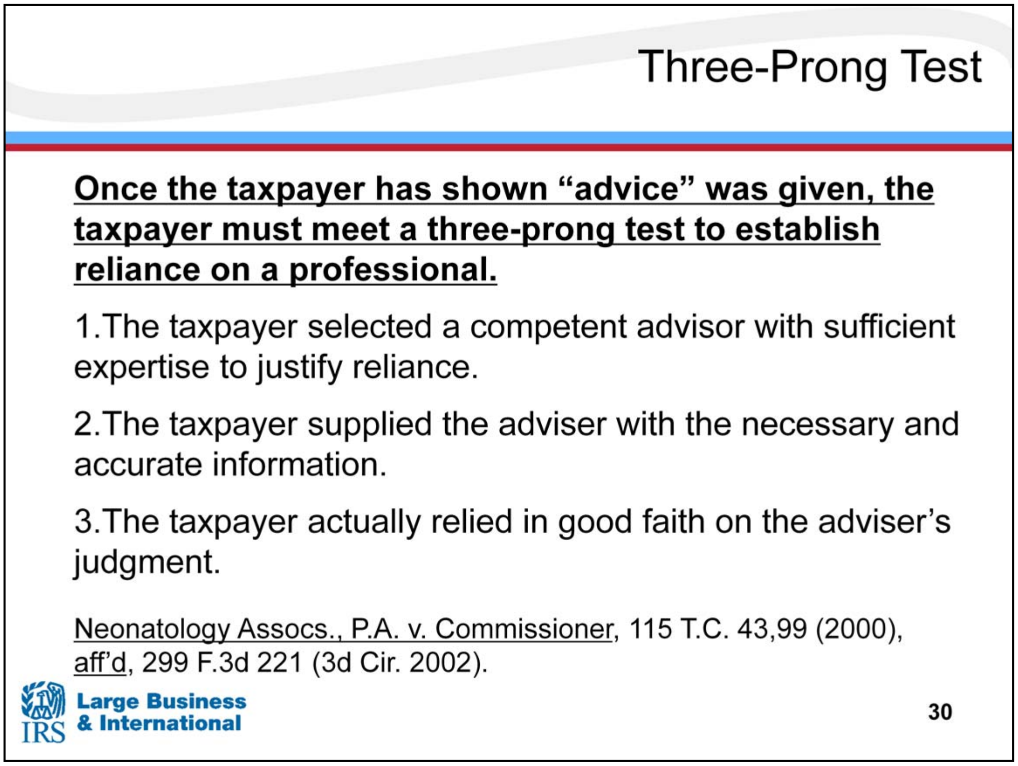
United States v. Boyle, 469 U.S. 241, 246 (1985).

In offshore cases:

“The banker didn’t tell me” – this is not advice.

Interview the taxpayer’s professional—it is unlikely s/he advised that the money earned and/or held offshore was not taxable.

If the taxpayer did not receive “advice” there is no reasonable cause.



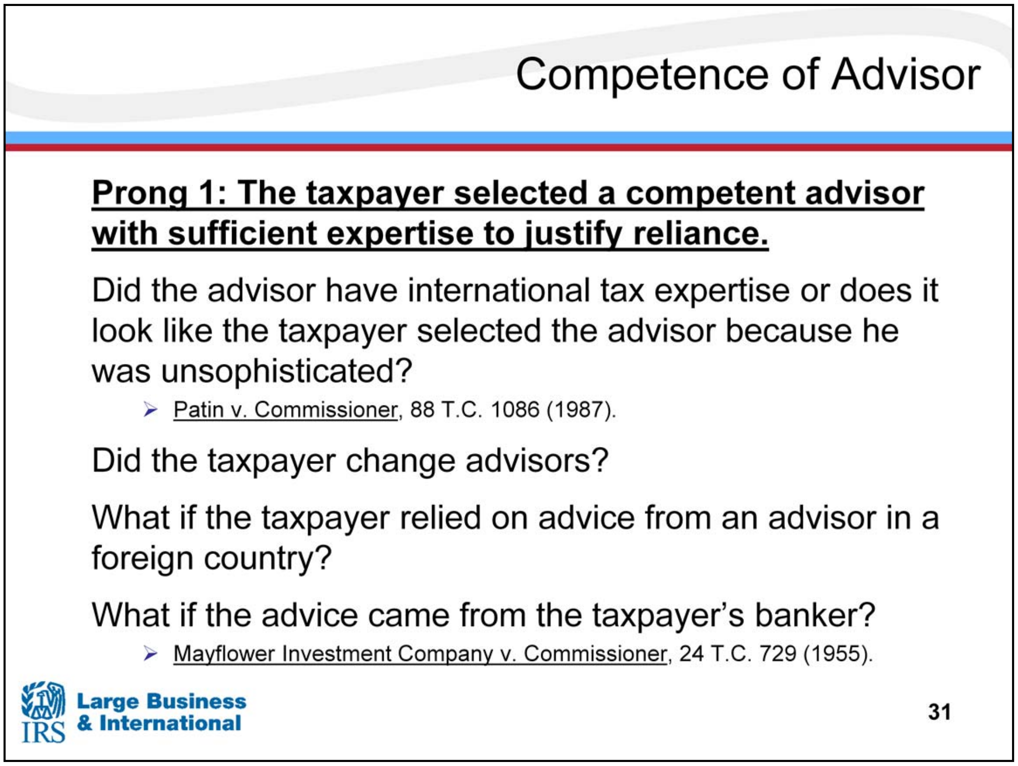
<u>Once the taxpayer has shown “advice” was given, the taxpayer must meet a three-prong test to establish reliance on a professional.</u>

The taxpayer selected a competent advisor with sufficient expertise to justify reliance.

The taxpayer supplied the adviser with the necessary and accurate information.

The taxpayer actually relied in good faith on the adviser’s judgment.

<u>Neonatology Assocs., P.A. v. Commissioner</u>, 115 T.C. 43,99 (2000), <u>aff’d</u>, 299 F.3d 221 (3d Cir. 2002).



<u>Prong 1: The taxpayer selected a competent advisor with sufficient expertise to justify reliance.</u>

Did the advisor have international tax expertise or does it look like the taxpayer selected the advisor because he was unsophisticated?

<u>Patin v. Commissioner</u>, 88 T.C. 1086 (1987).

Did the taxpayer change advisors?

What if the taxpayer relied on advice from an advisor in a foreign country?

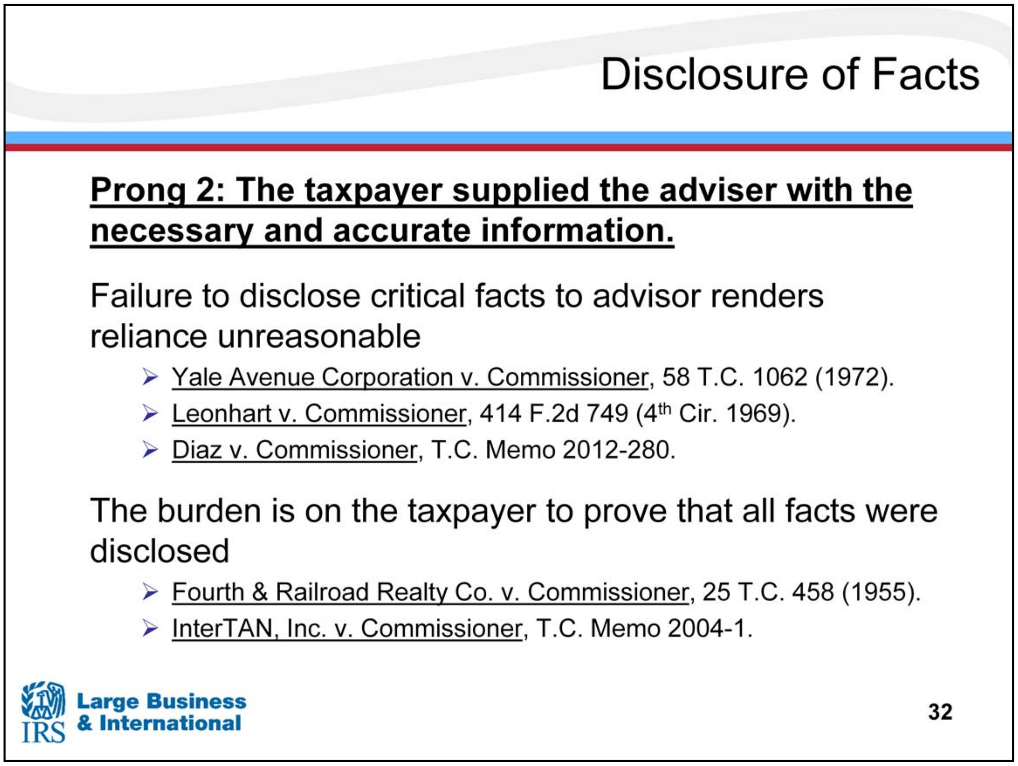
What if the advice came from the taxpayer's banker?

<u>Mayflower Investment Company v. Commissioner</u>, 24 T.C. 729 (1955).

<u>In offshore cases</u>:

The taxpayers are typically wealthy. It may be unreasonable for them to fail to seek competent tax advice.

Look carefully at the quality and the source of the advice upon which the taxpayer is "relying."



<u>Prong 2: The taxpayer supplied the adviser with the necessary and accurate information.</u>

Failure to disclose critical facts to advisor renders reliance unreasonable

- <u>Yale Avenue Corporation v. Commissioner</u>, 58 T.C. 1062 (1972).
- <u>Leonhart v. Commissioner</u>, 414 F.2d 749 (4th Cir. 1969).
- <u>Diaz v. Commissioner</u>, T.C. Memo 2012-280.

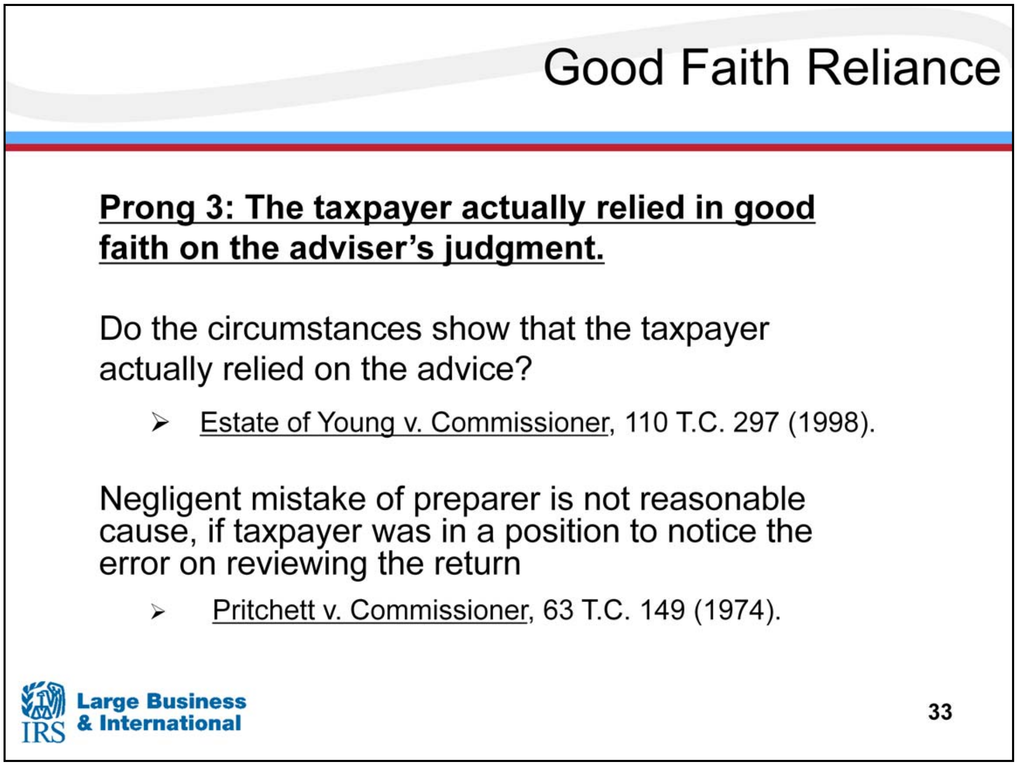
The burden is on the taxpayer to prove that all facts were disclosed

- <u>Fourth & Railroad Realty Co. v. Commissioner</u>, 25 T.C. 458 (1955).
- <u>InterTAN, Inc. v. Commissioner</u>, T.C. Memo 2004-1.

<u>In offshore cases</u>:

Taxpayers often do not disclose their offshore activities to their return preparer. Interview the return preparer carefully. Ask for the “tax planner” or “tax organizer” completed by the taxpayer.

Taxpayers may state that a foreign professional told them the money was not taxable until it was repatriated to the U.S. What did they tell/ask their U.S. tax return preparer? What documents did they disclose to the preparer? Was it reasonable for them to rely upon a foreign professional? Did they consult domestic professionals? If not, why not?



Prong 3: The taxpayer actually relied in good faith on the adviser's judgment.

Do the circumstances show that the taxpayer actually relied on the advice?

Estate of Young v. Commissioner, 110 T.C. 297 (1998).

Negligent mistake of preparer is not reasonable cause, if taxpayer was in a position to notice the error on reviewing the return

Pritchett v. Commissioner, 63 T.C. 149 (1974).

In offshore cases:

The Regulations state that a taxpayer cannot rely upon advice or an assumption the taxpayer knows—or has reason to know—is unlikely to be true.

Treas. Reg. § 1.6664-4(c)(ii)

A taxpayer who flies to a foreign tax haven, meets with private bankers, sets up secret accounts and structures, establishes code words, asks for statements not to be sent to the U.S., and fails to report this offshore income will generally not meet this standard!

Woods v. United States, 794 F. Supp. 2d 714 (W.D. Texas, 2011).

"Although Plaintiff Woods may not have qualified as a "tax specialist," he was a far cry from a man who had just fallen off a turnip truck. His wealth of knowledge and experience should have alerted him to the fact that the COBRA scheme was simply 'too good to be true.'"

Regs. 1.6664-4(c): "taxpayer's education, sophistication, and business experience will be relevant in determining whether taxpayer's reliance on tax advice was reasonable and made in good faith."

Was opinion received before position claimed on tax return?

Was opinion reviewed and considered?

How much detail was included?

Was the advisor independent?

What is the taxpayer's level of education, business knowledge, and familiarity with tax?

<u>Ignorance of a filing requirement is not reasonable cause unless the taxpayer made inquiry of a knowledgeable expert and was misinformed.</u>

The following is a case that involved Filing Requirement

Taxpayer set up a Nevis Trust. His preparer prepared and filed Forms 3520-A in each year.

However, the Forms 3520 reporting contributions into the trust were not filed.

Section 6677(d) provides that no penalty shall be imposed if the failure to file was "due to reasonable cause and not willful neglect."

The taxpayer claimed he was not liable for the penalty due to reasonable cause because his preparer failed to advise him of the Form 3520 filing requirement.

The Court denied the government's Motion for Summary Judgment on Reasonable Cause and the case went to a trial.

The Court instructed the jury that:

> ignorance of the law is not reasonable cause unless TP made reasonable inquiry or could not reasonably be expected to know of requirement; and
>
> willful neglect includes reckless indifference

The jury held for the government, finding the taxpayer's failure to file the Forms 3520 were based on his willful neglect.

Another case which discusses reliance is **<u>U.S. v. McBride</u>, 2012 U.S. Dist. LEXIS 161206 (D. Utah 2012).**

McBride could not rely on the advice of the person who designed his "Master Financial Plan" and who told him the structure legally eliminated the need to report on his taxes because,

> Promoter had an inherent conflict of interest
>
> No showing the promoter had any legal expertise

McBride could not rely on his tax return preparer because he never told the preparer he had a foreign account.

McBride could not rely on the failure of another advisor to give him correct advice because he had independent knowledge his tax scheme was risky.

McBride's failure to affirmatively seek legal advice on a matter known to be risky was reckless.

<u>The questions to ask of the taxpayer and advisor should focus on the requirements of the</u>

<u>defense:</u>

Advice: What was the advice given?

Advisor: Who was the advisor?

> a tax advisor, lawyer, banker, promoter or return preparer?
>
> How did taxpayer find the advisor, why, and when?

Disclosure: Facts provided by taxpayer to the advisor

> What did the taxpayer tell the advisor? Develop fully, particularly with respect to any offshore structures and accounts.
>
> What did the advisor tell the taxpayer? Get details of the advice.
>
> Get copies of all written advice.
>
> Secure accountant/advisor workpapers
>
> Obtain the tax planner completed by the taxpayer

Reliance: Was the alleged "reliance" reasonable?

TP gives preparer complete information, including bank statements for his foreign account. TP tells the return preparer "prepare whatever I have to file." Preparer reports the foreign interest but checks "No" box and prepares no FBAR.

> <u>Boyle</u> delegation or implied advice?
>
> What additional information would you want?
>
> > About the taxpayer?
> >
> > About the return preparer?

Suppose preparer knows TP is a wealthy immigrant but fails to ask about foreign accounts?

What if the advisor tells the taxpayer he is a new employee with no foreign experience?

What if the advisor is the taxpayer's brother-in-law?

What if the taxpayer is an attorney?

What if the advisor said he wasn't "positive" but was "pretty sure" an FBAR wasn't required?

What if the taxpayer has $10M in the account and goes to H&R Block?

What if taxpayer has filed FBARs in the past and says nothing?

What if the taxpayer has a high school education and inherited the account from his grandmother?

What if the accountant does not report the income on the account and the taxpayer knows "it is too good to be true?"

Offshore Voluntary Disclosure Programs

- Voluntary Disclosure Programs
  - 2012 OVDP (open-ended)
  - 2011 OVDI (closed 9/9/2011)
  - 2009 OVDP (closed 10/15/2009)
- Overview of the Offshore Voluntary Disclosure Program
  - Objective
  - Penalty Structure
  - Future Compliance

IRS Large Business & International

34

The IRS began an open-ended offshore voluntary disclosure program (OVDP) in January 2012 on the heels of strong interest in the 2011 and 2009 programs. The IRS may end the 2012 program at any time in the future. The IRS is offering people with undisclosed income from offshore accounts another opportunity to get current with their tax returns. The 2012 OVDP has a higher penalty rate than the previous program but offers clear benefits to encourage taxpayers to disclose foreign accounts now rather than risk detection by the IRS and possible criminal prosecution.

The 2009 OVDP demonstrated the value of a uniform penalty structure for taxpayers who came forward voluntarily and reported their previously undisclosed foreign accounts and assets. Not only did the initiative offer consistency and predictability to taxpayers in determining the amount of tax and penalties they faced, it also enabled the IRS to centralize the civil processing of offshore voluntary disclosures.

Therefore, it was determined that a similar initiatives should be available to the large number of taxpayers with offshore accounts and assets who applied to IRS Criminal Investigation's traditional voluntary disclosure practice since the October 15, 2009 deadline.

The objective of the Offshore Voluntary Disclosure Programs were to bring taxpayers that used undisclosed foreign accounts and undisclosed foreign entities to avoid or evade tax into compliance with United States tax laws. Taxpayers with undisclosed foreign accounts or entities voluntarily disclosed this information to become compliant, avoid substantial civil penalties, and generally eliminate the risk of criminal prosecution.

Taxpayers who participate in the OVDI must agree to:

File or amend all applicable returns, including information returns and FBARs;

Pay all taxes and interest due for tax years within a six year look-back period for the 2009 OVDP and 8 year look-back period for 2011 and 2012 Programs;

Pay the accuracy-related or delinquency penalty for years in the look-back period, and

Pay, in lieu of other penalties, including FBAR and information return penalties, a penalty equal to 20% of the highest aggregate balance or value in undisclosed foreign accounts or entities in the year of the look-back period for 2009 OVDP, 25% penalty for 2011 OVDI and 27.5% penalty for 2012 OVDP. Note - Under very limited circumstances a taxpayer may qualify for a reduced offshore penalty.

FATCA

EFFECTIVE March 18, 2010 – IRC § 6038D

- U.S. citizens, U.S. resident aliens, and a very limited number of nonresident individuals who own certain foreign financial accounts or other offshore assets (specified foreign financial assets) must report those assets to I.R.S.
- Use Form 8938 to report these assets
  - Attach Form 8938 to the annual income tax return (usually Form 1040)
- Taxpayers with a total value of specified foreign financial assets below a certain threshold do not have to file Form 8938
  - If the total value for an unmarried taxpayer is at or below $50,000 at the end of the tax year, there is no reporting requirement for the year, unless the total value was more than $75,000 at any time during the tax year
  - The threshold is higher for individuals who live outside the United States
  - Thresholds are different for married and single taxpayers

Large Business & International

35

How does FATCA impact U.S. individual taxpayers?

U.S. individual taxpayers must report information about certain foreign financial accounts and offshore assets on Form 8938 and attach it to their income tax return, if the total asset value exceeds the appropriate reporting threshold. The link for specified foreign financial assets takes you to irs.gov which provides a lengthy definition of specified foreign financial assets.

Form 8938 reporting is in addition to FBAR reporting. New filing requirement under title 26 starting in 2011.

Reporting thresholds vary based on whether you file a joint income tax return or live abroad. If you are single or file separately from your spouse, you must submit a Form 8938 if you have more than $200,000 of specified foreign financial assets at the end of the year and you live abroad; or more than $50,000, if you live in the United States. If you file jointly with your spouse, these thresholds double. You are considered to live abroad if you are a U.S. citizen whose tax home is in a foreign country and you have been present in a foreign country or countries for at least 330 days out of a consecutive 12-month period.

Taxpayers who do not have to file an income tax return for the tax year do not have to file Form 8938, regardless of the value of their specified foreign financial assets.

FATCA (cont'd)

- No filing requirement if no tax return required.
- Penalties apply for failure to file.
- The reporting requirement for ***Form 8938*** is separate from the reporting requirement for the FinCEN ***Form 114***, "FBAR" (formerly TD F 90-22.1).

Handout: Comparison of Form 8938 and FBAR Requirements

Large Business & International

36

Taxpayers who do not have to file an income tax return for the tax year do not have to file Form 8938, regardless of the value of their specified foreign financial assets.

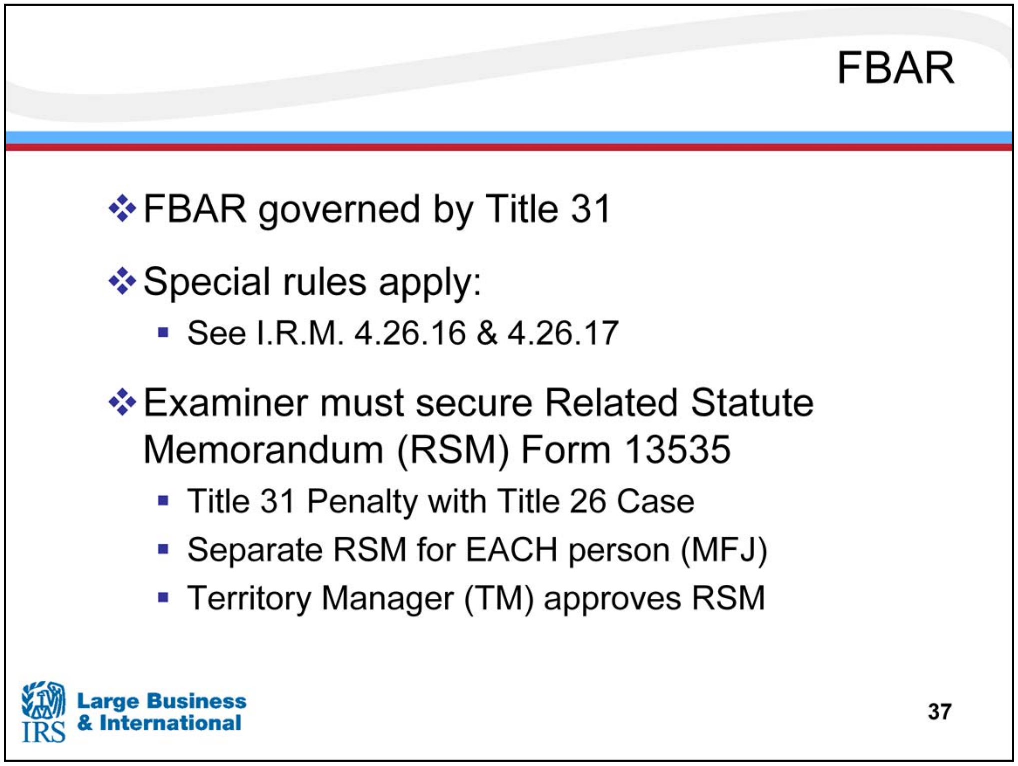
Non-Compliance with Form 8938 Reporting Requirements

The taxpayer must file Form 8938 and if they do not do so, they may be subject to penalties: a $10,000 failure to file penalty, an additional penalty of up to $50,000 for continued failure to file after IRS notification, and a 40 percent penalty on an understatement of tax attributable to non-disclosed assets.

If they make a showing that any failure to disclose is due to reasonable cause and not due to willful neglect, no penalty will be imposed for failure to file Form 8938, however. Reasonable cause is determined on a case-by-case basis, considering all relevant facts and circumstances.

The reporting requirement for ***Form 8938*** is separate from the reporting requirement for the FinCEN ***Form 114***, Report of Foreign Bank and Financial Accounts ("FBAR") (formerly TD F 90-22.1). An individual may have to file both forms and separate penalties may apply for failure to file each form.

Comparison of Form 8938 and FBAR Requirements This last bullet is a link to this web page on irs.gov. It is also included as a handout.



Now lets take a look at how FBARs impact case development.

FBARs are governed by Title 31, not Title 26.

Special rules apply to FBARs and can be found in IRM 4.26.16 and 4.26.17.

An RSM is required before we can ask any questions regarding the FBAR (including IDR)

<u>Basics</u>

There is an FBAR penalty

Schedule B – two questions – about whether taxpayer has a foreign account or foreign trust

FBAR form must be filed in connection with this account

<u>Penalty Structure 31 USC 5321</u>

<u>Negligent</u> (4.26.7.3.1) or Willfulness (4.26.7.3.2)

<u>Willfulness</u> involves the intentional, voluntary violation of a known legal duty. Gov't in civil context has a clear and convincing standard. Criminal is BRD.

4.26.7.4.3 Two factors in establishing willfulness are:

Knowledge of the law (education, on notice of filing requirement, filed other FBARs)

Knowledge of the facts (facts that show TP failure to record, report)

Willful violations occurring <u>*prior*</u> to October 23, 2004, a penalty not to exceed the greater of

An amount equal to the balance of the account at the time of the violation (not to exceed $100,000) OR $25,000.

Willful violations occurring <u>*after*</u> October 22, 2004, the maximum penalty is increased to the greater of

• $100,000, OR

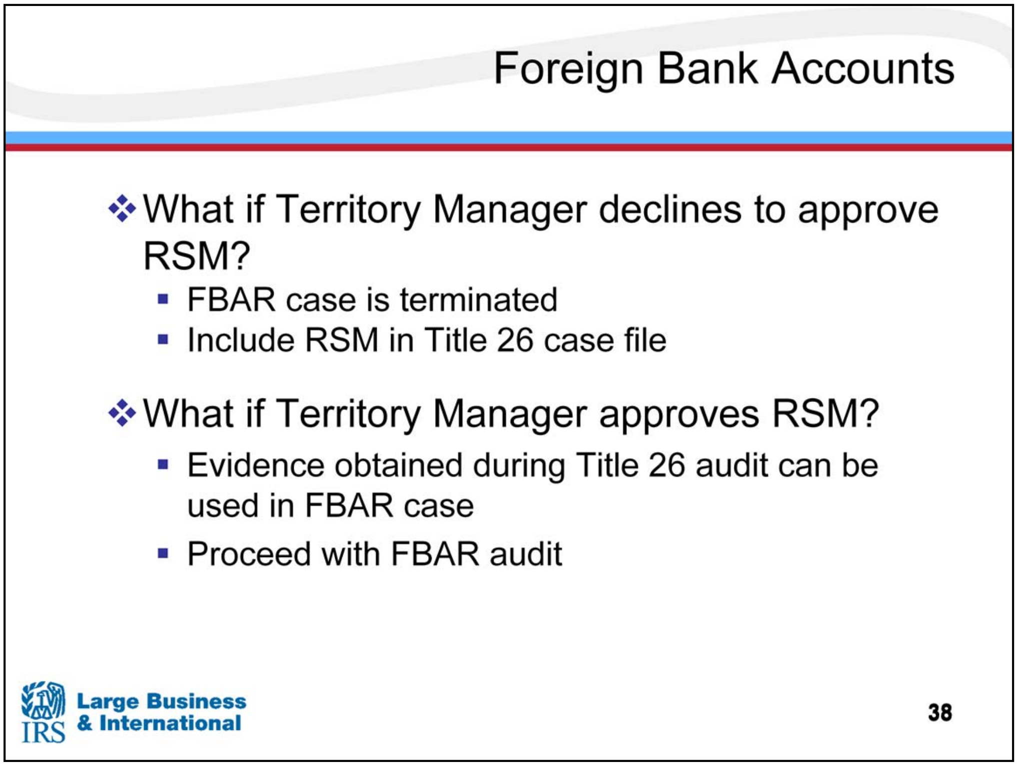
• 50 percent of the amount equal to the balance of the account at the time

<u>United States v. Williams</u>, Civil Action No.: l:09-cv-437 (E.D. Virginia)

Recent opinion

Facts of this case were very unique – the opinion seems to be limited to the specific facts of the case.

Practitioners or taxpayers should not take comfort in this opinion where there is a pattern of nonfiling or selective filing of FBARs, reporting foreign bank accounts.

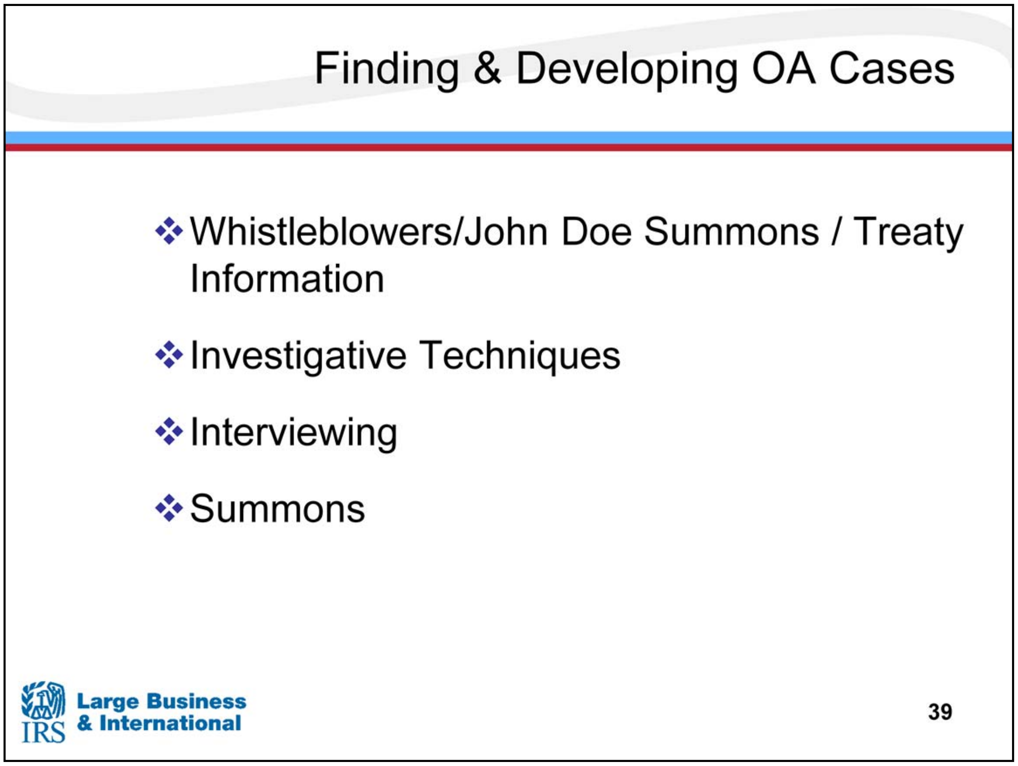


What if Territory Manager declines to approve RSM?

- FBAR case is terminated
- Include RSM in Title 26 case file

What if Territory Manager approves RSM?

- Evidence obtained during Title 26 audit can be used in FBAR case
- Proceed with FBAR audit



We have been fortunate to have several Whistleblowers, JDS Treaty cases that gives us leads and background information on the offshore arrangements. And in our next two sessions we will discuss tips and techniques in developing these offshore cases. We will discuss in detail, Investigative techniques which includes how to use statue exceptions, Interviewing Skills, and Use of Summons

Summary

- Offshore Arrangements IPN focuses on taxpayers who go offshore for the purpose of tax avoidance, although, some taxpayers may have legitimate reasons for offshore activities.
- Offshore Arrangements relies on other IPNs for technical arguments, as alternative positions to substance over form.
- The four components to an Offshore Arrangement are:
  1. Devise and Overall Plan
  2. Transfer money/assets offshore
  3. Control
  4. Repatriation
- Offshore structures may use Foreign Entities to conceal the U.S. person's beneficial ownership.
- Sometimes, earnings from domestic businesses shifted offshore, as well as the earnings generated on those assets, escape U.S. taxation.
- Some structures used to transfer funds offshore include False Invoicing, Re-Invoicing, while Offshore Credit Cards and Loan arrangements may be used to repatriate funds.
- Foreign Information Returns reveal a U.S. persons relationships with foreign transactions. Failure to file may be subject to penalty.

False Invoicing Case Study

- Introduction to case study facts
- Further development in Basic Structures Parts II and III

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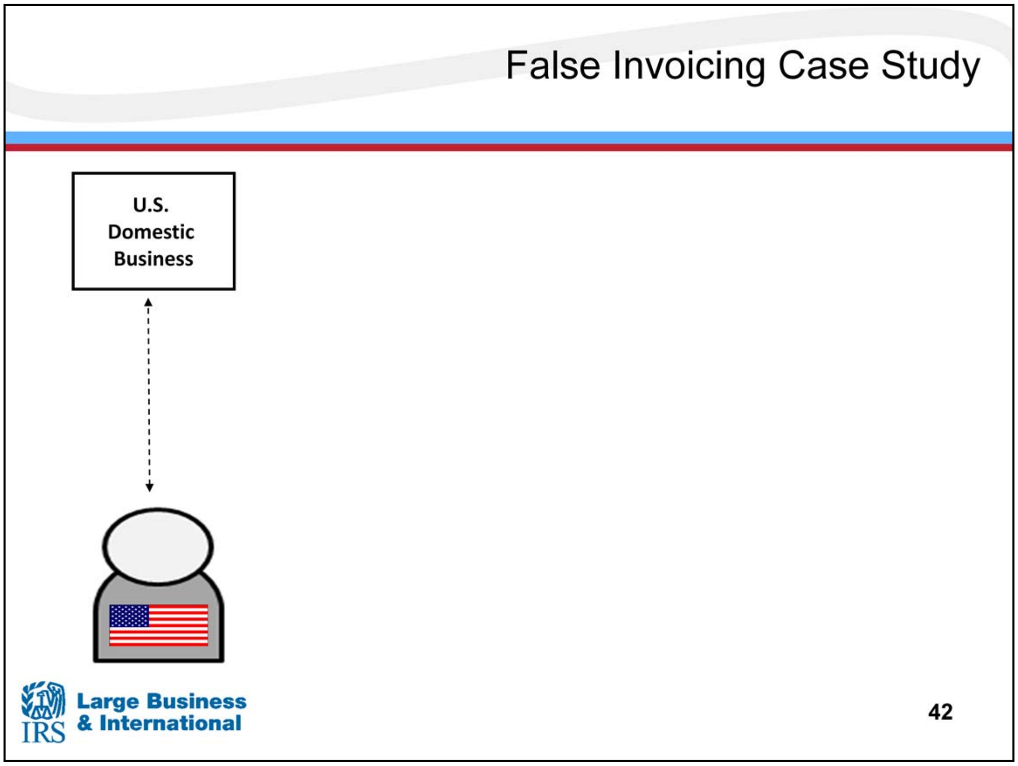
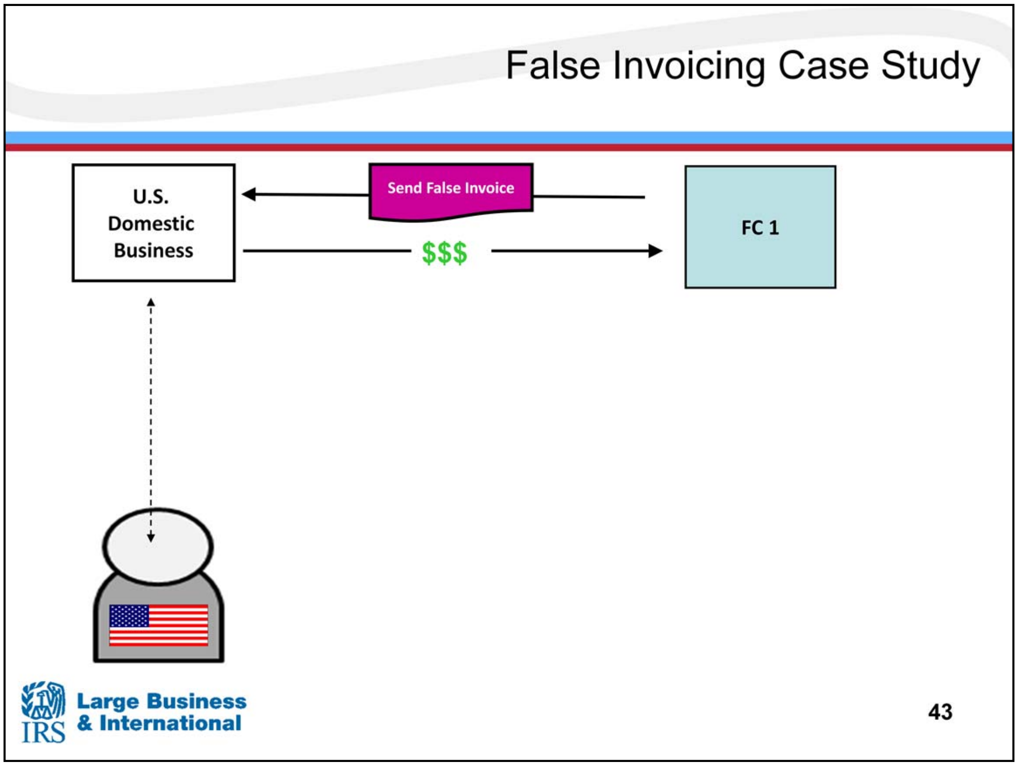
We are going to provide you with what we are calling the “False Invoicing Case Study”. This was a real case but all the identifying information has been changed.

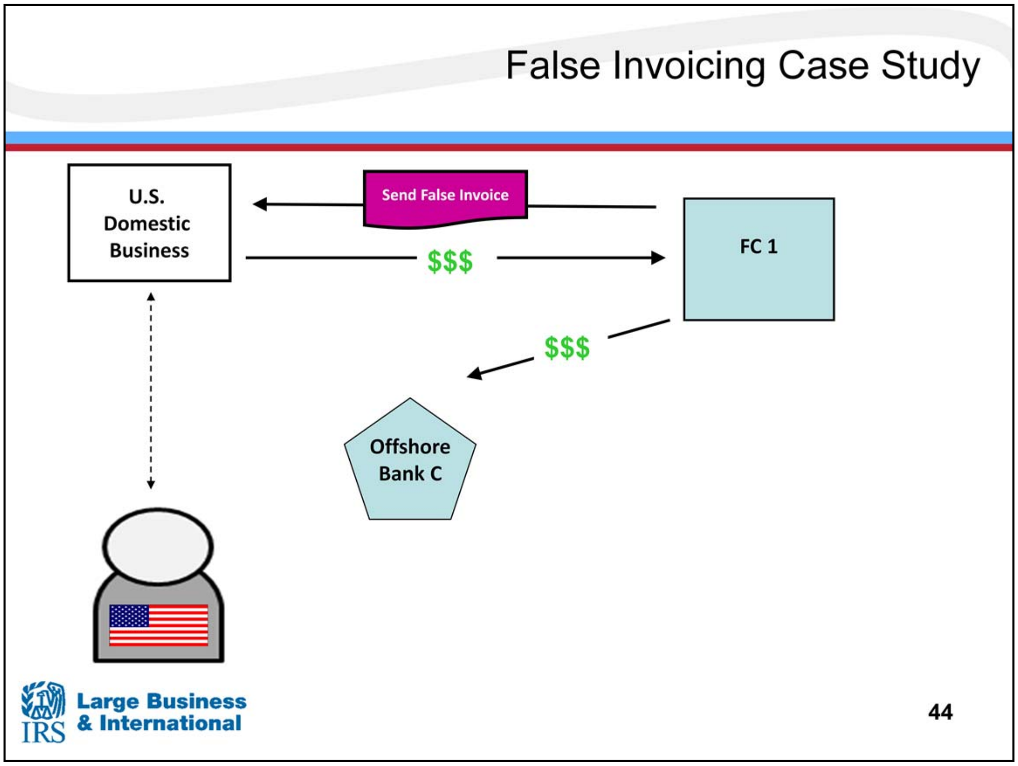
In this session, we will give you the basic background of the particular false invoicing arrangement, although it is categorized as a false invoicing arrangement remember that each false invoicing arrangement can have its own twist. In our next two sessions we further develop the case, discussing some of the investigative and interviewing techniques that were used, as well as, how applicable foreign information return penalties were applied.



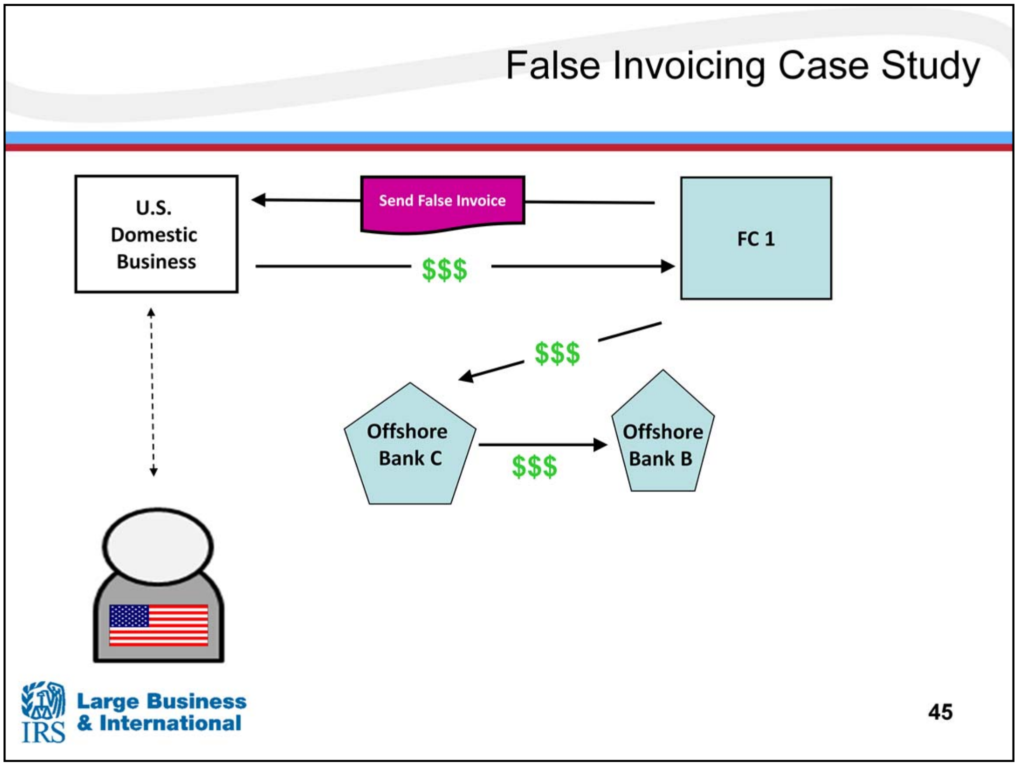
Here we go….the Taxpayer owned a Domestic Corporation which is in the manufacturing field. The Corporation purchases much of its materials and supplies from Asian vendors.



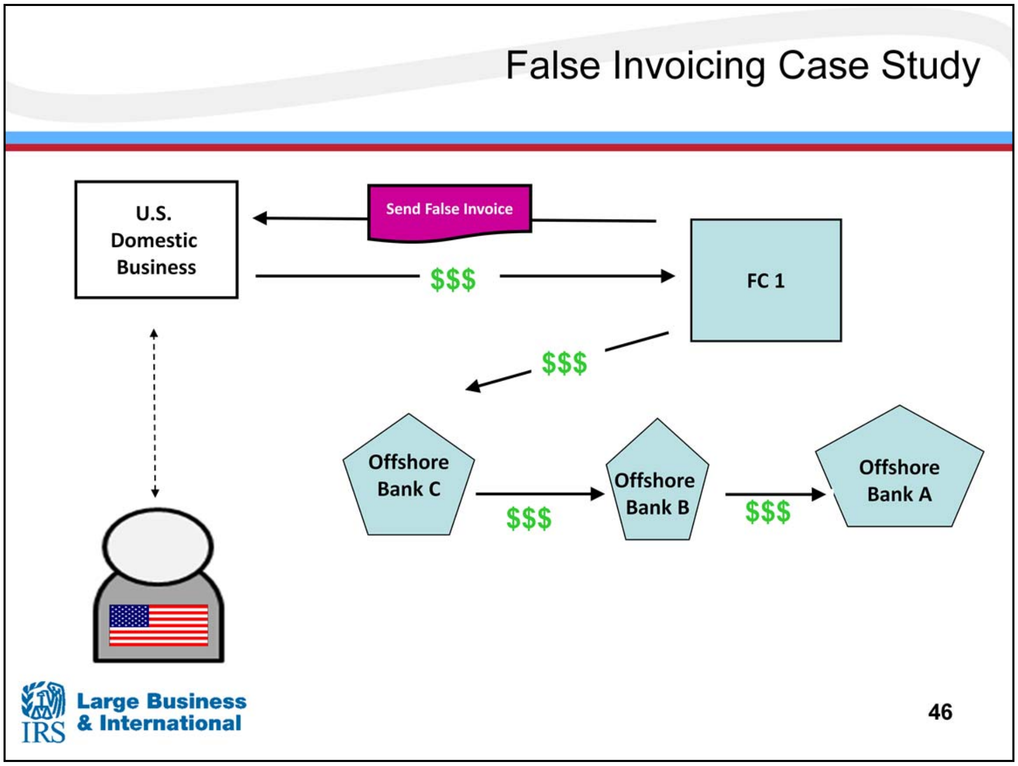
The individual shareholder set up an Foreign Corp which is shown as FC1 in an offshore jurisdiction.
The shareholder then arranged for a fictitious Inspection Services to supposedly inspect the materials purchased from his foreign suppliers.
An unrelated Management Company, who was retained by FC1 , produced and mailed out invoices to the U.S. Corp on behalf of FC1 for these inspection services.
The U.S. Corporation remitted payments to FC 1 for the amounts shown on the false invoice.



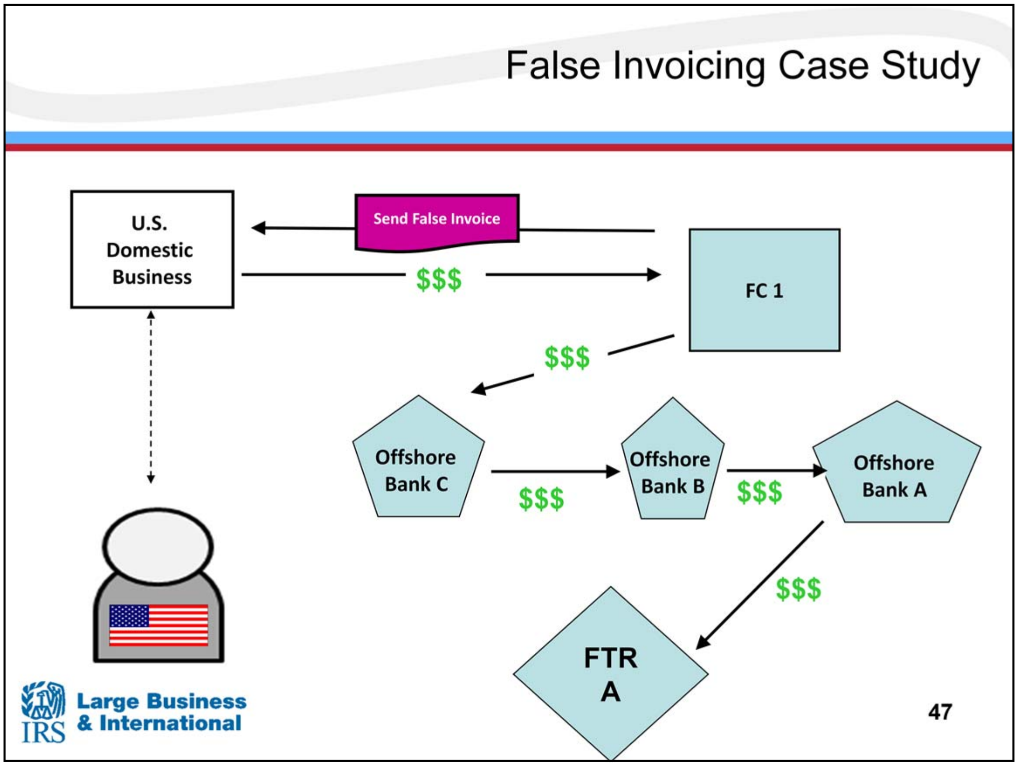
Once the payments were sent from the domestic corp to the FC1, FC1 deposited the payments into an account located in Foreign Country C shown as Offshore Bank C.



When the funds reached $50,000 in Offshore Bank C they were swept to an account located in a different foreign country which we will refer to as Offshore Bank B.

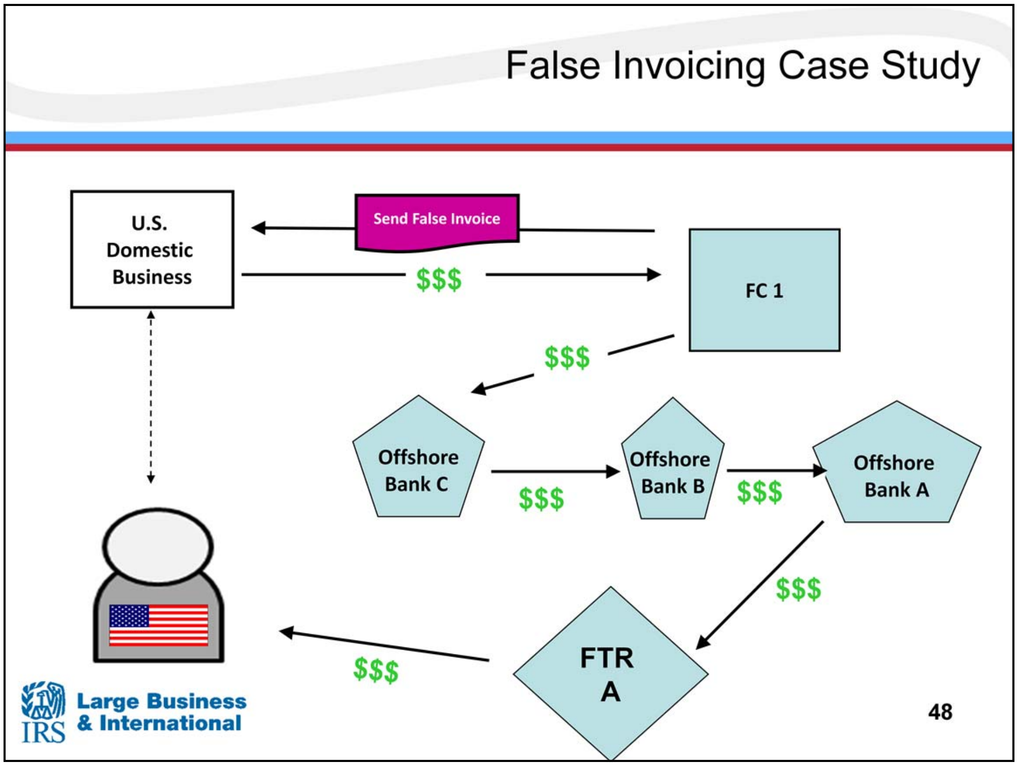


When the funds at Offshore Bank B reached $100,000 they were then transferred to and account in a third foreign country which we will call Offshore Bank A.



The Offshore Bank A credited the funds to an account owned by a Shiftung, which is akin to a Foreign Grantor Trust. It is denoted on the diagram as FTR A, it is organized in the same country as Offshore Bank A.

The Shiftung was titled a Foreign Foundation. The U.S. Taxpayer was the grantor/first beneficiary of the Shiftung.



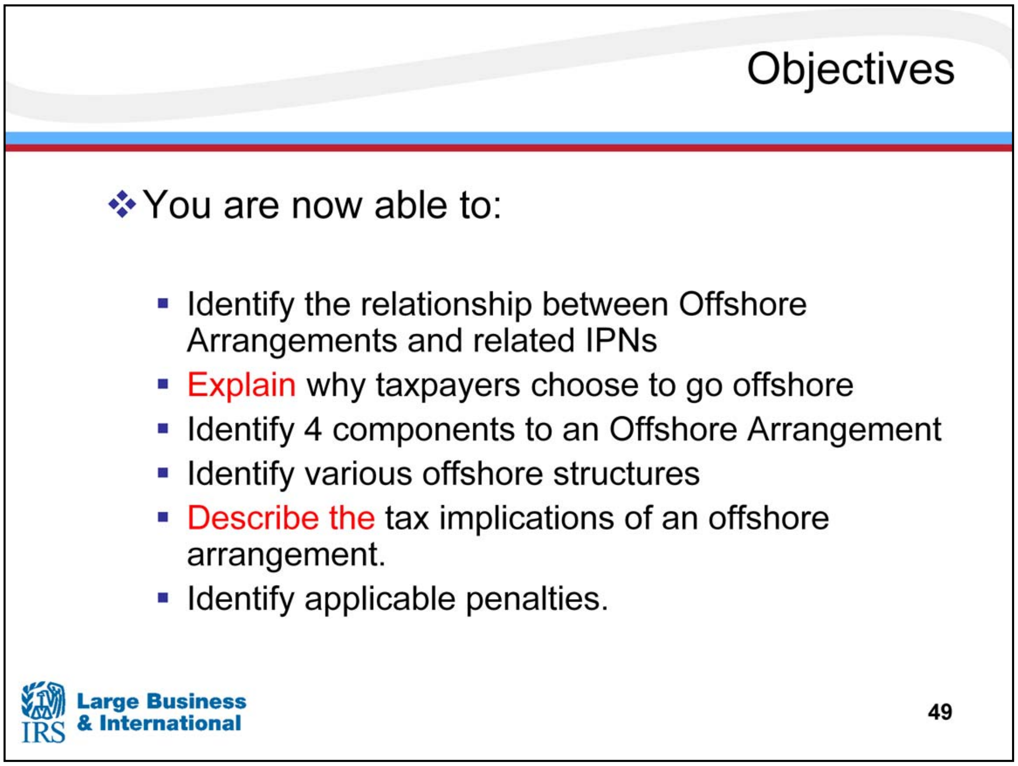
Since the U.S. Taxpayer was the grantor/first beneficiary of the Foreign Foundation A and exercised direction and control over the funds within the offshore bank account A, he could access and repatriate the funds at will.

Over the course of 8 years the taxpayer was able to divert through his False Invoicing scheme $5 million.

He repatriated only $100,000.00. The remainder of the funds remained on deposit for "a rainy day or for his retirement". Unfortunately, the taxpayer passed away before he could partake in his ill gotten gains. Rights to the account passed to his 3 sons in equal parts.

The U.S. Corporation and the Shareholder were examined by the IRS twice during the 8 year period and the scheme remained undetected.

In the next two sessions, we will cover some of the audit tools employed to unravel the scheme and fill in the missing pieces.



Here are our objectives for this session. At the end of the lesson you will be able to:

Identify the relationship between Offshore Arrangements and related IPNs

Explain why taxpayers choose to go offshore

Identify 4 components to an Offshore Arrangement

Identify various offshore structures

Describe the tax implications of an offshore arrangement.

Identify applicable penalties.

Contact

IPN Contact List

☐ First Name	Last Name	Area of Specialization	E-mail Address
OA	IPN	Send your comments & questions regarding emerging issues, new trends, new twists on existing issues & feedback to the IPN	lbi.iic.offshore.arrng.ipn@irs.gov

(b) (6)
[redacted]

CPE Question # 1

Do you want CPA/CPE Credit for participating in this Lesson?

a) **Yes**
b) No

CPE Question # 2

Which of the following statements is not true:

a) U.S. Persons are taxed on Worldwide Income.
b) U.S. Persons are taxed on U.S Source income.
c) Foreign Persons are taxed on U.S. source income.
d) Foreign Persons are taxed on foreign income.

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This goes back to the Jurisdiction to tax lesson.

The statement that is false is D. Foreign persons are taxed on their foreign income. Well they may be taxed by a foreign govt but they are not taxed by the US. Foreign Taxpayers are only taxed by the US on their US source income.

Again, that is the whole reason Offshore Arrangement try to appear to be a foreign person with foreign income, when in reality the true beneficial owner controlling the assets is a US person who is subject to tax on their worldwide income.

CPE Question # 3

True or False

One reason a U.S. person goes offshore is to conceal his/her beneficial ownership of foreign financial accounts and other foreign assets to avoid/evade U.S. tax.

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This is True. Concealment of beneficial ownership of the foreign financial assets is a key element in avoiding and evading US taxation.

CPE Question #4

Generally, which is a characteristic of an offshore financial secrecy jurisdiction?

a) Low or no tax on the conduct of business outside its shores.
b) Favorable laws for corporations, trusts, foundations and other legal entities or arrangements.
c) Taxpayer/Promoter works closely with offshore financial professionals to establish and/or assist with implementing the arrangement
d) All of the above.

The correct answer is D. Typically, Financial Secrecy Jurisdictions offer low or no tax for business conducted outside its borders, favorable laws established within their jurisdiction and have a variety of offshore financial professionals to assist with the arrangement.

CPE Question # 5

Which of the items shown below is generally **not** a component of an Offshore Arrangement?

a) Transfer of funds offshore
b) Repatriate/Access the funds
c) Filing a Foreign Information Return
d) Continue to control the funds offshore

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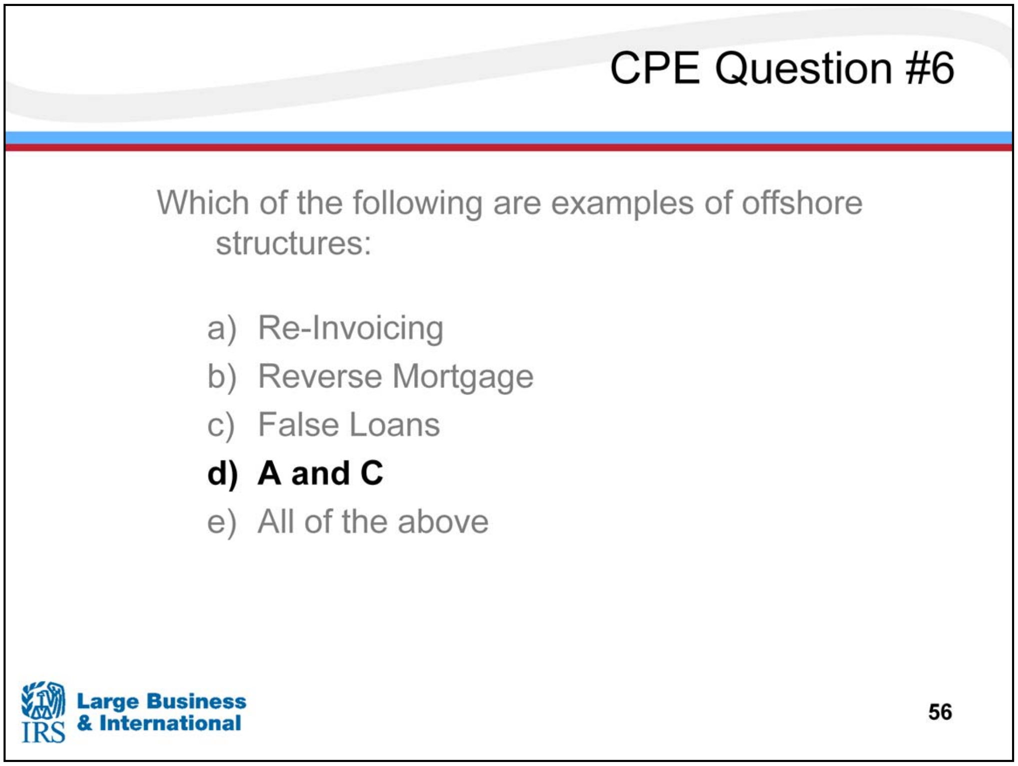
The answer is C. Transfer of funds offshore, repatriation of funds and continued control of the funds are components of an offshore arrangement. Typically, the TP will fail to file the foreign information returns so that their relationship with the arrangement is not identified.



The correct answer is D. Both Reinvoicing and False Loans are two examples of offshore arrangements that we have discussed.

Reverse mortgage, those are the commercials you see on TV wanting you to take the equity out of your home to supplement your retirement income.

CPE Question #7

What is the effective date of FATCA?

a) March 10, 2018
b) March 18, 2013
c) March 18, 2010
d) March 10, 2010

You had to watch the dates carefully on this one. FATCA was enacted on March 18, 2010. So the answer is C.

CPE Question #8

True **or** False

FBAR is governed under Title 31.

This is True.

FBAR is governed under Title 31

CPE Question #9

True or False

Under Title 26, Form 8938 is the form U.S. individual taxpayers use to report information about certain foreign financial accounts and specified foreign financial assets.

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59

This is also True.

FATCA introduced F8938 filing requirements under Title 26.

A similar form, but not as inclusive is the FBAR form with fall under Title 31.